ESG VIEWPOINT

Investing in a Just Transition

At a glance

- The energy transition is underway. With it comes a host of opportunities for businesses and investors as we build the low carbon economy.
- The transition brings many social impacts with it, and these will require effective and proactive management.
- We are engaging with companies on their plans for a just transition and are looking for evidence of strategic thinking and concrete action. We outline the key components of a successful strategy.
- We explore what a just transition means from an investment perspective, including the opportunities within our social bond strategies.

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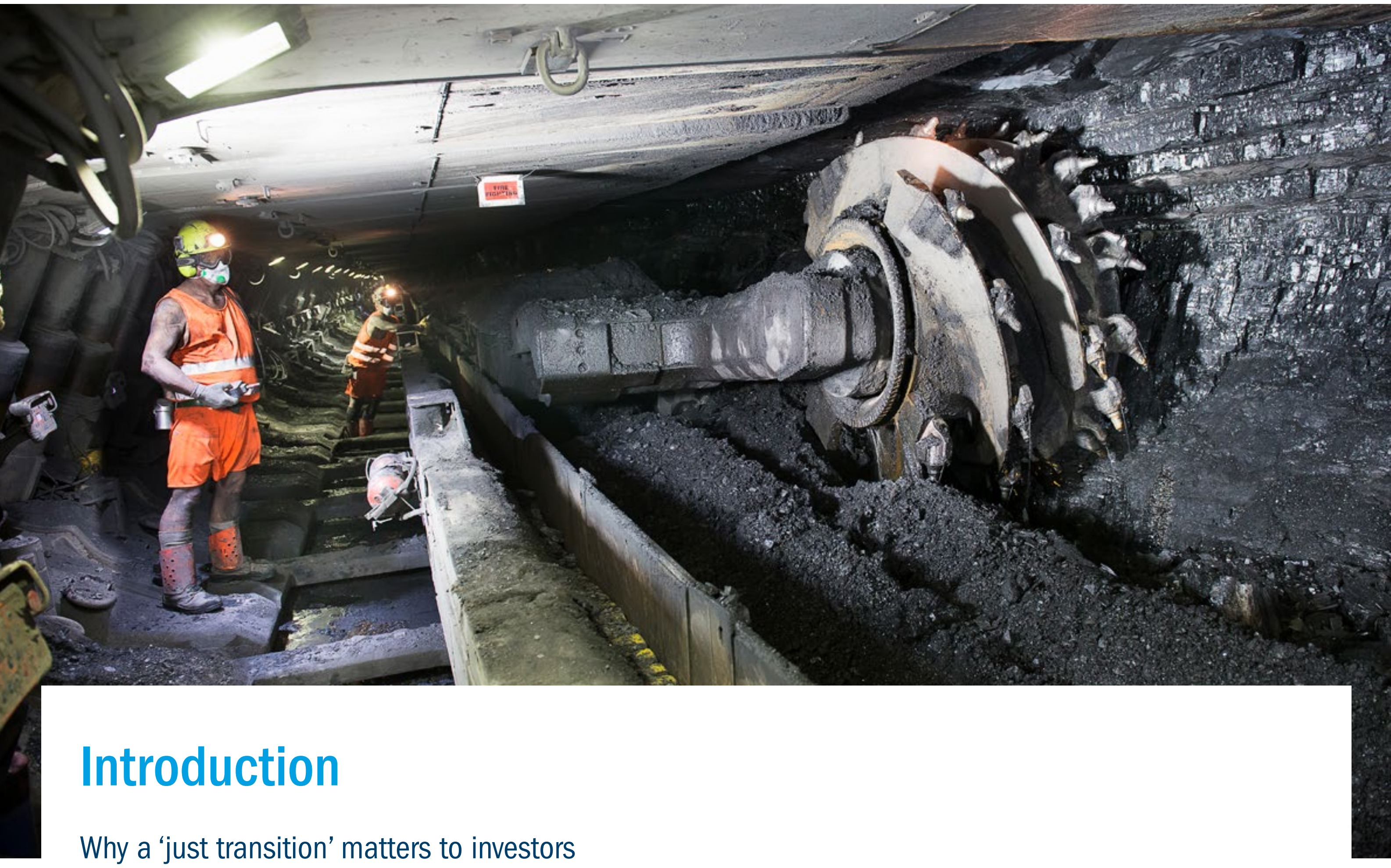

