ASI Position Statement – Fossil Fuels

February 2020

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Fossil Fuels – Our Approach for Investments

Financial risks related to fossil fuels are becoming more material as pressure to decarbonise the global economy is growing. Aberdeen Standard Investments (ASI) fully acknowledges the role of fossil fuels in causing and further exacerbating climate change. We support the goals of the Paris Agreement and believe that urgent action is required to limit global warming to 1.5°C. This means aiming for a global net-zero emissions economy by 2050, in which fossil fuels will only play a minor role.

On the path to that world, we need to transition to a low-carbon economy, in which fossil fuels are phased out and replaced with cost effective and reliable alternatives. This needs to be a 'just' transition where effects on communities, workers and energy security are carefully considered. We are aware that in some regions and certain industries, such as steel and cement, alternatives to fossil fuels are still costly and sometimes not yet available. Strong policy signals are needed to make the transition happen.

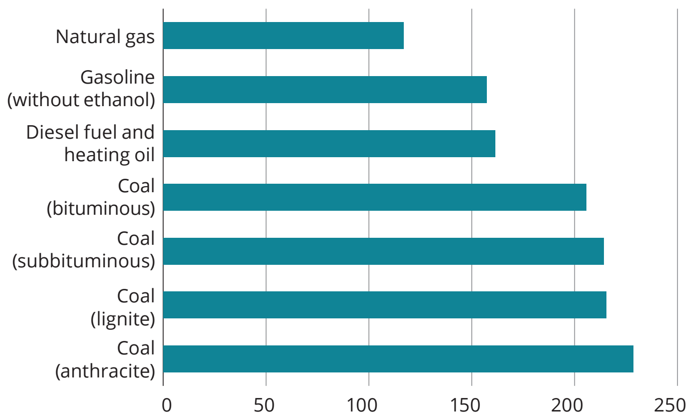
At ASI, consideration of climate-change risks and opportunities is an integral part of our investment process across all asset classes and sectors. We carefully consider fossil fuel related risks and the ability to transition to alternatives in our investment decisions. Not all fossil fuels are equal, as we detail below.

- **Coal** is the most carbon-intensive fossil fuel and using it has significant negative implications for air pollution and biodiversity. Unabated thermal coal used for electricity production should be eliminated as soon as it is practical. In line with the Intergovernmental Panel on Climate Change 1.5°C special report, global power generation should be thermal coal-free by 2050, and 2030 for Organisation for Economic Co-operation and Development (OECD) countries, preferably even earlier. But we also need to understand the impact it will have on communities and employment in regions that are heavily reliant on coal. Metallurgical (bituminous) coal used mainly for steel production is more difficult to replace and will therefore require a more considerate phase out.

- **Oil** is still used significantly in transportation and industry, but alternatives are emerging and growing. It is likely that oil demand will peak in the next decade if policies are implemented to achieve the goals of the Paris Agreement. This creates a stranded asset risk, meaning infrastructure assets and reserves lose their value. We want to see oil & gas companies reduce their investments in fossil fuel exploration and shift it towards low-carbon energy sources.

- **Natural gas** has the lowest carbon intensity out of all fossil fuels. It is an important transition fuel in many regions and we support the transition from more carbon-intensive fuels to gas where alternatives are limited. However, we also consider the risk of gas utilities and infrastructure becoming stranded in the medium to long term. Transitioning directly to low-carbon energy sources such as renewables is our preference and we strongly encourage it.

Pounds of CO2 emitted per million Btu of energy



Source: EIA, 9/1/2020.

It is also important to differentiate between conventional and unconventional production methods for oil and gas as they have different risks and impacts. For example, oil sands and unconventional gas have higher risks and involvement should be minimised.

As a large asset manager, we have an important role to play in influencing the transition to a low-carbon world and in reducing the reliance on fossil fuels. In our view, the solution is not simply divesting from all fossil fuels today.

However, where clients take a view of minimising exposure to carbon-intensive industries in their portfolios, we have specific products available that enable them to do so.

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How do we help reduce reliance on fossil fuels?

1. **Engagement on aligning with the goals of the Paris Agreement**
   In our actively managed investments, corporate engagement is essential to enable and support a 'just' energy transition. We believe that engagement on climate and Environmental, social and governance (ESG) issues with fossil fuel-related companies allows us to better understand their exposure and management of climate change risks and opportunities. It also provides us with the ability to influence and outline our expectations in relation to alignment with the goals of the Paris Agreement. We want to steer companies towards setting ambitious targets and increasing capital allocation towards low-carbon solutions. For example, we have engaged with European oil majors on aligning their strategies and investment plans with the Paris Agreement and setting targets that include Scope 3 emissions.

We also engage collaboratively with other asset managers and asset owners as part of Climate Action 100+, a five-year initiative to engage and influence high-emitting companies collaboratively.

We believe that engagement is more powerful for an effective energy transition than an absolute fossil fuel divestment approach. Divestment would simply transfer our ownership to another investor who may not take their stewardship responsibilities in relation to influencing fossil fuel companies as seriously as we do. We set clear milestones for our engagements and expect to see evidence of action. If we find that that there is limited progress in response to our engagement, our investment teams will carefully consider the consequences. This may mean reducing our positions or completely selling our holdings in fossil fuel-related companies.

2. **Investing in low-carbon transition leaders**
   Many of today's energy companies need to become the leaders of a successful energy transition and align themselves with the Paris Agreement to limit warming to 1.5°C. We want to support companies in their transformation where they have or are developing credible strategies to become transition leaders. In our view, companies that successfully manage climate-change risks and reduce their emissions will perform better in the long term.

   To identify the highest emitting companies in our portfolios, we have developed the capability to analyse the carbon footprint of portfolios and incorporate this into the investment process. This includes Scope 3 emissions, which are important as they represent 85% of the oil & gas industry's greenhouse gas emissions. We also use the analysis undertaken by the Transition Pathway Initiative to assess the quality of management and targets in relation to Paris Agreement goals.

3. **Voting and shareholder resolutions**
   As active asset managers, another important means of influencing when engagement has limited success is escalation via voting and support of shareholder resolutions. That's how we can publicly reflect our view on the need for a Paris-aligned low-carbon transition. At ASI, we have a well-resourced stewardship team with dedicated proxy voting capability that can provide escalation on climate-related matters. We have developed an approach to provide informed voting on the increasing number of climate-related shareholder resolutions. In 2018, we voted in favour of 60% of these shareholder resolutions, demonstrating that we are actively analysing and considering these resolutions and not just applying a blanket 'tick-box' approach.

4. **Investing in low-carbon infrastructure and real estate**
   While it is critical to influence the capital allocation of fossil fuel companies, we also invest capital directly in low-carbon assets to help reduce reliance on fossil fuels. We have increased our investment in green infrastructure, such as renewables, and have committed to net zero carbon emission buildings by 2050 in all our real estate investments.

For more detail, please see our publications: **Climate Change – Our Approach for Investments** and **Investing in a Changing Climate.**

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