



# Balancing the carbon equation:

how we are investing  
for a better climate

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**Federated  
Hermes**   
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## Climate emergency

**a situation in which urgent action is required to reduce or halt climate change and avoid potentially irreversible environmental damage resulting from it**

In 2019, there was a profound shift in awareness of – and engagement with – the climate emergency: it was the hottest year on record for the world’s oceans, the second-hottest year for global average temperatures, and wildfires raged from the US to the Amazon to Australia.

Protests were staged all over the world, led by Swedish teenage activist Greta Thunberg who encouraged young people to join in a ‘School Strike for Climate’ to protest against political inaction.

It is therefore unsurprising that as one of the most prominently debated terms of 2019, Oxford Dictionaries declared ‘climate emergency’ the word of the year. In just 12 months, usage of the term soared 10,796%<sup>1</sup>.

But this is not something new – since 1998, extreme weather events have led to around 16,000 deaths and economic losses of \$142bn on average every year<sup>2</sup>. But by limiting the global temperature increase to 1.5°C instead of 3°C, 70% of climate-related impacts in the water, health and agriculture sectors can be avoided<sup>3</sup>.

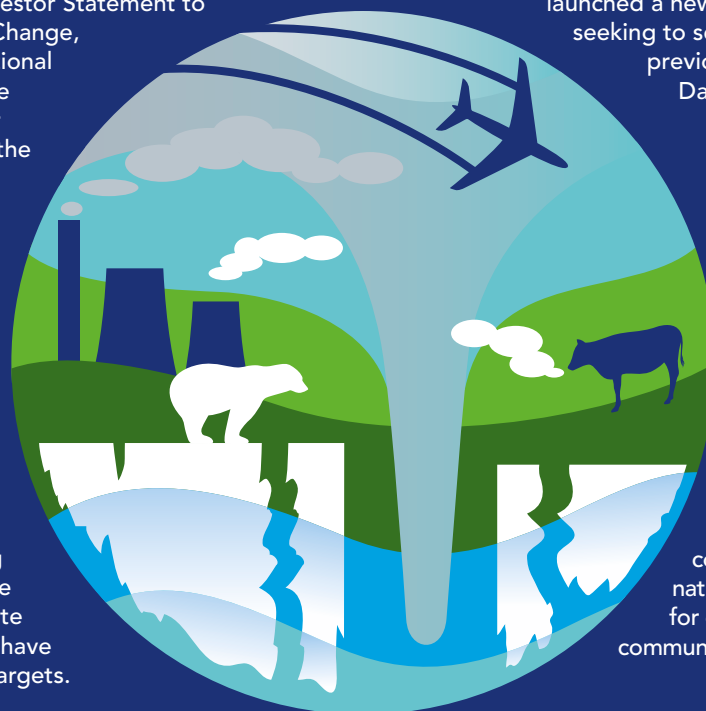
Today, climate change is an emergency – and 2020 must be the year for action. We must focus on outcomes, not intentions.

**854 companies are taking science-based climate action and 350 companies have approved Science-Based Targets**

In the asset management industry, climate change has stoked a significant shift in the investment universe.

- 631 investors managing over \$37tn in assets have signed the Global Investor Statement to Governments on Climate Change, coordinated by the Institutional Investors Group on Climate Change (IIGCC), calling for urgent implementation of the Paris Goals.

- The transition to a low-carbon economy is underway and accelerating globally. 854 companies are taking science-based climate action and 350 companies have approved Science-Based Targets.



- The IIGCC and the Danish government launched a new Climate Investment Coalition, seeking to scale up and internationalise the previous pledge made by a group of Danish pension funds for an extra \$50bn in green investments by 2030.

- Almost 50% of the world’s annual GDP now derives from nations and regions that are discussing or have set legislative net-zero emissions targets, to be achieved by 2050. Under the Paris Agreement, all parties committed to not only submitting nationally determined contributions for cutting emissions, but also to re-communicate or update their pledges by the end of 2020.

Source: Institutional Investors Group on Climate Change, Science Based Targets, and Energy and Climate Intelligence Unit, as at March 2020.

<sup>1</sup> “Oxford Dictionaries declares ‘climate emergency’ the word of 2019,” published by The Guardian in November 2019.

<sup>2</sup> “Brown to green: The G20 transition towards a net-zero emissions economy, 2019,” published by Climate Transparency in 2019.

<sup>3</sup> “Brown to green: The G20 transition towards a net-zero emissions economy, 2019,” published by Climate Transparency in 2019.

## Bespoke ESG solutions

Within our Global Equities capability, one of the benefits of our investment process is the ability to tailor the investable universe and the portfolio constraints to the needs of the underlying clients. This includes meeting specific risk, reward and environmental, social and governance (ESG) requirements.

For ESG, this is particularly useful as often its meaning can differ across different cohorts of people (see our commentary *A clear perspective on ESG investing* for further information). For example, ethical views on alcohol or nuclear power could be binary for some investors while for others, a certain percentage of the portfolio or revenues generated from a certain product may be permissible.

