AllianzGI Climate Policy Statement

Value. Shared.

1. Introduction

Unlike traditional financial risk factors, such as market price risks, assessing and quantifying climate change risks in investments is much harder and more complex.

Unlike traditional financial risk factors, such as market price risks, assessing and quantifying climate change risks in investments is much harder and more complex. The "failure of climate change mitigation and adaption" is a pressing long-term risk according to the World Economic Forum's Global Risks Report 2021. The Intergovernmental Panel on Climate Change (IPCC) reports show that greenhouse gas (GHG) emissions need to be strictly limited by 2050 to keep climate change well below 2°C above pre-industrial levels. There has also been strong progress to curb global warming and climate change, notably at the 21st Conference of the Parties, where global government leaders signed the Paris Agreement that aims to pursue limiting the temperature increase to 1.5°C above pre-industrial levels. Nevertheless, without a sharp decline in GHG emissions by 2030, global warming will surpass 1.5°C in the following decades, given the current level of international climate ambition.

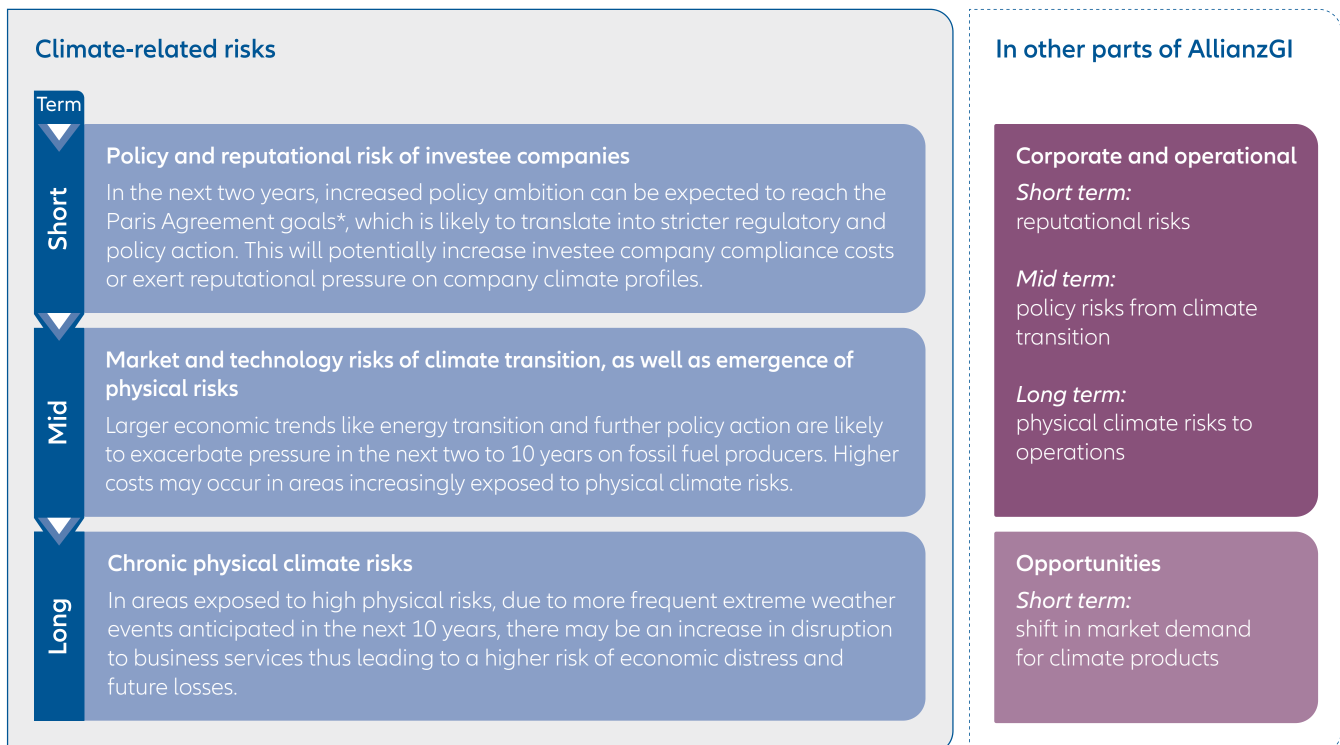
Thus, climate change is a serious issue for all our stakeholders. At Allianz Global Investors, climate risks are an important consideration when assessing potential investments. As an active investor, we can help to find innovative ways to allocate new capital – and reallocate existing capital – towards a climate transition that meets the Paris Agreement goals. We are a member of the Net Zero Asset Manager Initiative to act on the present and future climate demands jointly with other investment industry members. This is alongside our parent company, Allianz SE, which committed to decarbonise its asset owner portfolio as a founding member of the Net Zero Asset Owner Alliance. In recent years, we have laid strong foundations for our climate change strategy by supporting and implementing the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, as well as developing an enhanced systematic approach to investee engagement on climate. We are also supportive of climate efforts by Allianz SE, which has further strengthened its approach to exiting coal-based business models due to climate risks, and has committed as an investor to the Science Based Target initiative (SBTi) among many other efforts.

