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# Taking Climate Stewardship to The Next Level

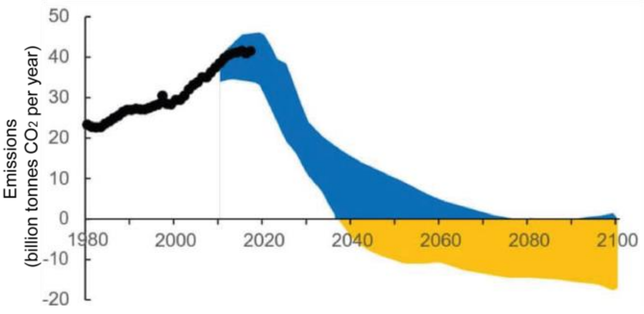
Stewardship and active ownership have become central in the world of investments. Being a responsible investor, once a niche area, is becoming vital, a licence to operate. The global economic impact of Covid-19 demonstrates the interconnectedness of human and economic health, strengthening the case for action on climate change. It is time to accelerate efforts to bolster environmental and social resilience. But what are the main drivers that can raise investor stewardship to the next level?

## The urgency of the climate crisis

In October 2018, the United Nations Intergovernmental Panel on Climate Change (IPCC) published a report on the dangers of global temperatures exceeding pre-industrial levels by more than 1.5° C. The report concluded that to strengthen the global response to climate threats, and promote sustainable development and efforts to eradicate poverty, the global economy must nearly halve its carbon emissions over the next decade and reach net-zero emissions by 2050 to have just a 50% chance of limiting warming to 1.5° C. Failure to do so could potentially create great risks for investor portfolios worldwide. Recent extreme weather events such as forest fires, hurricanes, severe droughts and floods have demonstrated yet again the urgency of the crisis we as a society are facing[1].

Corporations and investors have a role to play in this complex crisis as they need to reduce their emissions and cope with the impacts of global warming. Investors, as owners and lenders to companies, need to play an even stronger role through active ownership, fulfilling their fiduciary duty so as to encourage capital reallocation by companies towards net zero carbon. As the figure below demonstrates, to keep temperatures below about 1.5°C requires global $CO_2$ emissions to decline by around 45% from 2010 levels by 2030 and to reach net zero around 2050.

**FIGURE 1. HOW CLOSE TO 1.5°C ARE WE?**




Source: IPCC Report "Global Warming of 1.5° C", 2018

[1] To help investors understand the climate crisis, DWS's "Experts on Climate Change"[1] report provides a short readable article from a leading climate scientist, major law firm, actuary and accounting firm, investment consultant and DWS's investor perspective on climate risks and opportunities.

## Covid-19 shows working for sustainability together is vital

This year we are also experiencing significant market volatility due to the global outbreak of Covid-19, which is having extraordinary implications across all sectors of the global economy. These turbulent times are making abundantly clear just how vulnerable our global capital market is to unexpected developments and how we need to act together to address a common issue, whether a global disease or climate change.

As we battle the Covid-19 crisis and prepare for its aftermath, this year's shareholder voting season offers an important opportunity to revisit engagements on environmental, social and governance (ESG) topics. These engagements have the potential to set a new direction. Historically, a large body of research argues that crises, such as the 2008 financial crisis, can to an important extent be attributed to failures and weaknesses in corporate governance[2]. The need to strengthen the long-term, sustainable development of businesses to create value for all stakeholders is clear. But how can we work together towards avoiding the next global crisis?

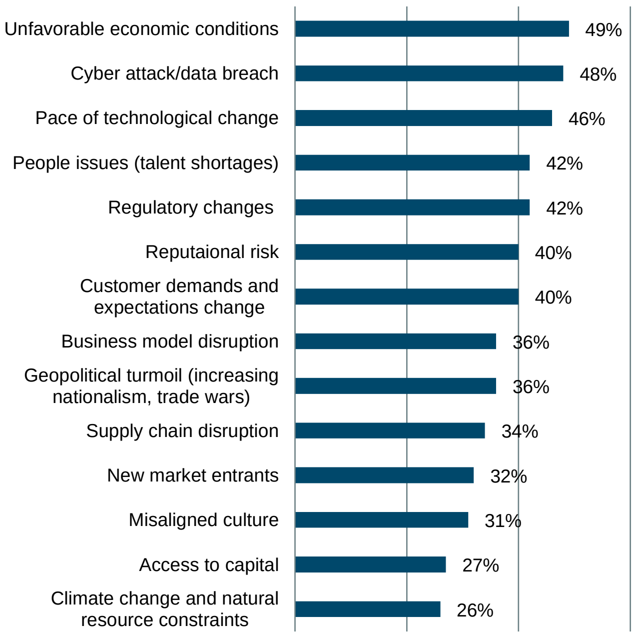
Capital allocation, in particular, is going to have to change. Increased investment in sustainable business models is likely. Especially in the recovery phase from Covid-19, this investment needs to focus on the companies with the best climate-oriented strategies, in order to achieve a degree of environmental resilience in the future.

Thus, investors need to pay attention to how rigorously boards and management are engaging with climate risks. A perhaps surprising finding from a recent survey by Ernst & Young shows that only a quarter of 500 global board members and CEOs believe that climate risks could have more than a moderate impact on their organisation over the next 12 months (See Fig. 2).

