=Finreon
St.Gallen Asset Management Solutions

Spin Off
University of St.Gallen

Finreon Engagement Report 2023-2024

June 2024

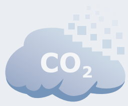
Management Summary

Engagement Statistics

The engagement cycle spanning from May 2023 to May 2024 started with the first *notice on short position* (incl. survey) sent to the shorted companies[1].

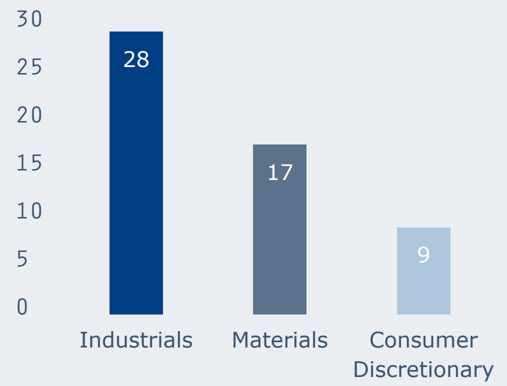
Total number of shorted companies	235
Total number of companies with reactions	89

Key statistics of companies with reactions

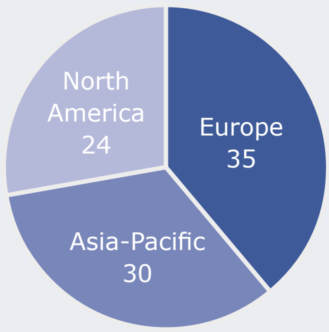


Responsible for 1'308'587'542 tons of CO_2 (scope 1 & 2)[2] equivalent to 28.5 % of the developed world listed equities' total emissions

Sector breakdown (Top 3)



Region breakdown



Modes of communication

[1] These statistics and information in the remainder of the report take account interactions with the companies until May 2024.
[2] Source: All carbon-related data from ISS ESG. GHG data, valid for all carbon data in the report unless specified otherwise: Scope 1 & 2 emissions (tCO_2e), reporting year 2021. Carbon risk ratings: The ISS ESG Carbon Risk Rating is a holistic and forward-looking assessment of the climate-related risk of companies on a scale from 0 (very poor performance) to 100 (excellent performance).

Main Outcomes of the Finreon Engagement Survey

The results of the survey sent together with the *notice on short position* provide valuable insights on the companies that took part in the survey and belong to the most CO_2-intensive organizations worldwide:

Profile of responding vs. non-responding companies

A high **38 % of companies (89 in total) have reacted to our engagement** – this reflects that climate change is on top of the agendas. The respondents were mostly 'deep' brown companies – those companies with the biggest potential for improvement.

GHG emissions' reduction in both two- and five-year horizons

A staggering **88 % of respondents expect an important decrease** in their (absolute) GHG emissions in both the two and five-year horizons – companies are changing and the next five years will play a pivotal role.

Ability to address climate-related risks and opportunities

Shorted brown companies report **high levels of preparation** for their ability to address climate-related risks and opportunities, while only few of them list concrete measures (such as e.g. adopting renewable energy or closing coal-powered plants).

Reactions regarding the *notice on short position's* effect

The *notice on short position* is a novel approach to doing engagement, and it has raised a lot of attention with **63 % of respondents reporting an important effect** on their awareness of the importance on climate-related questions to investors.

Effect of impact channels on the companies' effort towards decarbonization

An **overwhelming 87 % of companies report that market signals are an important driver** for their decarbonization efforts, while **92% confirm that engagement has an important impact** on their effort towards decarbonization.

= Finreon ENGAGEMENT POOL

Content

1. Motivation

Climate change is increasingly becoming reality and has already profound effects on the society and the economy. Accordingly, limiting global warming to below 2 degrees Celsius by the end of the century has become a political and social consensus. In order to achieve this goal, global greenhouse gas (GHG) emissions must reach net zero by 2050. This transition involves profound changes in how we produce energy, manage resources, and conduct business. Such a transition is associated with major risks for unsustainable companies with, among other things, high CO2 emissions[3], whereas it represents an opportunity for forward-looking companies.

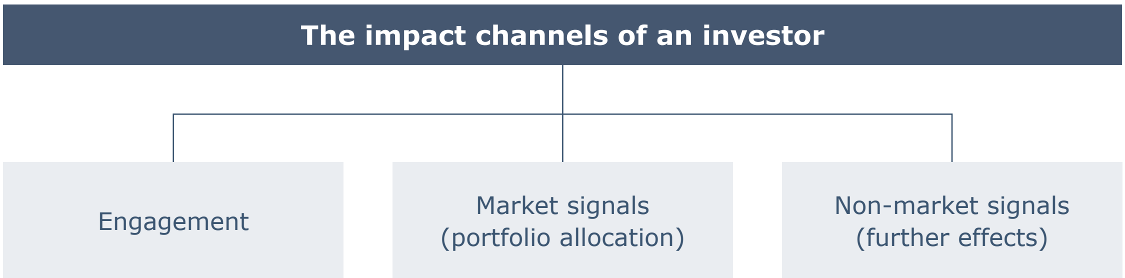
This paradigm shift is also influencing the investment strategies of investors. On the one hand, this means that greater transparency and disclosure about the extra-financial characteristics of portfolios is required. On the other hand, investors are also expected to contribute to the transition. However, one should realize that investors – especially in liquid markets such as listed equities or bonds – do not have the same influence channels as companies when it comes to contributing to the transition.

While a company can directly affect the real world by e.g. cutting CO2 emissions (=company impact), investors cannot directly impact the real world. As a matter of fact, reducing the financed carbon footprint of a portfolio – by e.g. selling stocks of a company with high CO2 emissions – does not lead to an immediate reduction of CO2 in the atmosphere. Rather, investors can indirectly influence companies through various impact channels, which will in turn lead to real-world effects (=investor impact)[4].

[3] In the remainder of the report, GHG emissions and CO_2 emissions are used interchangeably.
[4] See e.g. Busch T., Pruessner E., Brosche H. (2023). Principles for Impact Investments: Practical guidance for measuring and assessing the life cycle, magnitude, and tradeoffs of impact investments. Working Paper. Available at SSRN.com., also Heeb, F. Kölbel, J.F. (2021). The Investor's Guide to Impact; evidence-based advice for investors who want to change the world. University of Zurich, Center for Sustainable Finance and Private Wealth (CSP). Available at csp.uzh.ch.

1.1 Combination of Academically Recognized Impact Channels

Illustration 1: The three channels of investor impact. Own illustration based on Wilkens et al., 2023[5]



In the realm of the investor impact, academia generally recognizes three different types of impact channels[5]. Next to market signals (investment and divestment activities) and non-market signals (such as generating information or raising awareness), engagement plays a key role in the impact toolkit of investors, especially in liquid markets. Engagement refers to the process by which investors interact with companies to influence their behaviour and decisions, particularly in areas related to corporate governance, social responsibility, and environmental practices.