2. Our climate strategy

We see a diverse set of both climate risks (transition and physical) and opportunities in the short, medium and long term through the value of assets we manage on behalf of our clients. Integrating climate risks and opportunities into our investment products remains at the core of our business model. At the same time, we take seriously the operational climate risks and opportunities faced by AllianzGI as a corporation.

Climate-related risks

Climate-related risks may have a significant negative impact on the value of assets we manage, the standing of the investment products we sell, and our corporate activity. In the short term we see the policy and reputational risks that our investee companies are exposed to as the leading climate-related risks that may affect investments. In the medium term, market and technology risks of climate transition may develop more substantially, and we expect acute physical risks to emerge more frequently. From a long-term perspective, we think that chronic physical climate risks can become more significant.

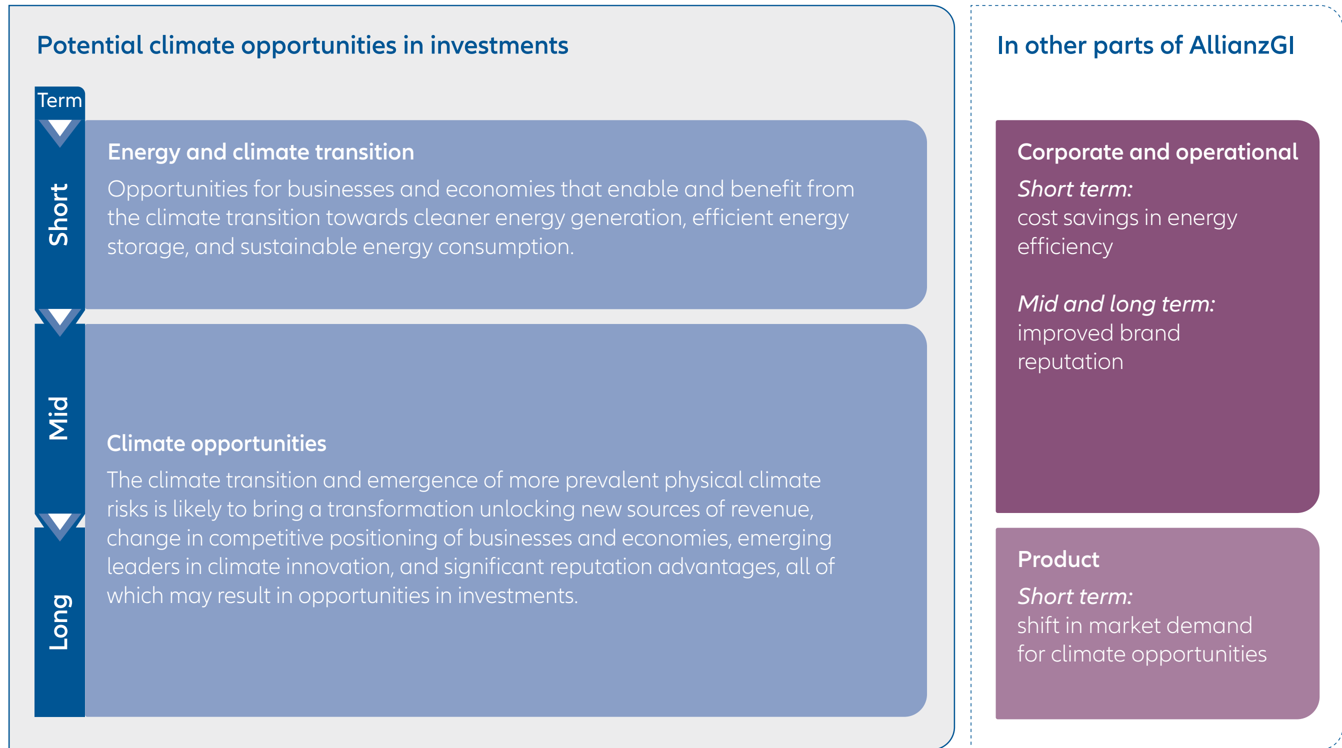


* Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change.

Climate-related opportunities

Climate-related opportunities are developments that may pose an upside potential to the value of assets we manage, enhance the market positioning of our investment products, and optimise our corporate activity.

In the short term, we see the activities that enable and benefit from the climate and energy transition as the leading opportunities that may affect investments. In the mid and long term, the climate-related investment opportunities are arising from competitive positioning and climate innovation.



2. Our approach

Governance

AllianzGI has a Sustainable Investing Working Group with representatives from the Investment Executive Committee and relevant internal stakeholders. It advises the Executive Committee (ExCo), our central governance and decision-making body at AllianzGI, and other relevant committees on sustainability issues including climate change. The ExCo has responsibility for all sustainability-related topics, including climate change. The Investment Executive Committee and Global Head of Investments have responsibility for all sustainability-related topics, including climate change, within our investments.

