Twelve Capital – Climate Impact Investing

May 2022

info@twelvecapital.com – www.twelvecapital.com – Connect with us on LinkedIn

Marketing material for professional/qualified investors only

Twelve's Litmus Test applies a different perspective on ESG, to see how money is steered towards low carbon activities.

The core of the "Litmus Test" is a thorough questionnaire with the three parts on the right.

85 questionnaires sent out (as at writing)

71 (>80%) answers received (mail or phone call)

63 financial institutions included in this analysis only (no fintech)

Investments – 57% have an impact investment target

- 57% of companies have an impact investment target. However, only 30% apply a concrete reduction number to it.
- Even more, only one company has set a reduction target for its investment portfolio of 7% annually, aligned with the Paris goals.
- Further, only 40% of the analysed companies know the amount of greenhouse gas emissions of their investment portfolio.
- However, 74% of the analysed insurance companies have an engagement process with their investee with the goal of reducing their GHG emissions.

Twelve Capital expects that in the near future companies will more and more measure the emissions of the investment portfolio and thus clear targets will be set.

Underwriting – Almost no targets seen

- Only one insurance company out of all analysed has already set a reduction target for their underwriting book. This indicates that setting targets on the liability side is still at its infancy stage.
- However, almost 50% of the analysed insurance companies stated that they have planned to measure and disclose the greenhouse gas emissions of their underwriting book in the near future.

Twelve Capital expects that the underwriting side will take a big step towards climate transition in the next two years, driven by the Net Zero Insurance Alliance.

Operations – 25% have a net-zero commitment

- Operational emissions (Scope 1, 2 and some areas of Scope 3) of financial institutions are negligible compared to the emissions of the balance sheet.
- Around 70% of the analysed financial institutions have set some kind of environmental friendly policies; from specific numeric targets to unspecific targets like exchanging light bulbs and using less printing paper.
- However, only about a forth of the considered financial institutions have stated a net-zero commitment of their operational emissions.

Twelve Capital expects that more and more companies will set and/or update a operational emission reduction target.

Table of Contents

Introduction

The financial industry is paramount towards delivering on net-zero[1]

"Up until today there was not enough money in the world to fund the transition. And this is a watershed. So now, it's [about] plugging it in." (Mark Carney, COP26, 04/11/2021)

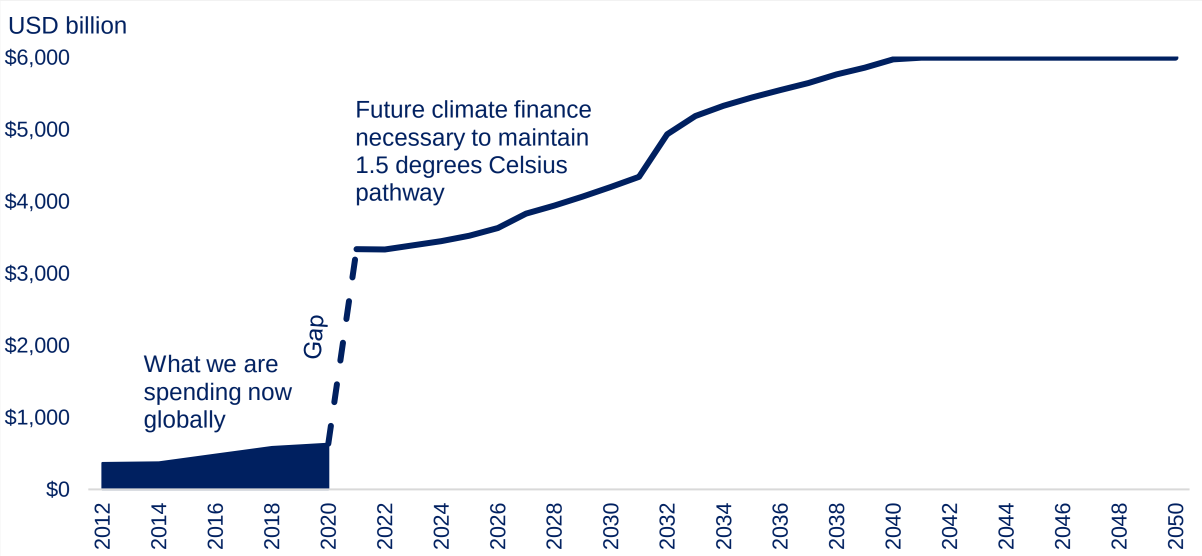
Funding gap needs to be closed

Financial services are key for a net-zero economy, as companies require funding and the (re-) insurance industry enforces on managing risks from climate change. Therefore, capital flows need to shift from high to low carbon activities. Furthermore, in order to reach the Paris Agreement target and for the world to be net-zero by 2050, around USD 90 trillion of infrastructure investment is required over the next 15 years alone (or roughly USD 4.1 trillon each year by 2030), according to the Intergovernmental Panel on Climate Change (IPCC)[2].