Fossil fuels are even more complex. That's because there may be various thresholds, tolerances or approaches to reduce exposure to fossil fuels that an investor is able to enforce. For example, coal extraction or a coal-powered utility may be considered un-investable (although a coal-powered utility could be converted to biomass). Investors may ask: what can be done about the extraction of metallurgical coal that is used in steel production, for which there are currently only a limited number of alternative products? Am I willing to take on risk (and the related performance impacts) to avoid certain products because they are pollutants, yet still drive a petrol car?

Within our Global Equities strategies, environmental considerations are assessed primarily during the stock selection process – and the extent to which a company is exposed to environmental risks and the management of those risks is evaluated on an industry relative basis.

### One of the benefits of our investment process is the ability to tailor the investable universe and the portfolio constraints to the needs of the underlying clients.

At a portfolio and corporate level, we also consider our exposure to climate change (see figure 1). At a portfolio level, we have worked with initiatives – such as CDP<sup>4</sup>, the Transition Pathway Initiative (TPI)<sup>5</sup> and the 2 Degrees Investing Initiative (2dii)<sup>6</sup> – to identify where risk is concentrated and pursue different approaches depending on the sector transition pathway to a low-carbon economy. The Paris Agreement Capital Transition Assessment (PACTA) tool from 2dii is designed to help financial institutions integrate climate objectives and long-term climate-related risks into their portfolio management. In addition, it provides pathways for different industries, highlights where companies are aligned or mis-aligned and has various scenarios built into the tool. As a company, we are members of many industry initiatives, including CA100+, IIGCC, and the UK-China Green Finance Initiative.

**Figure 1. Responsible investing – at corporate, portfolio and stock level**

<b>Corporate Level</b> Driving responsibility	 <b>Responsible investment policy and strategy</b> A clear vision to unlock hidden value by investing responsibly	 <b>ESG Integration</b> Founding signatory of Principles for Responsible Investment; all assets under management integrate ESG considerations	 <b>Sector and public policy engagement</b> Promote best practice and influence the market to implement responsible investment principles	 <b>Strategy and policy targets provide guidance and structure</b>
<b>Portfolio Level</b> Managing responsibly	 <b>Risk management</b> Managing aggregate exposures to ESG risks	 <b>Tracking ESG Risks</b> Portfolio ESG Monitor highlights the best & worst companies across our holdings	 <b>Independent assessment</b> Regular meetings with EOS at Federated Hermes (EOS) and our Responsibility team to discuss ESG risks	 <b>Sustainability and responsible investment tools integrated throughout the investment process</b>
<b>Stock Level</b> Investing responsibly	 <b>Stock Selection</b> Avoiding companies with unnecessary ESG risks and identifying companies undergoing positive change	 <b>Systematic assessment</b> ESG embedded in fundamental analysis via the QESG Score and ESG Dashboard	 <b>Active ownership</b> Voting and engagement insights from EOS along with controversial company reports	 <b>Combining insights from EOS with specialist external research</b>

Source: Federated Hermes, as at March 2020.

<sup>4</sup> CDP is an organisation that supports companies and cities to disclose the environmental impact of major corporations.

<sup>5</sup> The Transition Pathway Initiative is a global initiative led by asset owners to assess company progress on the transition to a low-carbon economy.

<sup>6</sup> 2dii is a non-profit think tank promoting the integration of climate risks in investment strategies and financial regulations.



Our Global Equity Low Carbon strategy – in addition to evaluating environmental, social and governance issues within the stock selection process – applies a negative screen to fossil fuel companies (that is, the strategy is run “ex-energy”).

In our application of ESG considerations we use dynamic tools and a robust framework to identify material information. In addition, we are supported by our stewardship service, EOS at Federated Hermes ('EOS'). By using a combination of both quantitative and qualitative approaches, we seek to capture all relevant insights, including research and engagement updates from EOS. In turn, these insights inform our investment decisions.

Indeed, our proprietary tools provide a unique perspective on ESG risks:

- Our QESG Score ranks each company’s ESG characteristics and indicates whether these risks are increasing or decreasing. It adopts a sector-neutral approach, ensuring we evaluate companies against their relevant peer group. The QESG Score incorporates data from best-of-breed data providers as well as EOS. It allows us to systematically analyse a company’s exposure to ESG risk.
- Our ESG Dashboard is a company reporting tool which captures ESG characteristics from a plethora of sources, displays the data in a useful way that is easy to interpret and contributes to investment decisions. The dashboard acts as an entry point for further detailed reports.
- We also use the ESG Dashboard in the latter stage of our investment process, specifically when we sense check individual trades, to ensure that we are accurately capturing the true attributes of the company. This includes data validation and scrutinising the company from a qualitative perspective including the latest engagement progress.

### Emission impossible?

There are many different aspects of climate change that require our consideration. One approach that has received significant attention focuses on carbon intensive assets. This includes companies which can be highlighted using scope 1 and scope 2 carbon metrics (see figure 2 for 'scope' definitions) – that is, companies within the utilities, energy and materials sectors. For companies in these sectors, standards for disclosure and management are generally higher.

### The “demand-side” of the carbon equation is crucial to lowering carbon risk and for achieving the Paris goals.

Within these sectors, we seek to target companies that have adopted the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and are already or in the process of adopting Science-Based Targets. In addition, engaging these companies is crucial: we encourage a faster adoption of lower carbon alternatives.