Investment process

AllianzGI's dedicated sustainable investment team, portfolio managers and analysts collectively monitor and assess the science, regulatory response and business implications of climate change closely, looking at implications for individual issuers and sectors. The teams analyse several ways in which climate change can be a driver of investment performance.

For example, we research:

1. How the uptake of low-carbon transportation may impact commodity prices, such as the oil price.
2. How the growth in the deployment of renewable energy may impact the solar and wind value chain and utilisation rates for traditional thermal power plants.
3. How carbon prices, tax credits and subsidy schemes for fossil fuels and renewable energy affect clean technologies and to what extent they disrupt incumbent business models.
4. How new technologies may enable our investee companies to set ambitious targets and who is at the forefront of developing these new technologies

For **publicly listed asset classes**, the teams look at extreme environmental risks on a corporate issuer level as part of their intrinsic ESG rating analysis, including possible tail risks from climate change transition risks. Research views and investment opinions are exchanged and documented on a global proprietary research platform, which can be accessed by all investment professionals.
For **private market asset classes**, the teams similarly consider climate risk on an issuer level. However, the due diligence process for private market investing often requires a high degree of detailed information. Depending on the individual investment strategy, the investment teams review specialist reports commissioned by independent advisors, conduct in-depth discussions with the management and/or existing equity owners, and seek advice from specialist ESG research colleagues within AllianzGI or Allianz SE. The due diligence process is used to identify the relevant climate risks for each investment. A bespoke analysis is subsequently performed if necessary. This can include both qualitative analysis (eg, Q&A with the management or independent advisers) or quantitative analysis (eg, building a cash-flow operating model for a single company and sensitising the inputs).