In 2020, only USD 632 billion was invested globally and governments bore the majority (51% of it). This funding gap needs to be urgently addressed and cannot be put on the public sector alone. Financial institutions are needed to contribute and support all efforts to achieve the Paris Agreement goals. There is a huge investment gap that governments cannot fill solely and where financial institutions can contribute and tap in.

To put into relation, total assets of global financial institutions reached an amount of USD 404 trillion by the end of 2019, according to Statista[3]. This emphasises that their contribution represents a vital part and market opportunities are given.

Chart 1: Tracked climate finance flows and estimates for what is needed until 2050.



Source: The Climate Policy Initiative, "Landscape of Climate Finance 2021".

---

[1] https://netzeroclimate.org: Net-zero refers to a state in which the greenhouse gases going into the atmosphere are balanced by removal out of the atmosphere.
[2] Climate Policy Initiative. (10 February 2022). Global Landscape of Climate Finance 2021. CPI.
[3] https://www.statista.com/statistics/421060/global-financial-institutions-assets/

Meeting climate impact objectives require a different perspective on ESG

Twelve's Litmus Test - a different perspective on ESG

When looking at the financial industry, Twelve Capital believes that the traditional ESG factors is a good, but only a first step. ESG is a very widely used and well-known framework, however, the urgency of climate action will increasingly force companies to apply a different perspective on ESG. What is meant by that?

Twelve Capital goes an extra mile and takes the ESG approach a step further by not only relying on ESG data alone, but by conducting an in-house "Litmus Test" on a companies emission and transition efforts. In focus are listed companies showing clear evidence of steering their capital to low carbon, climate resilient activities, such as an offering of new green products, services and underwriting activities. In addition, these need to demonstrate their commitment to reduce their energy consumption CO_2/GHG emissions and that they comply with a minimum standard on ESG based and in-house ESG process.

This "Litmus Test" enables a holistic assessment how a company steers its capital flows, be it on the investing side, the loan book and/or the underwriting side.

The core of the "Litmus Test" is a thorough questionnaire which is sent to selected (re-) insurance companies, banks, asset managers and fintech/insurtech organisations to analyse the company's practices, ambitions and plans to become a climate-friendly institution.

Chart 2: Twelve's Litmus Test

Source: Twelve Capital.

Why companies should and do care

Risks and opportunities for the financial industry

Climate change is a major challenge for the planet and poses both threats and opportunities which need to be tackled urgently. This will have a significant impact on the financial sector, depending on which carbon emission scenario ultimately occurs.

Twelve Capital's questionnaire's findings on climate-related risks:

Most analysed insurance companies expect to see an **increase of insurance claims**, and banks consider an increased risk with regard to a customers' ability to repay loans in the future. On the investment side, the risk of asset devaluation and of assets being stranded are most frequently mentioned by insurance companies and asset managers.

"Climate change risk is not a new and independent risk category: rather, it is an aggravating factor for the existing risk categories." (a bank about risks on investment side, January 2022)

Steps taken on climate-related risks include:

- The majority of property and casualty (P&C), multi-line and reinsurance companies that participated, stated that they **actively incorporate climate risk considerations in their pricing**.
- Most analysed life and health (L&H), multi-line and reinsurance companies anticipate that they can **increase their premiums** through time to offset the climate risk.

The findings on climate-related opportunities are:

- **Growth opportunity**. Most companies that were approached indicated that the development of or investment in sustainable/green/innovative products and services represent a great opportunity, especially also in view of volatile financial markets as well as the low correlation to traditional markets and low interest rates.
- **Additional underwriting solutions**. On the liability side of insurance companies an extended insurance solutions offering for catastrophic damage protection, covering electric vehicles, or offering a product that provides end-to-end coverage for renewable energy sources, such as solar, wind, fuel cell and biomass industries, could be put in place.
- **Investment diversification**. In an investment portfolio an allocation into renewable energy projects, investing in Solar Tax Credit transactions which support and further enhance the installation of solar systems, or investing in green building construction projects.
- **Risk management** processes' are widely spread and all participating companies are applying the TCFD[4] recommendations. An improved risk management process is paramount towards better pricing and assessing potential risks from climate change.

[4] Task Force on Climate-related Financial Disclosures.

Investments

What is done on the investment side to steer capital in the right direction?

Twelve's Litmus Test - a different perspective on ESG

To comply with the Paris Agreement, greenhouse gas (GHG) emissions need to be reduced about 7% annually in order to reach the goal of net-zero by 2050. Twelve Capital's questionnaire targets this area. The key findings are the following:

- Approximately 57% of the analysed companies have set environmental friendly investment targets (Chart 3); from reducing the carbon intensity of investments and investment portfolio to just phasing out coal investments
- About a third of responding institutions committed to have a net-zero target for their investment portfolio (Chart 4).
- However, looking at companies with numerical reduction targets within their investment portfolio, the number drops to 30%. And only one company claims to have set a reduction target of 7% annually (Chart 5).