It is also vital to consider scope 3 emissions, particularly for the wider portfolio. It is here that companies are increasingly focussing their efforts as they recognise that scope 3 emissions make up the majority of their overall carbon footprint. This requires a more sophisticated total portfolio approach focussing on companies as well as suppliers, customers and end of use. The “demand-side” of the carbon equation is crucial to lowering carbon risk and for achieving the Paris goals.

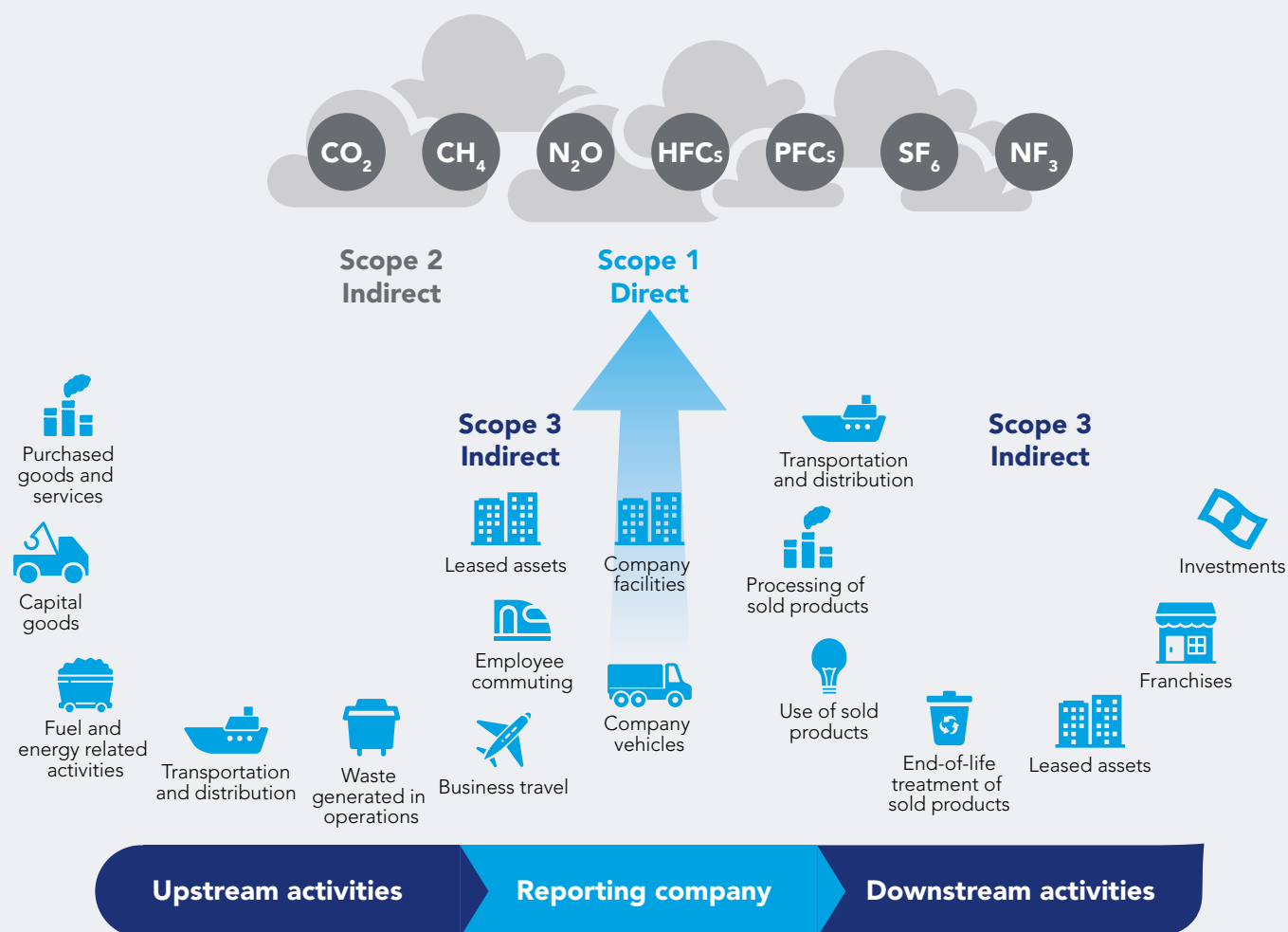


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**Figure 2.** Scope 3 emissions often represent a company's biggest greenhouse gas impacts



**Greenhouse gas emissions** are categorised into three groups by the Greenhouse Gas Protocol, a widely used international accounting tool.

- **Scope 1 emissions:** all direct GHG emissions by a company. It includes fuel combustion, company vehicles and fugitive emissions.
- **Scope 2 emissions:** indirect emissions from the generation of purchased electricity, heat and steam.
- **Scope 3 emissions:** all other indirect emissions that occur in a company's value chain (for example, purchased goods and services, business travel, employee commuting, waste disposal etc)

Source: Greenhouse Gas Protocol, as at 2016.

In line with the TCFD recommendations, it is our duty as investors to consider and more fully understand the carbon exposure of the companies in which we invest and, importantly, to communicate this with clients. In 2019, we updated our proprietary tool the ESG Dashboard; it now includes data from TPI, which as mentioned already is a global initiative that assesses company progress on the transition to a low-carbon economy. This data continues to broaden, and it provides a qualitative assessment of companies' resilience to transition risk. We must also tackle a key question: are companies building or reducing risk in terms of aligning to a 1.5°C pathway? This is a challenging area due to the scale and complexity of climate change as well as the contribution from individual companies and sectors.

