CAMRADATA

Net Zero Whitepaper

8th June 2022

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Welcome to CAMRADATA's Net Zero Whitepaper

The challenge of slowing climate change is a global one. This is recognised by the growing number of actors, from the most powerful governments to the humblest firms, producing net-zero policies and milestones. While most of these policies are less than three years old, they are already beginning to have an effect on the capital allocation of companies and investors. If we think about sovereign bonds, for example, some pension funds are already mulling whether to reduce exposure to states with later net-zero target dates than the pension fund itself or its sponsor.

Then there is the ambit of responsibility. It is now possible to enact a carbon hedge using derivatives to bring a portfolio's net emissions to zero with just a few days' trading. This is an extreme, if real, example of how far an investor wants to treat their own emissions without having much impact on the real world. If they face the other way, asset owners and asset managers have a new, growing pressure to foster decarbonisation within the companies they finance. For some firms, this will be a profitable pressure as they produce the goods and services that replace fossil fuels. For others, it will mean more R&D as they reconfigure. For still others, such as coal producers, it is not clear for how long they should remain in business.

But in all three scenarios, the dialogue between capital and business will be new. Sustainability has hitherto been marginal. Now, everyone has a role to play. And thanks to greater regulatory scrutiny and obligatory disclosure, who is doing what will find its way into the public realm. This may not be wholly productive as critics nitpick over any gaps between policy and action. Nevertheless, the gap for almost all organisations between actual and target emissions is currently so wide that constructive criticism should be welcomed.

Net Zero Roundtable

The CAMRADATA Net Zero Roundtable took place in London on 8th June 2022.

The CAMRADATA Net-Zero roundtable 2022 began by asking how many organisations represented, had a Net-Zero plan in place. The Phoenix Group, the UK's largest long-term savings business with £300bn assets under management, does have such a plan. Sindhu Krishna, head of responsible investments at Phoenix, said: "We believe Climate Change is a present and material risk. We have used Bank of England stress tests to evaluate what it means for our investments. I don't think there is a company which doesn't have a negative emissions number, according to the Task Force on Climate-Related Finance Disclosures (TCFD). As fiduciaries we have a responsibility to respond to that risk in the interests of our clients."

But Krishna emphasised that this is a new risk, so how investors act will change as the journey progresses. The interim targets for Phoenix Group for 2025 and 2030 are in the public domain. "Over time, everyone will have a legal obligation to produce a Net Zero commitment," said Krishna.

For Breckinridge, senior credit analyst, Joshua Perez, said it had signed up to the Net-Zero Asset Managers Initiative. He agreed with Krishna that as fiduciaries, it was an asset manager's responsibility to address Climate Change.

"Bondholders' bottom-line is the preservation of principal," he said. "We seek to mitigate risks day in, day out." But Perez also stressed the upside to Net-Zero in terms of opportunities to generate green revenues and to identify companies that are going to benefit from providing solutions targeted towards addressing climate change.

This side of analysis looked at various criteria, including where issuers are spending their Research & Development budgets. Perez and colleagues are looking for companies providing solutions to reduce emissions globally, while also focusing on identifying companies in high impact sectors that are leaders or laggards relative to sector peers

At the portfolio level, which is always a snapshot in time, Perez said that carbon budgets and overall emission profiles are changing. He sounded a warning: "The threshold for abatement is getting harder and harder to attain. Will we be able to get emissions down to where they need to be at a feasible rate?" Perez mooted a proper carbon price as one means of effective reduction.

For Newton Investment Management, Ian Burger, head of responsible investment, said its NZC goal was published in June 2022. He characterised the process behind such plans for all organisations as "internalising the externalities... bringing that risk onto the balance-sheet."

Burger noted that we have all gone up the learning curve in recent years. He recalled the chair of a mining group in 2010 struggling to understand what was meant by the phrase 'stranded assets'.

"We are hopeful impact valuation captures the consequences not just of emissions, but of all elements of a just transition, including diversity of the workforce, social equity, green impact and the broader corporate mission."