Chart 3: Percentage of the considered companies with investment targets in each sub-industry

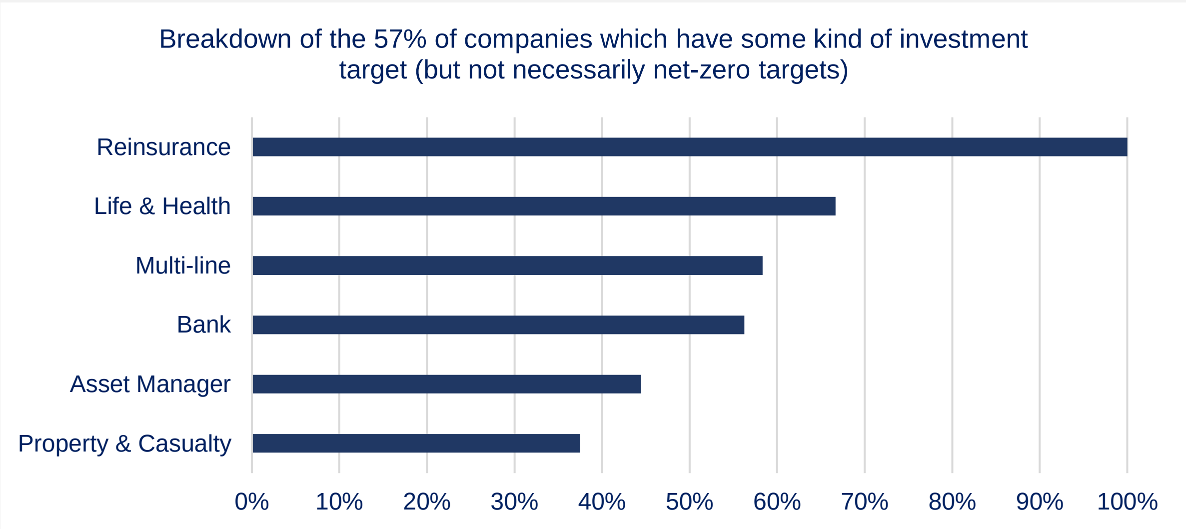


Chart 4: Breakdown of the considered companies with a net-zero investment commitment

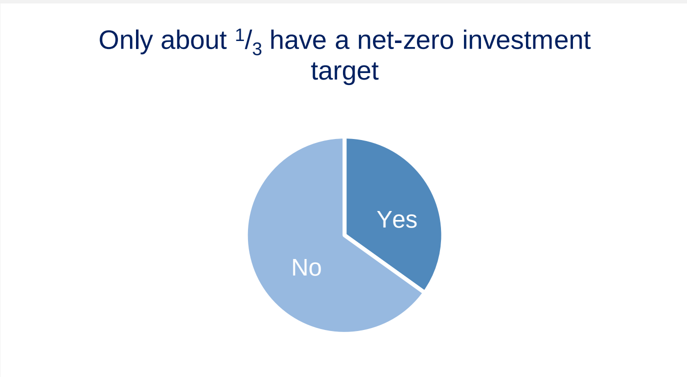
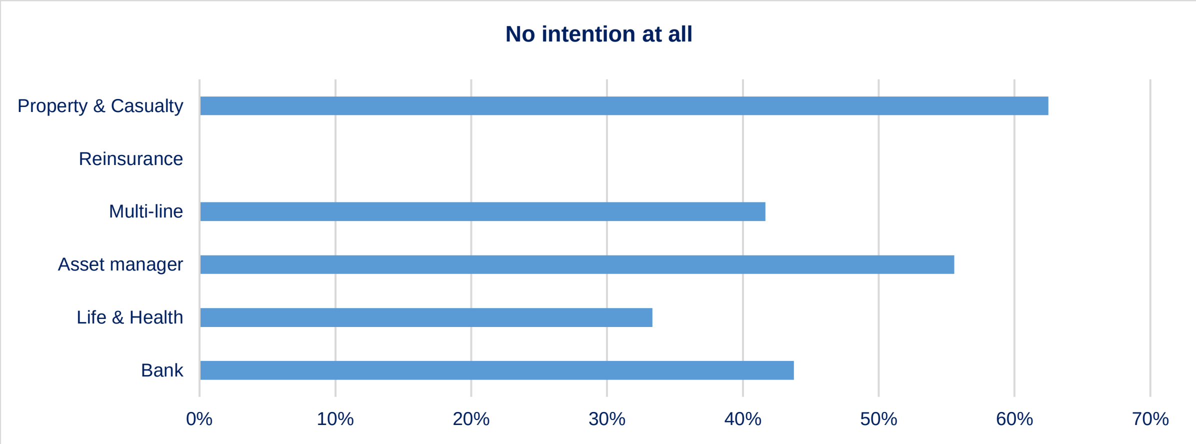
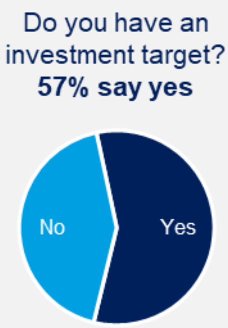
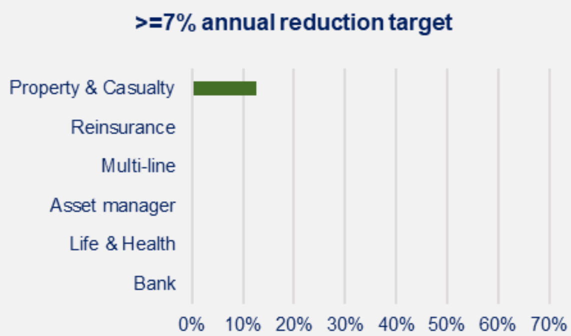


