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Pax World Investments

What the Paris Agreement Means for Investors

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The 21st Conference of the Parties to the United Nations Framework Convention on Climate Change (COP21) is over, and that means the foundation of the post-fossil fuel era has been laid. It's a good foreword, laying the four cornerstones of a world where all the tribes agree that climate change is a problem that must be solved. 195 nations have, for the first time in the history of climate negotiation, agreed to a set of actions that should reduce the danger we face from climate change.[1]

We are committed to the work of building a future that doesn't condemn our offspring to a hotter, more perilous planet.

For investors, there are clear winners and losers coming out of this agreement, as well as sectors that need to be closely monitored moving forward. More on that later. First, let's review what was accomplished at COP21.

KEY TAKEAWAYS

- The COP21 agreement laid the foundation of the post-fossil fuel era.
- There are clear winners and losers coming out of COP21, as well as sectors that need to be closely monitored moving forward.
- Investors have major roles to play in reducing emissions, as well as developing better ways to enter the post-carbon era.

The Cornerstones

195 nations agreed:

1. That greenhouse gas emissions (GHG) would peak as soon as possible, and achieve a balance between emissions and sinks in the second half of the 21st century;

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[1] United Nations, "Framework Convention on Climate Change," December 12, 2015. http://unfccc.int/resource/docs/2015/cop21/eng/l09.pdf

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2. To hold further increase in global warming well below 2^{0}C, and pursue efforts to limit warming to 1.5^{0}C above pre-industrial levels;

3. To review progress every five years, starting in 2018;

4. To provide $100 billion annually to developing nations to aid the mitigation of GHG emissions and adaptation to climate change.

The Biggest Compromises

Four good corners do not necessarily create a level foundation. There is wiggle room in the agreement that some—perhaps many—countries will try to widen to create more advantages for their own citizens and companies in world commerce. Human beings are not accustomed to thinking of their tribe as encompassing the entire planet, and we have very little experience with how to start. The Paris agreement has several compromises in it, and the degree to which these are exploited will determine the strength of the edifice we build. What are those?

1. Quantitative targets for emission reduction and financing for developing countries are not included in the binding parts of the agreement. That means that the agreement need not be submitted to Congress for approval, and it also means that no country will be held in violation of the agreement if the targets most countries have submitted are not met.

2. The other part of the agreement that isn't binding is that there is no liability or compensation for losses. So countries like the Seychelles, the Maldives and others that are losing territory to rising seas cannot use the agreement to sue the developed countries and other big emitters for their losses.

What happens next?

Nobody got exactly what they wanted in Paris, which pretty much fulfilled the expectations of everyone. Every nation has some interests at stake that run counter to the interests of others, and the last two weeks have been full of news about that. But the fact remains that the agreement does create an expectation for action on the part of all countries, and coloring too far outside those lines will carry a stigma and the possibility of serious counteraction on the part of others in the world community. What COP21 really did was to keep open the real possibility that we will solve this problem in time to avoid disaster. Diplomacy is a messy business, but the reason we have it is because it works at least well enough to build a low-carbon future on the foundation.

Winners and Losers

There will be winners and losers in this future. The fact that the big emitters—utilities that depend heavily on fossil fuel (particularly coal), mining companies with significant revenues from coal mining, air carriers with older, less energy efficient fleets, and pretty much every aluminum producer and cement manufacturer on the planet—will be under pressure probably

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isn't news to anyone who has paid any attention to the regulatory proposals to limit climate change. Note that this agreement does make the competitive position of fossil fuels—particularly coal—even more tenuous than it already is, but it doesn't oblige any government to put regulations in place that require keeping fossil fuels in the ground. That, if it happens, will be a response to the new competitive landscape and the rules that countries do put in place to achieve their targets.

The obvious winners are renewable energy producers, or companies that make the equipment that make electricity out of sunlight, wind, water, and other resources that don't require combustion to make energy. Manufacturers of efficient engines or energy efficiency equipment should also get a boost of adrenaline. Companies that enable people to meet, work, talk, or do anything else that normally requires travel without leaving home or office may also be winners.

Sectors to Watch

The game-changer is technology. Bill Gates, Mark Zuckerberg and Richard Branson, among others, launched the Breakthrough Energy Coalition during COP21, aimed at producing the technological building blocks of the post-fossil fuel world. Though many experts regard even the 2^{0}C target as nearly unachievable, most of the world's turn-on-a-dime moments are the result of new technology. Electricity storage—whether in better batteries, more usable pumped storage, ultracapacitors, flywheels, compressed air, or other possibilities—has the ability to completely change the business of making and using energy, particularly electricity.

Another technology space to watch is carbon capture and sequestration—particularly anything that can remove carbon dioxide from the atmosphere and put it somewhere that won't leak back into it. Several of the visionary technologies for removing carbon from the atmosphere sound a little like fairy dust, and in a way perhaps they are—but most of the technology we use on a daily basis would look like magic to most of our forebears. It would be foolish to pin all our hopes on nascent technologies—the Paris agreement makes it abundantly clear that we need to mobilize all our tools to reduce emissions now. But it would be equally foolish to focus all our attention on our current toolkit.

The Role of Investors

Investors have major roles to play in reducing emissions as well as developing better ways to enter the Beyond Carbon era. COP21 laid the foundation that enables investor power to flourish. There are several investor initiatives already underway, including the Investor Network on Climate Risk[3] in the U.S. (there are counterparts in Europe and Asia as well) which launched the Clean Trillion initiative to invest a trillion dollars in clean energy annually for the next 36 years; and the CDP (Carbon Disclosure Project), which works with over 820 investors (up from 35 in 2002) around the globe to urge companies to recognize and report climate risks and opportunities, and reduce emissions.

COP21 saw announcements of several new initiatives, including:

- RE105, a coalition of investors with over £350 billion in assets that pressures corporations to commit to 100% renewable electricity.

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- Paris Green Bonds Statement, launched by the Climate Bonds Initiative (CBI) with 27 investor signatories representing $11 trillion in assets. It is aimed at supporting long-term, sustainable green bond markets.

- The Green Infrastructure Investment Coalition, a product of the CBI and the Principles for Responsible Investment (PRI), which brings together investors, governments and development banks to improve the flow of capital to green infrastructure projects around the globe.

- The G20 Energy Efficiency Investor Statement, launched by the PRI, the United Nations Environment Programme Finance Initiative, and Ceres, aims to integrate energy efficiency into investment activities including portfolio construction, engagement, proxy voting, and asset allocation.

These are examples of the kind of investor activity we need much more of in the future in order to put fossil fuels to bed and create a safer future. COP21 essentially told fossil fuels it's time to put on the pajamas.

Pax World Management LLC

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