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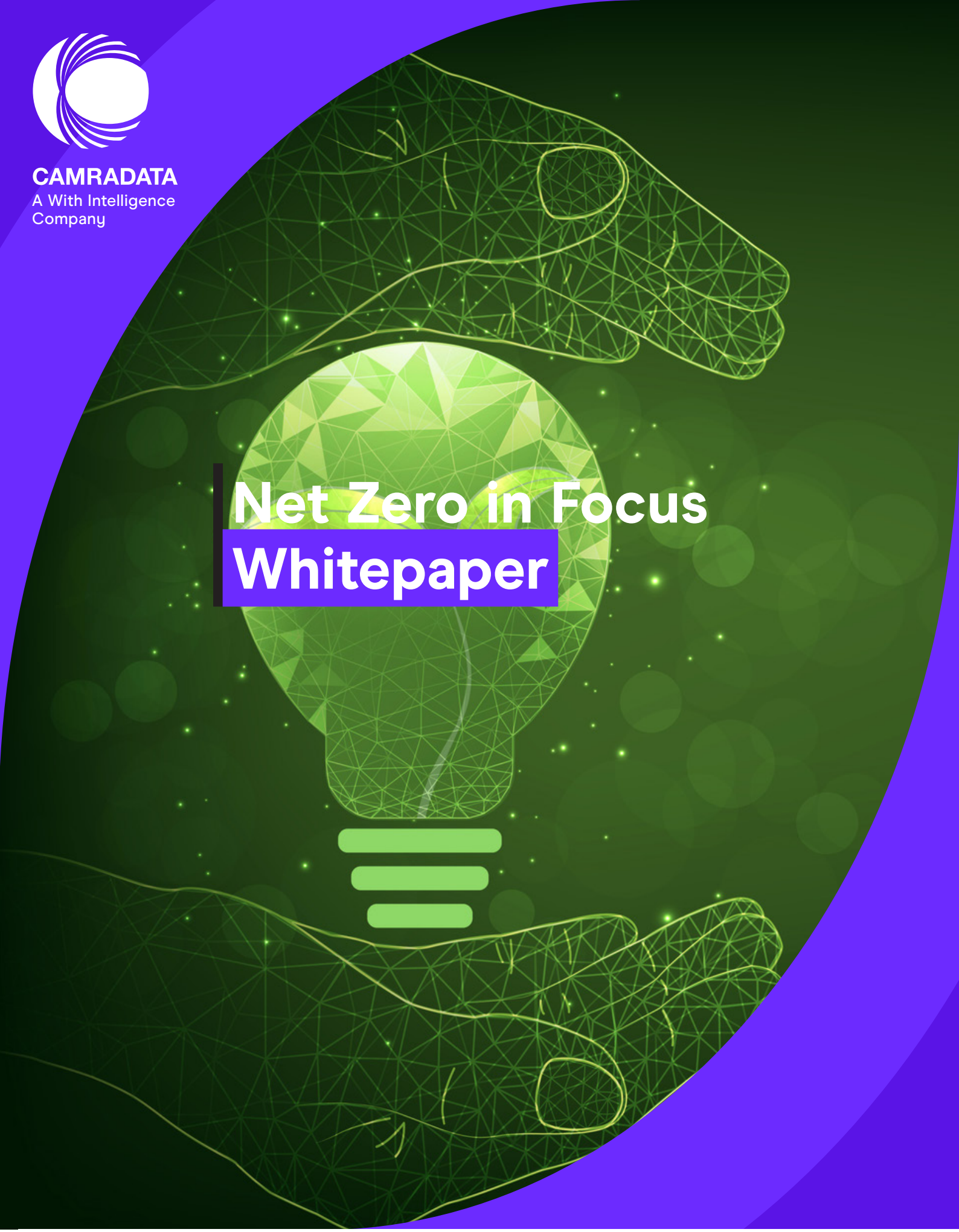

Net Zero in Focus Whitepaper

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Welcome to CAMRADATA's Net Zero in Focus Whitepaper

The term "net zero" has entered the modern business lexicon over the past few years, spurring companies, investors and funding facilitators to consider its impact and implications on their strategies.