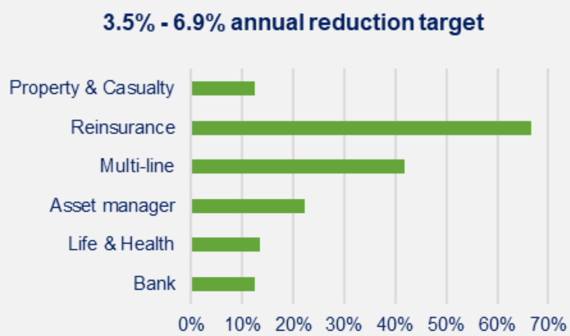
Chart 5: Percentage of stated annual investment emission reduction target in each sub-sector.

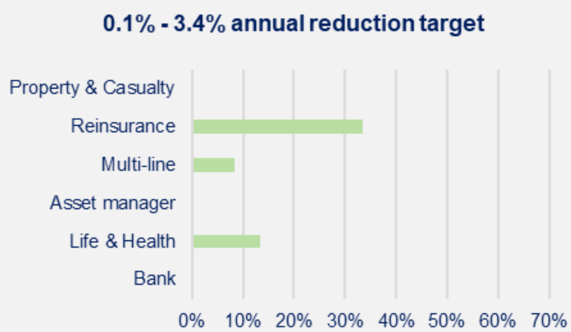
What is the breakdown?

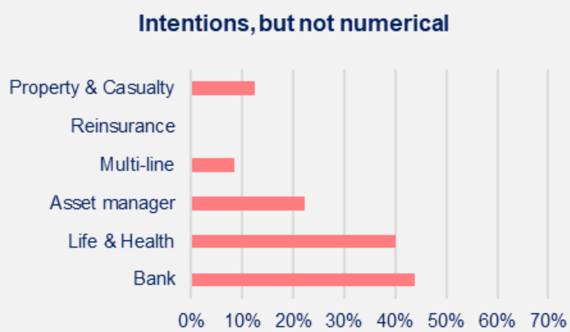












Roadmap for the financial industry towards net-zero: Investments

"We classify the investment companies to the ones that are Paris aligned, the ones that planned to be Paris aligned, and the ones that are not. We then engage with the latter. But still, also if the engagement process is the main pillar there is a need to set clear consequences for the ones that are not and will not be aligned because time is sharp." (a Life & Health Insurance company, February 2022)

Different pathways to reach the net-zero target:

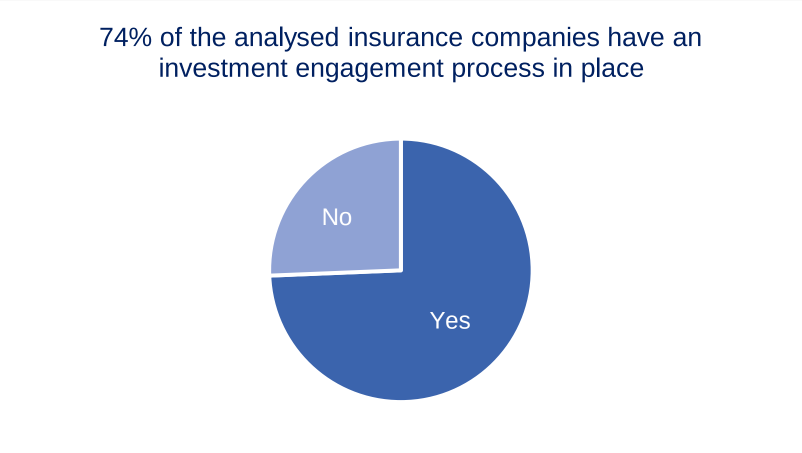
- Focus on **divestment**: This is set up as an exclusion criteria. If the performance and strategy of a company is weak, it is divested.
- Focus on **engagement**: This is focused on transition only. If the performance and strategy of an investee is weak, the investor helps in setting up targets and establish a transition plan.
- **Hybrid** approach (engaging and divesting): This is a hybrid approach. If the targets set in the engagement process phase are not met after a specific timeframe, the company is divested.

"Through our internal analysis, we are able to identify candidates for engagement. In addition, we look at the carbon footprints of our equity and corporate fixed income funds, which helps us focus our efforts on high carbon emitters held within the portfolio." (a bank, December 2021)

Engagement types:

- Collaborative engagement (e.g., Climate Action 100+)
- Direct engagement (e.g., asking investee companies to disclose a business plan consistent with net-zero 2050 or to set Science Based Targets)

Chart 6: Breakdown of the considered insurance companies with an engagement process on the investment side.