Sarika Goel, global head of sustainable investment research at Mercer, said that the firm did have a Net-Zero commitment for the Asia and Europe investments in its discretionary business, but not yet on the advisory side. "We are working through the principles of the commitment in alignment with our corporate governance," she said. As well as the research Mercer has published over the last ten years on Climate Change, Goel said it was incorporated into its core investment principles.

As a researcher, she noted issues with some managers' approach to portfolio decarbonisation, notably hasty offloading of the heaviest emitters.

Mark Irish, deputy head of ESG research at pension fund consultancy, Isio, said there was still uncertainty in the market and whilst a large proportion of clients had already embarked on understanding their Net Zero (NZ) journey, only a handful of of Isio clients had formed a NZ target. "Our advice to clients is to understand the current position and potential journey before you make a commitment," he said. Irish pointed out that size was a major explanatory factor: some clients with relatively small portfolios of £10-£100m struggle to find the governance budget.

Isio as a business itself has not yet made a commitment, having only launched in 2020, however is currently developing its NZ strategy which it is aiming to publish by the end of the year. Irish noted, however, that Isio's Research Team is working closely with clients on achieving their Net Zero Commitment (NZC) objectives and has recently written an 80-page investment case justifying integrating a climate tilt into an equity portfolio for one of the UK's largest schemes.

Alasdair Maclay, chief funds officer at the Global Steering Group for Impact Investments (GSG), completed the opening exchanges at the CAMRADATA roundtable by examining one global brand's NZC commitment. The company is Coca-Cola, which aims to be Net-Zero by 2040. First, Maclay praised Coca-Cola because its NZC measures include Scope 3, which puts it in a minority among all companies, listed or unlisted.

But emissions capture only a few important by-products of a drinks business. Versus its biggest rival, Pepsi, Coca Cola's overall environmental impact is far less sustainable according to the data published by Impact-Weighted Accounts Initiative. Maclay suggested that for enterprises wanting to be best-in-class, there had to be awareness of more than just emissions data among internal and external stakeholders.

He suggested that measuring impact holistically, relevant to each industrial sector but by globally accepted standards, would be the role of the embryonic International Sustainability Standards Board (ISSB). The G7 Impact Taskforce (ITF) was a project created by the UK in its 2021 presidency of the G7 countries to progress impact transparency and trail the way to impact valuation.

"We are hopeful impact valuation captures the consequences not just of emissions," said Maclay, "but of all elements of a just transition, including diversity of the workforce, social equity, green impact and the broader corporate mission."

Treading a new path

The CAMRADATA panel then discussed how to better understand the process of decarbonisation and how to manage investments accordingly.

Krishna said that for a small inhouse sustainability team, platforms have been useful to share ideas and questions.

"No one has gone down this path before so the more sharing, the better," she said, naming IIGCC as a most helpful forum. Phoenix joined IIGCC in 2019 and was one of five members to trial an assessment of carbon intensity of real portfolios against a model, multi-asset portfolio. "This was the how, not the why," she explained.

As a large asset owner, current teething problems include a lack of standardisation among third-party asset managers. Krishna said the situation was probably worse for smaller firms. She said it was great that managers developed proprietorial methodologies but that left asset owner clients to synthesie the results and relate the data to their own NZC commitment. She hoped that regulators could do more to standardise methodologies and reporting.

“Overall, Mercer was sceptical about blunt mechanistic approaches that do not take a more holistic approach incorporating integration and stewardship.”

Perez said the question was: how you are going to get to the end goal? “NZC changes your approach to investing,” he told the CAMRADATA panel. “Breckinridge continues to incorporate material ESG data but we are now more proactive in terms of driving for improved climate disclosure, goals and ultimately execution against company stated targets. What do we want out of these companies? There is a drive for a collaborative approach with issuers.”

He too praised IIGCC’s guidance: “It makes us more comfortable that there is a reputable framework for managing to Net Zero over the long term.”

In response to Krishna’s comment on the variety of managers’ responses, Perez agreed that there are numerous ways to calculate and report but he felt that that was ultimately a good thing because “best practices will surface over time.”