## Financial regulators are focusing on responsible investing

There has been significant movement in the regulatory space towards enhanced transparency and confidence in markets, particularly in Europe. The revised Shareholder Rights Directive (SRD II) of the European Union encourages long-term engagement by EU-listed company shareholders. To achieve this long-term objective, the SRD II describes new obligations for EU-listed companies and institutional investors, leading to greater transparency regarding the investment strategy, engagement policy and voting process in general meetings. It aims to strengthen the engagement between shareholders and portfolio companies and foster the long-term sustainability of investments. Furthermore, the EU is reforming the Non-financial Reporting Directive (NFRD), adding the concept of "Double Materiality" on climate change. Double materiality demands that companies should disclose the "financial materiality," the impact of climate change on the company's financial development and performance, and also the "environmental and social materiality," the direct and indirect impacts of a company's operations on the climate. These two policies are central to the EU Action Plan on Sustainable Finance of March 2018. The European Commission has outlined very clearly the ambitious objectives as part of a strategy to integrate ESG considerations into its financial policy framework and mobilise finance for sustainable growth. As public funding cannot close this required investment gap in sustainable investments, the focus now is on legislative actions on the capital market and its participants.

**FIGURE 2. RISKS WITH MORE THAN A MODERATE IMPACT EXPECTED BY BUSINESSES IN THE NEXT 12 MONTHS**




Source: "Board Members Preparedness for Major Risk Event Like COVID-19", Posted by Steve Klemash, Jennifer Lee, and Amy Brachio, EY Center for Board Matters, 2020.

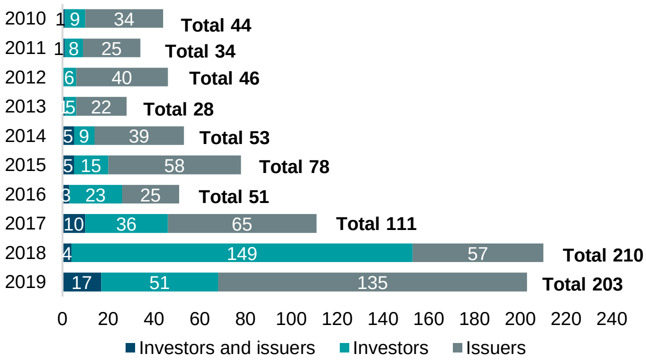
Moreover, since the financial crisis, corporate governance expectations for all market participants have changed. For investors, these are reflected by a growing number of local

[2] "The Corporate Governance Lessons from the Financial Crisis" the OECD Steering Committee on Corporate Governance, Kirkpatrick, 2009

stewardship codes that aim to increase demand for more effective stewardship and investment decision-making which is better aligned to the needs of institutional investors' clients and beneficiaries. The codes generally seek to promote higher levels of investor engagement by encouraging public disclosure of investors of how they discharge their stewardship responsibilities.

In the United States there has been a rise in active ownership over the past two decades, prompted by a series of failures, from the bursting of the dot-com bubble, to the accounting scandals such as Enron and the 2008 financial crisis. The Sarbanes-Oxley Act of 2002 addressed public and investor concerns and strengthened the accountability of both executive and non-executive directors as fiduciaries. Later, the listing requirements were amended and demanded a majority of board members and of key committees were independent. The Dodd-Frank Act of 2010 introduced an advisory say on pay for shareholders. These developments have led to a series of legislative actions, aiming at imposing more accountability and oversight responsibilities on company boards and therefore higher governance standards and investor confidence. While European corporations are generally regulation-driven, American corporations are more affected by shareholder pressure which is generally reflected in market regulations.

**FIGURE 3. THE NUMBER OF ESG REGULATIONS GLOBALLY HAS INCREASED DURING THE PAST DECADE**




Source: Who will regulate ESG? Regulations can be mandatory, voluntary or explanatory in nature and are collected globally. The number of regulations is absolute and not cumulative. Data from MSCI ESG Research, 2019.

## Stewardship is beginning to drive the choice of asset manager

Long-term investors have been expressing concerns about sustainability for several decades. But only recently have they started translating these into active ownership activities. The numbers back up the view that the capital markets are in the middle of a transformation. In 2006, when the Principles for Responsible Investment (PRI) were launched by the United Nations, 63 investment companies with $6.5 trillion in assets under management (AUM) signed a commitment to incorporate ESG issues into their investment decisions. By April 2020 the number of signatories had grown to more than 3,000 and represented around $90 trillion in AUM[3]. Investors can help create a more economically prosperous and sustainable society by exerting their shareholder and bondholder influence on companies.

One of the unique selling points of actively managed funds has always been that they go beyond reliance on analysis of a company's reported financials. Instead the aim has been to establish long-term relationships with companies and engage with them to improve their long-term financial value drivers and social and environmental conditions. There is a common misconception that active ownership might be considered irrelevant in passive portfolios as the portfolio manager cannot make buy-sell decisions on a given company based on successful or failed engagement efforts. However, exactly for that reason, active ownership applied to passive strategies often represents one of the most effective tools by which institutional investors can express their opinions on company financial performance and drive sustainable value creation.

Active ownership activities such as quality engagement and proxy voting are both a responsibility and an important instrument for asset managers in order to generate value for their clients; it gives them their "edge" in today's competitive market. The PRI, for example, evaluates signatories on a yearly basis via a transparency report and attributes scores to the quality of their active ownership, among other things. In recent years, there has been increasing use of engagement strategies in responsible investment. While early approaches tended to focus more on negative screening (exclusion of companies that do not meet social or environmental criteria) or positive screening (inclusion of companies that excel in these criteria), there is now an increased emphasis on dialogue with company management to attempt to change company activities and/or practices[4]. We believe exclusion has some shortcomings which must be carefully considered. Engagement with the possibility of exclusion may be a more effective means of influencing companies. Moreover, one of the principles of PRI's "Engagement 2.0" strategy is collaborative action: focusing on collective goals and the delivery of positive real-world outcomes is possible only through enhanced collaboration between investors. Enhanced collaboration – in a variety of forms – spreads the cost of addressing collective goals and is therefore central to achieving the required evolution in stewardship practice. We believe it is necessary to increase the incentives for all