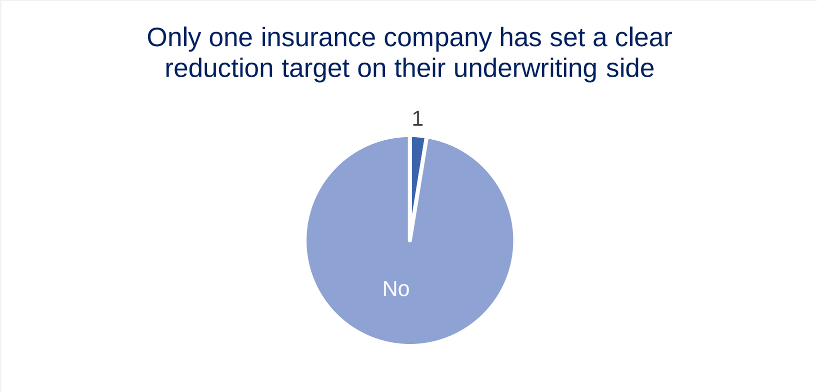
Liabilities

What is done on the liability side to steer capital in the right direction?

Liability reduction targets are rare

- Out of the insurance companies responding, only one has put in place a liability reduction target.
- This indicates that setting targets on the liability side is still at an early stage. Many insurance companies stated that they plan to set targets after the Net Zero Insurance Alliance has published a methodology for measuring underwriting portfolio emissions.
- Therefore, once this methodology is publicly available, insurance companies will start calculating the underwriting portfolio emissions and as a following step they can set a reduction target.

Chart 7: Breakdown of the considered insurance companies with an underwriting target



Roadmap for the financial industry towards net-zero: Liabilities

“Energy transition and decarbonisation are only possible if we support our clients in the development of their businesses towards models that progressively diminish their carbon footprint and climate impact.” (a multi-line insurance, January 2022)

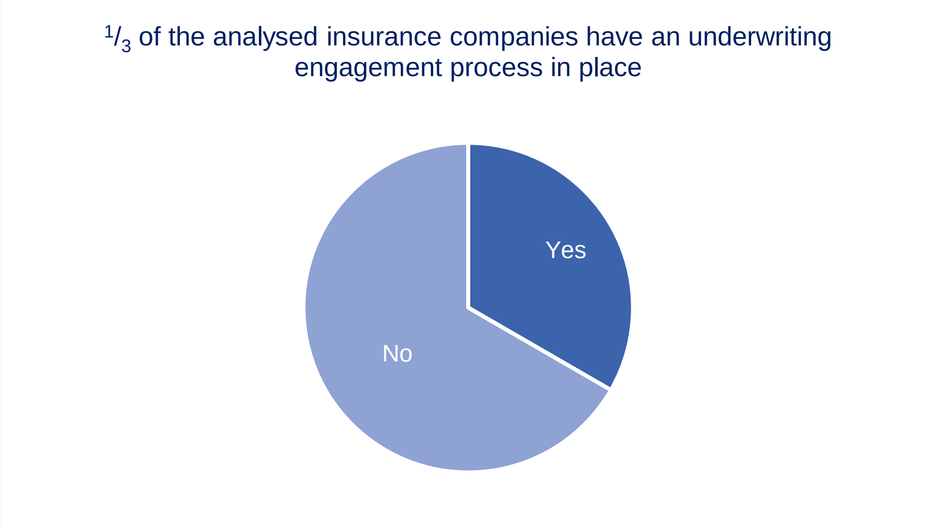
Divestment is a common approach

Over 50% of the analysed insurance companies indicated to undertake drastic divestment on high GHG emission holdings or operations.

Engagement process are in place too

While around $^{2}/_{3}$ of them have an engagement process in place on the investment side, only $^{1}/_{3}$ undertake in addition an engagement process on the liability side (Chart 8). This difference might be explained due to the fact that setting targets on the liability side are still at an early stage. However, it will get more important and prominent as insurance companies committed to the Net Zero Insurance Alliance will set interim targets and are required to take action in order to reach these targets.

Chart 8: Breakdown of the considered insurance companies with an engagement process on the liability side.

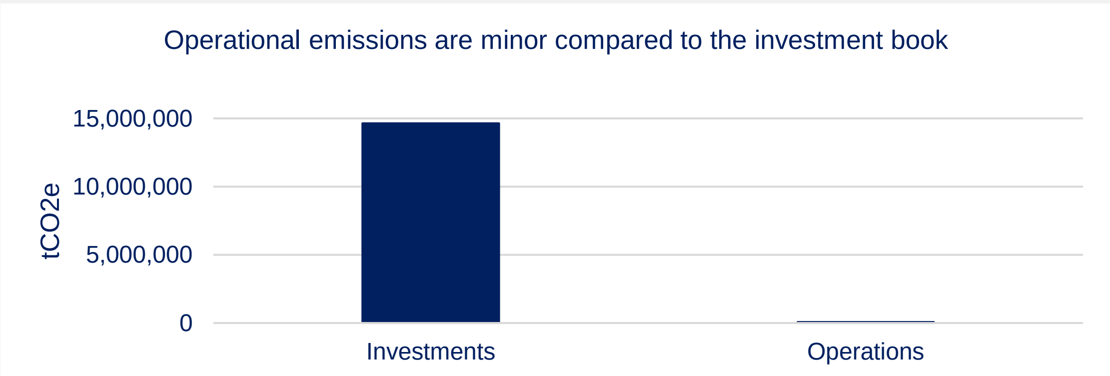


Operations

What is done on the operational side to steer capital in the right direction?

