

# STRATEGY & SUSTAINABILITY

NEWSLETTER

# 3

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## STRATEGIC ASSET ALLOCATION AND RESPONSIBLE INVESTMENT

In September 2017, the Research Commission of the **French Sustainable Investment Forum (SIF)** launched a working group on the **management of a strategic asset allocation** and the related subject of asset and liability management in the context of **responsible investment**, coordinated by CDC and Edmond de Rothschild Asset Management, along with a number of institutional investors and asset managers, including La Française Group. The aim of the working group was to consider the possibility of integrating the two analysis frameworks by identifying the stages in the asset allocation process in which **ESG** criteria may be applied. Initial findings on the state of play, data sources and investor expectations were revealed in 2018 and early 2019, and the final results will be presented at the **PRI in Person** conference in September.

The general framework of responsible investment is based on integrating environmental, social and governance (ESG) criteria applied to the issuers of financial instruments into the investment process, while the strategic asset allocation is a technique for maximising risk-adjusted portfolio returns by seeking diversification benefits related to the past or projected performance of each asset. How can these two approaches be reconciled? A "responsible" asset allocation can be created in two stages, by firstly incorporating ESG criteria into the investment process adopted for each asset class (equities, bonds, real estate, private equity, hedge funds, etc.) in order to obtain "responsible" exposures, and then combining these exposures using traditional financial optimisation techniques that target the efficient frontier. This implicitly assumes that there is no diversification benefit between asset classes related to ESG criteria, and that only the financial criteria are a source of diversification benefits.

Current finance research gets round the problem by quantifying the impact of ESG criteria in terms of projected financial performance to the extent that is possible, so as to bring the analysis framework within the traditional scope of finance theory. This underlies the "Climate Value at Risk" approach proposed by Carbon Delta and supported by a steering committee on the **Task Force on Climate-related Financial Disclosures in which UNEP FI and La Française Group are participants**, as well as that of the Impact Management Project, a community of investors and supranational bodies, in establishing an "impact" efficient frontier which factors the optimisation of ESG scores into the construction of a portfolio.

Regulation is also relevant in that the asset allocations of European institutional investors are subject to capital backing requirements under Solvency II. This regulation only takes into account the financial risks in calibrating capital requirements and has no regard to the risks related to ESG criteria. The incorporation of a "green supporting factor" within the regulation is sometimes mentioned, but this can be somewhat more arbitrary, and the financial quantification of ESG criteria in this regard adds an operational solution.

We will be at  
PRI in Person from  
10 to 12 Sept 2019

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# COULD LOW-TECH BE THE KEY TO A SUSTAINABLE FUTURE?

On 20 February 2019, the OID (Green Building Observatory) organised a conference in the La Française auditorium on applying the **"low-tech" movement to the real estate sector**. The conference began with a presentation by Philippe Bouix\* as part of the Real Estate & Outlooks cycle.

## Why low tech?

The conversation around low-tech is being fuelled by an undeniable truth: the depletion of resources leads to the overconsumption of energy and a vicious circle which is untenable in the long term. Mines that can be easily accessed have been exhausted, and in those currently open, the **resource concentration rates are much lower**, with ever-expanding amounts of **tech investment** and **energy required to operate them**, as illustrated by the use of shale gas.

Renewable energies, which do not run out, appear to be an answer to the growing need for energy. But the paradox is that producing, storing and processing this energy in increasingly large volumes requires resource-hungry technology, particularly in terms of rare metals.

At the same time, the **"circularity"** of the materials or objects produced and used today is very low. These resources are utilised in a **"dispersive"** way; for example plastic, as it can only be recycled a few times, and metals, because of how they are used. **High-tech** objects are made from **numerous components** that cannot be separated at the end of their lives. For more everyday objects, the problem stems from the number of different alloys used. Lastly, their use in micro or nano format makes them unsuitable for **recovery**: in the case of titanium, for example, 95% is used **in chemical form** (in paint, make up, creams, etc.).

The development of "simple" or low-tech solutions represents an opportunity to address the higher energy consumption of digital technologies. **Recycling, modularity, repairability, simplicity and restraint** are the watchwords of low tech. This allows for the involvement and autonomy of individuals, and makes it possible for communities of interests and skills to develop. The principles of frugal innovation, resilience and the circular economy are also pertinent. This is not just an issue of technology: we are talking about far-reaching societal change.