With our ESG integration efforts, all AllianzGI portfolio managers are able to consider climate change risks in the investment strategies that they manage.

Dedicated climate client solutions

Beyond mainstream investment strategies, AllianzGI offers climate thematic and impact-driven funds such as green bonds, climate transition equity, and illiquid renewable energy equity. These "green" assets contribute positively to the alignment of an asset owner's portfolio to a 1.5°C economy or well below, and the portfolio's compatibility with climate and energy transition targets.

Active stewardship

1. Engagement and proxy voting

For **publicly listed asset classes**, we have launched a dedicated climate engagement approach for several funds that invest in listed securities, recognising the importance of climate change and the power of engagement to drive real-world impact. This approach focuses on engaging with companies to facilitate their climate transition to a pathway aligned with a 1.5 degree low-carbon economy.

As a proxy for climate change impact, we identify the top absolute CO2 emitters per portfolio. To set realistic targets for each company, we analyse best practices per sector and assess the feasible progress that could be made going forward. This analytical framework provides a solid basis to define company-specific engagement targets. These are aligned within our listed equities and fixed income investment teams and documented on our global research and collaboration platform.

Examples of engagement targets could be GHG emissions reduction targets or board-level remuneration targets linked to climate change. The engagements are performed centrally, tracked over time, and their outcomes are reported – all of which supports our investment and, potentially, divestment decisions. Ultimately, climate engagement targets can help to improve risk-adjusted returns by helping companies to adjust their business models for the future.

Additionally, environmental and climate considerations are reflected in our proxy voting activities in respect of listed equity assets. Our voting records on climate-related shareholder resolutions demonstrate strong support for such resolutions, encouraging companies to pursue the transition to decarbonisation.

For **private market asset classes**, we typically have direct access to the management of our investee companies. Our private market assets often play a significant role in the capital structure of investee companies, and this enables a level of engagement that may generate improvements in ESG practices, such as by encouraging them to implement climate transition/resilient measures.

A considerable proportion of our private market assets under management are invested in real assets, such as infrastructure. By nature, real and infrastructure assets can have a significant impact (positive or negative) on climate transition. Using the EU Taxonomy as reference is helpful for quantifying the contribution of our real asset and infrastructure investments to climate change mitigation and adaptation. For example, we are invested in renewable power-generation assets, such as wind, solar and hydro plants, and assets that improve energy efficiency, such as portfolios of smart meters. It is our view that a power-generation asset fuelled (in part) by fossil fuels faces "stranded asset" risk if its operating life could be prematurely shortened due to regulatory carbon emissions caps, heavy taxation or an alternative climate-related penalty. Our firm-wide approach is that we believe there is an opportunity to enable the climate transition via engagement with the companies that use fossil fuels. Within private market asset classes, this can take the form of financing the capital expenditure to allow these companies to develop low-carbon technologies and rebalance their energy mix with some exposure to fossil fuels to meet the demand when a substitution option is not available. We also acknowledge the importance of evaluating a company in the context of its jurisdiction and the target impact of the investment – for instance, in emerging markets it is key to analyse the potential trade-off between providing basic electricity access to a certain population and the possibility that the source of such electricity results in some exposure to fossil fuels.

We will continue our engagement with companies on climate-related issues and encourage them to increase transparency reporting on leading climate initiatives, such as through the TCFD and Science Based Targets (SBT). We believe this approach will also lead to improved quality of disclosures provided to our investors by positioning them to meet their climate ambition more precisely. We also support and participate in the Climate Action 100+ initiative, as well as collective engagements with The Investor Forum.

2. Industry collaboration

As a part of our support for TCFD, we recognise the necessity for a broader change and alignment in the investment industry around climate risks and opportunities. We believe that this can bring several long-term benefits to our investors. These include more attention and efforts from investee companies due to more aligned climate expectations, more precise measurement through clear requirements on climate scenarios that meet investor needs, and more refined climate investment frameworks.