Breckinridge is an asset manager with its own proprietary framework. Perez also championed the Partnership for Carbon Accounting Financials (PCAF) as the gold standard for accounting for portfolio financed emissions, further adding that Breckinridge uses the 50% Fair Share guide from the Glasgow Financial Alliance for Net Zero (GFANZ), which recognises that some sectors are easier to decarbonise than others and therefore allows managers to invest broadly and engage. “Otherwise, you get portfolio decarbonisation but not real-world decarbonisation,” warned Perez.

Goel agreed on the variability of approaches taken by managers. “Some make commitments first and then think about implementation,” she said. “We have some managers doing both.”

She noted that some have less than 10% of assets under management committed to NZ. Goel said that Mercer’s preference was to assess asset managers not just with regard to particular strategies but at the level of the organisation itself to understand how they undertake climate stewardship.

She said that practices such as selling out of high emitters to achieve very rapid decarbonisation was one that merited further explanation. Conversely, there were strategies with higher-than-average intensity that made a feature of active engagement with companies on their transition targets. She said overall, Mercer was sceptical about blunt mechanistic approaches that do not take a more holistic approach incorporating integration and stewardship.

Elsewhere were to be found managers seeking value by selling out of lower-emitters to locate outperformance elsewhere. What mattered to Goel here was clear policies on engagement and a consistency of philosophy.

Burger endorsed the need for action. “Climate change is a known systematic risk,” he said. “It’s no good in 10 or 20 years complaining to board directors about their policies of 2022.”

He was adamant that engagement has a role to play. “A lot of investors ask what is our explicit engagement policy?” he noted. He said that managers had to be transparent in explaining what they are doing and to what effect. “Hiding behind engagement without substance is dangerous,” he said. And likewise, ardent campaigners can challenge target companies but if their goals for change are not realistic, then it is wasted engagement, according to Burger.

Burger cited the efficacy here of the Transition Pathways Initiative to figure out how decarbonisation might in practice occur. Newton also uses a scenario factor of carbon pricing at USD140 a ton to stress how different companies will fare as externalities get properly priced in. But Burger emphasised that USD140 per ton was a measure for understanding company plans, not a stick with which to beat them.

On researching managers’ portfolio decarbonisation plans, Irish said he was cautious about going to an asset manager and telling them to use one set of standards if they are already using another. Instead, the Isio approach is to understand how the manager is using various frameworks to feed into their investment process. Irish said that different users may value different Net Zero initiatives. For example, clients often favour the Science-Based Targets Initiative (SBTi) when analysing corporate investments.

However, he suggested that for consultants, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) provides a useful tool for understanding Net Zero pathways, i.e an orderly transition versus disorderly transition could have a massive effect on the financial outcomes for clients.

At this point, Burger noted that research by Climate Action Tracker in the midst of the Glasgow COP-26 summit that 73% of Net-Zero plans were inadequate. He asked the consultants and asset owners at the CAMRADATA roundtable how they worked with managers in order to achieve their targets.

“Will standards take away managers’ edge?”

Krishna said she was more for reporting.

Perez said Breckinridge’s model has fourteen climate related metrics for prospective issuers. One metric was whether a company has SBTI targets. He said that was indicative of a company that has outlined strong commitments for emissions reductions although he noted that SBTi did not require companies to reapply on a yearly basis and that an SBTi approved target alone is not enough to determine if a company is indeed aligned towards a Net Zero pathway. To avoid a checkbox approach of simply screening companies for SBTi approved targets, Breckinridge scrutinises issuers on their prospective goals, strategy to achieve their decarbonisation agendas and ultimately on their execution against these goals over time.

Krishna was then asked whether Phoenix had studied whether mitigating the risk of Climate Change in its portfolios had had any effect on its cost of capital. She responded that it had not. She did say, however, that it was increasingly seen as an industry standard to incorporate ESG considerations in investment. “If it doesn’t work for Phoenix, it can’t work for others,” she said. “Either way, there will be industry consensus.”

Maclay then returned to the theme of the totality of social impact in a Just Transition. He raised the issue of coalmining in South Africa, an activity red-lined for its carbon emissions but one that employs over 100,000 people and indirectly supports over two million people. “When you consider the role in society of these activities, it makes evaluation more complex,” he said.