Introduction

Why a 'just transition' matters to investors

The energy transition is underway. A rich seam of opportunities for businesses and investors is emerging as we build the low carbon economy, while the risks and dilemmas we will need to navigate are also becoming ever more evident. As signatories to the Net Zero Asset Managers Initiative[1] and the Just Transition Finance Challenge[2], we are committed to considering these fully as we embed the changes into our investment analysis.

As the transition progresses, consideration of the social dimension is critical. Significant risks to local communities and livelihoods need to be mitigated to avoid social unrest; investment is required in the skills to deliver green growth; and the thoughtful planning and building of trust and social licence with communities, customers and wider stakeholders must be put in place to ensure a just transition, with minimal negative impact on the worst off in our communities. Effective and proactive management of the social implications of transition will build resilience and underpin the ability to deploy capital at scale. As investors, we need to understand what this looks like and be clear in our expectations for the fair treatment of people.

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What do we mean by 'just transition'?

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[1] The Net Zero Asset Managers initiative – An international group of asset managers committed to supporting the goal of net zero greenhouse gas emissions
[2] Just-Transition-Criteria.pdf (impactinvest.org.uk)

What do we mean by a 'just transition'?

'Just transition' is a term that acknowledges and addresses the human implications of the energy transition, both in transitioning 'out' of carbon intensive infrastructure and transitioning 'in' to new energy sources, products and services. It is not a firm set of rules but rather a concept and an ambition, though 'guidelines for a just transition' were published by the International Labor Organisation (ILO) as part of the 2015 Paris Agreement and represent a basic framework for good practice.[3]

It is generally accepted that there are three core elements of a just transition, as articulated by the G7-backed Impact Taskforce, which are: advancing climate and environmental action; improving socio-economic distribution and equity; and increasing community voice.

As investors, these topics arise in our discussions with companies within the broader context of engagement around workforce management, customer and wider stakeholder relations and general business planning.

Companies like SSE have a responsibility to manage the impact of transition out of high-carbon activities and into a net zero world: minimising potential negative outcomes while at the same time seizing the opportunities to increase value and share economic prosperity.

[3] Guidelines for a just transition towards environmentally sustainable economies and societies for all (ilo.org)

Investment implications

As investors, we would like to see the principles of a just transition normalised within climate disclosures as relevant to individual businesses, supporting our ability to understand how these impact on business planning. We are looking for clearer evidence of strategic thinking and concrete action from those businesses at the heart of the energy transition, and sufficient forward planning around material changes to human capital requirements. This can have a tangible impact on companies' financial performance through, for instance, improving their success in both public and private sector tenders, and avoiding costly labour disputes.

We are embedding engagement on the topic in our stewardship to better understand corporate planning and to encourage progress. Moreover, where available, we are seeking investment opportunities in support of effective practices.

Stewardship – Just transition is integral to the net zero engagement we are undertaking as members of the CA 100+ coalition, and we are engaging individually and collaboratively on the topic. Our engagement to date has focused predominantly on high carbon and directly related industries, oil and gas and power utilities, but we are broadening the scope of our conversation to relevant businesses in other sectors, including mining, building materials and automotives.

Some of the most challenging aspects of achieving a just transition are the issues around the impacts on consumers. New technologies, such as electric vehicles or domestic heat pumps, can be more expensive than their conventional alternatives, and efforts by governments to mandate adoption can be highly effective in their environmental impact, but have undesirable social outcomes. Subsidy programmes such as the US Inflation Reduction Act can help to bridge the gap and make the transition more affordable to all. Constructive company engagement with governments can help to ensure that such policies work effectively.

The 2023 AGM season saw a tick-up in the filing of shareholder proposals requesting more clarity on corporate strategies with respect to just transition, including at Marathon Petroleum, Exxon, Chevron, and BorgWarner. We are supporting these where we think accelerated action is merited.