## Low-tech and real estate

The time has come for the real estate sector, which is a major consumer of resources (materials and energy), to ask itself the right questions. To reduce its impact, and use low-tech in a smart way, there are some interesting and disruptive possibilities, such as:

- **Shared use** of buildings. The building with the lowest impact is the one that isn't built, and offices are only used for around 30% of the time overall. And buildings that aren't used also have **an impact on the environment**, due to the raw materials, carbon footprint and harmful effects of artificial surfaces.
- Construction that factors in **future demolition**. Aspects such as re-use, redeployment, recycling, the circular economy, storage and the recovery of materials should be taken into account from the building design stage and need to reflect the local context.
- Build local. This means removing our dependence on the geopolitical climate by no longer sourcing from Africa, Asia or the Americas. Using **sustainable human labour** that is available locally rather than unsustainable resource-consuming machines.
- Working on resilience, to ensure the sustainability of buildings that can withstand increasingly severe **climate events**.

**As described, the low-tech movement is not a purely technical issue, but a socio-technical, organisational and cultural phenomenon.**

\* Author of: L'âge des low tech : vers une civilisation technologiquement soutenable



The more **high-tech**  
we go, the less space  
left for the **circular**  
economy



# CLIMATE VALUE AT RISK AND SCENARIO ANALYSIS: MAKING THE LINK BETWEEN FINANCIAL AND CLIMATE RISKS

On 10 May in London, around 20 investors<sup>(1)</sup> from 11 countries, including La Française, that had participated in a **UNEP FI pilot working group** on the implementation of recommendations for **climate reporting**<sup>(2)</sup> shared the results of their analysis and case studies on the impact of different climate scenarios on their portfolios. The “Changing Courses” report, [download here](#) was presented and discussed at the afternoon launch event, in the presence of 300 people and after introductory speeches from the CEO of Aviva UK Life, Angela Darlington and Sarah Breeden, Executive Director at the Bank of England.

Intended to be a tool enabling other investors to gain a better understanding of how to make **the link between financial risks and the climate**, it provides an overview of methodologies for analysing climate scenarios, then concentrates on the methods used by the pilot working group and tested by investors in order to assess **the impact of climate change on their portfolios**. It also sets out a number of case studies shared by the 20 original investors and summarises their feedback.

For La Française, participating in this working group has enabled us to remain at the cutting edge of climate finance. As investors, we are exposed to climate risks and opportunities in our portfolios, as the companies in which we invest need to adapt during this transition period towards a low-carbon economy. And measuring the resilience of our portfolios to climate change is a key and complex challenge, based on multiple assumptions that project the impact of climate change on the various companies in a dynamic and forward-looking way. This is an exercise that has so far been too difficult and therefore somewhat out of reach, as the methodologies are in their infancy and need further work.

That is why we have partnered with other major investors within the working group to share our issues and further our discussions in a structured and meaningful manner. During the test phase for the new Climate Value at Risk (CVaR) tool developed by Carbon Delta, we were able to discuss the assumptions made by Carbon Delta and, as a group, challenge them. We then used this tool to analyse some of our portfolios against various climate scenarios. Although the results still require improvement, **the Climate VaR sheds new light** on the risks to the climate by taking into account transition as well as physical risks, **by including forward-looking elements** via the patents filed by companies, and lastly, by enabling the selection – which we think is essential – of a range of climate scenarios based on projections of temperature increases of 1.5°, 2° or 3°. It is an innovative tool that will enhance our fundamental analyses, and which we plan to use in the future in managing our portfolios as one of the elements in our analysis of the resilience of companies to climate change.

We hope that the “Changing Courses” report will bring what we have learnt to a wider audience of investors who share the same concerns and serve to increase the harmonisation of corporate climate reporting, thereby helping investors.



Measuring the  
**resilience** of our  
portfolios to climate  
change is a **key**  
challenge.



(1) Addenda Capital, Afore Citibanamex, Aviva plc, Bentall Kennedy, CDPQ, CDL Group, City Developments Limited, Desjardins, DNB Asset Management, Investa, KLP Kapitalforvaltning, La Française Group, La Salle Investment Management, Link, M&G Prudential, Manulife Investment Management, Nordea Asset Management, Norges Bank Investment Management, Rockefeller Capital Management, Storebrand Asset Management, TD Asset Management

(2) Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), [www.fsb-tcfd.org](http://www.fsb-tcfd.org)

# IMPACT INVESTING

## JOIN US AT OUR INTERACTIVE EVENT – AVAILABLE VIA STREAMING

On **9 September 2019**, La Française is holding the third edition of Mix. **This is an interactive event, streamed from the La Française Blueroom**, in which experts will debate topical issues and future trends.

Impact investing will be this year's theme, to coincide with the PRI in Person conference – for which la Française is a sponsor – which takes place in September. The speakers will include experts on the subject such as Valérie Masson Delmotte (Co-Chair of GIEC) and Henri Reboullet (CEO of Vattenfall France), and there will be an introduction by Father Éric Salobir, known as "the GAFA whisperer".

**SAVE THE DATE**

**LE MIX #3**

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