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Annie Chen

Stewarding wealth for the common good: how an Asian family office incorporated climate change mitigation into its portfolio

Katy Yung and Ivo Knoepfel
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'From an Asian perspective, climate change is not a distant threat – it is happening today. I want to make sure that the way my capital is invested is part of the solution and not the problem.'

So says Annie Chen, founder of RS Group (http://www.rsgroup.asia/) , a Hong Kong-based family office. Air pollution in Beijing, bushfires in Australia and typhoons in the Philippines underline her remarks. Consequently, RS Group incorporates climate change considerations in all its activities and across asset classes, with the dual goal of contributing to climate change mitigation and ensuring its investment portfolio is fit for the future.


Katy Yung

RS Group uses a 'total portfolio management' approach, under which all of its activities, from strategic philanthropy to capital management, support its mission of contributing to sustainable development. Since 2009, it has built a globally diversified portfolio managed by over a dozen external asset managers (typically 3-4 per asset class). At the moment, sustainable strategies make up over 70 per cent of its investments. In the coming years, legacy private equity investments will be replaced by sustainable and impact strategies, bringing RS Group closer to its goal of a 100 per cent sustainable allocation. Philanthropic capital is also used to support transformative ideas on sustainable development, especially in the Asian region, while at the same time empowering people and communities in building a more balanced, productive and just society. RS Group takes a long-term horizon (typically 7-10 years) when constructing its portfolio to achieve returns in line with its mission.

About Annie Chen

Born in Hong Kong and educated in the US, Annie Chen is the founder and chair of RS Group, her family office, which is physically housed within a broader family office shared among her parents and siblings across three generations. Since 2008, she has been working on incorporating her own values into her private portfolio through RS Group towards the goals of sustainable development.

Climate change strategy

Recognizing the importance of climate change to sustainability, RS Group sought ways in which different parts of its portfolio could contribute to climate change mitigation and adaptation. The challenge was to select measures that would lead to a tangible impact without substantially changing risk and return levels of the overall investment portfolio. The Group devised a three-part strategy:

- **Support** (invest in climate change solutions)
- **Avoid** (divest from fossil fuel-intense industries)
- **Engage** (engage with investment holdings and share experiences with the broader community)


Ivo Knoepfel

Support

'My team has found that integrating the climate change issue across the whole portfolio and across all asset classes is indeed possible and makes financial sense if you are a long-term investor.'

Philanthropy

Grants have been given to two groups, Carbon Tracker Initiative and ADM Capital Foundation, that are working on issues related to climate change globally and locally. Carbon Tracker is assessing the systemic risks of unburnable carbon for China's capital markets and raising awareness among global and Asian investors (see box). ADM Capital Foundation, the philanthropic arm of a Hong Kong-based asset manager, is partnering with RS Group to provide strategic and operational support to environmental NGOs such as Clean Air Network and China Water Risk in Hong Kong. These partnerships also provide RS Group with helpful insights that inform its investment activities and engagement with fund managers.

Carbon Tracker Initiative *(http://www.carbontracker.org)*

A UK-based NGO whose mission is to align capital markets with the climate change agenda. It aims to highlight the carbon risk in equity markets by identifying the scale of unburnable carbon on stock exchanges around the world and the implications for companies and investors. Their recently published report Unburnable Carbon 2013: Wasted capital and stranded assets shows up the mismatch between the carbon embedded in global coal, oil and gas reserves on major stock exchanges (762GtCO2) and the global carbon budget to limit global warming to 2°C (125-225GtCO2). This suggests that companies' existing valuations and risk assumptions (representing up to US$1.27 trillion in debt and US$4 trillion in equity) may have overlooked the implications of unburnable carbon. Future development of high-cost fossil fuel projects should also be reviewed to protect shareholders' interest. The report includes a list of recommendations for action targeting policymakers, financial intermediaries and investors.

Listed equity
For large-cap equity, RS Group is invested in funds such as Generation Global Equity fund and First State Global Emerging Markets Sustainability fund, which incorporate climate change risks and opportunities when selecting and evaluating companies. For small and mid-cap equity, the Group looks to specialist funds like Impax Environmental Markets fund which invests in companies that are focused on energy efficiency improvements, renewable energy use, water treatment, and recycling. Almost 10 per cent of RS Group's capital is allocated to companies developing innovative solutions to the climate change challenge, a figure that will further increase once other investments are implemented.

Private equity
RS Group is invested in a PE fund (SJF Ventures III Fund) which provides growth capital to North American companies developing solutions in energy efficiency, sustainable food and agriculture, and efficient material use. There are also investments in funds which target bottom-of-the-pyramid populations with specific social objectives. Some of their investments, for instance, are in companies that provide electricity to off-grid rural communities through affordable solar lamps and biofuel generators.

Direct investment
RS Group holds a direct equity stake in Sustainalytics, a leading independent ESG (environmental, social and governance) research provider, with the goal of supporting better investment research and good coverage of Asian companies.

Fixed income
Investment was made in corporate and sovereign bond funds (for example, Dexia Sustainable World Bond fund and LGT Sustainable Impact Global Bond fund) that take climate change into account when selecting issuers. The LGT fund also has a substantial allocation to 'Green Bonds' that fund climate mitigation and adaptation projects managed by leading development banks like the IFC.