Across our Global Equities product suite, we focus on transition risk for both our holdings and the benchmark using the TPI framework. A recent report by the TPI showed that 21% of companies still do not disclose enough information to allow investors to understand their exposure to the transition, and of those who do disclose the majority are not aligned to the Paris Agreement<sup>7</sup>. What's more, a report published late last year by InfluenceMap, a London-based climate-change think tank, found that the world's 15 largest investment institutions, which have €37tn in assets under management between them, are collectively deviating from the Paris-aligned allocations needed to reach the Paris Agreement goal of stopping global temperatures rising by 2°.

This must change in 2020 – a strategic focus on climate change must become a necessity.

<sup>7</sup> "TPI State of Transition Report," published by the Transition Pathway Initiative in 2020.

 CASE STUDY

## US financial services group

### Supporting the transition to a low-carbon economy

The financial services sector has a vital role to play in achieving Paris Alignment by encouraging and supporting companies in their transition to a low-carbon economy as well as demonstrating ambitious policy positioning on climate action. This can be achieved by minimising the industry's exposure to the most polluting companies and by identifying opportunities to help its customers and clients in their own efforts to reduce emissions and find business opportunities in the transition. Doing this also contributes to rebuilding and deepening the trust of its stakeholders by demonstrating that the industry can be a powerful force in creating prosperity and other societal benefits.

We have exposure to a diversified financial services holding company that provides a broad range of services including investment banking, retail brokerage and cash management.

The company is naturally exposed to high regulatory risk. The company was flagged in connection with significant litigation and investigations regarding products and services offered by the bank, and has been embroiled in controversies over the years.

However, in the management of ethical issues, the bank now has relatively strong policies. In addition, it has significantly increased its compliance staff, reorganised anti-money laundering operations into one central function and changed its control processes in response to a forex controversy.

As such, we do not deem any of the controversies as severe currently, but we will continue to monitor the implementation of changes and any new controversies closely.

From an environmental perspective, the group has committed to reducing its credit exposure to the coal mining industry and is an outperformer in its peer group. It has climate targets which have been verified by the Science-Based Target initiatives official quality check. The bank was on the way to achieving its clean energy finance target earlier than planned, but it has since revised the way it calculates its targets – and we agree that this is a better way of assessing the bank's progress. We expect the bank will meet this target and set more onerous ones as the global economy moves to decarbonise.

The group also became the first bank to sign the UN's Principles for Responsible Banking, under which it has agreed to prioritise the Sustainable Development Goals (SDGs), to demonstrate its commitment towards sustainable business. In 2019 the group made CDP's Climate Change A list which names the world's most pioneering companies leading on environmental transparency and performance<sup>8</sup>.

The company's CEO also has oversight of climate-related activities which is seen as best practice for climate governance. The group's early voluntary adoption of the TCFD framework (it produced its first report aligned by the TCFD recommendations in 2018) is an example of the recognition that it places on the issues and risks associated with climate change. The bank is also a participant in the UN Environment Finance Initiative's TCFD pilot project on climate change scenario analysis for bank lending portfolios – and as part of this, it undertook significant work to build its understanding of climate change exposures across the business<sup>9</sup>. In addition, it was one of the first companies globally to release scenario analysis formally to shareholders.



<sup>8</sup> "The A List," published by CDP in 2019.

<sup>9</sup> "Building a TCFD with teeth," published by the bank in February 2020.

## Aligning with Paris, what does it mean?

In practice, what does aligning with the Paris Agreement mean? In the simplest terms, it means that investment needs to be climate-resilient and consistent with the Paris Agreement’s long-term mitigation goal of limiting global warming to well below 2°C and pursuing 1.5°C.

To achieve the Paris goals investors will need to consider the approach for them - engage, divest or both. For example, investors could target green-investing opportunities while at the same time engage for change in the sectors that are furthest from achieving Paris-alignment.

Of course, different asset managers will adopt different approaches to achieving Paris-aligned portfolios and meeting clients’ needs on climate change, which are market and asset class specific. Geography also plays a significant role too. An equity portfolio that invests in India, China and South Africa will have a very different power generation mix and transition pathway to those invested in countries like Germany and the UK (see figure 3). In addition, the policy landscape also differs significantly for companies operating in those countries.