Several papers have shown the effectiveness of engagement for instance on companies' Environmental, Social and Governance (ESG) performance[6] or their corporate climate policy[7]. While engagement has long been in the spotlight for shareholders wishing to influence the policies and practices of their portfolio companies on questions of environmental, social and governance aspects, organizations and investors are increasingly recognizing the potential of engagement for the broader investment community (such as bondholders and long-short portfolios for instance).

This broader interest for engagement stems from the fact that most investors have committed to achieve net zero portfolio emissions by 2050 or sooner. To ensure their investment strategy is consistent with achieving this goal, they must now use all the impact channels at their disposal (see illustration 1) to influence companies and their trajectory of future emissions in order to drive down CO_2 emissions in the real economy. The need for action is further exacerbated by the observation that climate change is already unfolding its profound consequences across companies, sectors and regions. A particular investment strategy that differs from holding shares of a company and that is increasingly considered by investors worldwide[8] consists in taking sustainability-motivated short positions in specific high-carbon companies.

[5] Wilkens, M., Jacob, S., Rohleder, M., Zink, J. (2023). The Impact of Sustainable Investment Funds – Impact Channels, Status Quo of Literature, and Practical Applications. Available at SSRN.com.

[6] Barko, T., Cremers, M., Renneboog, L. (2021): Shareholder Engagement on Environmental, Social, and Governance Performance. Journal of Business Ethics. Available at springer.com.

[7] Heeb, F., Kölbel, J. F. (2024). The Impact of Climate Engagement: A Field Experiment. Swiss Finance Institute Resarch Paper, No. 24-04. Available at SSRN.com.

[8] The United Nations Principles for Responsible Investing (2021, Shorting and Responsible Investment A Review. Available at UNPRI.org) observes that a growing number of their signatories use shorting in their investment portfolios.

By taking short positions in a financial instrument (i.e. selling it), the investor gains a negative economic exposure towards the company underlying the instrument[9] (risk materiality perspective) and sends a (negative) market signal[10] (net zero materiality[11] perspective). For instance, the United Nations Principles for Responsible Investing describes[12] taking a short position as the reflection of an economic exposure that has real-world implications for employees, the environment and affected stakeholders. Applied in the framework of a sustainable investment approach, short positions can be:

- a strategy to signal that an entity, security, or asset may be inaccurately priced due to its insufficient consideration ESG factors in its operations.

- an alternative to screening, to „provide opportunities to profit from an underlying economic exposure and engage with companies – opportunities that would not be avail-able were the position to be excluded".

- a strategy to mitigate the aggregate exposure of a portfolio to significant risks associated with ESG factors.[13]

Because of the sustainability-motivated nature of short positions in such strategies, the combination of short positions with engagement becomes key to help convey the investors' view regarding ESG-related risks, practices or policies[14] both to the market and to the shorted companies. Because listed companies' management do pay attention to feedback from the market and especially to short positions[15], engaging with shorted companies helps clarify the market signal and the reasons behind the decision to short. Furthermore, the combination of short positions with engagement enables an alignment of incentives between investors and companies by e.g. allowing investors to remove their short positions (and therefore the negative signal) and invest in the company should it improve sufficiently from a sustainability perspective. Finally, combining short positions with engagement can optimally complement other sustainable investment approaches on the long side[16] because the approach allows to broaden the universe of companies on which impact channels can be applied to.

9 Seiz, R., Vial, C. & Gougler, A. (2023). Avoiding greenwashing in investment portfolios through consistent emissions classification and transparent reporting of derivatives. Available at SSRN.com

10 Furdak, R., Xiang, V. & Zheng, D. (2020). The Big Green Short. Man Institute Analysis. Available at man.com

11 Institutional Investors Group on Climate Change (2022). Incorporating Derivatives & Hedge Funds into the Net Zero Investment Framework. Available at iigcc.org.

12 United Nations Principles for Responsible Investment. (2021). Shorting and Responsible Investment: A Review. Available at UNPRI.org.

13 For the motivations underlying the use of such financial instruments, see also Varsani, H. et al. (2024). ESG and Climate Reporting with Derivatives. MSCI Research Insights. Available at MSCI.com.

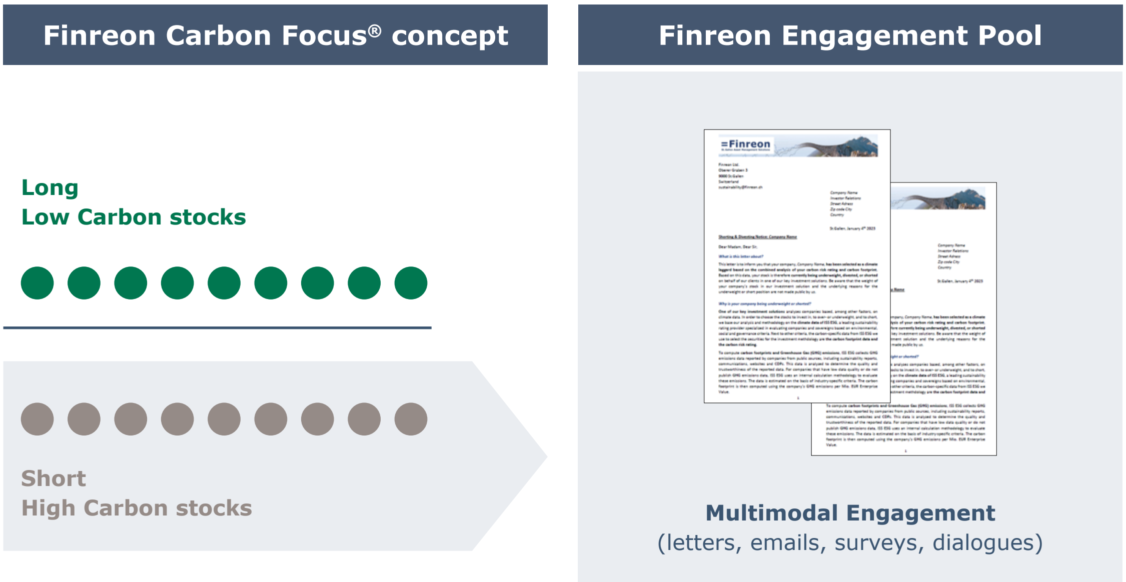
14 United Nations Principles for Responsible Investment. (2021). Shorting and Responsible Investment: A Review. Available at UNPRI.org. For a thorough discussion on the combination of engagement with short positions, see also Gougler, A., Seiz, R. (2024). „We are shorting your stock": Combining sustainability-based shorting with engagement. Available at SSRN.com.

15 Institutional Investors Group on Climate Change (2022). Incorporating Derivatives & Hedge Funds into the Net Zero Investment Framework. Available at iigcc.org.

16 Gougler, A., Seiz, R. (2024). „We are shorting your stock": Combining sustainability-based shorting with engagement. Available at SSRN.com.