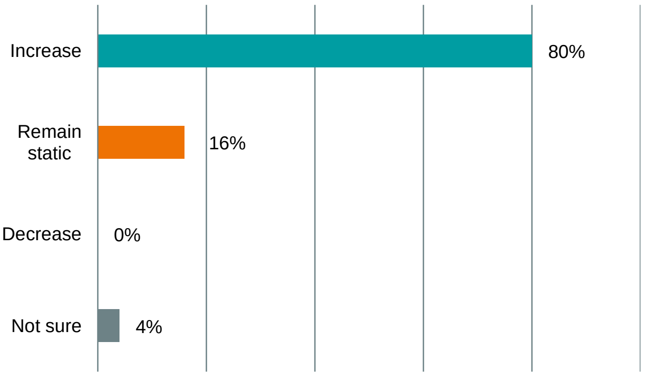
[3] Principles for Responsible Investment, 2019

[4] Ivar Kolstad, "Three myths about engagement and exclusion in responsible investment", 2014 (See secondary sources under References)

investors to engage with issuers, and make this a requirement so as to improve the quality of engagement. While this is already gradually taking place, policy and regulation can speed up the improvement in order to address the numerous ESG issues in society. For the German regulator, for example, collective engagement can be seen as so-called “acting in concert” in the light of the mergers & acquisitions law; this has an impact on German issuers especially and therefore on asset managers in Germany. While many current policies such as the SRD II and different countries’ stewardship codes expect collaborative engagement from investors, the differences in (sometimes contradictory) laws and regulations create further uncertainties and constraints for investors. The transparency requirements are becoming more demanding every year and we see increasing interest from our own clients in our PRI scores. Moreover, more than half of the pension funds surveyed by a CREATE-DWS Research in 2019 stated they used the stewardship records of the investment managers to a “large extent” in their selection process[5].

**FIGURE 4. STEWARDSHIP DEMANDS ON PASSIVE FUNDS MANAGERS WILL INCREASE OVER THE NEXT THREE YEARS**

(% of respondents)



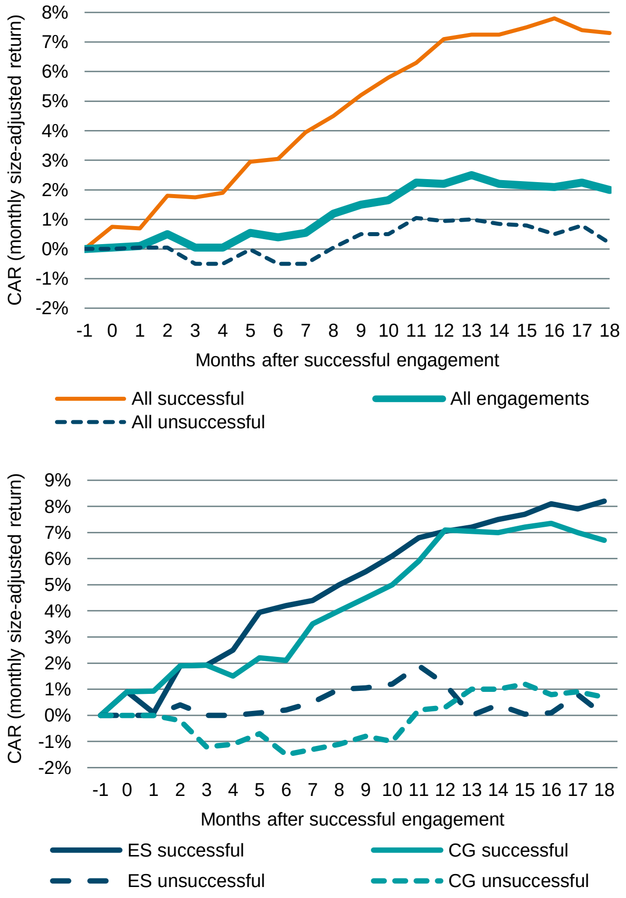

Source: CREATE Research Survey 2019

## Stewardship creates added value not only in qualitative but also in quantitative terms

A large number of research papers explore the link between sustainability and corporate financial performance, using a wide range of methods, data samples and approaches. These have generally concluded that sound ESG standards do not harm performance but rather improve it and lower the cost of financing[6]. However, despite increasing stewardship activity by investors, exactly how engagement with ESG topics creates value remains vague. There are a number of studies which have shown that successful ESG engagement activities lead to cumulative size-adjusted abnormal returns over the years following the initial engagement (See Fig.5) [7].

The PRI goes further in concluding that engagement brings value not only in terms of pure financial returns. Engagement can create a variety of benefits such as enhanced exchange of information (“communication value”); the production and circulation of new ESG-related knowledge (“learning value”); and the political benefits that can be derived from engagement, for instance, through enhanced executive support for ESG issues (“political value”)[8].

**FIGURE 5. MEASURING SUCCESS OF ENGAGEMENT EVENTS**




Source: Dimson, Karakaş and Li, “Performance improvement in 613 companies engaged from 1999-2009 by a large US asset manager”, 2015

[5] “Passive Investing 2019 The rise of stewardship”, 127 pension plans in 20 markets participated in the research and follow-up structured interviews. Annual research program Create-Research and DWS, 2019
[6] See Gunnar Friede, Timo Busch & Alexander Bassen, “ESG and financial performance: aggregated evidence from more than 2000 empirical studies,” *Journal of Sustainable Finance & Investment*,” 2015.
[7] Dimson, Karakaş and Li, “Active Ownership”. Performance improvement in 613 companies engaged from 1999-2009 by a large US asset manager, 2015
[8] PRI on ”How ESG Engagement Creates Value”, 2015.