Figure 3. Emissions targets vary by country

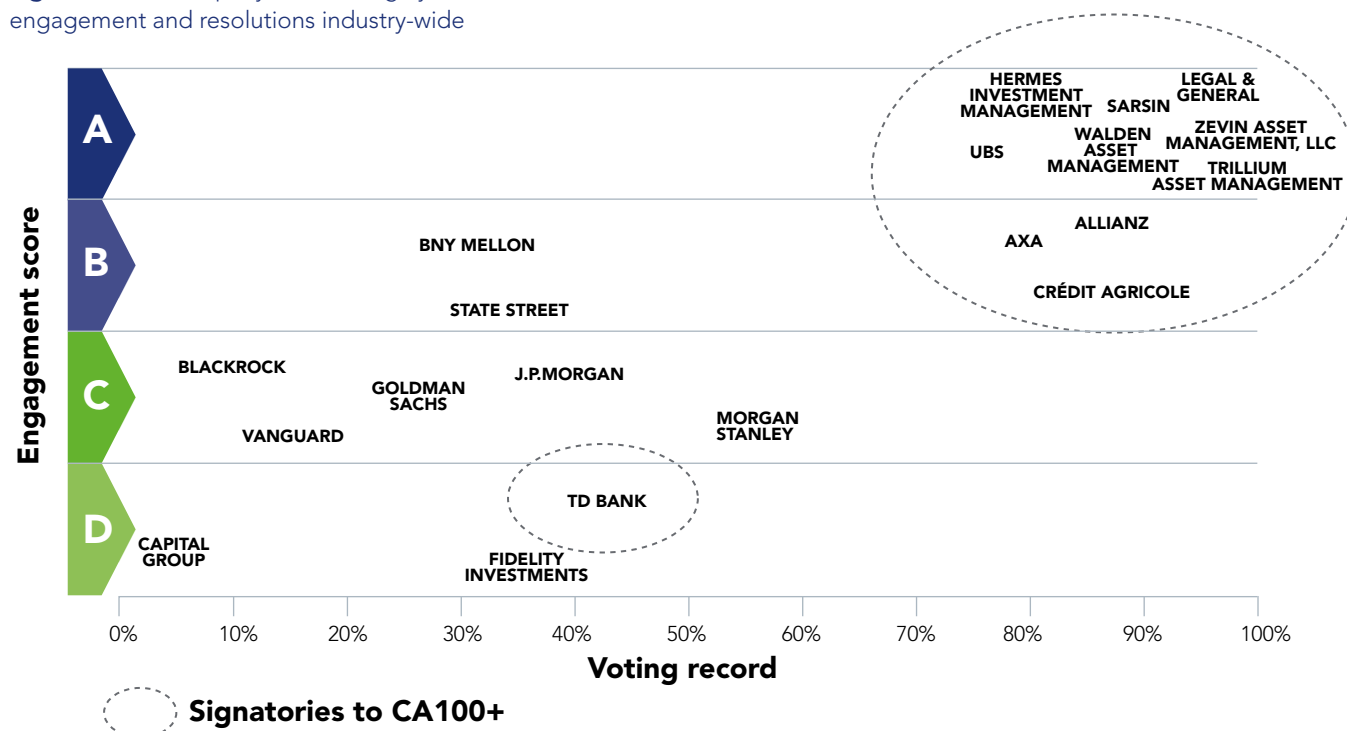
Country	Base year	Target year	% Reduction	Target type
India	2005	2030	33% – 35%	Emissions intensity
Thailand	2005	2030	20% – 25%	Absolute emissions
Poland	1990	2030	40%	Absolute emissions
Italy	1990	2030	40%	Absolute emissions
Malaysia	2005	2030	45%	Emissions intensity
Finland	1990	2030	40%	Absolute emissions
Russia	1990	2030	70%	Absolute emissions
China	2005	2030	60%-65%	Emissions intensity

Source: INDC’s UN Database.

Engaging with companies to facilitate and encourage alignment with the Paris Agreement will become increasingly important for investors – particularly engaging with companies in sectors which continue to lag. Last year, InfluenceMap assessed financial institutions’ levels of engagement from recommending shareholder proposals and having an escalation

strategy in place for when engagement stalls to public policy engagement. We were among a small number of asset managers that scored highly on climate-related engagement and resolutions.

Figure 4. As a company, we rank highly on climate-related engagement and resolutions industry-wide

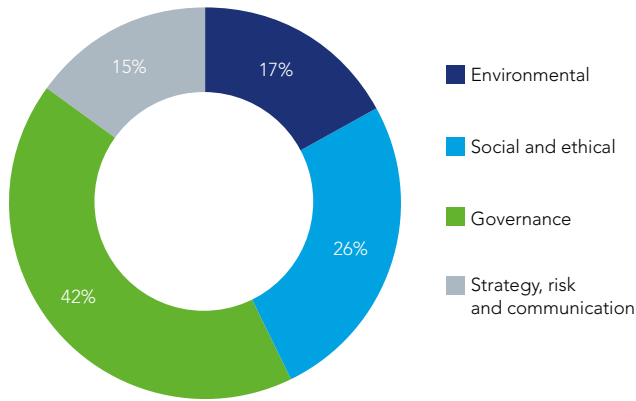


Source: InfluenceMap, as at November 2019. Note: all activities previously carried out by Hermes Investment Management now form the international business of Federated Hermes.



Within our Global Equity ESG strategy, we had 132 live engagement objectives as at 31 December 2019 – of which we have made progress on 65 issues<sup>10</sup>. In addition, our strategy’s carbon footprint is 32% lower compared to the benchmark MSCI ACWI index<sup>11</sup>.

