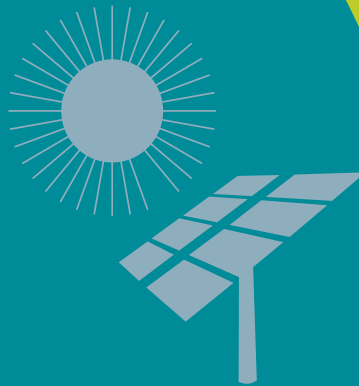
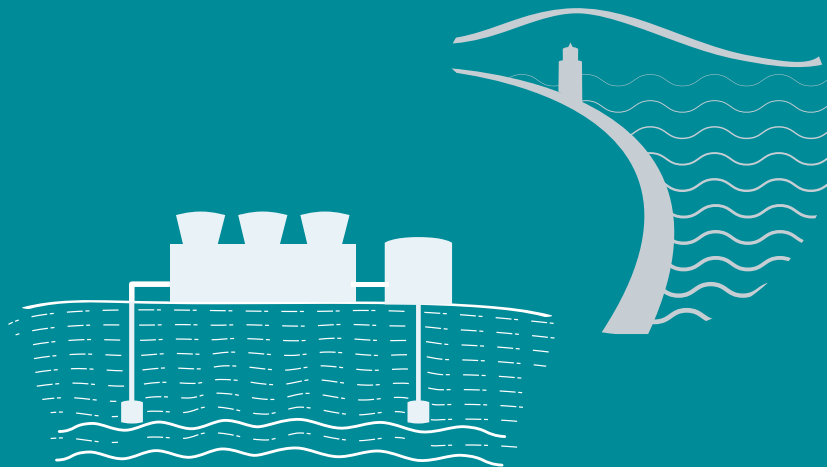




# GETTING REAL ABOUT THE ENERGY TRANSITION



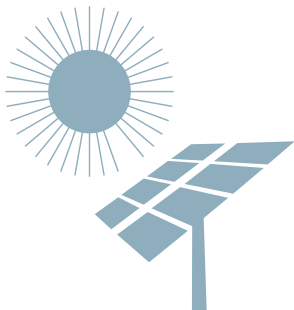
**MAKE MONEY.  
MAKE A DIFFERENCE.**



## WHAT IS ENERGY TRANSITION?

One of society's most complex and difficult problems is how to shift from a fossil-fuel based to a low-carbon energy based system. We call this the energy transition challenge.

As demand rises for energy (in all its forms), so too does the production of fossil fuels – which currently supply 80% of the world's energy consumption.<sup>1</sup> The reason why we are so reliant on fossil fuels is simple – they are an incredibly rich and relatively cheap source of energy. Our global economy, and standard of living, has benefited immensely from the exploitation of fossil fuels. Breaking the link between economic and social well-being and the use of high-carbon energy will be challenging, but to ensure long-term sustainability for the planet we need to explore alternatives.



## WHAT IS THE CARBON BUBBLE?

**565 billion tonnes of CO<sub>2</sub>**

### Remaining carbon budget

This is how much CO<sub>2</sub> can be emitted until 2050 and still give a reasonable chance of staying below 2 degrees Celsius of global warming.

**2,795 billion tonnes of CO<sub>2</sub>**

### Carbon Bubble

The emissions from burning of all known reserves of coal, oil and natural gas.