## Are investors doing enough?

As highlighted in the previous sections, we believe engagement should already be an integral part of the investment process and investors with a long track record in active ownership will have a competitive advantage, which will allow them protecting their investment cases.

Climate change is a significant risk for many investors now and assessing its impact on a company's business model and competitive position is becoming an integral part of any corporate analysis. Extreme weather events, carbon pricing or fast-paced shifts in consumer preferences may have a material financial impact on companies. However, one should not ignore the substantial investment opportunities that may be created by climate-related technologies, government responses to the climate challenge, and shifts in consumer demand. It is not sufficient for investors simply to encourage companies to manage financial risks for companies and investors. It is of paramount importance that investors focus on systemic change and ensure that corporations are making sufficiently ambitious and innovative efforts to reduce emissions, become more resilient and contribute meaningfully to the UN's Sustainable Development Goals (SDGs). When companies' response to investor engagement is inadequate and a material risk is identified which is not being properly addressed, shareholders should resort to their voting power and hold board members accountable. The "G" in ESG provides the fundamentals for the "E" and the "S". We believe that companies with sound governance in place tend to experience less environmental and social challenges or are much better positioned to manage them effectively. At a number of general meetings in 2019 shareholders resorted to voting against entire boards that had failed to take adequate action to address the climate crisis such as some of the big oil majors. Companies without clear risk management and insufficient investment in innovation and new opportunities will be the first to move down the list of preferred investment cases. That does not necessarily mean, however, that capital should be allocated only to companies that are 100% 'green'. Companies that have a solid plan to achieve environmental and societal resilience should also be rewarded. The major players in the energy sector, for example, have the capacity and resources to invest in R&D and find the solutions needed for the transition to a low carbon future.

We believe that to evaluate the effectiveness of companies' climate policies investors need to focus in particular on their progress in five areas:

- Enhanced and mandatory extra-financial disclosure and good climate governance at board level.
- Clear, short, medium and long-term targets, in line with the Paris Agreement and the SDGs, managed correctly in order to deliver a reduced carbon future.
- Linking between these targets and executive compensation.
- Shareholder proposals on climate change addressed properly and effectively.
- Support for government climate policies and alignment of their own and industry associations' lobbying activities with their climate strategies

## A new paradigm for extra-financial information and climate governance

As highlighted in the previous sections, we believe that extra-financial factors, such as brand reputation and intellectual capital as well as market value, are generally indirectly related to a company's financial performance and strategy, especially when evaluated over time, is no longer news. Investors' consideration of intangibles has become more prominent in the past decade but the question of the materiality and reliability of extra-financial information remains. Successful engagement leads to a better flow of information and quality of understanding between companies and investors. Thus, one of the most important aspects of climate-related engagement should be to foster more transparent and reliable reporting on the issue. There have been multiple initiatives to support companies on their disclosures, such as the Global Reporting Initiative (GRI) guidelines in 2000, the International Integrated Reporting Council's Framework in 2013, the more recent Task Force on Climate-related Financial Disclosures (TCFD) recommendations in 2017 as well as the Sustainability Accounting Standards Board (SASB) standards in 2018. Both the TCFD and SASB categories cover the physical, liability, and transition risks associated with climate change and guide companies in providing material, reliable and comprehensive information that is comparable within each industry.

In 2018, DWS chaired a working group that expanded the TCFD framework to include corporate disclosure and management of physical climate risks and opportunities[9]. The Institutional Investors Group on Climate Change has also produced a number of 'Investor Expectations' documents for sectors including oil and gas, utilities, automotive manufacturing, mining, steel and construction materials. According to research by Leaders Arena, all PRI signatories have started to disclose in line with the TCFD in 2020 and will be expected to adopt the recommendations progressively within their reporting practices in order to close the circle of transparency and increase communication and learning value globally and across industries[10].

Boards are increasingly recognising the need to assess the financial and extra-financial risks from climate change as companies adapt to the risks and opportunities and seek to safeguard their business models. As the challenge is anything but simple, we believe that boards of directors need the necessary climate expertise and effective climate governance in place. In our engagements with companies we strongly encourage the appointment of a dedicated climate expert, especially in the sectors that are most directly affected. There are also initiatives emerging such as the "Chapter Zero: Directors' Climate Journey", that organise curated online content and events on climate change for directors. It aims to help non-executive directors to have effective boardroom discussions and debates about the impacts of climate change on their businesses and the appropriate strategic response[11].

## Are companies' climate targets transparent and ambitious enough?

Climate Action 100+ is a good example of the relevance of climate stewardship. It is an investor-led initiative to engage more than 160 of the world's largest corporate greenhouse gas emitters to curb emissions, strengthen climate-related financial disclosures and improve governance on climate change risks. Since its launch it has grown into one of the largest investor-led engagement initiatives, with over 450 investor signatories with $40 trillion AUM. The initiative's achievements demonstrate that engagement has not only a communication and learning value, but also an important political value.