Figure 5. Tracking engagement progress: Global Equity ESG

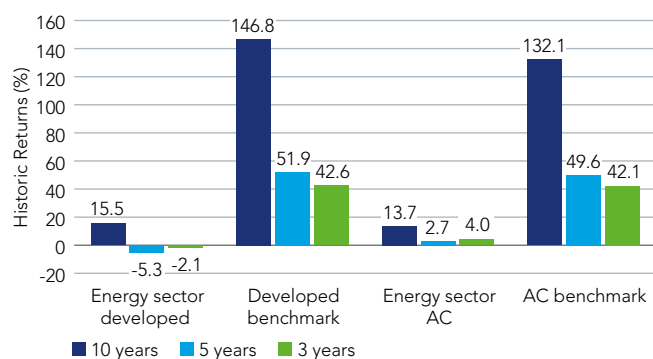


Source: Federated Hermes, as at 31 December 2019.

At the international business of Federated Hermes, we invest in companies where the ESG attributes are positive or there is ESG momentum, and we would always engage with companies involved in activities that we deem to be less than desirable. At the same time, we only exclude/divest where we are legally obliged to do so (this has broadly been limited to cluster munitions and anti-personal mines). There are many companies which although we do not officially exclude them based on a prescriptive list would not make it through our investment process.

Excluding carbon-intensive companies from portfolios over the last decade would have had a positive impact on performance (see Figure 6). However, this exclusion would have led to some volatility. Looking back over a longer time period, an energy exclusion would cost up to 8% in returns. This underperformance has been eroded significantly in the last five years.

Figure 6. Performance of energy companies versus the Global Developed and All Country (AC) benchmarks



Source: Federated Hermes, Factset, as at 31 December 2019.

<sup>10</sup> Federated Hermes as at 31 December 2019.

<sup>11</sup> Federated Hermes as at 31 December 2019.

# 132

The number of live engagement objectives in our Global Equity ESG strategy

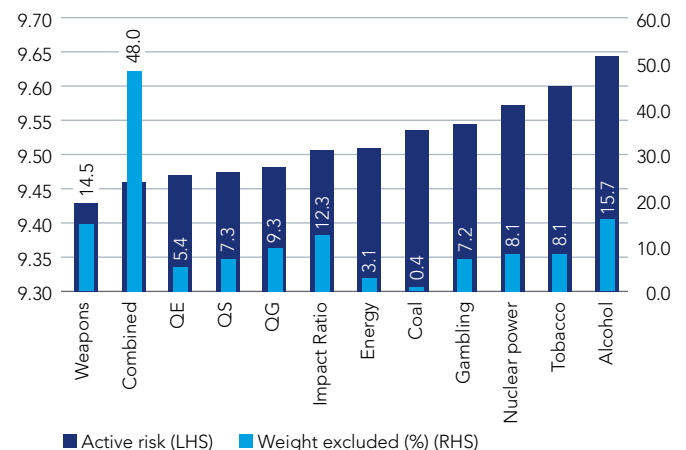
One of the key characteristics of our Global Equities product suite is that it is customisable: benchmarks, risk appetite, geographic regions, market sectors and weighting towards ESG exposure can be changed to meet investor needs. Investors can therefore choose to screen specific sectors, but they also must consider what level of customisation they would like.

For example, if an investor wanted to tackle their climate change concerns through an exclusions list, we could create models for four different approaches that, while ostensibly meeting the same goal, produce diverse risk and performance outcomes:

- Screen out coal stocks by omitting any company deriving more than 50% of its revenue from coal, or is categorised in the coal sub-industry Global Industry Classification Standard (GICS) classification
- Create an exclusion list covering the entire energy sector
- Compile a ‘high-impact’ list that screens out the most environmentally damaging companies in the investment universe. The list features the top 10% of firms according to their respective Impact Ratio, a metric supplied by data provider Trucost that is based on the total direct and indirect environmental costs per unit of revenue
- Implementing an industry-adjusted high-impact ratio list to recalibrate for biases in the previous method. This contains the companies with Impact Ratios in the top 10% of their industry peer group.

The volatility of different exclusions is shown in Figure 7. The energy exclusion leads to higher risk than would be expected for the weight in the benchmark.

Figure 7. Risk and weight of different exclusion lists



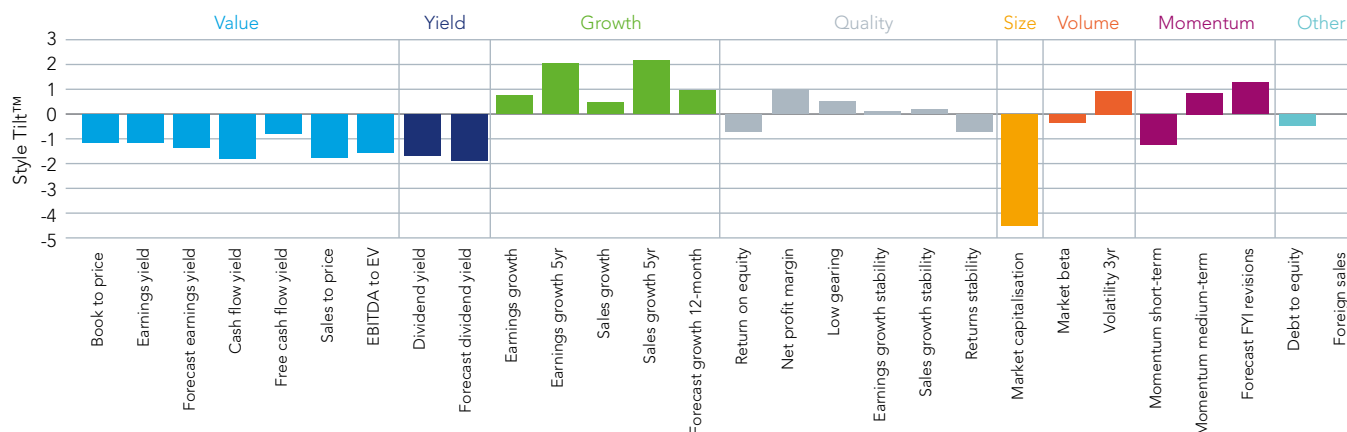
Source: Federated Hermes, Factset, as at 31 December 2019.