- Operational emissions (Scope 1, 2 and some parts of 3[5]) of financial institutions are negligible compared to the emissions of the balance sheet (Chart 9).
- It is nevertheless important that companies show that they are taking action and apply a comprehensive approach to reduce their operational emissions and to “walk the talk”.
- Overall, targets for operational emissions are somewhat more ambitious than for investments (which may be explained by the fact that operational emissions are already significantly lower and easier to steer and control).
- Some examples of what companies are conducting to reduce emissions, include switching the energy sources they use to renewable energy, reducing business flights and shifting to virtual meetings, and/or apply more efficient light bulbs to reduce energy consumption.

Chart 9: Accumulated GHG emissions of an analysed insurance company of the investments versus the operations.



[5] https://ghgprotocol.org/blog/you-too-can-master-value-chain-emissions

Targets

- Around 70% of them set in place environmental friendly policies (Chart 10); from specific numeric targets to unspecific targets like using less printing paper
- About 1/4 of the financial institutions stated a net-zero commitment of their operational emissions (Chart 11).
- However, only looking at companies with a specified numeric reduction target, the above number drops to roughly 50%. And only around 10% strive for the required 7% annual reduction rate (Chart 12).

Chart 10: Percentage of the considered companies with investment targets in each sub-industry.

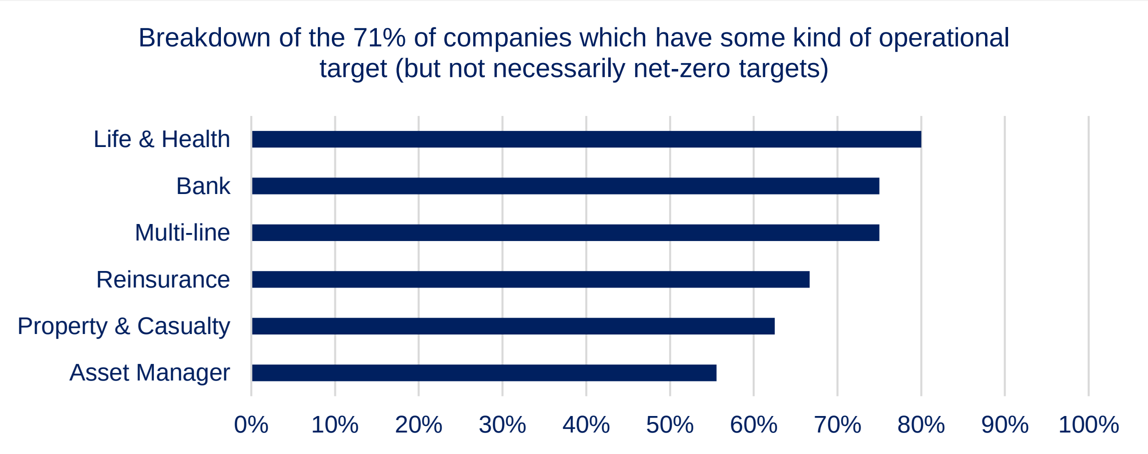
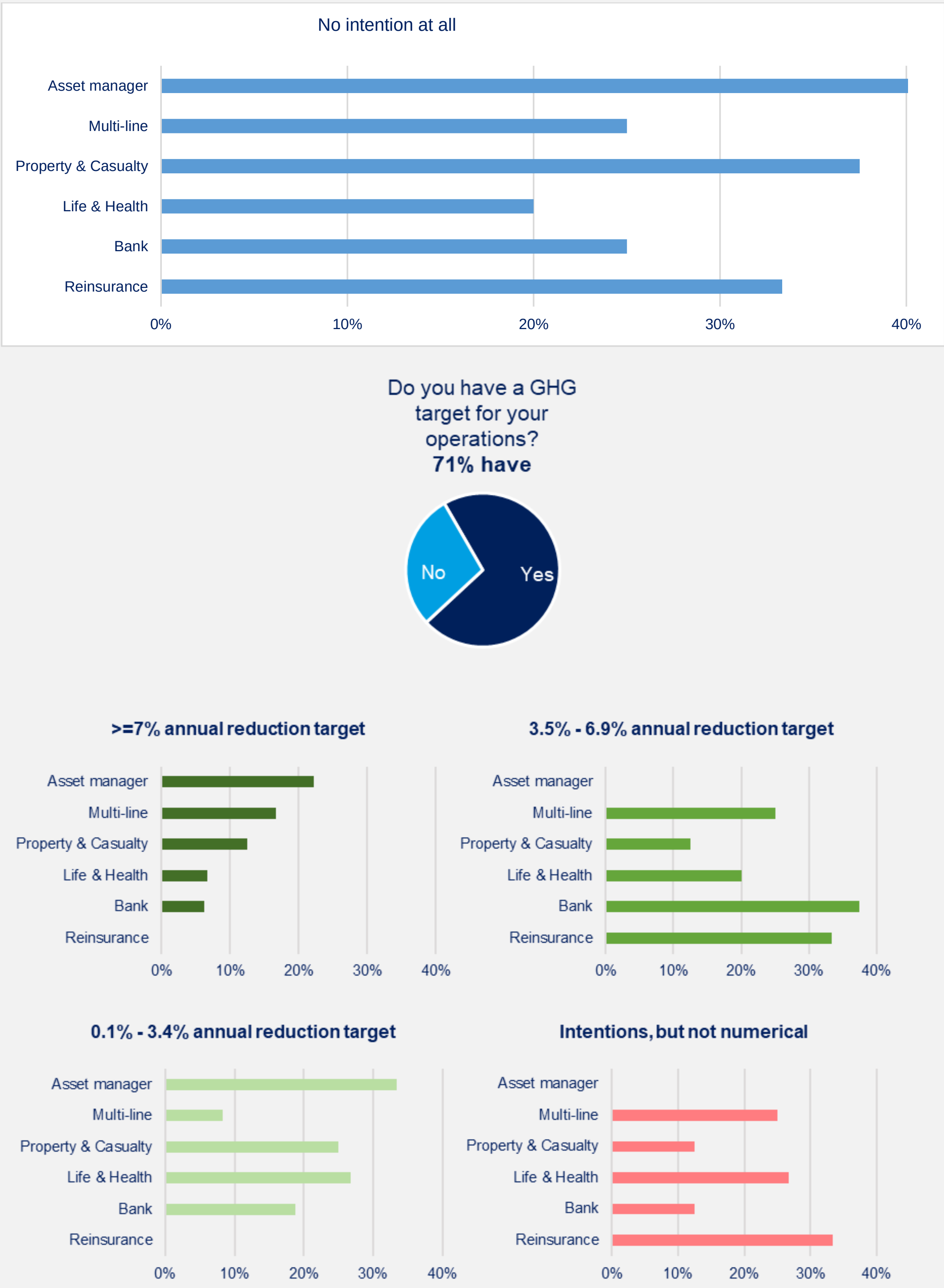