## HOW DO WE BEST ENCOURAGE ENERGY TRANSITION?

The divestment of all fossil fuel companies is an investment idea that is gaining traction. But this is a partial solution that does not challenge fossil fuels companies and policy makers to implement the changes required to transition to a low-carbon economy. Nor does divestment tap into the vast potential investors have to help drive change. For almost a decade Ethical Funds has been working on a more effective response to the energy transition challenge that includes:

- **Exclude** the least progressive companies/industries (e.g. coal)
- **Engage** companies to encourage more innovation, diversify and lower the demand for fossil fuels
- **Advocate** for progressive policy that contains a price on carbon
- **Collaborate** with stakeholders and build consensus on how best to approach and transition to a low carbon economy

## THE CARBON BUBBLE<sup>2</sup>

To meet globally agreed upon goals for mitigating climate change, Carbon Tracker estimates that the world can emit a further 565 billion tonnes of carbon dioxide (CO<sub>2</sub>) before passing critical thresholds. We have already discovered enough fossil fuel reserves to emit 2,795 billion tonnes of CO<sub>2</sub> – nearly 5 times what we can safely burn. Yet we are still looking for more. If we are serious about addressing climate change and decide to keep some portion of these reserves in the ground, at some point the value of fossil fuel companies will plummet, with potentially catastrophic impacts on the global economy. In order to deflate this bubble, we need to ensure the profits made today from fossil fuels are utilized in meaningful ways, such as research and development that targets specifically a path to a low carbon economy.

## EXCLUSION VERSUS DIVESTMENT

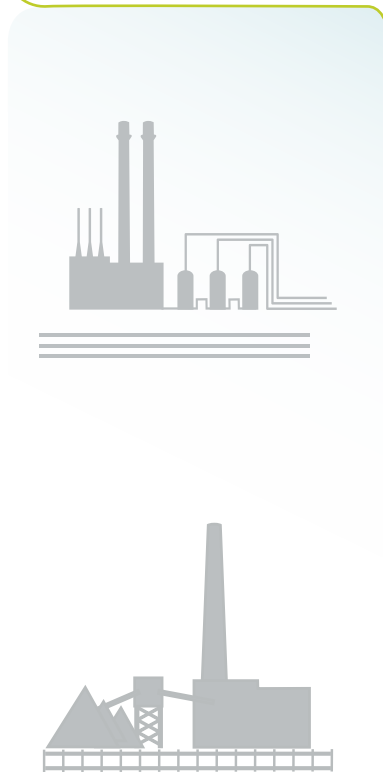
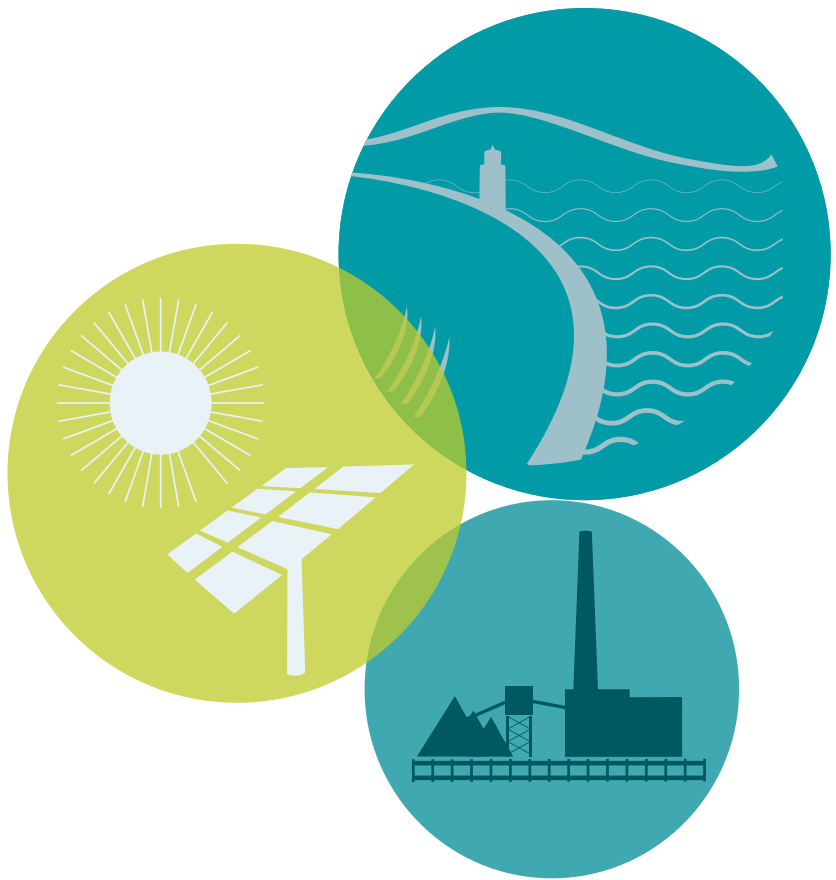
A divestment-only approach is not a solution in itself. Divesting of the producers of fossil fuels will do nothing to stem the growing demand for their product, and in all likelihood means selling to another investor who is less concerned about climate change.