Some examples of the most prominent public commitments that have resulted from investor engagement are:

_ **Royal Dutch Shell** committed to a range of industry-leading climate commitments, including emissions reduction targets that include Scope 3 emissions – indirect emissions in a company's value chain

_ **Rio Tinto** has exited from mining coal, published a TCFD report, and committed to an asset-by-asset review to set emissions reduction targets

_ **Volkswagen** committed to becoming 'climate neutral' by 2050 and launching nearly 70 electric vehicle models by 2028

_ **Glencore**, the world's largest exporter of thermal coal, agreed to cap coal production at current levels of about 145 million tonnes per year

_ **Enel** committed to net carbon neutrality by 2050

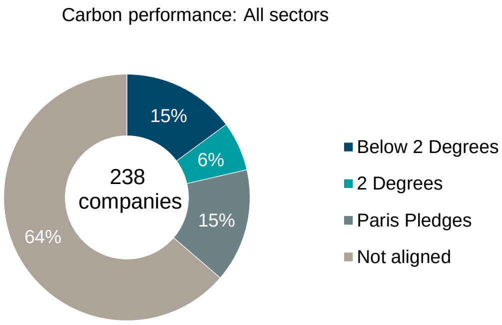
We at DWS joined the initiative in 2017, focusing on a utilities company based in Italy. In the past three years, the company has made significant improvements to its ESG governance. It has also made its reporting on extra-financial aspects of its business more transparent, abiding by the recommendations of the TCFD, and published a commitment to net carbon-neutrality by 2050.

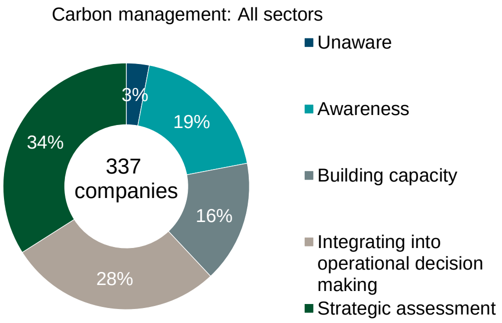
Nevertheless, the first progress report of the Climate 100+ initiative shows that while companies across many sectors have announced ambitious goals, the task of moving all of them into alignment with the goals of the Paris Agreement has only just begun. Our view is that the progress made is valuable, far more is needed and investor engagement will be required to ensure that momentum is sustained. According to the Transition Pathway Initiative[12] (TPI), too many carbon-intensive companies still have poor carbon management and their business models are not aligned with the Paris Agreement goals (See Fig. 6).

The TPI is a global initiative led by asset owners which assesses companies' preparedness for the transition to a low carbon economy. As of March 2020, 332 publicly-listed companies across 16 high carbon sectors have been analysed in many sectors, including automobiles, steel, cement, coal, oil and gas, electric utilities, paper, aluminium and aviation. Over 70 investors (including DWS) are supporters, jointly representing $18 trillion combined in AuM or AuA.

[9] "Advancing TCFD guidance on physical climate risks and opportunities", 2018
[10] "SASB TCFD Materiality Analysis", Leaders Arena, 2020
[11] "Chapter Zero: Directors' Climate Journey", 2019
[12] Transition Pathway Initiative, "Carbon Performance of European Integrated Oil and Gas Companies: Briefing paper" , 2020

**FIGURE 6. CORPORATE CARBON PERFORMANCE VS MANAGEMENT**




Source: DWS Investment GmbH, Data: Transition Pathway Initiative Tool, 2020

Based on their analysis "investors can now determine a net zero standard for the oil and gas sector that includes absolute emissions and emissions intensity targets covering all downstream, Scope 3 emissions. Critically, these targets must apply to all energy products sold, including those acquired from third parties"[13].

Many investors engage directly with the same companies and others through their own active ownership agenda. With the first global stocktake of country targets through United Nations Framework Convention on Climate Change (UNFCCC) approaching this year, the role of the private sector to support effective climate policy has never been clearer. A change in mindset was an important milestone for the climate change journey; now we are entering a more ambitious phase of setting clear targets, delivering on them and innovating for better solutions.

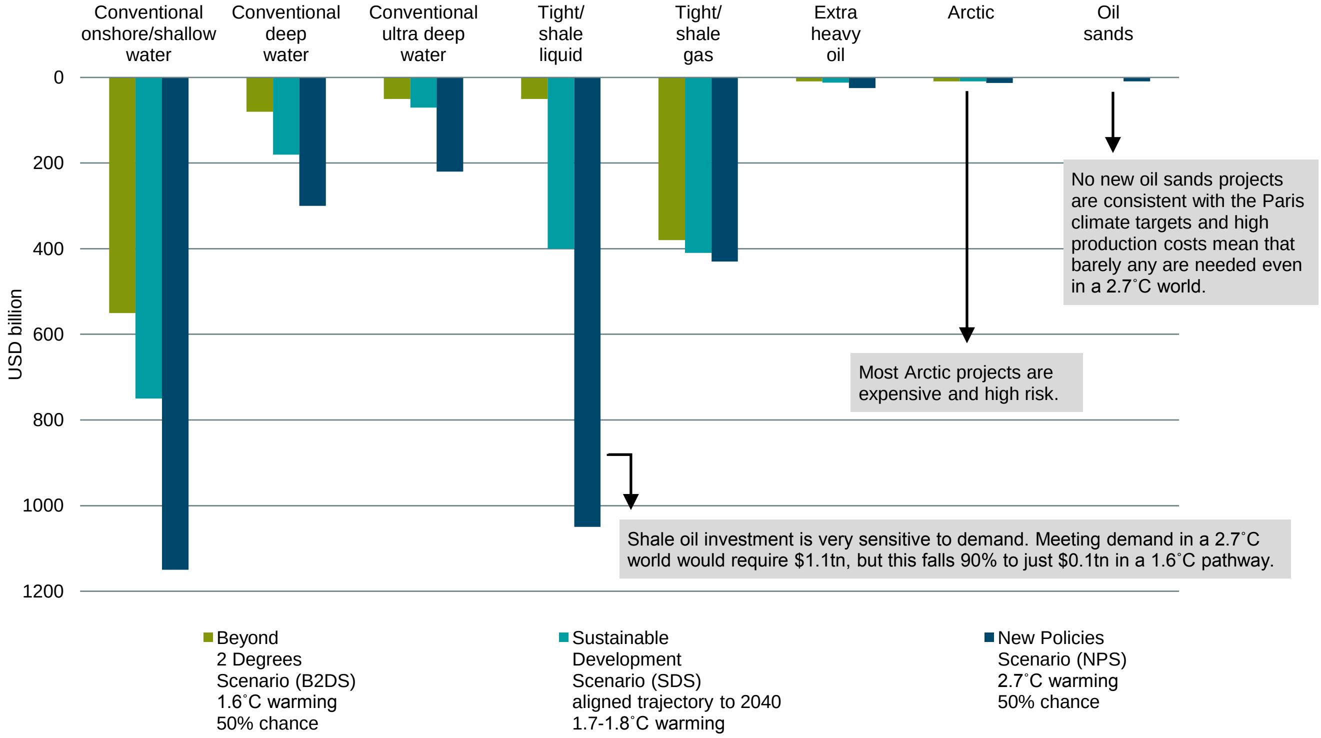
## Executive compensation: is there a link between climate goals and management incentives?