We have been an active member of the Paris Aligned Investment Initiative, launched by the Institutional Investors Group on Climate Change (IIGCC) to bring together some of the world's largest asset owners and asset managers for the development of a "Net Zero Investment Framework". For a full list of our climate-related memberships, see Appendix.

3. Public policy engagement

AllianzGI aims, either individually or in collaboration with others, to actively conduct, where necessary, dialogue with public policymakers or regulators to support the evolution of a sustainable landscape for climate change investment. We also ensure that any relevant direct and indirect policy advocacy we undertake supports achieving global net zero emissions by 2050 or sooner.

4. Reporting

We aim to be as transparent as possible in our climate-related profile and hence we disclose entity and investment-related climate metrics in the AllianzGI annual TCFD report. Our TCFD report also displays our fund-level reporting capabilities, which provide transparency to our clients on the climate profile of their investments. Additionally, we report on our TCFD activities in the annual PRI reporting.

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APPENDIX

What are stranded assets?

One of the investment risks discussed in the context of climate change is so called "stranded assets". These are assets which may not deliver expected returns because of regulatory, technological and economic reasons connected to climate change risk. In the short term, the assets considered most exposed are fossil fuel reserves, which may experience accelerated write-offs if they can no longer be deployed due to regulatory carbon emissions caps or heavy taxation. In the context of climate change, the assets at risk of becoming stranded first are likely to be fossil fuel reserves: coal, oil and gas. Particularly in focus are fossil fuel reserves that are subject to controversial and complex exploration practices, for example oil sands mining, shale and fracking. These are often exploited through high-cost activity in remote regions such as deep and high seas, or the Arctic, and which are comparatively high carbon dioxide contributors within the fossil fuel energy mix, such as certain types of coal.

Do you think there is a risk of stranded assets?

We accept the assumption that there are more fossil fuel reserves available globally than could ever be burned to keep global warming and climate change in check. Capital invested today in future oil, gas and coal production is at risk of being stranded or wasted, and shareholders may not get the returns they have modelled for. In our research-based risk assessment we take a differentiated and corporate-specific view: broad-brush, top-down assumptions deliver flawed investment signals. Sectors we consider particularly exposed are mining, energy, utility and transportation. Even within these sectors, we think there can be large differences to stranded asset risk exposure.