2. The Finreon Engagement Concept

Illustration 2: The Finreon Engagement Pool engages with the most carbon-intensive global companies in each sector which are being shorted in the Finreon Carbon Focus® investment concept



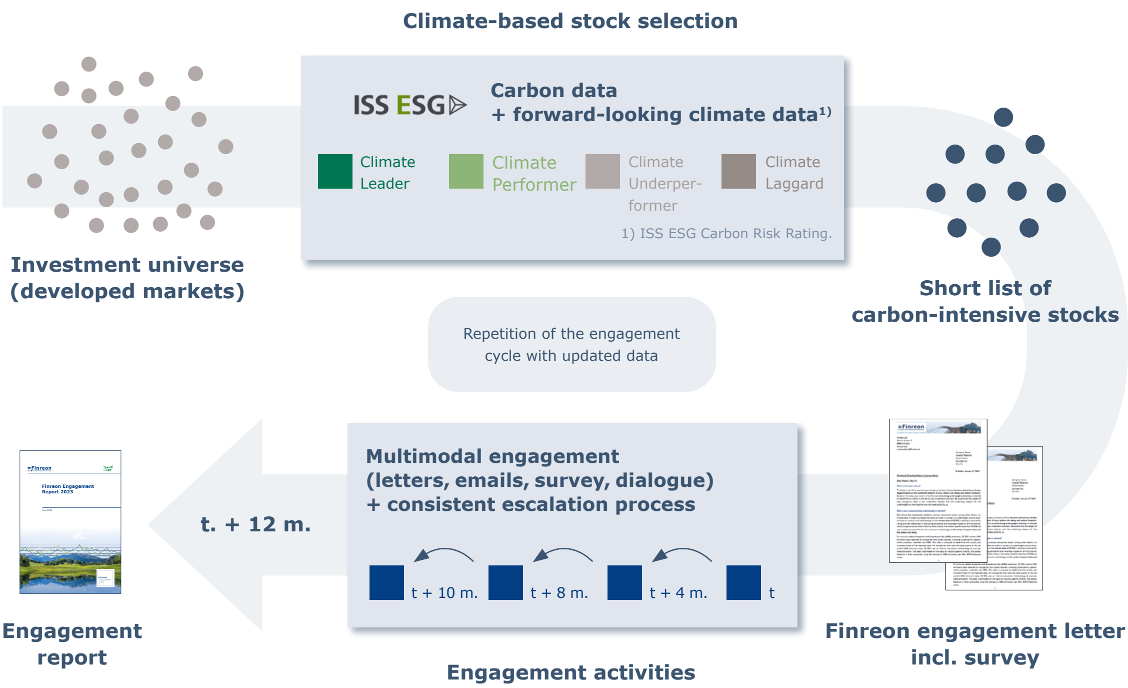
Finreon's engagement concept – through the Finreon Engagement Pool – innovatively combines short positions and engagement and builds upon the Finreon Carbon Focus® investment solution. This investment approach analyses developed markets' listed companies based, among other factors, on climate data. In order to choose the global[17] stocks to invest in, to over- or underweight, and to short, Finreon bases its analysis and methodology on the climate data of ISS ESG, a leading sustainability rating provider specializing in evaluating companies and sovereigns based on environmental, social and governance criteria.

Next to other criteria, the carbon-specific data from ISS ESG used by Finreon to select the stocks for the investment methodology are the carbon footprint data (as a current/backward looking measure) and the carbon risk rating (as an estimate/forward looking measure). Based on this analysis, the most carbon-intensive companies for each sector are selected and shorted. These companies, which cause very high GHG emissions levels both absolutely and compared to their sector peers, are proactively informed about this pressure as part of our engagement concept, thus reinforcing the market signal and fostering transparent dialogues for a low-carbon future.

[17] The investment universe consists of stocks from developed markets.

2.1 The Engagement Process

Illustration 3: The Finreon engagement process follows a systematic and data-based process based on the Swiss Stewardship Code



Finreon follows a systematic engagement process based on the principles formulated by the Swiss Stewardship Code[18]. In the first step and following the Finreon Carbon Focus® investment concept, the companies to be shorted based on climate considerations are selected. In the second step, all companies on the short list are then contacted with the Finreon engagement letter dubbed *notice on short position* and invited to fill out the Finreon engagement online survey. The survey is an important tool in the engagement process and serves three functions:

1. It allows to frame our engagement efforts on the aspects of the decarbonization that are deemed most pressing.

2. It allows to gather more granular information on certain topics, so that Finreon can use the information for its exchange with companies and as a base case for future assessment of the company's efforts.

3. It allows to collect aggregate data on the most CO2-intensive companies worldwide in order to be able to draw some high-level conclusions e.g. on their approach to decarbonization and their stance on the impact channels used by investor.

[18] For more information, please refer to section 6 of the report.

Some aspects of the survey will truly unfold their value over the long run (such as e.g. the assessment of how fast they plan to decarbonize their business activities and the lists of concrete measures meant to be implemented in the near future), some other aspects of the survey provide valuable insights on the most CO_2-intensive companies that took part in the survey (see Management Summary).

The engagement activities are conducted through different channels (letters, emails, survey, dialogues). Two aspects of the engagement process that play an important role in the consistency and credibility of an engagement initiative are 1) the monitoring of companies considered in the engagement and 2) a clear escalation process in case of unsatisfactory results. The combination of shorts positions with engagement offers several advantages in these two aspects:

1) **Monitoring:** In order to be able to monitor companies appropriately, stakeholders should regularly assess the situation, ESG performance and long-term prospects of the companies on the engagement list. The Finreon engagement concept actively monitors the companies based on data. Companies considered in the Finreon engagement concept are selected based on their CO_2 footprint as well as on forward-looking, carbon-related metrics. Finreon then regularly monitors the companies on the short list based on these quantitative measures, which are regularly updated by ISS ESG. In the engagement process, the companies are also informed that Finreon only considers measurable improvements in those aspects (such as a decreasing carbon footprint or an improving carbon risk rating). Thanks to the regular rebalancing of the short list and the regularly updated data, sufficient improvements means that improving companies may be removed from the short list. On the other hand, companies with worsening or stagnating metrics can be identified and the short positions on those companies can be maintained or increased, and the companies can be further engaged with.

2) **Escalation process:** Investors should also envisage escalation measures if companies with which engagement is pursued do not achieve desired results. A clear escalation process is already in place with regards to the communication of the engagement (see illustration 3). When it comes to escalation measures in case of stagnating or worsening metrics, the fact that these companies are being shorted means that the market pressure is therefore already being exerted. In case of stagnating or worsening climate-related results, the short position can be increased, meaning the market signal is reinforced. As a result, the companies have a clear and immediate incentive to quickly take the steps necessary to improve their climate profile in order to be removed from the short list. Only concrete improvements that can be measured in the carbon-related data can lead to the company being removed from the short list, and not mere declarations of intent that can be weakened or eliminated. On the other hand, if there is sufficient improvement in the above-mentioned criteria, the company can be removed from the short list. Depending on the company profile and key figures, companies can even be included on the long side of the Finreon Carbon Focus® concept (see illustration 2), thus providing a positive market signal to the company.

