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RESPONSIBLE INVESTING

Why We Currently Own Tesla, and Don't Own Fossil Fuels

By: John Streur | May 26, 2022

Washington - Last week, media reports noted that the S&P Dow Jones Indices had dropped Tesla from sustainability indexes and added exposure to multinational oil companies. Seeing a global leader in the electric vehicle (EV) industry removed from a sustainable index at the same time oil companies are added, combined with Tesla CEO Elon Musk's response of a tweet declaring "ESG is an outrageous scam," caused many to raise questions about what, exactly, environmental, social and governance (ESG) investing is.

We obviously do not agree with Elon Musk that ESG is a scam. Rather, we think investors differ on how they incorporate ESG information in the investment process. They have different thresholds for how much ESG risk they are willing to assume and evaluate ESG performance based on different time horizons. These considerations also may be influenced by their views of current and future developments across companies, consumers, regulators and capital markets.

Coincidentally, just before the S&P dumped Tesla from its sustainability index, the company put out its 144-page 2021 Sustainability Report. When we examine companies, we focus on what is changing, either for the better or the worse, in the ESG performance areas Calvert prioritizes in each industry segment. We are interested in how companies are managing evolving and emerging risks, taking advantage of market and business opportunities, and addressing systemic barriers to improvement on ESG factors. In Tesla, we have seen stable to improving ESG trends.

A Clear Road Map for Improvement

Our investment conviction in Tesla stems from its leadership in EV manufacturing and signs of demonstrable improvement in its diversity, equity and inclusion (DEI) and human capital management (HCM) data, which, in turn, allows us to better assess Tesla's social risk relative to peers. Calvert believes that operational ESG performance, which includes Tesla's ability to employ the best talent to build competitive advantage, can be just as important as the positive environmental impact of Tesla's EVs.

Some of the ways Tesla shows EV manufacturing leadership include:

Innovation in EVs and Transportation

Tesla now accounts for about 20% of all battery electric vehicles (BEVs) sold globally since 2010 and is expected to account for 30% of new sales in 2022. We see its current growth plans as a key driver for deployment of massive battery manufacturing capacity that is likely to benefit the whole EV industry for decades. The company's road map calls for 3TWh of battery manufacturing capacity by 2030. For perspective, industry forecasts put global demand for lithium-ion batteries for transport at 2.8TWh by 2030.[1]

Tesla's appetite for innovative solutions comes at a price. The company's controversial deployment of its "Autopilot" system raised flags around the ESG world and among vehicle safety regulators. However, even as it rightly faces scrutiny from regulators for its handling of the investigations after multiple deaths and injuries linked to Autopilot, Tesla continues to zealously innovate in this area.

Supply Chain Risk

All EV makers need lithium, manganese, nickel, cobalt, aluminum, iron, phosphorus and oxygen in their drivetrain batteries. Some of these materials, in particular lithium and cobalt, are mined in countries that do not follow internationally recognized labor and environmental standards. This means carmakers need to carefully balance their supply chain necessities to avoid running into serious controversies with financially material impact.

For sourcing materials, Tesla developed a program based on OECD Due Diligence Guidance for Responsible Mineral Supply Chains. Under the program, Tesla uses direct sourcing of materials and direct local engagement to reduce risks. The company also relies on audits on refiners and mine sites carried out by third parties such us the Responsible Minerals Assurance Process (RMAP) standards set forth by the Responsible Minerals Initiative (RMI).

Engagement Efforts-and Results

Companies in the auto industry rely on a highly skilled workforce to bring new products to the market. Lack of recruitment and training initiatives, or a hostile work culture that lacks inclusivity and equity, may hinder R&D effectiveness, delay new product development and ruin competitive advantage. As a result, Calvert has been actively engaging Tesla on DEI and monitoring the company's involvement in controversies related to racial discrimination lawsuits, harassment and retaliation.

This engagement appears to be contributing to positive results. In 2022, Tesla started disclosing workforce diversity data in line with EEO-1 standards. This is a sign of credible improvement, as corporate transparency and metrics are cornerstones of effective human capital management.