Regarding the choice of standards, Maclay believed that GFANZ was bringing people together on more aligned metrics. He wondered, however, where the balance between healthy competition and standardisation lay. “Will standards take away managers’ edge?” he asked.

On the possibility of cost-of-capital reduction for companies, Maclay pointed to the $1trillion issuance last year of Sustainability-Linked Bonds (SLBs). “That is capital based on environmental outcomes,” he said.

Maclay accepted that there were elements of “smoke and mirrors” in some of the terms set “but fundamentally they are results-based.”

Maclay asked the other CAMRADATA panellists whether they saw more opportunities for SLBs and where they saw that market headed? Perez answered that the more specific the KPIs, the better. He reckoned that the criteria were often too easy to achieve and in tandem the step-up criteria, by term and size, were not punitive. However, he saw that as the market for SLBs grew, investors would become more discerning about issuing companies and their terms.

Irish contrasted SLBs with private investments, where he saw more back-to-back negotiations with companies. He agreed with Perez that the terms to SLBs had to be meaningful, both from a sustainable and financial perspective. He urged proper evaluation, including versus non SLB issuance. “Are we fulfilling our fiduciary duty to get a better deal?” asked Irish.

Who’s helping you?

The CAMRADATA panel were asked which organisations or groups helped them formulate and achieve their Net-Zero transition.

Krishna, who had already praised IIGCC, mentioned the Association of British Insurers.

Perez mentioned CERES, Climate Action 100+ and IIGCC. Burger

mentioned the Consumer Goods Forum in the UK as well as the Responsible Investment Network, which he co-founded almost two decades ago.

Irish highlighted concerns related to the European Union's Sustainable Finance Disclosures Regulation (SFDR). He felt that SFDR has potentially gone somewhat against its original purpose – to prevent greenwashing in financial services – by leaving such a wide spectrum of interpretation, notably for Article 8 categorisation. Mark hoped that the incoming UK SDR will help eliminate this uncertainty for UK investors.

This led to a debate about understanding labels and parameters. Perez noted that the first movers in ESG in the US were mission-based organisations that often request customised mandates. But as ESG mainstreams, more pooled products abound. He noted that as in Europe, the regulator in the US (SEC) is beginning to crackdown on greenwashing.

Krishna said that ESG labels were going broadly in the right direction. "At Phoenix, we are going down the pathway of disclosure. If managers make a claim, we want them to evidence it."

She said the key question for asset managers was whether the ultimate client, the woman in the street, would understand their actions?

Maclay said that he was an investment professional but would score his own personal pension provider "one out of ten" for its information disclosure on ESG, which he described as opaque.

Burger agreed that there was a lot still to be done on reporting. The one observation he did want to make is that there is a danger of managers being scrutinised – and possibly punished – on a line-by-line basis. His fear was that regulators were looking for 'sin stocks' rather than evaluating strategies for their holistic character. That could have unintended consequences for managers actively engaging with companies nearer the start than the end of their decarbonisation journey.

Goel agreed with Krishna that the intentions behind labelling are good. She clarified, however, that Mercer doesn't see categorisation such as Article 8 or 9 under SFDR as necessarily signifying a superior strategy.

Goel responded that managers determine the SFDR classification of their funds but in manager research at Mercer, SFDR classification wasn't commented on. Instead, Mercer has ratings of 1 to 4 for ESG integration. These are distinct from its traditional manager ratings of A to C.

Irish added that many Isio clients, typically UK based, do not know what SFDR Articles 6-9 means.

The CAMRADATA discussion on the path to NZC concluded with thoughts from Maclay that great progress has been made in the last couple of years. For the near future, he believed that disclosure is the most important and valuable tool at our disposal.