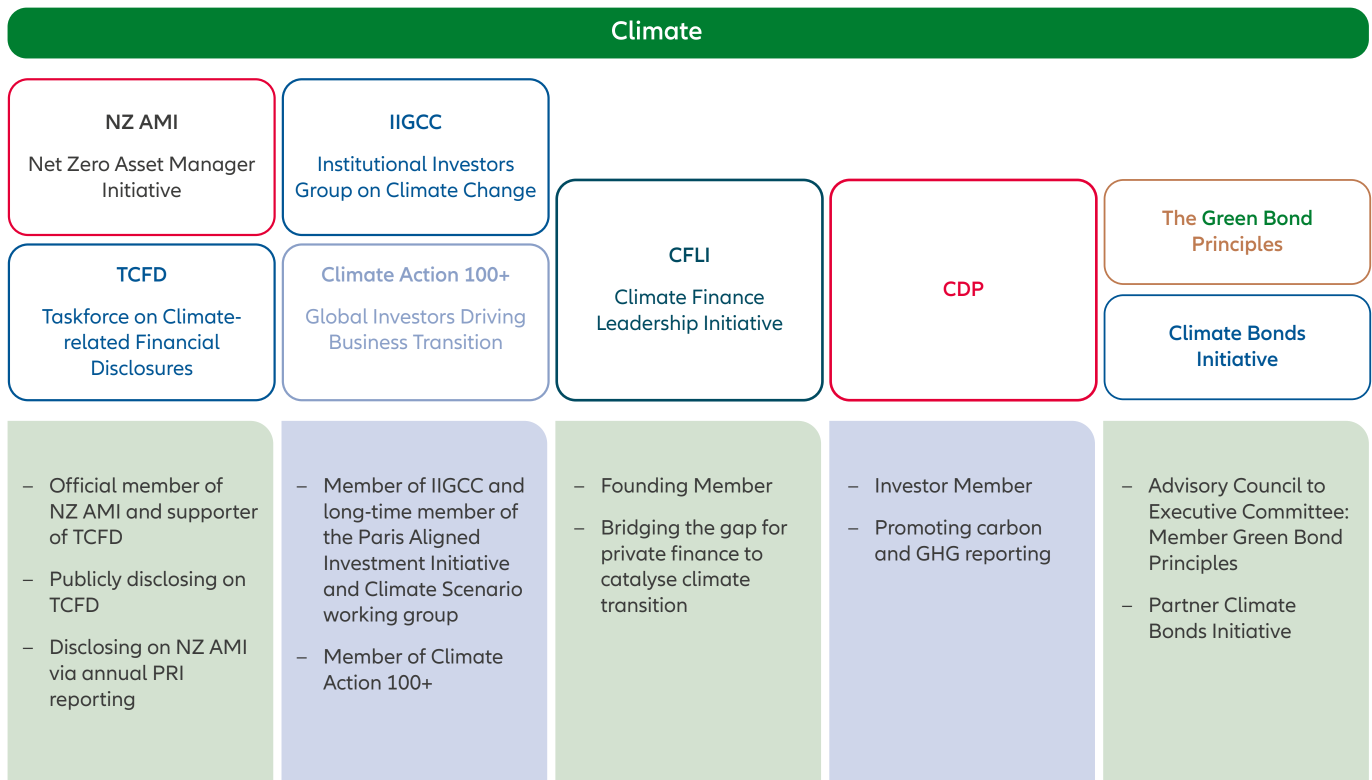
What is your view on climate risk triggered corporate exclusions?

While exclusions may be perceived to deliver an immediate portfolio climate risk exposure reduction, there are important caveats to be considered. There are only a small number of corporates whose business is built on pure-play fossil energy or mining. There are many grey areas. For example, most utilities are active in traditional and renewable energies. Through exclusions, stock may just change hands – there is no societal impact, ie, no contribution to the transformation to a low-carbon 2°C economy. And companies may be willing and able to change their business models and products – exclusions would deprive clients of these possible investment opportunities. Divesting may imply the risk of selling "low", immediately locking in losses and forfeiting mean reversion. Depending on the size of exclusions, portfolio tracking error and hidden, unwanted portfolio exposure are all important considerations. Moreover, divesting prevents the opportunity of a "just" transition. In summary, we think portfolio exclusions have important shortfalls compared to other instruments such as engagement at the regulatory and corporate levels or proxy voting related to climate risk. Active stewardship, including on material climate risk issues, is an essential part of AllianzGI's ESG policy. Exclusions may be considered if corporate engagement has failed to deliver results.

What do you think of low-carbon indices?

We think climate risks are too complex to be wrapped into a rule-based, passive index strategy. We are convinced that active asset management that takes account of corporate climate risks and opportunities in a holistic, educated and differentiated way can deliver better investment performance results. We think assessing climate risk on simple metrics such as carbon intensity, carbon reserves on the balance sheet, or exposure to green technologies does not offer a clear understanding of the underlying risks/opportunities posed by a transition towards a low-carbon economy. Many variables will affect this risk/reward profile, depending on the aspects such as regional footprint, commodity exposures, strategic focus and adaptive capacity. All these factors lend themselves to fundamental analysis, which may or may not include analysis of metrics such as carbon intensity.

Overview of relevant memberships



Source: Allianz Global Investors, 2021. For illustrative purposes only. GHG: Greenhouse gas.

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