Chart 11: Breakdown of the considered companies with a net-zero operations commitment.

Chart 12: Percentage of stated annual operational emission reduction target in each sub-sector.

What is the breakdown?



Importance of Transition Enablers (FinTech/InsurTech)

For investment portfolio:	For underwriting ((re-) insurance):	For operations:
– ESG tracker to systematically develop relationships and record client engagement with a focus on ESG – Location-specific intelligence on climate change and ESG exposure to create a specific risk-adjusted and asset-level benchmark of global real estate investment – Data analytics to screen and benchmark companies and assets in clean energy	– Data and analytics to enable identification and forecasting of key risks to help lenders assess portfolio level and asset/ applicant specific risks – Climate risk modelling services – Providing data analytics to screen and benchmark companies and assets in clean energy – Digitalisation of mortgage process – Transition from on premise to cloud based computing	– Electronic access in order that resources are minimised – Improving efficiency of operations – Decarbonisation assessment to define action plan to reduce operational carbon footprint – Help consumer to understand their operational emissions

Outlook

Twelve Capital views it as vital that companies start to committing to be a net-zero company by 2050, combined by setting a near- and mid-term target if this has not been done yet. Companies being part of the net-zero alliance are required to set such targets and to define and apply quantitative data on how much they intend to reduced their investment/underwriting emissions within a specific timeframe. It is important to see companies taking action.

Investment:	Underwriting:	Operations:
– Over 60% of the analysed companies do not know the GHG emissions of their investment portfolio. – The insurance sector is the major contributor to the 40% knowing the respective emissions. – It is expected that in the near future companies will more and more measure the emissions of the investment portfolio and thus tangible targets will be set.	– Almost 50% of the analysed insurance companies stated that they have planned to measure and disclose the GHG emissions of their underwriting book in the near future. – It is expected that the underwriting side will take a big step towards climate transition in the next two years, driven by the Net Zero Insurance Alliance.	– It is expected that operational emissions go up this year as companies had huge reduction due to the pandemic. – It is also expected that over the long term emissions will be reduced (compared to pre-pandemic) as for example virtual meetings will more and more replace business travel.

GFANZ and the Net Zero Alliances

It is observed that processes to steer towards a low-carbon economy are more in-depth and developed on the investment side. To some extent, this push could be attributed to the Net Zero Asset Owner Alliance (NZ AOA), which was launched in September 2019.

In April 2021, the Net Zero Banking Alliance (NZ BA) was formed, followed by the Net Zero Insurance Alliance (NZ IA) in July 2021. These relatively new alliances suggest that other business areas of financial institutions will further emphasise in focussing to deliver on the net-zero targets. The Glasgow Financial Alliance for Net Zero (GFANZ), as well launched in April 2021, combines the stated (and all other existing) net-zero initiatives and helps to accelerate the transition to a net-zero global economy.