Yet, a net-zero ambition on its own solves few climate change challenges while creating issues around fiduciary duty for investors.

Having a net-zero portfolio does not guarantee a net-zero world, nor does it effectively steer the investor towards any certainty of positive financial returns over any time period.

Instead, engagement, stewardship and cooperation, along with a grasp of the technical difficulties surrounding a just transition need to feed into strategic investment theories and practice.

As innovation advances, leading to complex negotiations on raw materials, workforce challenges and outsourcing of emissions, politicians are also getting in on the net-zero act and bringing their own interjections on the matter.

With such an array of choices, obstacles and an unclear path to what net-zero looks like – if it can ever be achieved – where should institutional investors start?

In this whitepaper we will unpick the opportunities and attempt to offer solutions for myriad challenges that accompany a complicated route to our future.

Meet the Team

Natasha Silva
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Net Zero in Focus Roundtable

The CAMRADATA Net Zero in Focus Roundtable took place in the late summer of 2024

Around a decade ago, sustainable or environmental, social and governance (ESG) investing were both relatively niche and simple to execute. Excluding so-called 'bad' companies earned the badge of being a 'responsible' investor for a long time.

Now, dovetailing investment with the explicit and pressing issue of climate change has become an increasingly complex challenge as the theme shifts across investor types, asset classes – and motivation.

For example, there is a growing belief that superior long-term returns can be earned through engagement around business models that are out of step with a climate-change-led agenda. This belief is infiltrating investment strategies of all sizes and types and leading to new methods of portfolio construction.

Furthermore, there is a growing acknowledgement that having a 'clean' portfolio doesn't necessarily have a real-world impact; just because some investors don't own an oil company, it doesn't prevent those firms from existing.

Essentially, as the CAMRADATA Net Zero in Focus Roundtable discussed, the ESG investment trend, like many others before it, has evolved to become a multi-faceted discussion.

"We've definitely seen a shift," said Jordan Griffiths, senior sustainable investment consultant at Barnett Waddingham.

"Net zero is not just about investing and leaving it; investors are now more conscious of what is happening beyond emissions and appreciate how the topic is evolving, looking at the risks and opportunities not just from an emissions standpoint, but also the real-world impact of social and environmental factors."

Active engagement

The concepts of stewardship and engagement were discussed at length by the participants, who noted that investment firms can use their capital to encourage businesses to change for the betterment of the planet, and potentially investor returns.

> ***"We can have a low-carbon portfolio, but is it risk-free from a climate perspective? I think we need a more innovative way of looking forward, and I think behaviour is being driven by regulation which doesn't necessarily consider climate holistically."***

Reference was made to companies like the oil majors, such as BP, which is shifting towards becoming a broad-based energy company with growing renewable businesses.

A dominant view in sustainable investing now recognises that investment across the broader economy is required to achieve an energy transition. It also recognises that just because a company may be a high emitter today, it may have a very positive, forward-looking, sustainable profile – for example, a utility that is shutting down its coal-fired generation and replacing it with renewable sources.

Several participants also stated that some high carbon emitting sectors were arguably fundamental to the success of greener technologies, such as mining firms being vital in supplying the likes of cobalt to the electric vehicle battery sector.

"Rather than just excluding companies or entire sectors, we can start using a forward-looking approach on our investment universe and think about how we can aid the transition to net zero," said Maria Elena Drew, director of research, responsible investing at T. Rowe Price.

"Some of our clients that set fossil fuel exclusions or greenhouse gas emission reduction targets when they started investing sustainably have recognised the shortcomings of doing that, but it was their only option when they began."

She added that she did feel there had been a "step-change" and that she was now having lots of discussions with clients about how to implement their sustainability and climate-related goals – especially with a focus on forward-looking targets.

But some felt not all managers or clients had shifted their approach far enough.

"I feel there is still a carbon tunnel vision, and the focus has not shifted sufficiently with the obsession on reporting and data, but not using that often or well enough to make investment decisions," said Sarita Gosrani, director of ESG and responsible investing at bfinance.