Furthermore, denouncing one industry has the potential to reinforce political divisions and stifle rather than advance change. And lastly, according to some estimates state-owned and privately held companies control up to 80% of fossil fuel reserves, reinforcing that a significant proportion of the market is immune to divestment.<sup>3</sup>

Divestment may have a role to play for some investors, but Ethical Funds has a long-established general policy of exclusion, making divestment a last resort for us.

When we do exclude companies its typically those that fund organizations that challenge the scientific consensus about climate change or are involved in lobbying to impede climate-related legislation. An example would be our exclusion of Exxon Mobil for its concerted and damaging campaign to undermine action on climate change.

As well, to be eligible for our portfolios, high-carbon companies must be able to articulate the climate-related risks they face and provide evidence of credible actions to mitigate them. We expect to increase our expectations as alternatives begin to emerge.



### EXPECTATIONS FOR COAL

Coal is the most damaging fossil fuel and we have therefore set the highest expectations for this industry.

Special expectations for coal companies include:

- Explicitly supporting the implementation of climate legislation, including a price on carbon
- Actively working on carbon capture and sequestration (CCS) technologies
- No involvement in mountain-top removal mining methods

To date, no coal companies have met these expectations.

## ENGAGEMENT MUST BE PART OF THE SOLUTION

Our long-term vision for energy companies is that they will be positioned for a low carbon future, focused on innovation, supportive of progressive environmental policy and respectful of human rights and Indigenous communities.

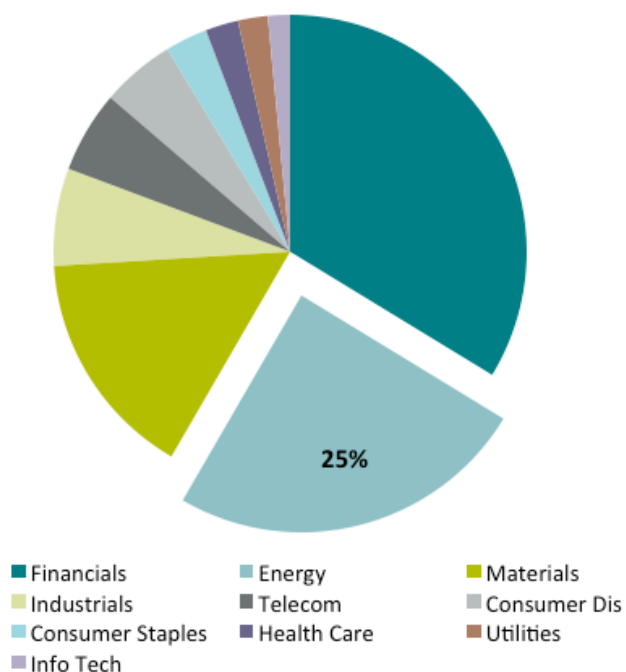
Fossil fuel companies do not currently meet all aspects of our long-term vision, but this does not mean we can simply ignore them, as the energy sector is a large component of our economy. We believe that a robust engagement strategy is the most effective way to enable the transition we need to see in society – and in this industry. We have been very successful in driving change to date, and we expect to achieve more in the near future. Some highlights include:

- We were one of the first investors in Canada to push companies to disclose their carbon risks and mitigation strategies, filing over 11 shareholder proposals
- We were the First Canadian Investor Member of the Carbon Disclosure Project (CDP)
- We pushed companies to publicly state support for placing a carbon price – starting with Suncor and now echoed by the Canadian Association of Petroleum Producers
- We filed shareholder proposals with Suncor and Encana, asking them to perform and disclose on shadow carbon pricing - now this is the norm, not the exception
- We pressed all the major banks to embed carbon risk analysis into their lending policies
- We successfully urged Canadian Natural Resources to tie executive bonuses to carbon intensity
- We encouraged broad improvement on key oil sands issues: collaboration on environmental technologies, greatly increased innovation and R&D spending, an industry-wide focus on reducing steam-to-oil ratios, linking environmental performance to executive pay, and public support for carbon policy

## NOT JUST ABOUT FOSSIL FUEL COMPANIES...

A major aspect of the energy transition challenge is the increasing demand for energy across all sectors. As a result, we are engaging all sectors on strategies to reduce demand – including banks, information technology, retail, consumer goods, and more.

S&P/TSX Sector Breakdown by Market Cap<sup>4</sup>

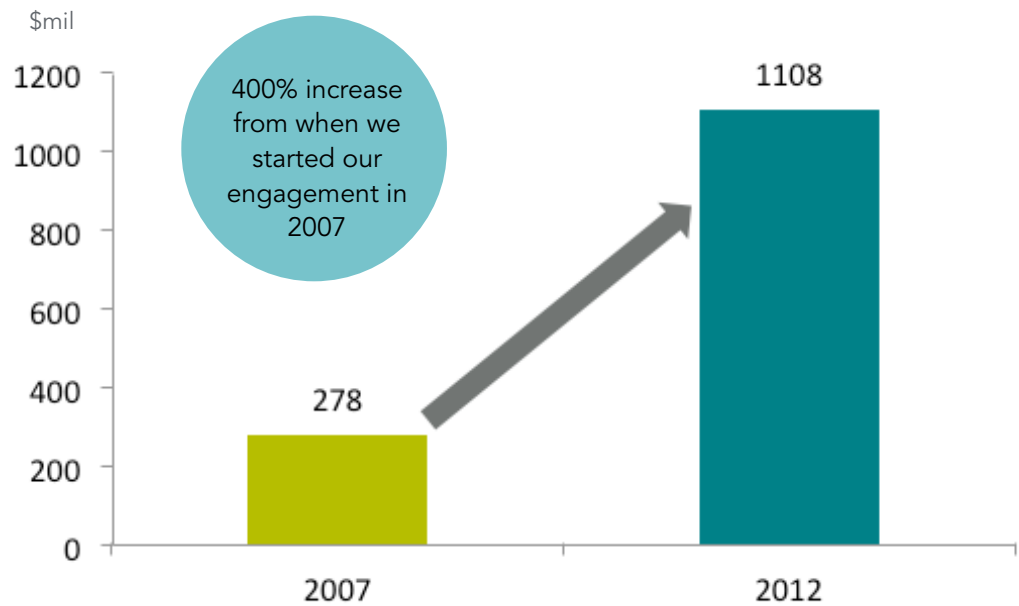


Today we are bringing all of this work together, as we engage companies about their plans to remain viable in a low-carbon future. We are asking companies to focus on innovation, support progressive policy, and diversify into renewables and other energy solutions. Not every company will make the transition, but ultimately, finding workable solutions will be greatly facilitated by the cooperation and leadership of the fossil fuels industry.

## FOCUS ON INNOVATION

One key engagement focus has been improving innovation in the oil and gas sector, and in particular the oil sands. The fruits of Ethical Funds engagement are starting to show in company research and development (R&D) numbers as evidenced by a 400% spend increase in R&D by Canadian oil sands companies from 2007 to 2012.

