THE TRANSITION RISK OF YOUR INVESTMENT

Carbon Impact

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GENERAL OVERVIEW OF CARBON EMISSIONS

The growth of carbon emissions has increased to reach an unprecedented peak: we emit 6 times more than in 1950[1]. TToday, climate change has become a concern for all! In this sense, we must act for a carbon-free world, and this requires greener investments and less carbonated portfolio strategies.

Several strategies have been implemented to achieve a prosperous, modern, competitive, and climate-neutral economy. In terms of climate policy, the EU has issued Carbon Permits in 2005. The objective is to limit the increase in global temperature to a level below 2°C before 2050, and to aim for a maximum increase of 1.5°C (compared to the pre-industrial level). Since then, the increasing cost of the carbon emission related to emissions gives a measure of the "Transition risk" – the risk related to a shift toward a low-carbon economy. The price of the Carbon Permits went from 20€ per ton in 2020 to almost 90€ per ton at the start of 2022

Other initiatives have emerged around the world in areas such as energy efficiency, promotion of renewable energy sources, public transport, transport infrastructure, urban and rural planning, agriculture, and waste management. In Europe, Carbon emissions are a central part of SFDR reports required for art. 8 and 9 products.

[1] https://ourworldindata.org/co2-emissions

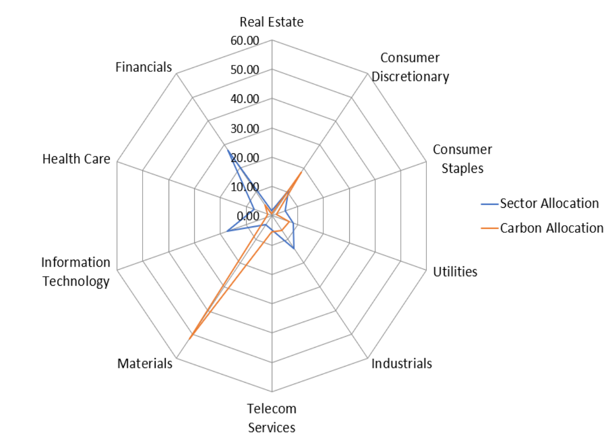

Image 1 - Carbon and sector allocation

TRANSITION RISK

The transition towards climate-friendly production systems has led regulators around the world to create legislation that will tax the carbon emissions of every company. Each company that emits greenhouse gases (GHG), has a liability attached to it that can be measured through the carbon permit price.

Investors must measure this cost, to have a precise idea of the level of transition risk their portfolio bears. The methodology developed by the R&D department of AMINDIS and published in the Journal of Performance Measurement allows investment managers to measure the transition risk of their portfolio and identify the most exposed holdings. It is decomposed in the following steps:

- **01** Measure the position in carbon terms – **Carbon Footprint**
- **02** Model **future Carbon Footprint**
- **03** Determine a **carbon forward price curve**
- **04** Price the **future Carbon Footprint**
- **05** Discount the "Carbon Footprint Cash Flows" - **Carbon Liability Cost**
- **06** Calculate the **Carbon Liability Cost by position** - a fraction of ownership held times Carbon Liability
- **07** Calculate the **impact on return and contribution** to return

IMPROVE THE PORTFOLIO STRATEGY BY FOCUSING ON LOW-EMITTING SECURITIES

The transition to a low-carbon economy involves profound changes in socio-economic systems. The actions that companies will put in place to mitigate climate challenges, cannot be perfectly known in advance. It induces risks and opportunities for economic actors to build their portfolio strategy in a context of uncertainty.

AMINDIS offers full flexibility in the implementation of a methodology to measure the impact of over/underweighting carbon-emitting sectors and securities on the return of the portfolio:

1. Integrate data from any provider for Carbon Footprint indicators (GHG scope 1,2 or 3)
2. Simple and complex models for future carbon emissions. Assumptions can be taken by issuer, sector of globally
3. Linear or complex carbon forward price curves. Possibility of working with multiple curves
4. Use of free carbon quotas to compensate for carbon-intense activities or companies

The methodology can be used for different purposes in the investment management process:

1. Ex-ante risk assessment
2. Portfolio optimisation by reallocating securities to lower the transition risk
3. Stress testing
4. Portfolio reporting (client and regulatory)
5. Back testing the carbon reduction trajectory

This approach provides a better understanding of the challenges in the medium and long term of the low-carbon transition. The methodology helps to find a way around the complex ecosystem of climate-related scenarios by providing:

01 Indicators easy to understand and easy to compare (helpful to select the best in class)

02 Full flexibility in the configuration to fit the decarbonation strategy at the sector or the issuer level

03 A top-down approach from the portfolio level to the issuer level

The only solution allowing you to solve the Impact, Risk, Return equation with a holistic view across all business functions for premium investment decisions!

ASSET MANAGEMENT & INSURANCE SOFTWARE & SERVICES

We are industry pioneers transposing groundbreaking ideas into an adaptable software answering the needs of asset managers and insurers.

We offer a tailor-made solution to help you better analyse your portfolio and take the best investment decisions.

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