"We can have a low-carbon portfolio, but is it risk-free from a climate perspective? I think we need a more innovative way of looking forward, and I think behaviour is being driven by regulation which doesn't necessarily consider climate holistically."

Moving target

Gosrani added that focusing too much on a single target could become problematic for fund managers and asset owners, especially if they decide to alter that aspiration at a later date.

"You could argue that portfolio net-zero goals are at odds with real world change," she said.

This was echoed by Oliver MacArthur, impact research lead at Aon.

"The recent momentum in signing up to net-zero

targets has been significant, but often the risk-return perspective and the constraints that such targets create on the portfolio given market shift, could be more thought through," he said.

"Interim reductions on the way to net zero by 2050 are going to have to be rethought in the context of the energy crisis and the Ukraine war.

"This means that perhaps the discussion needs to move from net zero to one more focused on the climate transition, which is very much the narrative within various bodies including COP (Conference of the Parties); it's about moving away from a top-down linear decarbonisation to a more pragmatic focus on real world outcomes that is adaptive over time."

Ryan Allison, senior climate investment risk manager at Phoenix Group, agreed with this assessment, acknowledging that his firm continues to review progress against its targets.

"We set our targets in 2020 and we're continuing to keep progress towards them under regular review, to inform the actions we need to take," he said.

"We are getting very close to our 2025 target now and we believe we are on track to achieve it under most scenarios, however how likely we are to achieve our 2030 target is currently less certain.

"We recognise we need the right policy and regulatory environment to achieve our 2030 target, and that we will be significantly more dependent on action by others such as governments and high-emitting sectors."

Supportive frameworks

Participants agreed that regulatory requirements or industry frameworks could help set a baseline for the fund management industry, and improve sustainable investing to a new, higher standard.

Reference was made to the likes of the Paris Aligned Investment Initiative (PAII), which has a new net zero investment framework – or NZIF 2.0 as the organisation calls it.

As the Paris Aligned Asset Owners website says itself, net-zero strategies are "more likely to be more effective when they simultaneously address the external environment", which can either facilitate or inhibit investor activities.

"This dynamic interaction among all elements highlights the necessity of a comprehensive and integrated approach to achieving net-zero goals," it added.

Participants at the roundtable welcomed initiatives like this and stated that regulation had an important role to play.

Barnett Waddingham's Griffiths said there was a "big role" for regulation to play, as it sets a minimum standard, gets sustainable investing firmly on the agenda and nurtures discussions about its risks and opportunities.

"Regulation is really critical," Alex Quant, head of ESG research at XPS Investment, added in support to that argument.

"Top-down intervention has to play a bigger role, because the government wants capital markets to be a driver for change.

"But ultimately, investors only operate within the guardrails of how the economy is shifting, especially those who are more reticent, because if they don't feel the transition risks coming, they won't change their behaviour."

Participants discussed how some clients felt that sustainability was so important, they were willing to reduce the size of their potential investment universe to back those firms that are already deemed more environmentally sustainable.

But others were not willing to sacrifice investment performance for the green agenda.

For the latter cohort, though, they can still embrace engagement and stewardship as avenues to bring about change.

"Engagement is a key lever, and it's about communicating this to clients or underlying investors," said Aon's MacArthur.

"It has been good to see a shift in engagement, including the creation of specific engagement targets that help galvanise investor capital behind encouraging high emitters to shift their business models to be more climate-friendly, consistent with net zero goals."

He added that firms that run money for institutional clients would likely be more competitive if they were able to offer customised climate-related offerings, or strategies whereby the approach to sustainability could be bespoke.

But regardless of the approaches available, the roundtable participants were unanimous in their view that their fiduciary duty to deliver good client outcomes was front and centre.

This could marry up with an ESG strategy, but ultimately firms needed to approach sustainable investing in a way that they genuinely felt would improve client outcomes.

On returns, we believe that integrating ESG factors does drive long-term value for our customers, especially for a firm like ours that is an asset owner for the long-term savings and pensions industry."