Note: OE, QS & QG refer to excluding the bottom 10% using the Federated Hermes proprietary quantitative environmental, social and governance scores.



As well as considering the risk and return characteristics, style tilts are also imperative to consider when thinking about long term investment. The value, growth and quality style tilts of a portfolio can determine the environment in which a portfolio might out- or under-perform. As part of our reporting, we discuss these attributes with clients. Typically quarter-on-quarter, we do not see big changes as we have a long-term investment horizon of three to five years. Figure 8 and 9 demonstrate the style implications of excluding a broad range of exclusions and the energy sector respectively. Indeed, both charts show that the individual style deviations are relatively small – typically less than three standard deviations. Looking at the combined list, 'size' is the one outlier - that is, a negative exposure or tilt away from larger companies. As we have seen in 2019, the difference between large- and small- cap companies can be extreme, which is why it is necessary to ensure that investors understand these exposures and adjust them as required.

**Figure 8.** Style bias caused by the multi-industry screen on the MSCI World



Source: Style Analytics, Federated Hermes, as at 31 December 2019.

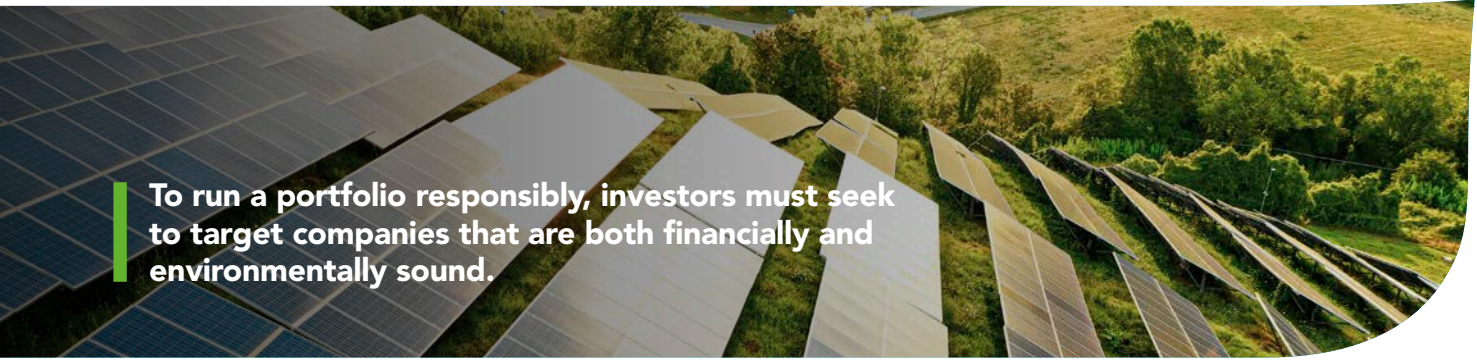
**Figure 9.** Style bias caused by the energy screen on the MSCI World



Source: Style Analytics, Federated Hermes, as at 31 December 2019.



**Our Global Equities strategies are customisable: benchmarks, risk appetite, geographic regions, market sectors and weightings towards ESG exposure can be changed to meet investors needs.**



To run a portfolio responsibly, investors must seek to target companies that are both financially and environmentally sound.

### Running a responsible portfolio

To run a portfolio responsibly, it is important to target companies that are both financially and environmentally sound. To identify these companies – and see through the greenwash – sector expertise as well as climate knowledge is crucial. Of course, companies need to tread a fine line: although they may be taking more climate action, sometimes they are criticised despite positive action. For example, British budget airline EasyJet received some backlash last year after it announced plans to offset all jet fuel emissions through schemes to plant trees or avoid the release of additional carbon dioxide<sup>12</sup>.

# 2,500

The number of companies that disclosed crucial data on environmental impacts in 2019

CDP – a not-for-profit charity running the global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts – is at the forefront of driving efforts to increase corporate transparency. Last year, over 2,500 companies disclosed crucial data on environmental impacts. Spanning 114 questions and yielding over 2.1m data points in return, CDP questionnaires on climate change, water security and deforestation are a source of standardised, uniform and comparable data that are being used by investors, companies and the market at large in the transition to a low-carbon economy.

Indeed, the latest CDP report highlighted that management quality relates to inputs and carbon performance links to outputs<sup>13</sup>. In turn, it found that both management quality and carbon performance and positively associated and that this association holds in each of the four areas of the TCFD (see Figure 10), but most notably in strategy. However, investors need to engage directly on emissions targets.