Real assets
Investments in infrastructure and agricultural assets offer interesting opportunities to contribute to climate change mitigation while improving portfolio returns and diversification. RS Group has made a recent investment in funds-of-funds for green power generation in a range of emerging markets (mix of renewable energy and cleaner traditional energy) and in sustainably managed farmland mainly in Australia and New Zealand.

Avoid

Annie Chen: 'We are aware of the complexities around climate change especially when it comes to fossil fuel-intense industries. This is an important dialogue to be engaged in. We cannot shy away from it because it is difficult or controversial.'

Given the sustainability focus of RS Group's investment strategies, its exposure to fossil fuel-intense companies was inherently lower than the benchmark. Nevertheless, RS Group saw the need to ensure that its portfolio would not be exposed to fossil fuel producers, the sector most at risk from so-called unburnable carbon, and evaluated the possibility of completely divesting from this sector.

Three major considerations were taken into account. First, fossil fuel producers make up about 10 per cent of global stock indexes and in certain phases outperform the market. Second, some investors believe that active engagement, as opposed to divestment, is more effective in inducing positive change. Third, the fiduciary duties of boards and the time horizons of investors are often short-term, whereas the fulfilment or not of policy risks takes longer, thus making the divestment case harder to justify.

Awareness of fossil fuel risks gaining momentum
Divestment campaigns led by environmental activist Bill McKibben's organization, 350.org, have mobilized universities, foundations and pension funds to eliminate fossil fuel-intense assets from their investment portfolios. NGOs like Carbon Tracker have gained traction in exposing the financial risks of overvaluing 'unburnable carbon' within listed fossil fuel companies. This has resulted in reverberations among mainstream institutions, and prompted rating agencies such as HSBC, Citibank, MSCI and Standard and Poor's to examine this topic. Organized by CERES (a US-based sustainability advocacy group) and Carbon Tracker, 70 global investors representing US$3 trillion in assets have recently written to 40 oil, gas and coal companies urging them to conduct assessments of their exposure to carbon asset risk. Family offices like The Russell Family Foundation (TRFF) have also announced their decision to address the climate impact of fossil fuels through a multi-faceted approach including shareholder engagement, divestment, renewable energy reinvestment, and movement building.

RS Group came to the conclusion that the arguments in favour of excluding fossil fuel producers outweigh any potential risks, and therefore implemented a policy to divest from fossil fuel producers. A policy was introduced requiring a gradual reduction of existing investments and the exclusion of such companies from new investments. On a case by case basis, RS Group will consider investments in fossil fuel producers that are moving their portfolio into a cleaner energy mix.

RS Group's divestment policy towards fossil fuel producers does not, however, address climate risks related to other fossil fuel-intense industries such as building materials, utilities and transportation. Here, it relies on its investment managers to consider the issues. In addition, managers are expected to actively engage with their portfolio companies on climate-related risks and opportunities.

A closer look at risks and returns
A recent study conducted by Impax Asset Management (http://www.impaxam.com) found that removing the fossil fuel energy stocks from the MSCI World Index over a seven-year period (till end of April 2013) only increased tracking error by a modest 1.6 per cent a year and increased returns by 0.5 per cent annually. This provides a helpful point of reference for investors who are concerned that removing an entire sector could lead to significant volatility, tracking error and under-performance in equity markets.

Engage

RS Group believes that communication is critical to amplifying the impact of its activities. Investment managers are expected to actively engage their portfolio companies on climate change issues through proxy voting and dialogues when this is likely to affect the business and investment case. Many of its investment managers also participate in industry-wide initiatives such as the Carbon Disclosure Project and the Carbon Disclosure Leadership Index, aimed at improving transparency around climate risks. RS Group is also planning to discuss in depth with investment managers their approach in valuing coal, oil and gas companies in the light of the 'unburnable carbon' debate. The most important part of RS Group's engagement, though, will be with other philanthropists and investors, particularly in Asia, with the goal of motivating them to better incorporate climate change mitigation in their activities.

Conclusion

(http://www.carbontracker.org)

'I am part of a new generation of wealth holders who are concerned about the state of our commons. Our environment is our most critical commons. We hope other family offices and investors will join us in tackling these issues. We can prove to the world that asset owners may truly do good and do well, and demonstrate how it is possible to steward wealth not just for future generations but for the common good.'

Climate change will become an increasingly important issue for society and for investors. RS Group is convinced that long-term investors such as family offices can improve their investment portfolios by incorporating climate change considerations. If done thoughtfully, this is an effective way to mitigate risk, create opportunities and contribute to social goals. Results so far are encouraging: in the first three years since implementing the strategy, the financial returns of the RS Group portfolio have been in line with traditional benchmarks. Given the prevalence of Asian families who are active in their operating business, there is also great opportunity to incorporate climate change-related practices into business strategies and operations. Already, there have been some great examples of Asian companies in the shipping, textiles and manufacturing space that are re-tooling the way they run their business.

The steps taken by RS Group are only one example of how climate change can be approached on a portfolio level. Each investor will need to identify measures that are appropriate for its investment strategy and risk/return expectations. But the results of RS Group's approach have shown, as Annie Chen remarks, that 'integrating the climate change issue across the while portfolio and across all asset classes is indeed possible and makes financial sense if you are a long-term investor'.

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