This builds on earlier signs of progress. In 2020, Tesla launched its first DEI Impact report and expanded its human rights policy to its operations rather than just its supply chain. In 2021, it showed first signs of incorporating operation carbon reductions into its business strategy, committing to set a science-based greenhouse gas (GHG) reduction target with the Science Based Targets Initiative (SBTi). In addition, Tesla has extensively profiled its health and safety record and initiatives for the past couple of years, underlying the fact that the company has been taking some operational ESG performance seriously.

But concerns remain. Repeated racial discrimination lawsuits and harassment allegations over the past couple of years are deeply concerning, and Calvert continues to engage with Tesla and other stakeholders to affirm that the company has the right oversight and accountability mechanisms in place to improve performance.

Moving ahead, Calvert will monitor recruiting efforts and internal programs, and will continue our assessments of whether Tesla remains on a trajectory of improving human capital management, eliminating occurrences of discrimination and harassment, and fostering a work culture that is both productive and inclusive.

Our Views on Oil

A quick word on why we do not currently own the oil companies the S&P added to its sustainability indexes. Long term, we see risk above the threshold that we are comfortable with, based on our research framed by the Calvert Principles for Responsible Investing.

The risks relate to oil companies' fundamental business, which is known to contribute to CO2 and methane emissions and is exposed to geopolitical risk. The first set of factors bring product replacement risk-there is a lot of innovation and commercial development on a global scale geared to replace fossil fuel as the world's primary energy source. The geopolitical risk is due to the concentration of ownership of oil primarily in the hands of a few countries, many of which have banded together to form a cartel that can manage supply and pricing.

Although we do not directly own oil and gas exploration and production companies, we may own companies that do business with fossil fuel producers or are a part of the energy value chain. As a result, we do considerable research on the oil and gas industry, and we are respectful that several fossil fuel companies are deploying capital to mitigate carbon emissions through carbon capture systems into renewable or other lower carbon energy production strategies. We have not yet seen a strategy that lowers the long-term risks to a level consistent with our Responsible Investing strategy. When and if we do, we will most likely invest.

Bottom line: We see Tesla as a company working to strengthen ESG practices and achieving incremental yet notable progress. We believe the company must be more strategic in managing its human capital and proactive in addressing diversity, equity and inclusion issues; and we expect it to engage with investors and other stakeholders to do so.

Note: Alejandro Zamorano, Jun Goh, Kimberly Stokes and John Wilson contributed to this report.

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1. BloombergNEF's Long-Term Electric Vehicle Outlook 2021.

Investing involves risk including the risk of loss. There is no guarantee that any investment strategy, including those with an ESG focus, will work under all market conditions. Investors should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Past performance is no guarantee of future results.

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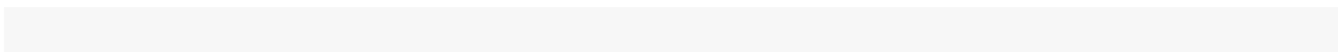
As of March 31, 2022, Calvert portfolios hold the following companies within its automobile manufacturers subindustry:



- *Bayerische Motoren Werke AG*
- *BYD Company Limited Class H*
- *Ford Motor Company*
- *Geely Automobile Holdings Limited*
- *General Motors Company*
- *Great Wall Motor Co., Ltd. Class H*
- *Guangzhou Automobile Group Co., Ltd. Class H*
- *Hyundai Motor Company*
- *Isuzu Motors Limited*
- *Kia Corp.*
- *Mahindra & Mahindra Ltd.*
- *Maruti Suzuki India Limited*
- *Mercedes-Benz Group AG*
- *NIO Inc. Class A*
- *Renault SA*
- *SUBARU CORP*
- *Tata Motors Limited*
- *Tesla Inc*
- *Thor Industries, Inc*
- *Toyota Motor Corp.*
- *Volkswagen AG*
- *XPeng, Inc. Class A*

As of March 31, 2022, Calvert portfolios hold no companies within its Integrated Oil & Gas subindustry, or within its Oil & Gas Exploration & Production subindustry.

John Streur
President and CEO
Calvert Research and Management

"Calvert believes that operational ESG performance, which includes Tesla's ability to employ the best talent to build competitive advantage, can be just as important as the positive environmental impact of Tesla's EVs."

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