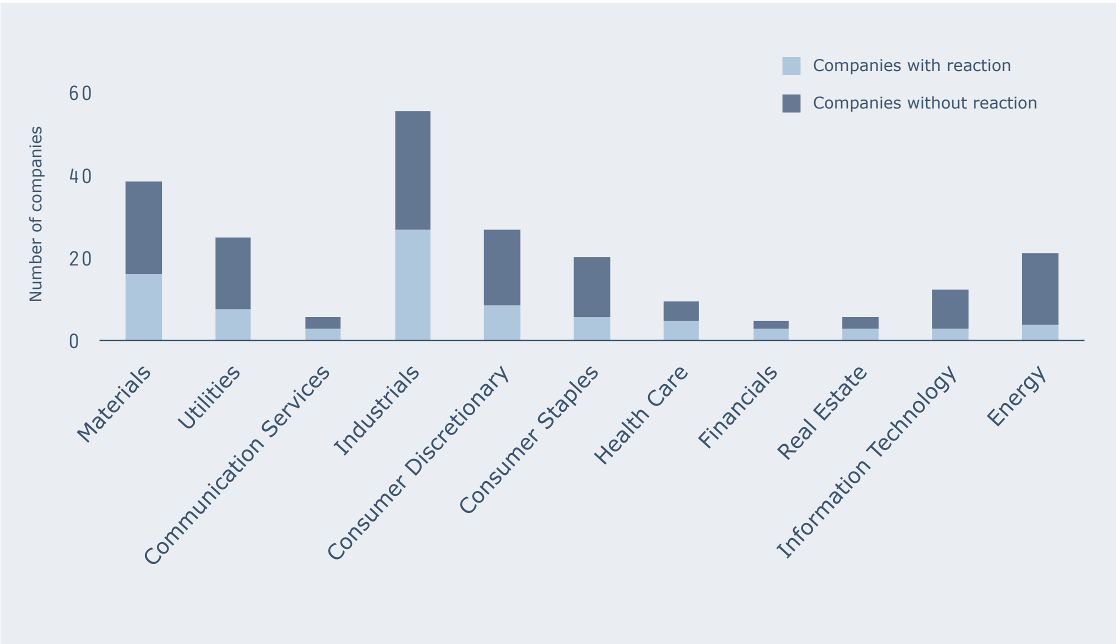
3. Detailed Findings of the Finreon Engagement Survey

3.1 Profile of Responding vs. Non-Responding Companies

Our escalation process in the communication channel is designed to give companies enough time to react to our initiative. Moreover, it includes a reminder so that companies are given another chance to react to our solicitations. Finally, Finreon contacts two different departments and hierarchy levels (Investor Relations and the Chief Financial Officer) so that our attempt to establish an exchange is not dependent on a single point of contact.

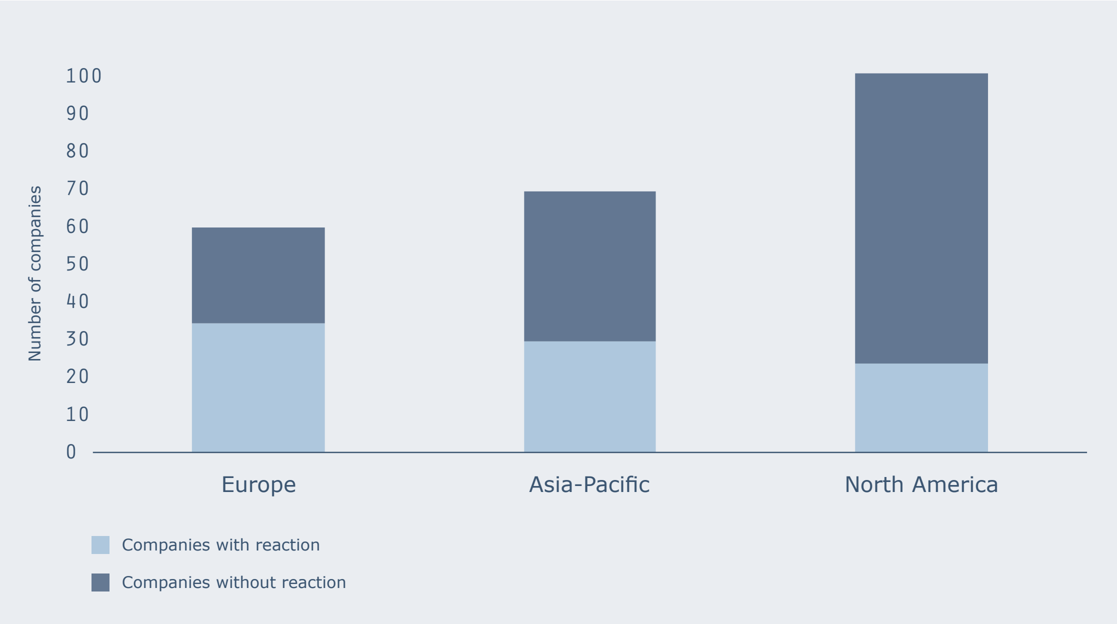
For the completed cycle ranging from May 2023 to May 2024, 38 % of the companies reacted through the different modes of communication at their disposal (see Management Summary).

Illustration 4: Share of responding companies by sector



Looking into the relative share of respondents and non-respondents by sector, some sectors are more responsive than others, such as financial (response rate of 60 %), real estate (50 %) and communication services (50 %). Industrials and materials, which constitute an important part of the shorted companies, also feature above-average response rates (with 48 % and 43 % respectively). On the other end of the spectrum, the sectors with the lowest response rate are energy (18 %), consumer staples (24 %) and utilities (27 %).