> ***"At Phoenix, we are going down the pathway of disclosure. If managers make a claim, we want them to evidence it."***

Roundtable Participants

Breckinridge
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Joshua Perez, CFA

Senior Research Analyst

Personal Profile

Josh is a senior research analyst at Breckinridge. He is also a member of the firm's Sustainability Committee. In his role, Josh performs corporate credit analysis. Josh joined Breckinridge in 2018 and has over 11 years of industry experience. Prior to joining Breckinridge, he worked at Sun Life Investment Management as a director in public fixed income credit research, where he was responsible for the energy sector. Josh also held various positions at Sun Life while participating in the company's rotational leadership development program, including roles in investment product marketing and credit analysis. Josh received his undergraduate degree in corporate finance and accounting from Bentley University. He is a CFA® charterholder and is an FSA Credential holder.

Company Profile

Breckinridge Capital Advisors is a Boston-based, independently owned asset manager specializing in investment grade fixed income portfolio management.

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Reflecting our commitment to ESG and sustainability, Breckinridge is a Massachusetts Benefit Corporation.

Roundtable Participants

Ian Burger

Head of Responsible Investment

Personal Profile

Ian is the head of responsible investment at Newton. He is responsible for integrating ESG considerations throughout our investment process, for our approach to stewardship and for implementing our sustainable investment process; he is a member of Newton's Responsible and Ethical Investment Oversight Group.

Ian is involved in shaping the debate on ESG matters through his membership and participation in various groups such as co-chairing the GC100 and Investors Group, being the chair of the International Corporate Governance Network, as well as a member of the UK Pension and Lifetime Savings Association's Stewardship Advisory Group and member of the IFRS Advisory Council.

Ian is a Fellow of the ICSA: The Chartered Governance Institute, a charity trustee and received the ICSA President's medal at the institute's 125th anniversary.

If Ian isn't on the side-lines supporting his children's sporting activities, he can often be found either hiking up a mountain, paddle boarding in the English Channel or attempting to keep pace cycling with his children.

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Company Profile

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We seek to understand the 'mosaic' (full picture) of each investment candidate we assess. Our investment platform harnesses both fundamental and quantitative research, which incorporates ESG analysis and is underpinned by a thematic framework. We also aim to drive positive change through voting and continuing engagement with companies.

www.newtonim.com

Alasdair Maclay

Chief Funds Officer

Personal Profile

Alasdair is the Chief Funds Officer at the Global Steering Group for Impact Investment (GSG, www.gsgii.org). He is responsible for all fundraising and donor relationships for the GSG, and supports the fundraising for the National Advisory Boards, Outcomes Funds, and other policy and product initiatives.

He was seconded for 2 years as Chief Strategy Officer at the Education Outcomes Fund (EOF, www.educationoutcomesfund.org). He was responsible for strategy and all donor, outcome funder, and impact investor relationships for EOF.

Alasdair was the Director of Strategy & Development at the Rhodes Trust from 2014-2019, leading on over £300m of philanthropic fundraising, with a focus on the expansion of the Rhodes Scholarships into new geographic regions, including West and East Africa, the Middle East, China, and South East Asia, and building strategic operating partnerships with aligned organisations.

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Driving real impact

Mark Irish, CFA, CAIA

Deputy Head of ESG Consulting

Personal Profile

Mark is a Consultant in the Investment Advisory team at Isio, where his focus is on developing and delivering investment advice to Isio's clients. Mark is also Deputy Head of ESG Consulting as part of Isio's ESG Research Team whose focus is on strategic ESG considerations and funds that explicitly integrate ESG into the investment process.

Mark joined Isio in November 2020 from Willis Towers Watson and has experience in advising UK institutional investors on all aspects of their investment arrangements.

isio.

Roundtable Participants

Sarika Goel

Global Head of Sustainable Investment Research

Personal Profile

Sarika is a Principal in Mercer's Wealth Business and Global Head of Sustainable Investment Research. She leads on building and expanding research coverage of SI investment strategies across asset classes, including those aligned to the UN Sustainable Development Goals, climate transition and other stewardship themes. She also leads on ESG research and integration across asset classes, working with other manager research boutiques to assess how asset managers are integrating ESG into their investment decisions. Sarika is a member of the Strategic Research Group and responsible for intellectual capital focusing on implementable solutions in sustainability themes.