Executive pay is one of the most important aspects of good corporate governance and a central topic of engagement as it is one of the signals for a well-operated business. The alignment between the board and management on the appropriateness and transparency of the executive pay structure would generally support that signal. While a number of companies have been communicating their commitments to carbon emission reductions, changes to compensation plans have been very limited. As the deadlines to achieve the goals of the Paris Alignment approach, it is becoming more urgent to respond to climate change is getting narrower, and with compensation policies generally applying for several years once they are concluded, the pressure for them to reflect today's realities is growing.

Going forward, we believe that, depending on the industry and business model, the removal of the short-term incentive (STI), or merging of the STI and long-term incentive (LTI) may also be more appropriate than the traditional incentive models. We consider a combination of financial and extra-financial metrics that are directly linked to the business strategy as most appropriate. Looking at some of the largest oil and gas companies globally, we notice that while transparency is improving, the current performance metrics in executive compensation do not always align with the corporations' communications on their goals for net zero emissions. We expect companies to focus on value creation rather than volume. Thus, value- or returns-based indicators should find their way into executive incentives, instead of a strong focus on metrics based on production growth. As the Environmental Defense Fund asserts, climate incentives must be robust enough to "change decision-making with the speed and seriousness required to achieve the energy transformation we need"[14]. According to a report published by the Carbon Tracker Initiative, a third of variable pay is directly or indirectly incentivised by growth, while just 1% of pay is directly linked to climate measures such as emission reduction[15]. The setting of ambitious corporate strategies for an energy transition might be the first step that companies need to undertake. However, delivering on these targets is only possible if there is a strong link to executives' incentives. Thus, a key in climate stewardship is investor engagement on achieving an optimal level of transparency and ambitious executive compensation plans.

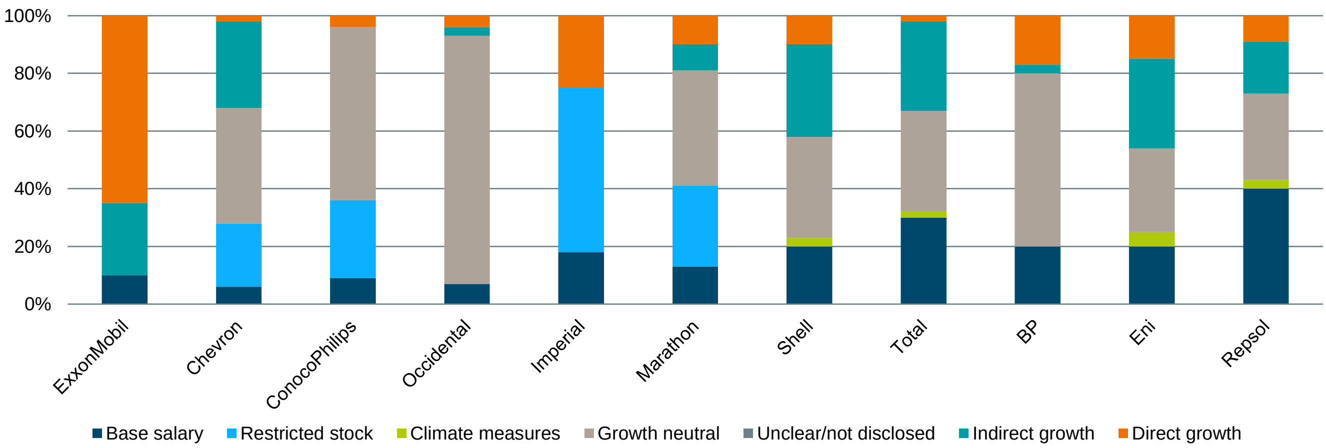
[13] Transition Pathway Initiative, "Carbon Performance of European Integrated Oil and Gas Companies: Briefing paper" and "Shell and Eni lead European oil majors' race to net zero emissions", 2020
[14] Environmental Defense Fund (No Date). "Will Shareholders Get Money's Worth As Oil Giants Link Executive Pay to Climate Results?"
[15] Carbon Tracker Initiative, "Fanning the Flames: How executives continue to be rewarded to produce more oil and gas at odds with the energy transition", Review on the remuneration policies of 30 of the largest listed oil and gas companies; 2020

**FIGURE 7. 2019-2030 CAPITAL EXPENDITURE FOR OIL AND GAS PROJECTS COMPLIANT WITH DIFFERENT SCENARIOS**




Source: Carbon Tracker Initiative, "Capex report 2019 Infographic", based on Rystad Energy, IEA, CTI analysis. 2019