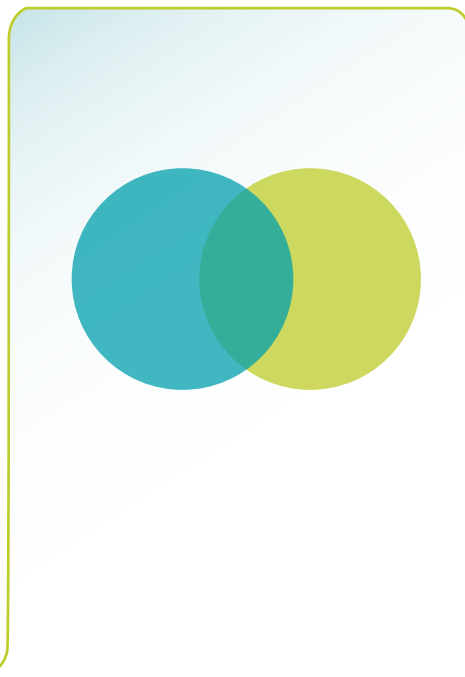
Total R&D spend of Canadian oil sands companies<sup>6</sup>



## COLLABORATION

For 2013-15 we are chairing the Boreal Leadership Council (BLC), a multi-stakeholder coalition with a goal of conserving at least 50% of the Canadian Boreal forest, with sustainable development practices in the rest. Canada's Boreal forest stores an estimated 208 billion tonnes of carbon –almost 300 times Canada's total 2012 GHG emissions.

Since we joined the BLC in 2005, over 65 million hectares have been preserved outright, 41 million hectares certified to sustainable forest practices and 30 million hectares deferred from resource extraction to protect caribou.<sup>5</sup>



## POLICY

Company-by-company engagement is vital, but not enough. Society needs to move much faster with shared goals and strategies for the energy transition. We need clear policy direction. We are one of the most active investors in public policy advocacy, engaging governments, regulators and standard-setters to achieve broad changes across entire sectors or jurisdictions.

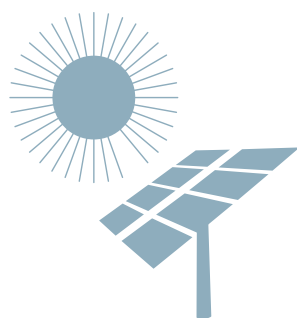
Ethical Funds has submitted 10 policy submissions on climate change since 2006.

# OUR FRAMEWORK TO RESPONSIBLE ENERGY PRACTICES

1. Equitable, meaningful, economy-wide carbon pricing ensuring the profits from fossil fuels today support the development of low carbon energy for the future.
2. Support research, development and commercialization of technologies to reduce emissions, increase efficiency, and develop new sources of energy.
3. Protect the vast Canadian Boreal and its role as a global carbon sink.

4. An ambitious, credible energy transition strategy with clear targets and goals.

The energy transition can be an important opportunity for society - or an enormous risk. Investors and consumers of energy both have a stake in responsible energy and we need dialogue with the energy industry to ensure that the transition to a low carbon economy is a smooth one. Ethical Funds long running history of working with energy companies through dialogue has proven to be effective, making divestment a last resort. Our time-tested, comprehensive strategy that includes exclusion, engagement, advocacy and collaboration must be the way forward to ensure a sustainable future for all stakeholders.



## SUGGESTED READINGS

As part of our overall commitment to transparency, all of our submissions can be found on our website at: <http://www.neiinvestments.com/Pages/ESGServices/PublicPolicyAndStandards.aspx>

See our focus list for more detail on other sectors we are engaging with on developing strategies to reduce fossil fuel demand and energy transition at: <http://www.ethicalfunds.com/Pages/Stories/Engagements.aspx>

## SOURCES

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3. International Energy Agency World Energy Outlook 2013
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5. The carbon the world forgot at <http://www.borealbirds.org/carbonreport.shtml>
6. <http://researchinfosource.com/toprd.shtml>



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