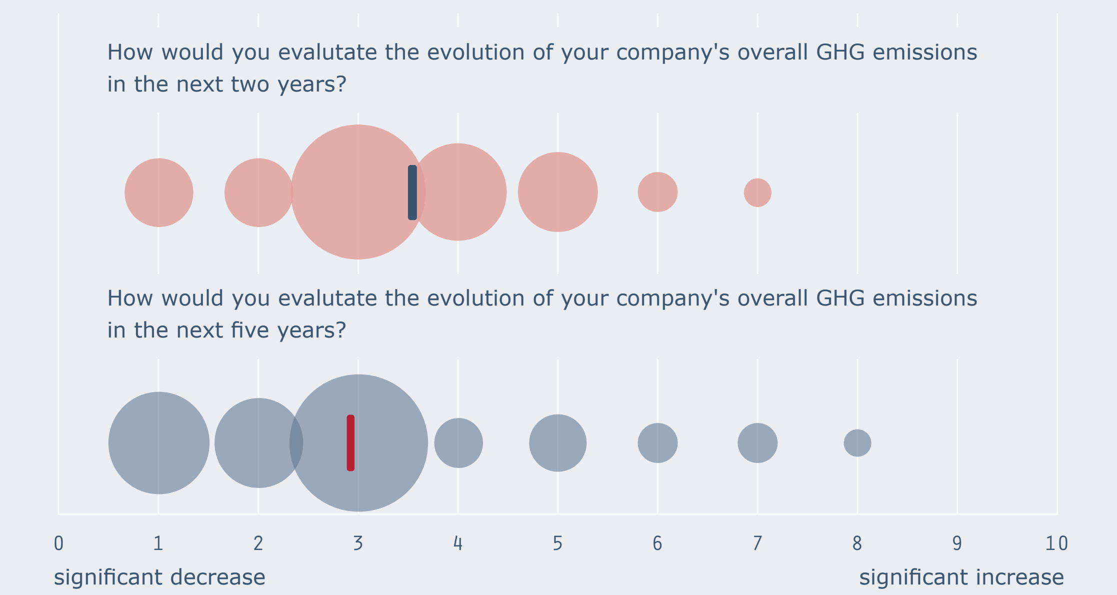
Illustration 5: Share of responding companies by region



From a regional perspective, the relative amount of responses from region is in accordance with the general trend observable in sustainability approaches and regulation. Potentially due to the geographic proximity with Finreon and its customer base, but also due to Europe being a longstanding frontrunner in international efforts to keep global warming under 2 degrees Celsius, almost 60 % of European companies approached have reacted to our solicitations. In North America, where numerous US states have introduced anti-ESG regulations, the response rate is lower, with just over 22 % of companies having responded. Asia-Pacific lies in between Europe and North America with a response rate of 42 %. Looking more granularly into Asia-Pacific, some differences arise: While Japan exhibits a response rate of 48 %, Australia with a response rate of 22 % seems to be more in line with the trend observed in North America.

3.2 GHG Emissions Reduction in Two- and Five-year Horizons

Illustration 6: Self-assessment of the evolution of companies' GHG emissions for the next two and the next five years

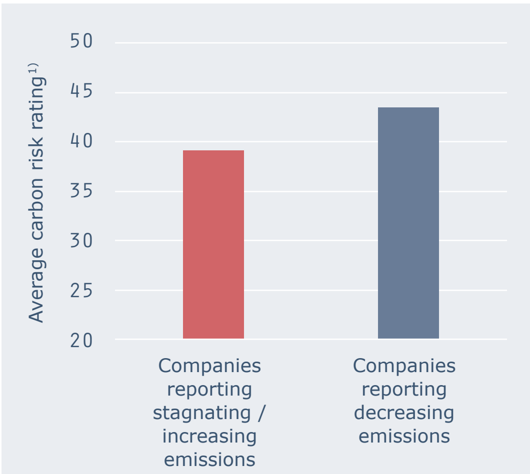


The size of the bubbles corresponds to the number of respondents per answer value, the vertical line represents the average.

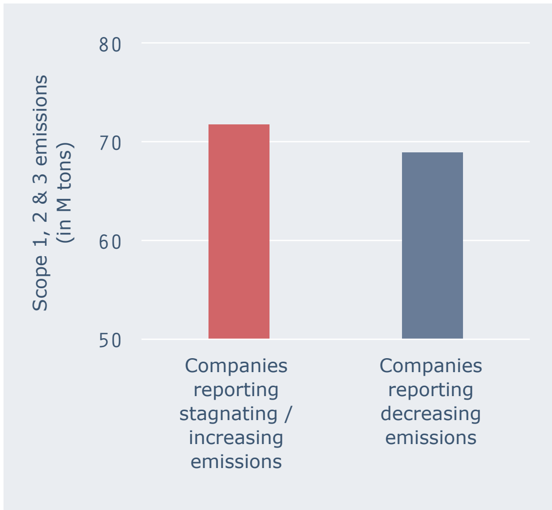
To be able to monitor these companies in the long term, the survey also requires companies to assess their efforts and objectives on different subjects. Among other things, companies are asked to report their assessment of how their overall level of GHG emissions will develop in both the next two and five years. In the question, the focus is purposely set on absolute GHG emissions – and not carbon intensity or footprint – in order to highlight the fact that an absolute reduction of emissions is necessary in order to remain in line with the goals of the Paris agreement. This framing should also convey the necessity of emissions rapidly decoupling from economic growth, so that a reduction in emissions should also be reconcilable with the development of the underlying business. Moreover, the time horizons – two and five years – are meant to highlight the fact that swift climate action is necessary so that these companies improve and reduce their own climate risk profile while also reducing their impact on the climate. The qualitative answers – which should also enable a crosssector comparison - provide interesting insights in the short- and medium-term targets of high-carbon emitters.

First, a majority of these companies plans to reduce their emissions (average answer at 3.3) and also plan to achieve a greater level of reduction in the longer, five-year time frame (average answer at 2.9). Among the sectors that plan on the most significant reductions, utilities stand out with an average answer of 2.5 in the next two years and 2 in the next five years (improvement of the score by 20 % between the two horizons), followed by communication services and financials. Among the sectors that are less optimistic, energy stands out with a self-assessment of 4.5 and for 4 for the next two and five years respectively, followed by industrials (3.7 and 3.2 respectively). Next to this self-assessment, companies also had the opportunity to quantify their two- and five-year targets, which will be used in the future to compare companies' climate performance with their stated goals. The ultimate aim of this measure is to increase companies' awareness and accountability.

Illustration 7: Carbon-related characteristics of companies reporting stagnating / increasing GHG emissions vs. companies reporting decreasing emissions in the next two and five years



[1] Scale from 0 (very poor performance) to 100 (excellent performance)



While a majority (88 %) of companies reports a reduction in their absolute GHG emissions in both the next two and five years, a minority of the responding high-emitters present on the short list does not plan to decrease their GHG emissions – be it in the next two or five years – and some of the respondents even forecast an increase in emissions. These companies show some common characteristics. First, the forward-looking characteristics (calculated with the ISS ESG carbon risk rating) of these companies are on average lower than that of the companies planning a reduction in GHG emissions. Notably, none of the companies showcase a carbon risk rating higher than 50, which highlights that these companies are lagging behind in terms of their efforts towards the transition. Second, the (backward-looking) the average scope 1, 2 & 3 GHG emissions of these companies are above that of the companies reporting an improvement in their overall GHG emissions.