**FIGURE 8. OVERVIEW OF THE SHARE OF DIFFERENCE PERFORMANCE INDICATORS FOR CEO REMUNERATION**[16]




Source: Carbon Tracker Initiative, "Fanning the Flames: How executives continue to be rewarded to produce more oil and gas at odds with the energy transition" (2020)

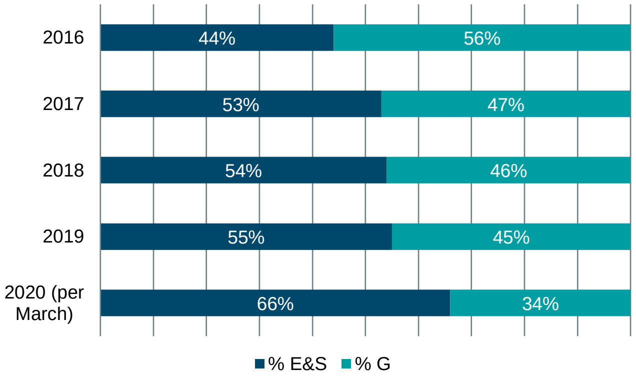
## Shareholder proposals: why the big fuss?

One way in which shareholders can hold management accountable on critical issues is to file or support a shareholder proposal. Through their proposals and votes, shareholders are able to play a role in the long-term development of a company. However, shareholder proposals can in some cases be seen as destroying value instead of protecting it, depending on how well informed the shareholder filing it is. The fact that the cost of bringing such proposals is relatively low makes it even more important to analyse their effectiveness carefully. The support of an informed shareholder base can play a significant role in reaping the rewards of low-cost shareholder activism and with it well-governed corporations.

[16] Analysis based on company reports. Total incentive incl. base salary element of fixed pay only (exc. pension payments and other benefits). 2018 performance year.

Shareholder proposals have historically been a popular mechanism used by investors in the United States. Recently there has been a rise in the filing of ESG-related shareholder proposals, in particular regarding climate change. In 2017, environmental and social (E&S) shareholder proposal filings exceeded the number of governance proposal filings for the first time[17]. The trend continued in 2018 and 2019 and we expect it to accelerate in 2020.

**FIGURE 9. THE NUMBER OF ENVIRONMENTAL AND SOCIAL PROPOSALS IN THE UNITED STATES IS INCREASING**



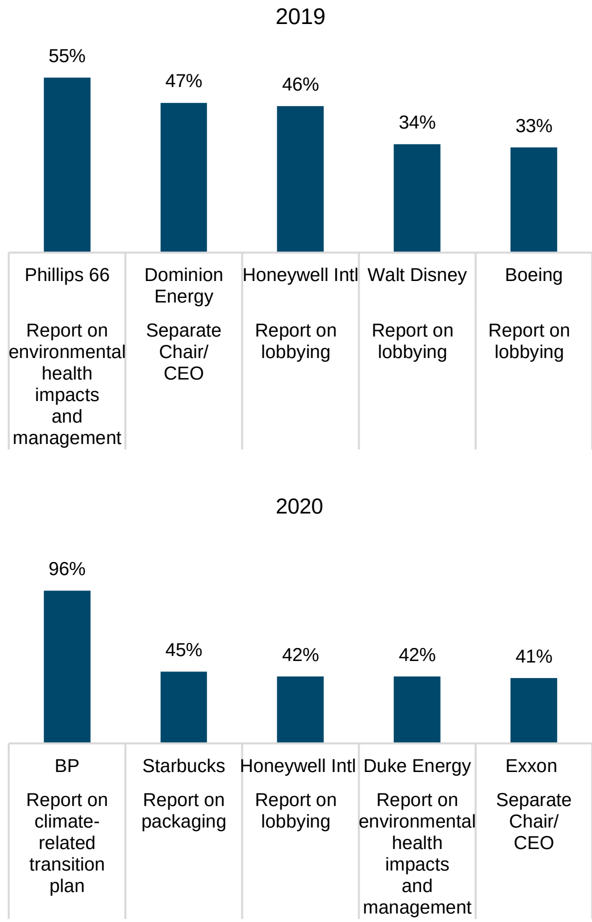

Source: "2020 Proxy Season Preview" based on ISS data as of March, 2020, posted on April 27, 2020, https://corpgov.law.harvard.edu/

E&S proposals increased not only in number but also in the support they obtained in 2019 and the same has been seen at the beginning of the proxy season, when annual shareholder meetings are held, in 2020. These represented more than half of the proposals filed for three consecutive years now and the overall support last year increased to 27%[18]. This year we expect an even more substantial increase, which clearly demonstrates that these topics remain a priority for shareholder action. But what can these proposals really bring to the table?

In 2019, 39% of climate-related shareholder proposals in the United States were withdrawn by the filing investors due to commitments by companies to take action on the issues raised in the proposals[19]. In 2019 and 2020, 90% and 70%, respectively, of shareholder proposals relating to renewables and energy efficiency were withdrawn for the same reason: commitments by companies to take action. Looking back at these precedents, we might expect that shareholder proposals will bring increased awareness and action from corporates. , we believe investors nowadays are much more experienced in their active ownership approaches and the urgency of the climate crisis will require multiple initiatives to encourage change.

Companies themselves are expected to do much more to improve their crisis prevention and management. In recent years there have been an increasing number of governance failures, provoking substantial fines and reputational damage for the companies concerned. Bribery and corruption allegations against Airbus led finally in January this year to a total fine of €3.6 billion plus interest and costs payable to the French, U.K. and U.S. authorities in order to avoid prosecution. Boeing's product safety failures and plane crashes are still under investigation and at this year's AGM the board's oversight of management strategy and corporate culture was called into question by a lot of concerned investors. On climate change, investors are continuing to pressure companies with proposals as well as engagements, as their actions are still not deemed sufficient enough to address the climate crisis on time.