Prior to joining Mercer in 2010, Sarika spent three years at RBC Wealth Management in London within the Advisory and Discretionary business groups. Previously, she spent two years as an equity research associate at Scotia Capital in Toronto, Canada, covering the Canadian Banks and Diversified Financials sectors.

Sarika holds an MBA from the Rotman School of Management, University of Toronto, and is a CFA® charterholder.

Mercer

Sindhu Krishna

Head of Sustainable Investments

Personal Profile

Sindhu Krishna is the head of Sustainable Investments team at the Phoenix Group, and her team is responsible for integrating ESG considerations within the investment portfolios of the Group.

She has been part of the Group for over nine years having held various investment team roles and prior to that, she worked within investment teams at Zurich Insurance Group. Sindhu is a CFA charter holder and also holds an MBA from Warwick Business School.

Phoenix

Moderator

Brendan Maton

Freelance Journalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.
Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles.

Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE. Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

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THE BRECKINRIDGE NET ZERO APPROACH

Our mission is to facilitate a sustainable flow of capital from long-term investors to responsible companies and municipalities. Being a signatory of the Net Zero Asset Managers initiative (NZAMi) is consistent with our mission and our pursuit of deeper insights of investment risks as they evolve. We believe that climate risks are mispriced in the markets and our net zero frameworks enhance our ability to assess climate-related risks and identify investment opportunities.

Breckinridge offers customizations in accordance with the goals of investors seeking to transition corporate bond holdings to net zero greenhouse gas (GHG) emissions by 2050 consistent with a maximum temperature rise of 2 degrees or less.

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Corporations Sign Net Zero Pledge, But Can They Back It Up?

Authors:
Joshua Perez, CFA
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There's a lot of buzz about net zero carbon emissions and net zero pledges. This article explains what net zero is and how Breckinridge Capital Advisors monitors progress as companies pursue a pathway to towards net zero.

Net zero emissions refers to the goal of not adding to the greenhouse gases (GHG) that have been emitted already into the earth's atmosphere. By making a net zero pledge, a company commits to reducing its GHG emissions to as close to zero as possible by 2050 and to offset any remaining GHG emissions using negative emissions technologies and carbon-credits, for example.

The net zero campaign stems from the 2015 Paris Agreement, an international treaty on climate change. The overall goal is to stop global warming from exceeding 1.5 degrees Celsius above that of preindustrial levels. Considering that global temperatures have already risen to 1.1 degrees Celsius above that level, this has become a priority of the world's political and corporate leaders.
Growth in Companies Announcing Net Zero Goals

A growing number of companies have publicly endorsed the Paris Agreement by setting net zero goals of their own. The Net Zero Tracker (NZT), an academic and nonprofit-led initiative, is monitoring the world's largest 2,000 companies for their GHG emission reduction goals. NZT determined that 717 – or 36 percent – of these companies have set a net zero goal in March 2022, up from 21 percent in March 2021.1

In addition, some of these companies have signed on to the Climate Pledge, an initiative started by Amazon Corp. The 312 signatories promise to achieve the more ambitious goal of net zero carbon emissions by 2040.

These companies have committed to:

- Measure and report their GHG emissions regularly
- Implement decarbonization strategies in line with the goals of the Paris Agreement
- Neutralize any remaining emissions through quantifiable carbon offsets.

Highlighting the need for transparent and consistent reporting

The net zero pursuit by companies is also attributed to their management teams' growing recognition that climate transition risk is a material ESG issue. Moody's forecasts that companies that proactively transition to a net zero business model over the next 10 years will cut their probability of default by 50% versus companies that postpone or are hesitant to act. As a result, we may consider the commitment to a net zero pledge as a credit positive. However, it is important to note that a net zero pledge represents a very ambitious and aspirational undertaking. Many companies express a commitment to reduce emissions by a set amount, yet they may lack transparency in how they intend to achieve their stated goals. There is also inconsistency around emissions reporting.

From an investment analysis perspective, it is important to not just disclose emissions reductions targets but also validate them, for example by an organization such as the Science Based Targets initiative (SBTi).

Only roughly one-third of organizations that have disclosed emissions reduction targets are validated as credible by the SBTi, according to the CDP's 2021 Climate Transition Plan report. Further, only 6 percent of all reporting organizations disclosed details of a net zero target.