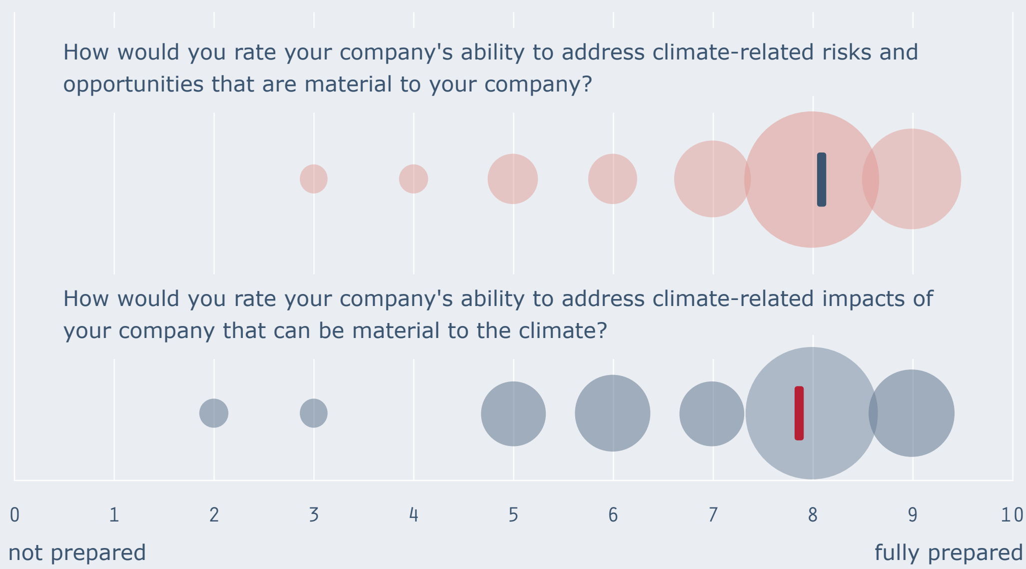
These companies stem from three sectors: industrials, energy and utilities. Looking at sector-specific absolute emissions, the companies in the industrial sector all belong to the top 25% (scope 1 & 2) and top 30% (scope 1, 2 & 3) of companies in their sector when compared to the entire universe of companies (world equities index). The one representative from the energy sector reporting stagnating / increasing emissions belongs to the top 10 of companies with the highest GHG emissions (both scope 1 & 2 and scope 1, 2 & 3) in its sector. Therefore, this rules out the hypothesis that companies planning no important improvement in GHG emissions might do so because they have already greatly improved compared to other firms in the same sector.

One company from the utilities sector offered an explanation as to why their emissions will not be decreasing in the next five years: "In the near term, we are planning to promote sophisticated use of natural gas to contribute to the overall reduction of CO_2 emissions in society, which may result in an increase in our CO_2 emissions [in the short-term]". They then also provide a high-level explanation of how they want to reduce emissions in the long-term, with the main measure being the "introduction of e-methane – a carbon-neutral gaseous energy form".

3.3 Ability to Address Climate-related Risk and Opportunities

The concept of double materiality has become increasingly central to discussions on sustainable finance. Unlike traditional financial materiality, which focuses solely on how sustainability-linked factors impact a company's financial performance, double materiality broadens this scope. It acknowledges that a company's operations can have significant effects on the environment and society, and these impacts, in turn, can materially affect the company itself. The survey includes two questions, one that asks respondents to evaluate their company's capability to manage and respond to external climate-related risks and opportunities that could impact the company's financial performance and strategic operations ("outside-in perspective"), and one that seeks to assess how well the company addresses its own contributions to climate change, highlighting the company's efforts to mitigate its environmental footprint and improve sustainability practices (inside-out perspective).

Illustration 8: Self-assessment of companies' preparedness level from a double materiality perspective



The size of the bubbles corresponds to the number of respondents per answer value, the vertical line represents the average.

As can be seen from illustration 8, companies report very high levels of preparation to address climate-related risks and opportunities that are material to them (outside-in perspective), with an average answer of 8.1, suggesting they are very well prepared. Interestingly, the responding companies, which have been selected due to their comparatively high levels of GHG emissions and based on the forward-looking carbon risk, also report high levels of preparation to address their climate-related impacts that can be material to the climate (inside-out perspective).

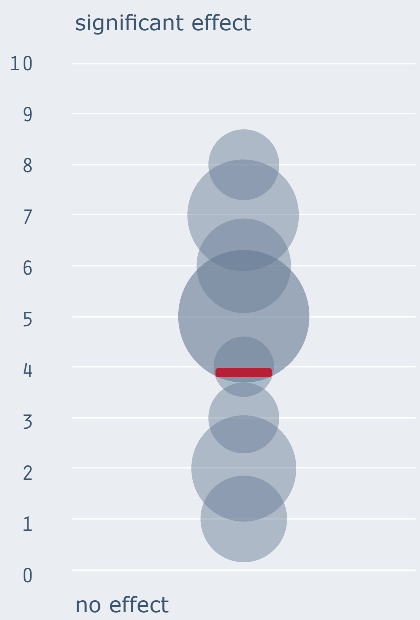
In the section dedicated to comments, some companies list concrete measures that they are taking (such as widely adopting renewable energy, closing down coal-powered plants, entering partnerships with customers and/or suppliers to decrease GHG emissions) and report some short-term quantifiable goals (such as capital expenditures dedicated to the decarbonization, emissions' reductions, renewable energy targets). Most companies, however, refer to their (less concrete) long-term commitment of achieving net zero GHG emissions by 2050 and to planned or upcoming initiatives.

The two companies reporting lower levels of preparedness (answer under 5 on both questions) stem from different sectors (industries and consumer discretionary) and from different regions (Europe and Asia-Pacific). Both do not provide any explanation to their answers in the section dedicated to comments. One of the companies has a carbon risk rating of 32, suggesting that the company is indeed ill-prepared for the future challenges posed by the transition. The other one committed to the Science-Based Target Initiative (SBTi) in 2022, suggesting that the company might be starting to take steps to address the climate-related aspects of its activities.

3.4 Effect of the *Notice on Short Position* on Shorted Companies

How would you rate the effect of this *notice on short position* on your company's awareness of the importance of climate-related questions to investors?

Illustration 9:
Results of the above-mentioned question about the effect of the *notice on short position*



The size of the bubbles corresponds to the number of respondents per answer value, the vertical line represents the average.

The *notice of short position* is a new instrument for engagement activities and the expression of a novel approach that combines shorting with engagement. Surveyed about the effect of the *notice on short position* on their company's awareness of the importance on climate-related questions to investors, companies have reported some effect on average (average at 4.9). Notably, 63 % of respondents have given this question a value of 5 or more, which highlights the interest and higher level of effect on their awareness of the importance on climate-related questions to investors. Looking at regional statistics, Asia-Pacific exhibits higher levels of effect of the notice on short position, with an average answer at 5.8. Second is Europe, with an average of 4.3, but some countries prove more receptive than others, for instance Germany (average of 7 with three respondents from that country). On third position, North America shows the lowest average answer with 4. As a new and innovative instrument, the notice on short position proves itself a useful tool to raise awareness on the importance of climate-related challenges to investors, especially because this seems to not be constrained to companies geographically close to Finreon, but rather also unfolds its impact in other regions, such as Asia-Pacific.

