

**Flash Commentary: Climate Change**

**Paris Agreement:  
Validates national and local actions**



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- We view the Paris Agreement as accelerating the ‘race to the top’ in responding to climate change. Developed countries will need technologies and business models that de-carbonize their existing economies. Developing nations will focus on technologies that drive strong economic growth and improve living standards.
- Going forward, the Paris Agreement solidifies countries’ commitments to reducing emissions and adapting to climate impacts. Transparency will spur countries to do more through social pressure while investment in innovation will drive the deployment of emissions reduction technologies.
- India and China, who were reticent to place restrictions on growth during the last negotiations in Copenhagen, have adopted the Agreement as reducing emissions now generates co-benefits by addressing serious domestic issues. China can reduce its air pollution with new low emission technologies while India can provide power to 400 million underserved consumers through solar power and storage. Understanding co-benefits is key to identifying investment opportunities, particularly in developing countries.
- Outside of the United States, where election season creates heightened risk that the next President could renege on commitments, there is little political risk that countries will abandon their pledges. Differentiation between countries and detailed understanding of climate policy is critical for investments in technologies and business models that rely on government support.

**Key points of the Paris Agreement:**

Greenhouse gas (GHG) emissions will peak as soon as possible and then be ‘carbon neutral’ (balance between GHG emissions and sinks) in the second half of this century.

Global temperature increase will be kept “well below” 2°C and parties agree to pursue efforts to limit it to 1.5°C.

Progress will be reviewed by each country and progress reported every 5 years.

Developed countries have pledged \$100 billion to aid the transition in developing countries through 2020, with further financing committed thereafter.

Source: Cornerstone Capital Group

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## Why are we bullish on the Paris Agreement?

The Paris Agreement (the Agreement) is the first globally adopted agreement on climate change since the Kyoto Protocol in 1997.<sup>1</sup> It represents a strengthening global response to climate change, and the resultant 'race to the top' on climate-related innovation will create significant investment opportunities.

The US and other developed countries, with legacy assets in energy, transport and manufacturing, have to use innovation and policy to cost-effectively transition their systems. Less developed countries will be able to roll out new technologies faster, assuming that appropriate governance and regulatory structures are in place.

Investment opportunities and risks will vary significantly by region, based on a complex intersection of priority needs, funding sources and methods, degree of government involvement and effectiveness. In our view, investments should include a focus on empowering consumers and facilitating economic growth.

While the broad consensus on the Agreement is in line with our positive view, there are detractors who cite various shortcomings. We summarize those concerns, and what we see as mitigating factors, in an appendix to this note.

### Benefits for developing economies

A clear change since the Copenhagen Agreement is the role of India and China in global climate negotiations. Prior negotiations were hampered by the countries' strong insistence that their economic growth not be curbed by a global climate response. China and India now align with other countries, including the US, on climate response because of 'co-benefits'. India and China are able to achieve their commitments under the Agreement while addressing critical domestic issues:

- China has severe air pollution issues, and low/zero emission technologies in manufacturing, transport and energy will be critical for addressing the problem.
- India recognizes solar as a key technology for cost-effectively providing electricity to 400 million consumers that the electricity grid has failed to reach or underserves.<sup>2</sup>

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<sup>1</sup> The most recent predecessor to the Paris Agreement, the Copenhagen Agreement in 2009, was 'taken note of' by delegates and was not adopted.

<sup>2</sup> "Millions of people in India have no electricity," The Economic Times, <http://economictimes.indiatimes.com/new-sections/energy/millions-of-people-in-india-have-noelectricity/lifenologyshow/41089385.cms>

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Other co-benefit investments could include food refrigeration systems that are cheap and do not rely on hydrofluorocarbon<sup>1</sup> (HFCs) for developing food supply chains in Africa, China and India. The use of HFCs has major climate impacts and food refrigeration reduces food waste in developing countries. Understanding these co-benefits will help identify investment opportunities for investors.

## Challenges for the US

The political will to adhere to the Agreement is more of a question for the US than other countries. In 1997, the US Congress refused to ratify the Kyoto Protocol and substantially weakened the treaty. While the Paris Agreement does not require ratification, it's possible that the next President will renege on the US' climate commitments. Other major economies such as China, Germany and Japan do not face this short-term political risk.

## Recommendation/next steps section

Differentiation and detailed understanding of climate policy is critical for climate related investments. These considerations were identified previously as part of Cornerstone Capital Group's [Statement on Climate Change](#).

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<sup>1</sup> HFCs, which belong to a category of substances known as short-lived climate forcers (SLCFs), have an incredibly high potential to contribute to global warming, yet a relatively short atmospheric lifetime.

## Appendix: Addressing concerns about the Paris Agreement

Concerns	Considerations
Emission reduction commitments by the 195 participating nations are voluntary	<ul style="list-style-type: none"> <li>■ Progress reports on commitments are binding; failure to report will be considered breach of agreement and could impact funding and other incentives</li> <li>■ Commitments represent the national aspirations of countries, and changes to targets could present a domestic political issue</li> <li>■ Other globally binding treaties, such as the current Doha Round of the World Trade Organization, have stalled — so voluntary agreements with compliance incentives and transparency may be preferable</li> </ul>
Five-year reporting periods are too long and do not, by themselves, incentivize emissions reductions	<ul style="list-style-type: none"> <li>■ While the mechanism of reporting remains unclear, increased transparency and frequent reporting will develop the trust across countries for further agreements on emissions reductions</li> <li>■ India and China sought 10-year reporting periods but the US led the Agreement to more frequent five-year reporting</li> </ul>
No new climate policies	<ul style="list-style-type: none"> <li>■ It is expected that the numerous policies developed over the last five years will evolve and strengthen, in addition to new policies being implemented over the next five years</li> <li>■ Recently announced policies such as US Clean Power Plan (finalized in October 2015), Alberta carbon tax (announced in November 2015), and the India-led Global Solar Alliance shows that countries and states view the commitments as real targets</li> </ul>
China and India still have rising emissions	<ul style="list-style-type: none"> <li>■ Even though India and China have committed to reductions in carbon emissions per unit of GDP rather than actual emissions, their participation is critical given their forecast contribution to emissions by 2050</li> <li>■ More urgent domestic issues such as air pollution in China and rural electrification in India can be better addressed by low or no emission technologies such as renewable and distributed energy</li> </ul>
2.7 degree target based on current commitments and an aspirational 1.5 degree target	<ul style="list-style-type: none"> <li>■ Countries have committed to reaching 2.7 degrees when a 'no commitment' scenario may have seen temperatures rise to a median of 3.8 degrees with a low probability, high risk scenario of 7 degrees</li> <li>■ If countries are able to cost-effectively track towards 2.7 degrees target, it will show that a 2 degree target is achievable</li> </ul>
Long-term targets can be reduced due to new governments and changing economic circumstances	<ul style="list-style-type: none"> <li>■ Any response to climate change has to be undertaken in the context of global economic conditions</li> <li>■ Linking the financial incentives to the targets provides a stronger link for developing nations</li> </ul>

Source: Cornerstone Capital Group



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