We believe there are several key components to a successful just transition strategy:

- **Acknowledgement and spotlighting of the social dimension** of transition and a commitment to the effective management of those aspects to which the company is exposed.
- **Adequate board and executive management oversight** of planning, processes and performance, with setting and disclosure of KPIs that are measurable and time-bound where possible and appropriate to ensure accountability.
- **Evidence of stakeholder consultation** in the development of the strategy, in a process that is robust and accountable with the input of groups directly affected by transition.
- **Identification of shifting human capital requirements** and commitment to workers affected by decarbonisation through retention, retraining, redeployment and/or compensation, as appropriate.
- **Proactive strategy for customers and communities** and engagement with government agencies as needed – for example, in community infrastructure for the electrification of transport.
- **Thoughtful reference to wider human rights policies** to avoid creating new social harms – for instance, in seeking fair labour standards and free, prior and informed consent of communities in the mining of transition minerals.

In our experience to date, most companies are still in the foothills of action on this topic, despite the lead time needed to establish and implement an effective plan. However, there has been some progress with most exposed companies now acknowleding the concept in their reporting. In the US we have seen the publication of an initial plan by Marathon Petroleum following shareholder resolutions in 2022 and 2023, as well as an introductory statement by Exxon to be followed by a more detailed strategy, while also chairing a key industry group on the topic.[4] The UK power utility, SSE, remains a stand-out example of leadership on just transition planning and communication.

Investment – An investment strategy for just transition is generally one that looks for opportunities generated by the energy transition, but with due regard for the social dimension in the analysis. At Columbia Threadneedle Investments, SSE is widely held in equity portfolios as an example of a company whose constructive and forward-looking strategy is underpinning attractive growth.[5]

Beyond this, there are also opportunities to channel capital more explicitly in support of a just transition. There is still limited specifically targeted issuance, but the International Capital Market Association (ICMA) has now adopted ‘just transition’ wording within its social bond principles, highlighting that impactful bonds can target those affected by the transition as a vulnerable population and that this can be embedded in reporting, bringing social and environmental co-benefits together. Columbia Threadneedle is delighted to have been part of the working group that implemented this update.

We remain firm advocates for bonds issued to fund projects that alleviate the socioeconomic impact of the transition – for instance, through reskilling and re-educating workforce and supporting communities that are affected by fuel poverty.

We are using influence where appropriate – for example, encouraging the idea of KPIs linked to job retention metrics and upskilling training hours for the existing workforce. These KPIs could be linked to a sustainability-linked bond issuance or (and even better) a “super bond” that combines sustainability-linked KPIs for the wider company with a dedicated use of proceeds bond, which supports individual projects.

Another company that has shown leadership in considering the principles of a just transition in its planning is EDP (Energias de Portugal). Explicit in EDP’s 2030 plans is a target to decarbonise while leaving no one behind. This intent was carried out well, with the closure of the Sines Power Plant in 2021. Preparation for this closure included significant thought to the impact on EDP employees. Ultimately, direct workers were offered other work within the company or early retirement, and indirect workers were supported in finding employment alternatives in the region through a newly created local support office. Columbia Threadneedle is delighted to have been part of the working group that suggested this update.

Furthermore, EDP recognises that an energy transition will not happen effectively without good leadership and management teams; to support the pivot within the company, EDP offered training and leadership programmes to existing employees, with 52,000 hours completed in 2020.

EDP has considered and integrated important aspects of a just transition into its business plan. This year, it has hit its target of implementing the Just Transition Plan at every plant that is being transitioned.

Case study: **SSE plc**

SSE, an electricity company operating in the UK and Ireland, plans to invest £40bn in low-carbon infrastructure over the next 10 years. A core pillar of this strategy focuses on the social dimension, with the ability to successfully deploy investment at scale dependent on the consent of its stakeholders. In 2020, SSE was among the first energy companies to outline a comprehensive strategic framework for just transition, and the company continues to provide detailed progress reporting against that plan.