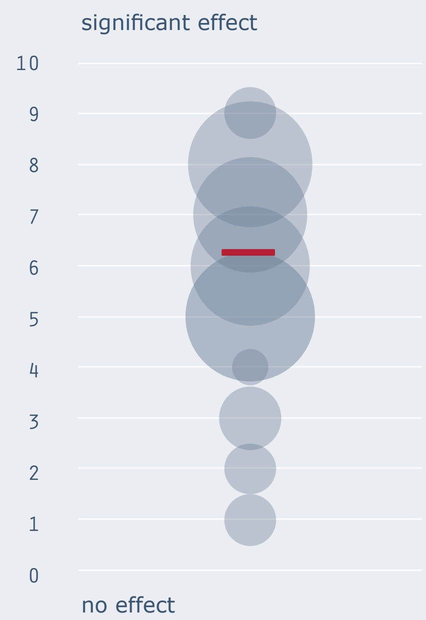
«It is the first time we hear about such a **shorting approach based on the CO_2 emissions** of our company, but we can assure you that we take climate change very seriously.»

Dialogue
with a company active in the hotel business, USA
responsible for 16 M tons CO_2 (scope 1,2 & 3)

3.5 Effect of Impact Channels on the Companies' Effort towards Decarbonization

Generally, how would you rate the effect of market signals (investment, divestment, shorting) on your company's effort towards decarbonization?

Illustration 10:
Results of the above-mentioned question about the effect of market signals



The size of the bubbles corresponds to the number of respondents per answer value, the vertical line represents the average.

With over 85 % of survey participants responding with 5 or more and an average of 6.2, it appears that market signals have a considerable effect of the shorted companies' effort towards decarbonization. Market signals include instruments such as e.g. investment, divestment or shorting and can be viewed as a market-based effort of climate-aware market participants to influence high-carbon companies in transitioning their business models. With market signals, investors decide to provide financing (in the case of investments) or withdraw funding (in the case of e.g. divestment). Since listed companies rely on financial markets for their capital, sustainability-motivated investors tend to use these levers to signal their support or scepticism towards companies' business models. The survey results suggest that market signals are indeed an effective way to signal to companies and the market about one's opinion about the climate-related efforts of a company. Moreover, the effect companies attribute to market signals do not seem to differ from region to region, as Asia-Pacific, Europe and North America all exhibit average answers above 6 (6.3, 6.4 and 6 respectively).

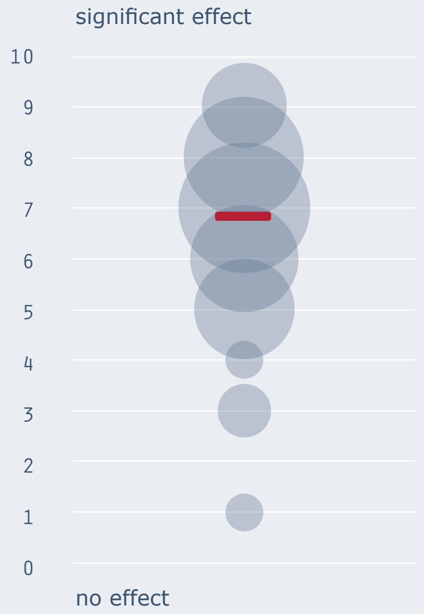
«We take our carbon footprint seriously. We have already **shared your letters with our CFO** so we can spare you the task of contacting him separately on this matter.»

Email exchange
with a conglomerate, Japan
responsible for 249 M tons CO_2 (scope 1,2 & 3)

How would you rate the effect of engagement on your company's effort towards decarbonization?

Another academically recognized impact channel is engagement. Answers to the survey suggest that engagement is a powerful tool to influence carbon-intensive companies' efforts towards decarbonization. Of the respondents to the survey, over 92 % answered with a value of 5 or above and the average lies at 6.9. These results are in line with the literature[19] on engagement suggesting that this impact channel can be effectively used to raise awareness and, depending on the form of engagement chosen, steer companies' efforts to accelerate the reduction of GHG emissions. Looking at regional differences, while both Europe and Asia-Pacific report higher average answer (7 for both regions), North American companies responding to the survey exhibit a lower average (6.3), suggesting that this impact channel might be slightly less effective than for companies located in other regions, even though the score is still largely higher than 5. There are also some notable differences between sectors. While companies in the utilities sector report a high average answer (8.8), consumer staples' companies (all from Europe) report a low average answer (4.3).

Illustration 11:
Results of the above-mentioned question about the effect of engagement



The size of the bubbles corresponds to the number of respondents per answer value, the vertical line represents the average.

«We understand the reasons underlying your decision of shorting our stock. **What concrete steps could we take so that our company can be removed from your short list?»**

Dialogue
with a steel company, Europe
responsible for 170 M tons CO_2 (scope 1,2 & 3)

[19] See e.g. Busch T., Pruessner E., Brosche H. (2023). Principles for Impact Investments: Practical guidance for measuring and assessing the life cycle, magnitude, and tradeoffs of impact investments. *Working Paper.* Available at SSRN.com, also Heeb, F. Kölbel, J.F. (2021). The Investor's Guide to Impact; evidence-based advice for investors who want to change the world. University of Zurich, Center for Sustainable Finance and Private Wealth (CSP). Available at csp.uzh.ch.

4. Engaging on the Transition through Dialogue

In order to disclose the reasons behind the short position, complement the market signal and raise awareness on climate-related topics, Finreon has conducted dialogues with eleven focus companies in this engagement cycle. In the following, two typical dialogue cases are presented.

4.1 The Case of an International Steel Company

Brief description of the company

— One of the world's leading steel and mining businesses.
— Operates in 60 countries and has a significant presence in both developed and emerging markets.
— Major supplier of steel products to the automotive, construction, appliance, and packaging industries.

Climate and Sustainability profile

— Largest carbon footprint in its sector (materials) for scope 1 & 2 in the investment universe.
— ISS ESG Carbon Risk Rating: 39.
— UN SDG Overall Score: -5.5 (significant negative impact).
— No clear short-term GHG reduction target (up to 2026).
— No clear plan to decarbonize its investments (CAPEX).

Getting in touch

- Reaction after second step of the escalation process (reminder to Investor Relations).
- Scheduling of a virtual meeting with representatives of both the Investor Relations and Sustainability teams.

Dialogue

- Interest for our Finreon Carbon Focus® approach, its investment strategy and the selection process of shorted companies.
- Explanation from the company about how they monitor both market signals and engagement to understand and respond to the expectations of financial markets.
- Discussion on their level of capital expenditures towards decarbonization (less than 4 % of total capital expenditures in the last ten years).
- Discussion around their project to open new coal-powered plants and how it aligns with the goal of reducing GHG emissions.
- Presentation of concrete measures they will be taking in the next few years to reduce their GHG emissions.

Next steps

- Follow-up meeting in Q3/2024 to exchange about the measures discussed.