Figure 10. The four overarching TCFD recommendations

Governance	Strategy	Risk Management	Metrics and Targets
<p>Disclose the organisation's governance around climate-related risks and opportunities.</p> <p>a) Describe the board's oversight of climate-related risks and opportunities.</p> <p>b) Describe management's role in assessing and managing climate-related risks and opportunities.</p>	<p>Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material.</p> <p>a) Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term.</p> <p>b) Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.</p> <p>c) Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.</p>	<p>Disclose how the organisation identifies, assesses, and manages climate-related risks.</p> <p>a) Describe the organisation's processes for identifying and assessing climate-related risks.</p> <p>b) Describe the organisation's processes for managing climate-related risks.</p> <p>c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.</p>	<p>Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.</p> <p>a) Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.</p> <p>b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas emissions, and the related risks.</p> <p>c) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.</p>

Source: TCFD Status Report, as at June 2019.

<sup>12</sup> For instance, "Can carbon offsets tackle airlines' emissions problem?" published by The Guardian in November 2019.

<sup>13</sup> "Task Force on Climate-related Financial Disclosures: Status Report," published by the Financial Stability Board in June 2019.

Many companies have built basic capacity to manage the low-carbon transition. However, too many big emitters are yet to integrate climate change into their operations, let alone take a strategic approach. What's more, significant disclosure gaps remain around corporate emissions.

Climate leadership is crucial – and this can be demonstrated through target setting, strategy planning, implementation and mitigation, and reporting. As part of our reporting, we provide company-specific case studies demonstrating companies processes for identifying, assessing and managing physical and transitional risks and opportunities – and how they have been applied.

However, there are a number of challenges that act as information barriers:

- Scientific climate models are subject to uncertainty (that's because multiple models are available worldwide and they are based on complex systems, which apply a large number of assumptions); however, this is improving.
- Information is unevenly distributed, with some key financial agents lacking visibility of climate risk which may expose them to loss. For example:
  - Banks are still delving into their loan books to evaluate underlying properties' exposure to climate risk (for example, location and power use). Historically, this information has not necessarily been recorded.
  - Within certain entities, specifically those that have a complicated web of cross holdings and multiple layers of ownership structures, it can be difficult to ascertain underlying responsibility and liability.
- Both public and disaster mapping data and modelling is uncoordinated and difficult to access (not only is the data collection time consuming, real time updates are not available)

### Towards a context-based approach to sustainable investing

As the world becomes more populous, urbanised and prosperous, demand for energy, food and water will rise. We must therefore be cognisant of the fact that the earth has a finite amount of natural resources that can be used to satisfy this demand. We must plan to align to these limits to safeguard our planet for future generations – instead of pushing beyond the limits of its ability to cope.

To do this, a context-based approach to sustainable investing should be adopted by investors. Within our Global Equities product suite, we seek to invest in companies with a competitive advantage and sustainable business models. We integrate ESG factors and active ownership to unlock opportunities – that is, companies that are part of the next phase of sustainable growth.

**Climate leadership is crucial – and this can be demonstrated through target setting, strategy planning, implementation and mitigation and reporting.**

<sup>14</sup> Source: Federated Hermes, as at 31 March 2020.

<sup>15</sup> Source: Johns Hopkins University of Medicine, as at 14 April 2020.

In H2 2019, we employed PACTA – which as already mentioned is a tool designed by the *2dii* that analyses the alignment of equity, bond, or lending portfolios with various climate scenarios – to evaluate our holdings in line with various climate scenarios. This resulted in discussions about transition pathways – and so, we developed a tool to focus on environmental opportunities. Using a revenue threshold of zero, our Global Equity ESG portfolio has a 32% exposure to environmental opportunities which is in line with the benchmark.<sup>14</sup> There is exposure across all sectors, except Consumer Staples. At a 10% revenue threshold, the portfolio exposure reduces to 11%. As well as using this metric to highlight green revenue exposure, we can also assess companies that are increasing this area of their business year-on-year.

As awareness of the climate crisis continues to increase, companies' responses will accelerate too. In such an instance, we will be able to identify companies which have a fuller understanding of their exposure and those that do not.

The TCFD disclosures are one way of identifying companies' preparedness to transition and physical risk. We can also seek to identify companies that are aligned to the Paris Agreement through their business activities and policy and industry memberships.

In the Global Equities team, we reward greater transparency and more robust data. However, we are also realistic and pragmatic about the current opportunity – and what is achievable from an economic perspective. What's more, in terms of climate solutions, there are still many less obvious areas that are not gaining significant attention, such as food waste and education – and we will endeavour to continue to pursue these areas within a mainstream investing landscape.



**We integrate ESG factors and active ownership in our Global Equities strategies to unlock opportunities.**

### A lesson in global crisis management

Today, the world is confronting another global crisis – the coronavirus pandemic. So far, it has killed more than 120,000 people and it is putting a severe strain on health systems and economies worldwide<sup>15</sup>. Countries are taking immediate action to stop the spread of the coronavirus – otherwise, the cost of inaction would be immense.

Climate change is also a global crisis – and to date, the global response has been slow. We must learn from today's devastating pandemic: to prevent the gravest impacts of a global crisis, world leaders must act together to implement change. We cannot afford to ignore the global crisis of climate change – 2020 must be the year for action.



### Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes now form the international business of Federated Hermes.

Our brand has evolved, but we still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important new strategies from the entire group.

### Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
- **Private markets:** real estate, infrastructure, private equity and debt
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

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