FAB ESG WEEKLY UPDATE

19 August 2022

This week, we identified the following events of significance within sustainability and their respective business implications.

REGULATORY

1. The **U.S. Securities and Exchange Commission (SEC)** is **probing ESG funds, focusing on whether managers are trading away their right to vote on ESG issues**. U.S. regulators have been peppering firms offering funds that are marketed as sustainable with queries for several months, including how they lend out their shares and whether they recall them before corporate elections.

- The SEC investigation delves into whether asset managers are making the proper disclosures to investors. It drives at the heart of whether ESG investment funds can meet their promise of helping combat societal ills through long-term investments in certain companies, especially if shares they lend out wind up with short-sellers taking an opposing view.
- Asset managers have argued publicly that there are policies in place to prevent firms from borrowing securities solely for the purpose of voting on shareholder resolutions. For ESG fund managers, the practice of short-selling can raise specific challenges. Short-term bets against companies could make it harder for an ESG fund manager to influence a portfolio company to become more sustainable over a longer period. It also creates the awkward appearance of aiding investors who are betting against the companies that the fund has deemed worthy investments.

2. The **European Central Bank (ECB)** examined the **effectiveness of green quantitative easing in climate change mitigation**. The study used a global integrated assessment model and focused only on corporate bonds held by monetary authorities.

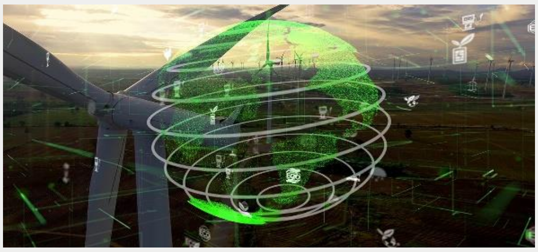
- Results show a reduction of global temperature by 0.04ºC by 2100, but also suggested that green QE would lead to a partial crowding out of private capital in the green sector. In contrast, the modelled effects of carbon pricing suggest that a global carbon tax of $50 per tonne would be four times more effective.
- The study concludes that green quantitative easing may be an effective complementary policy instrument, especially if governments fail to coordinate on introducing substantial and global carbon pricing. Green quantitative easing refers to a change in the portfolio allocation of a given outstanding stock of private sector securities (bonds) held by the monetary authority, towards bonds issued by the green sector.

3. Attorneys general in 18 U.S. states joined Missouri's **investigation into ESG Ratings Company Morningstar and its Subsidiary Sustainalytics for alleged consumer fraud or unfair trade practices**, the first of its kind. The probe aims to understand if Morningstar violated consumer-protection law with its evaluations of companies' performance on environmental, social and governance issues.

- Morningstar was questioned about which news sources the research company uses for ESG analysis. The probe is also looking at whether the firm and its Sustainalytics ESG ratings unit violated a Missouri law aimed at protecting Israel from a campaign to isolate the Jewish state over its treatment of Palestinians.
- Morningstar in June said it would cancel a Sustainalytics human rights product after an independent review sparked by complaints by Jewish groups found the product focused disproportionately on the Israeli-Palestinian conflict. In June the Illinois Investment Policy Board, which oversees state pension holdings, unanimously passed a motion finding Morningstar had not violated a state law against boycotting Israel and closed its own investigation.

RESEARCH

1. Morningstar shared a **report** highlighting a **tepid demand for U.S. sustainable funds in July**. Investors deposited $120 million into U.S. sustainable funds last month, a tepid amount of inflows that coincided with a broader retreat from mutual funds and ETFs. Funds termed sustainable by Morningstar include those which integrate environmental, social and corporate governance factors into their investment processes.



- July marked the second consecutive month of net new deposits for sustainable funds, though they gathered considerably less than the $492 million notched in June. Sustainable funds took in $8.9 billion during the first seven months of the year, a sharp drop from the $45.1 billion they attracted during the same period in 2021.
- It is the longest streak of net withdrawals since Morningstar began tracking the data in 1993, as investors contend with stock market volatility and concerns about inflation and interest rate hikes. After a bumper year in 2021, funds which consider ESG criteria struggled during the market sell-off earlier this year, with widespread underperformance and softer demand.

2. Climate Analytics published a **study** which found that the **global decarbonisation scenarios produced by BP, Royal Dutch Shell and Equinor are incompatible with the Paris Agreement's climate objectives**. The research work focused on six institutional scenarios published between 2020 and mid-2021, including four from the oil majors (two from BP), and two developed by the International Energy Agency (IEA).