> ***"The goal is to understand the ability of corporate bond issuers to achieve their net zero goals, because we view GHG emissions as a material risk to the long-term financial performance and viability of companies in many sectors."***

With so many companies signing the Climate Pledge or publicly announcing their goal, it is uncertain whether they all know what their commitment entails. Certainly many Climate Pledge signatories are genuinely on board in their commitments. From an investment perspective, however, it is necessary to take a cautious view.

Scope 3 emissions are critical

A particular challenge for many companies is how to reduce scope 3 emissions, which lie outside of their control. Scope 1 are direct emissions and scope 2 are indirect emissions from the generation of purchased energy. Scope 3 are all indirect emissions stemming across a company's value chain, from upstream sourcing of raw materials to downstream use of a company's products or services.

To achieve net zero goals, companies must reduce emissions through their entire supply chain, source less energy-intensive raw materials, and/or develop products that have fewer use-phase emissions.

Although there is no uniform disclosure standard in the U.S., the vast majority of Fortune 500 companies follow the standards outlined by the Greenhouse Protocol. Emissions reporting must be scrutinized based on those metrics.

Further, on March 20, 2022, the U.S. Securities and Exchange Commission proposed mandatory climate disclosures for public companies that outline material climate-related risks, the threat these risks pose to a company's bottom line, and what management and company boards are doing about it. If the rule moves forward in its current state, firms will also have to calculate their carbon footprints using the GHG Protocol Corporate Standard and have the estimates independently verified.

Decarbonizing effectively requires lower cost curves for existing alternative emissions technologies and for the development of new financially viable negative emissions technologies. For example, Morgan Stanley estimates that a price on carbon of $60/ton CO2 to $150/ton CO2 for Carbon Capture & Storage (CCS) to be economical, this compares to tax credits for captured CO2 of $50/ton in the US and $35/ton for CO2 sequestered through enhanced oil recovery. This illustrates that a higher price on carbon is likely needed to incentivize further CCS investment.2

Other technologies, such as hydrogen and energy storage, will also need to see their cost curves decline to become viable replacements for existing fossil fuel energy sources, so as to reduce GHG emissions.

Breckinridge is committed to accountability

Breckinridge Capital Advisors is monitoring net zero progress among corporations through its Climate Transition Risk framework, which combines quantitative and qualitative analysis to assess the long-term potential of a bond issuer to achieve a net zero outcome. Our engagement with corporate bond issuers is an integral aspect of our qualitative process.

The goal is to understand the ability of corporate bond issuers to achieve their net zero goals, because we view GHG emissions as a material risk to the long-term financial performance and viability of companies in many sectors. Maintaining an objective, detailed assessment as to what companies are doing to back up emissions reduction pledges with tangible progress is an integral component of our security research process.

1. Shetty, D. (2021, March). A Fifth of the World's Largest Companies Committed to Net Zero. Forbes. Retrieved from: https://www.forbes.com/sites/dishashetty/2021/03/24/a-fifth-of-worlds-largest-companies-committed-to-net-zero-target/?sh=4a0a3b67662
2. Morgan Stanley April 2021 report, "Carbon Capture: A hidden Opportunity."

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For more information, please visit the Net Zero Asset Managers Initiative website here.

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Finding Net Zero

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Under most current scientific projections around climate change, it is anticipated that global carbon emissions will peak around 2030, at a level that is around 16% higher than it is today, as the growth of emerging markets outstrips the reductions in emissions made by developed markets. This path is at odds with what most scientists agree is needed if we are to limit the worst effects of rising global temperatures.

On a historical and cumulative basis, we know that the modernisation of the Western world has caused the majority of emissions, but from a forward-looking perspective, the population and wealth growth in emerging markets is where much of the future concern lies over efforts to limit and reduce emissions.