**FIGURE 10. PROMINENT CLIMATE-RELATED SHAREHOLDER PROPOSALS AND THEIR SUPPORT RATE IN 2019 AND 2020**




Source: DWS analysis, Data by Ceres https://investorportal.ceres.org/, 2020

[17] "An Early Look at 2019 US Shareholder Proposals". Subodh Mishra, Institutional Shareholder Services, Inc., 2019.

[18] "2020 Proxy Season Preview" based on ISS data as of March, 2020, posted on April 27, 2020

[19] Ceres "Proxy Voting Guidebook 2020", 2020.

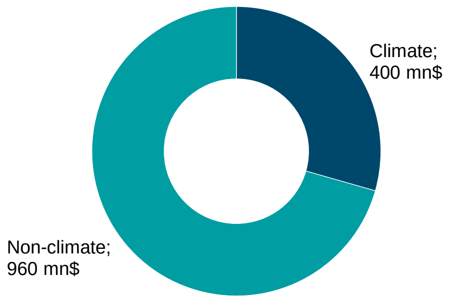
## Lobbying: how to have a real impact

Public policy plays a critical role in enabling society to respond effectively to climate change via appropriate policy measures to mitigate climate risks. As companies are influential stakeholders, in particular with their corporate lobbying practices, the political value of investor engagement becomes evident. Investors should push companies to support cost-effective policy measures to mitigate climate change risks and foster a progressive transition to a low carbon economy. But isn't that already the case? It turns out that there is more work to be done, both from the companies' and from the investors' side. While many companies are adopting robust climate change policies and play a productive role in policy debates, some are also supporters of trade associations or other organisations who lobby against climate policies. According to the findings of the think tank, InfluenceMap, very few large and politically influential corporations are engaging positively on climate policy globally; most are neutral or even negative influencers, outweighing supportive ones by around three to one[20].

**FIGURE 11. THE OIL MAJORS AND THEIR CAPITAL SPENDING ON CLIMATE LOBBYING**

Forecast capital spending 2019


Spending on branding and lobbying 2018




Source: Energy giants spent $1bn on climate lobbying, PR since Paris: watchdog, Data: InfluenceMap, 2019

Although these companies firmly rejected the findings, investors should take a closer look at the capital spending and climate lobbying ratios going forward. A more recent report by The Proceedings of the National Academy of Sciences of the United States (PNAS), published in January 2020, also brought it up as an issue, raising two important questions: do campaign contributions from oil and gas companies influence legislators to vote against the environment, or do these companies invest in legislators that have a proven anti-environmental voting record? The evidence based on 28 years of campaign data confirms that the more a given member of Congress votes against environmental policies, the more contributions they receive from oil and gas companies to support their re-election[21].

Investors, on the other hand, have been criticised in the past years for being too slow and not pushing hard enough. In their role as capital providers, investors need to demand that companies provide enhanced transparency on their lobbying activities, both direct and indirect, and ensure they have the necessary governance processes in place to align their climate policy and lobbying. The criticism usually applies to cases when investors prefer to discuss their concerns with company management and board members behind closed doors; many are hesitant to reveal their criticism in voting decisions or public statements. This hesitation is understandable and necessary to maintain a constructive long-term dialogue. Companies are providing investors with valuable information on their strategic development and investors are fiduciaries and need to protect the interests of their clients' capital.

The Covid-19 pandemic has confronted society with an extreme situation. With preserving health and saving lives the priority, many governments have provided financial aid for businesses and individuals. Therefore, corporate lobbying has been very active, seeking aid. Though much of the activity is for immediate relief, there is increasing concern that hastily made political and economic decisions during the pandemic could have critical longer-term effects. Investors need to monitor certain lobbying very closely, in particular that from the fossil fuel value chain, which might try to turn government intervention on Covid-19 to their advantage by, for example, toning down or delaying the targets of the Paris Alignment. The pandemic should not distract from the urgency of the climate change issue, which remains the most substantial global threat to society and the financial system.

[20] InfluenceMap "Corporate Lobbying: How Companies Really Impact Progress on Climate", 2018

[21] "Oil and gas companies invest in legislators that vote against the environment", Goldberga, Marlona, Wanga, van der Lindenb , Leiserowitza, from Yale University, University of Cambridge, 2020

## Final remarks

Governments and the world as a whole were alerted two years ago to the need to address climate change and to do so quickly because time is very limited before it becomes irreversible. Corporations and investors have an important role to play in their duties towards all stakeholders. Investor stewardship, including active engagement with companies and proxy voting, is both a competitive advantage and an opportunity to influence companies to tackle climate issues responsibly, thereby generating economic value in the longer term. Major corporations globally have made some progress with commitments to align their strategies to the Paris Agreement. Many of them were strongly influenced by investor initiatives and engagement programmes as well as regulatory developments in favour of sustainable investment and long-termism.

However, there is a need for more action by investors and also by corporations themselves. Investors should not only encourage companies to improve their disclosure and risk management but also, we believe, play an important role by pushing companies to shift their policies and capital expenditure towards accelerating emission reductions and improving society' resilience to climate change. Many investors are deciding to divest their holdings of carbon-intensive companies or reduce their exposure to them. In order to prevent the next big crisis, we need to act in a collective manner by supporting well-managed, sustainable business models and stable political and social systems. Finally, we believe policymakers and regulators also have an important role. They should increase the incentives for all investors to keep improving their stewardship activities with the companies in which they invest, individually and collectively.

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