- Most of the scenarios evaluated were classified as inconsistent with the Paris Agreement as they fail to limit warming to well below 2℃, let alone 1.5℃, and would exceed the 1.5℃ warming limit by a significant margin. The study concluded that only the International Energy Agency (IEA) Net Zero 2050 scenario is aligned with the criteria for Paris Agreement.
- The research work points out three challenges to understanding the stated climate outcome of published institutional emission pathways. The first is the time horizon of the scenarios, the limited representation of greenhouse gases and aerosol emissions, perceived inconsistency and relative opacity of the climate assessments. The second key challenge is that most institutional scenarios focus on carbon emissions from the energy sector. The third challenge identified is transparency in the quantification of the climate impact of the scenario.

3. Util released a **study** concluding that **ESG labelling provides limited insights for investors**. Funds that score highly on some United Nations (UN) Sustainable Development Goals (SDGs) often score low on others. The sustainable investment data specialist company analysed 6,000 U.S. funds and stated there is no such thing as a good or bad investment in terms of the UN's Sustainable Development Goals.

- Almost every company, industry and fund impacts some goals positively, others negatively. Util found that the 10 laggards on climate action were mostly utilities funds. Against other SDGs, however, every one of them is among the top 100 leaders in terms of the quality education, affordable and Clean Energy, decent work and economic growth, and industry, innovation and infrastructure metrics.
- Util argued that the environmental, social and governance factors represented such different, even conflicting, objectives that it was time for the concept to be scrapped. The company's research highlights the need for an approach that allows for a lot of different investor preferences.

COMMERCIAL

1. Emirates Water and Electricity Company (EWEC) and the **Abu Dhabi Department of Economic Development (ADDED)** signed a memorandum of understanding focused on **boosting sustainability best practices and promoting the adoption of Clean Energy Certificates (CECs)** across the emirate's industrial sector.

- The parties will also spearhead the development of proposals to ensure continuous enhancements of the ecosystem to attract new investments and enable sustainable factories to thrive in Abu Dhabi, supporting the emirate's long-term strategic plans, including Abu Dhabi Industrial Strategy, by leveraging the full potential of innovative technologies and enhancing sustainability across the ecosystem in line with the UAE Net Zero by 2050 strategic initiative.
- The Abu Dhabi Department of Energy (DoE) issued a regulatory policy for clean energy certificates in August 2021, in a bid to drive the transition to a sustainable decarbonised energy sector and marking a foundational step to establishing an energy attribute certificates market and facilitating trading renewable and nuclear.

2. Alphabet completed the proceeds allocation of the **largest-ever corporate sustainability bond**. Google's parent company deployed $5.7 billion to key sustainable investment areas, in the largest issuance ever done by a company. The eligible uses of proceeds from the offering included 8 green and social categories, ranging from energy efficiency and clean energy to affordable housing and COVID-19 response.

- Approximately $5.3 billion were invested in environmental projects. The top category for investment was green buildings, with nearly $2.5 billion in expenditures related to design, construction and improvements of 14 green buildings, totalling 807,000 square meters. The company allocated $1.75 billion to clean energy expenditures and contractual commitments to purchase electricity from renewable sources. Alphabet allocated $1 billion to energy efficiency through expansion and improvement of energy-efficient facilities and infrastructure. Also, $22 million and $8 million were allocated to the clean transportation and circular economy and design categories, respectively.
- On the social front, Alphabet allocated $185 million in contractual commitments that finance loans to small businesses, which the company estimates will result in 49,950 loans closed to small and medium-sized enterprises. $148 million was allocated across 15 racial equity initiatives.

3. Pandora launched a **jewellery collection with recycled gold and lab-created diamonds made with renewable energy**. The move follows last year's announcement by the company that it will end the use of mined diamonds, opting instead for those manufactured in labs. Pandora committed to craft all its jewellery from recycled silver and gold by 2025.

- Pandora's lab-created diamonds have a carbon footprint 95% lower than their mined counterparts. Lab-created diamonds have the same optical, chemical, thermal, and physical characteristics as mined diamonds, and are graded by the same standards.
- Last year, the company pledged to cut 50% emissions by 2030 across its operations and value chain to reach net-zero emissions by 2040. The jewellery maker also introduced reduced-plastic packaging across its stores and online, including carrier bags that will no longer contain any plastic, and jewellery boxes with plastic reduced by more than 75%.