The strategy differentiates between transitioning “in”: looking at growing a skilled workforce for green jobs, considering consumer fairness and building and operating new assets; and transitioning “out”: supporting workers in high carbon jobs and communities affected more broadly.

There are two particular aspects of SSE’s strategy and experience that stand out:

1. It is multistakeholder, involving a wide range of affected people and groups. SSE has also been active in its interactions with government, trying to bridge gaps where multiple different departments need to come together.
2. It incorporates a cultural pillar ‘respect and record cultural heritage’, which speaks to an understanding of the wider social and cultural meaning for communities. SSE is recording the heritage of its high carbon assets and ensuring, where possible, that the sites can be repurposed to retain social value.

There have been successes already, such as more than 40% of the offshore wind team having joined from high carbon industries; however, there are also many challenges, and progress overall can be slow. Despite the difficulties, a strategy of transparency with investors and other stakeholders has built confidence.

4. https://www.marathonpetroleum.com/content/documents/Responsibility/JustTransitionReport.pdf
5. The mention of any specific shares should not be taken as a recommendation to deal. Columbia Threadneedle Investments does not give any investment advice.

Conclusions and outlook

What's next?

It is evident that a 'just transition' matters greatly, and investors, the corporate sector and society as a whole will benefit from giving the social dimension of transition the attention it requires. These issues take time and considerable effort to plan for, but we are already seeing market leaders take important steps. Our expectations for companies driving the transition to outline meaningful strategies are increasing as we move forward. We will continue to engage for progress, and to work on a robust assessment of related risk and opportunity in our investment analysis.

We expect the scope to broaden. The concept of a just transition is often limited in application to the fallout of closure of high carbon power generation, but we believe it has much wider applicability. We can extend the principles to the whole social side of climate change adaptation and mitigation as companies plan for supply-chain resilience, from shifts in agriculture sourcing to garment factories in South Asia exposed to physical climate risk.

There are challenges in tackling this topic. Social and environmental targets can sometimes come into conflict, and we must work hard as investors to avoid contradictory expectations on companies while supporting meaningful efforts to navigate the difficulties. A just transition to net zero can only really be achieved through a collaborative approach between all stakeholders, and we are fully committed to playing our part as investors.

Despite the challenges, it is also clear that the opportunities generated by the low carbon energy transition have the potential to be extraordinary, for both investors and society. It will require effective management of the social issues for that potential to be realised and lay solid foundations for growth. We will continue to develop our thinking on the topic of a just transition and to work in support of its success.

Too often climate change and net zero are thought of as challenges for technology to solve, that it is a technocratic problem with technocratic answers. The truth is climate change is all about people. It is people who are creating it, it is people who will solve it and it is people who will suffer from its impact.

Meet the authors

Alice Evans, Managing Director, Responsible Investment

Alice is a strategist in the Responsible Investment team, leading on the approach to Social issues across investment and stewardship. Between 2018 and 2022 Alice was Co-Head of Responsible Investment, focusing on Active Ownership and ESG Integration, and from 2010 to 2016 she was a fund manager in Responsible Global Equities.

Prior to joining the group, Alice gained ten years of investment experience, initially at JP Morgan Asset Management then at Henderson Global Investors, as a fund manager on the Sustainable & Responsible Investment funds and a healthcare sector specialist. Alice holds an MSci in Physics from the University of Bristol and is a CFA Charterholder.

Vicki Bakhshi, Director, Climate Strategist, Responsible Investment

Vicki joined the Responsible Investment team in 2006. She has worked on climate change for two decades, with her previous roles including climate advisor in the UK Prime Minister's office, and a member of the Stern Review team. Outside of work she enjoys hiking in different parts of the UK.

Letitia Byatt, Social Impact Analyst

Letty joined Columbia Threadneedle Investments in 2022 having previously worked at RLAM. She is a Social Impact Analyst for the UK, European and Global Social Bond strategies, working closely with fund managers to identify positive social impact opportunities for the Social Impact Bond funds. She holds the CFA ESG Investing Certificate and has completed a Sustainable Finance course at the University of Cambridge Institute for Sustainability Leadership. Outside of work Letty adores sailing and being in the ocean.

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