4.2 The Case of an International Oil & Gas Company

Brief description of the company

— Major global player in the energy sector, primarily engaged in oil & gas exploration and production.
— Based in Europe, it has operations in over 66 countries.
— It is known for its integrated business model that spans from exploration, production, and refining to selling and distributing energy

Climate and Sustainability profile

— In the top 20 % for Scope 1 & 2 carbon footprint in the energy sector, top 50 % for Scope 3 carbon footprint.
— ISS ESG Carbon Risk Rating: 29.
— UN SDG Overall Score: -3.2 (limited negative impact).
— Currently not aligned with the goal of limiting global warming to 1.5 °C.

Getting in touch

- Reaction after third step of the escalation process *(notice on short position* incl. survey sent to the Chief Financial Officer).
- Scheduling of a virtual meeting, after company filled out the survey, with an Investor Relations ESG specialist and with a representative of the Sustainability team.

Dialogue

- Presentation of the Finreon Carbon Focus® approach and explanations about which data are used to select shorted companies.
- Explanations from the company about how market signals and engagement are considered as feedback tools but will not change the company’s long-term decarbonization strategy. Their answer in the survey was "5" to questions relating to impact channels.
- Discussion on their commitment to the SBTi and if they engage with the initiative to develop a standard for the oil & gas sector.
- Discussion around their decarbonization strategy, and more specifically on the role Carbon Capture, Utilization and Storage (CCUS) (mentioned in their Say on Climate).
- Discussion on how their plan to move away from oil and increase their share of energy from gas can be reconciled with their commitment to net zero emissions.
- Presentation by the company of one flagship CCUS project that is in development.

Next steps

- Follow-up meeting end of 2024 so both parties can get an update from each other.

4.3 Dialogue Statistics

Finreon conducted dialogues with **eleven companies** during the engagement cycle with a clear focus on:

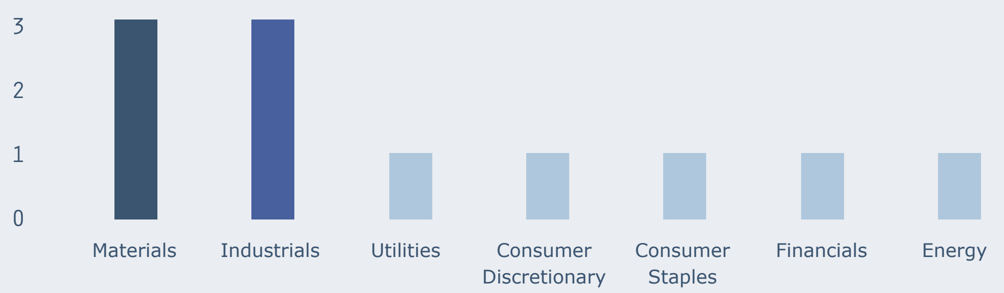
- Explaining the **reasons motivating the short position**
- Discussing the **actions to be taken** by CO_2-intensive companies **to reduce greenhouse gas emissions** (decarbonization).

Total number of companies with which a dialogue was conducted	11

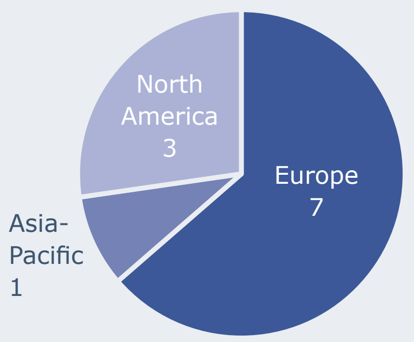
Key statistics of companies with which a dialogue was conducted

Responsible for 336'550'244 tons of CO_2e (scope 1 & 2) equivalent to 8.0 % of the developed world listed equities' total emissions

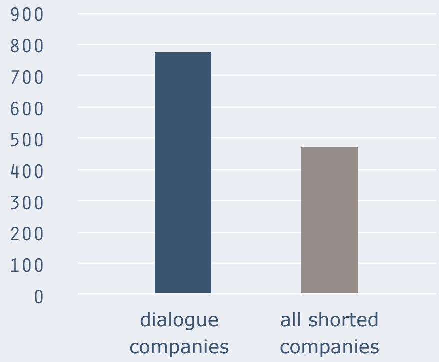
Sector breakdown



Regional breakdown



Average carbon footprint
tCO_2e/ €M EVIC (Scope 1 & 2)



5. Engagement with Climate Action 100+

Climate Action 100+ is an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change. Its signatories engage with companies to address climate change risks and opportunities. The aim of Climate Action 100+ is to halve GHG emissions by 2030 and achieve net zero by 2050 in alignment with the Paris Agreement. The approach follows three goals:

- Establishing governance frameworks to clarify board responsibilities regarding climate risk.
- Reducing emissions throughout the value chain and collaborating with stakeholders to facilitate sector-specific transitions.
- Enhancing disclosure and implementing plans that align with TCFD recommendations to improve investment decisions.

Because our engagement efforts are largely aligned to the goals of Climate Action 100+, Finreon joined the initiative in early 2024 and will be participating in collaborative engagement with one of the focus companies. Joining Climate Action 100+ means that Finreon is now working with other signatories on company-related commitments and thereby further expanding our influence. Together with other investors, Finreon is committed to a constructive exchange to shape a more sustainable future.

A proud participant of:

Climate Action 100+
Global Investors Driving Business Transition

6. Alignment with the Swiss Stewardship Code

The Swiss Stewardship Code is a set of principles designed to promote responsible investment and corporate governance among institutional investors in Switzerland. The code was by developed the Swiss Asset Management Association and Swiss Sustainable Finance with the support of pension funds, asset managers and service providers. Finreon makes sure to align with the Swiss Stewardship Code, especially with the following key principles relevant to the Finreon engagement concept:

Governance:
Regular evaluation of the engagement concept and engagement activities in the Finreon ESG Board.

Stewardship Policies:
Clear and systematic engagement concept in line with the Finreon Carbon Focus® investment solution.

Engagement:
Individual engagement (with companies), collective engagement (with Climate Action 100+) and public engagement (dialogue with universities, public bodies and authorities).

Escalation:
Clear list of measures for exerting pressure with a systematic escalation process, both in terms of communications and market signal.

Monitoring:
Monitoring of companies based on CO_2 data (backward-looking), carbon risk data (forward-looking) and results of interactions with companies.

Transparency & Reporting:
Transparent engagement process and reporting of our activities with the yearly engagement report.

7. Literature

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Contact Details

Finreon Ltd.
Oberer Graben 3
CH–9000 St.Gallen

+41 71 230 08 06

ralf.seiz@finreon.ch
www.finreon.ch

Dr. Ralf Seiz
CEO and founder
Lecturer at the University of St.Gallen

Finreon is an established spin-off from the University of St.Gallen and offers competent and professional services in the field of asset management und finance.

Our concepts are based on years of practical experience, combined with the latest findings in financial market theory.

Signatory of:

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