> ***"Balancing the improvement of living standards in countries in Asia and Africa with a reduction in carbon emissions presents a significant challenge over the next two to three decades."***

As wealth increases, people buy increasing amounts of energy-hungry items – from fridges to cars. While some of the energy required to support those goods will come increasingly from renewables, we expect that the bulk will continue to be derived from fossil fuels, at least over the next 10-20 years. Thus, while the burden of historic emissions lies with the developed world, balancing the improvement of living standards in countries in Asia and Africa with a reduction in carbon emissions presents a significant challenge over the next two to three decades.

In terms of government targets around limiting emissions, there are wide discrepancies between the scope of targets across the world and the cost involved in executing the energy transition, making it difficult to determine how net-zero targets will ultimately be met. We think it is helpful to draw out some of the milestones for hitting net zero in a more tangible way.

The International Energy Agency (IEA) recently released a 'net zero scenario' which sets out some of the necessary (and quite radical) conditions it believes will be necessary to achieve net zero in the most cost-effective way. Several key points stand out:

- No new oil and gas fields or coal mines to be approved
- Electric vehicles (EVs) to make up 60% of the global market by 2030
- Net-zero electricity to be achieved globally by 2040

The present-day reality is somewhat different: EVs currently represent around 9% of new car sales and clean energy supplies around 35% of the grid globally, but these are at least areas where progress is being made; we are aware that in areas such as cement, shipping, long-distance aviation and trucking, for example, many of the technologies required to produce effective, affordable and scalable solutions don't yet exist.

So, while it is feasible to bring the IEA's ambitious goals forward, this will not happen without a better regulatory framework. On its own, a purely market-based transition could take much longer under collective government goals currently in existence.

High cost of the transition

The transition to a low-carbon energy scenario also requires significant investment. The world currently spends around $2 trillion per year on its energy system, and economists estimate that it will require around $4 trillion of annual investment to achieve net zero, significantly more than current levels of investment. When weighed against annual GDP, the cost for the US alone has been estimated at around $1.6 trillion.

This scenario is also adding to current inflationary headwinds: over the last five years we have seen reduced investment in fossil fuels, while commensurate reinvestment in low-carbon substitutes has not occurred (at a time when the volume of fossil-fuel operations has continued to grow).

At Newton, we are trying to play our part. As we seek to invest and engage with companies that we believe are demonstrating a genuine commitment to re-

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al-world decarbonisation, we believe it makes sense to reject the idea of a linear reduction target, as we anticipate that the path to net zero will be uneven and anything but linear. With this in mind, we have joined the Net Zero Asset Managers initiative, and have aligned ourselves with an independent methodology produced by the Science Based Targets initiative (SBTi).
This involves a commitment to aim for an interim target of 50% of the financed emissions from the investments we make on behalf of our clients to be covered by credible net-zero transition plans by 2030, and 100% to be covered by 2040.
We will seek to meet these headline targets via a range of transparent measures around investments in climate 'solution providers', engagement with fossil-fuel companies to support their energy transition, and active stewardship activities.
We believe in the SBTi methodology for two key reasons:
1 – It focuses on the future and on corporate strategies seeking to reduce carbon emissions, rather than using backward-looking measures.

2 – It forces us to focus on real-world emission reductions rather than superficial portfolio decarbonisation. This leads us to engage more often with companies in the energy sector, and in emerging markets, where capital is most urgently needed to help the transition to net-zero carbon emissions.

What else is Newton doing?

While the 2030 and 2040 milestone targets might still seem some way off, we are making investment decisions today that we believe will aid our progress along the way. First, we are stepping away from areas we deem to be unacceptably risky, such as new coal mines, new coal-fired power stations, and speculative or high-cost oil projects. These are also areas carrying the highest regulatory risk, as well as being at greater near to mid-term risk of substitution by cleaner energy sources.
We are also focusing on selective, well-managed opportunities around energy-transition metals like copper, EV infrastructure or supply chains, and clean energy.

Just because something is 'green' doesn't necessarily make it a good investment, but we expect to see a growing number of investment opportunities in the energy-transition area over the coming months and years. If a company is well managed, executes well and operates in a stable regulatory environment, we think it is more likely to offer greater green-growth opportunities in the future. Moreover, by investing in and engaging with such companies, asset managers can play a key role in the energy transition.

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