Even though companies still have a long way to go, which poses and will remain major challenges, in which transparency and data availability will certainly play a vital role, there is an increasing awareness of the urgency to act against climate change.

“Finance is no longer a mirror that reflects a world that’s not doing enough. It’s becoming a window through which ambitious climate action can deliver the sustainable future the people all over the world are demanding.” (Mark Carney, COP26, 04/11/2021)

Twelve Capital AG
Dufourstrasse 101
8008 Zurich, Switzerland
Phone: +41 (0)44 5000 120

Twelve Capital (UK) Ltd
Moss House, 15-16 Brook’s Mews
London W1K 4DS, United Kingdom
Phone: +44 (0)203 856 6760

Twelve Capital (DE) GmbH
Theatinerstraße 11
80333 Munich, Germany
Phone: +49 (0)89 839316 111

info@twelvecapital.com
www.twelvecapital.com

About Twelve Capital

Twelve Capital is an independent investment manager specialising in insurance investments for institutional clients. Its investment expertise covers the entire balance sheet, including Insurance Bonds, Insurance Private Debt, Catastrophe Bonds, Private Insurance-Linked Securities and Equity. It also composes portfolios of its Best Ideas. It was founded in October 2010 and is majority-owned by its employees. It has offices in Zurich, London and Munich.

Disclaimer

This material has been prepared by Twelve Capital AG, Twelve Capital (UK) Limited, Twelve Capital (DE) GmbH or their affiliates (collectively, “Twelve Capital”). This material has been furnished solely upon request and is intended for the recipient personally and may not be reproduced or otherwise disseminated in whole or in part without prior written consent from Twelve Capital. It is expressly not intended for persons who, due to their nationality or place of residence, are not permitted access to such information under local law as the product may not be authorised or its offering may be restricted in certain jurisdictions. It is the responsibility of every investor to satisfy himself as to the full observance of such laws, regulations and restrictions of the relevant jurisdiction. This is an advertising document.

This information was produced by Twelve Capital to the best of its knowledge and belief. However, the information herein may be based on estimates and may in no event be relied upon. All information and opinions contained in this document are subject to change without notice. Twelve Capital’s analyses and ratings, including Solvency II compliance analysis, Twelve Capital’s Counterparty Credit Rating and Twelve Capital’s Legal Rating, are statements of Twelve Capital’s current opinions and not statements of fact. Source for all data and charts (if not indicated otherwise): Twelve Capital. Twelve Capital does not assume any liability with respect to incorrect or incomplete information (whether received from public sources or whether prepared by itself or not). This material does not constitute a prospectus, a request/offer, nor a recommendation of any kind, e.g. to buy/subscribe or sell/redeem investment instruments or to perform other transactions. The investment instruments mentioned herein involve significant risks including the possible loss of the amount invested as described in detail in the offering memorandum(s) for these instruments which will be available upon request. Investments in foreign currencies involve the additional risk that the foreign currency might lose value against the investor's reference currency. Investors should understand these risks before reaching any decision with respect to these instruments. The information does not take account of personal circumstances and therefore constitutes merely promotional communication, and not investment advice. Consequently, Investors are advised to take all necessary legal, regulatory and tax advice on the consequences of an investment in the product. Past performance is no indication or guarantee of future performance. The performance shown does not take account of any commissions and costs associated with subscribing to and redeeming shares.

Note to EEA investors: when distributed in the EEA, this information has been distributed by Twelve Capital (DE) GmbH in accordance with the terms of its authorisation and regulation by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).

Note to US investors: Neither this information nor any copy thereof may be sent, taken into or distributed in the United States or to any U.S. person (within the meaning of Regulation S under the US Securities Act of 1933, as amended). The products and services described herein may not be offered to or purchased directly or indirectly by US persons.

Twelve Capital AG is licensed as "Manager of collective investment schemes" by the Swiss regulator FINMA. Twelve Capital AG is incorporated in Switzerland, registered number 130.3.015.932-9, registered office: Dufourstrasse 101, 8008 Zurich. Twelve Capital (UK) Limited is incorporated in England & Wales: company number 08685046, registered office: Moss House, 15-16 Brook’s Mews, London, W1K 4DS. Twelve Capital (UK) Limited is authorised and regulated by the UK Financial Conduct Authority and is registered as a commodity pool operator (“CPO”) with the U.S. Commodity Futures Trading Commission (“CFTC”) and is a member of the National Futures Association (the “NFA”) in such capacity. Such registrations and membership in no way implies that the FCA, the CFTC or the NFA have endorsed Twelve Capital (UK) Limited’s qualifications to provide the advisory services described in this document. Twelve Capital (DE) GmbH is authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) in Germany. Twelve Capital (DE) GmbH is incorporated in Munich, Germany, commercial register number (registry court: Munich) HRB 252423, registered office: Theatinerstrasse 11, 80333 Munich.