"For us, integrating ESG and decarbonisation strategies is in the best interests of our customers from a risk and return perspective," said Allison, of Phoenix Group.

"Climate and sustainability risk are material financial risks, and so we put good risk management front and centre. On returns, we believe that integrating ESG factors does drive long-term value for our customers, especially for a firm like ours that is an asset owner for the long-term savings and pensions industry."

Drew at T. Rowe Price stated that her aim with clients was to understand their financial and sustainability goals and find the right way of expressing those through a portfolio.

"I spend a lot of time with existing and potential clients to understand their financial and sustainability goals and how they prioritise the two. This helps determine the investment structure that best meets their needs because certain sustainability goals will constrain the investment universe more than others," she said.

With regards to net zero, Drew added that T. Rowe Price offers practical solutions for asset owners interested in aligning their investments to this goal by 2050 at the latest. These typically incorporate one or a combination of the following four approaches, from least to most constrained: Net Zero Stewardship, T. Rowe Price Net Zero Transition Framework, Greenhouse Gas emissions reductions and/or Climate Solutions Alignment.

"Our T. Rowe Price Net Zero Transition Framework, for example," Drew said, "seeks to deliver financial returns while promoting the transition to net zero. It is an investment-led approach, aligning to a recognised industry standard, for incorporating climate transition targets alongside the existing investment process."

Political will

With the UK's general election imminent at the time of the roundtable, and France's first round of elections completed, the panel turned to the impact of politics on net-zero ambitions.

Griffiths noted that in 2023 the UK government had rowed back on some net-zero pledges, including delaying the ban on the sale of new petrol and diesel cars from 2030 to 2035.

While this was pitched as a way of helping the economy, Griffiths noted that many businesses also craved certainty.

He also touched upon the potential for Donald Trump to recoup the presidency in the United States, as well as a "shift towards populism" in Europe that could mean more anti-ESG sentiment emerging.

Drew noted that periods of technological revolution have often come alongside a rise in populism.

"The two are interrelated and if you go back and look at the academic research on technological revolutions, the pattern we are seeing is textbook," she said.

"When we speak with companies around the world, we see a continued and growing trend of adoption of greenhouse gas reduction and net zero targets. I think most C-suites believe a green transition is inevitable – the differences are more about timeline, use of new technologies and use of carbon capture or offsets. When we look at the diverging regulatory environment, we see countries are facing 'just transition' issues, so they are going slower," continued Drew.

"In our view, a lot of this may facilitate a more sustained transition in the long run."

What Drew thought could be a realistic outcome is for legacy assets to be allowed to operate for longer.

That could actually be desirable, some of the panel acknowledged, as it could assist in achieving that aforementioned just transition, which focuses on managing the social impact of pursuing environmental goals.

Human capital

Ensuring that sustainable investing doesn't unduly cause social upheaval is another development in the investment theme.

Just as ESG investing has moved beyond just exclusionary approaches, it now goes further to try and consider the impact of its decisions on cohorts of workers. For instance, if all investors simultaneously stopped investing in oil, then what would the world's oil firm employees do for work?

This is a key plank of engagement, either to ensure that workers are being trained to be employable in a new or emerging part of the company, or that they are being supported to learn new skills that would see them be able to gain work in another industry.

The Transition Plan Taskforce has clear guidance on analysing and mitigating social risks and opportunities, and similarly on nature-related risks. The UK is trying to embed the concepts into legislation, meaning that the incoming government will need to work on mandating transition planning across the economy.

In Europe, transition planning is embedded in the Corporate Sustainability Reporting Directive, which requires disclosure of transition plans to ensure that companies' business models and strategies are compatible with the Paris Agreement goals.

Essentially, the panel agreed that transparency was vital; asset managers needed to be clear about how their current portfolio was positioned and what the rationale was behind their ESG strategies.

"The FCA's Sustainability Disclosure Requirements and investment labels regime should be a good addition to the UK, and I hope it is a starting point for clients to make them feel that they know what the mission of a particular fund is and whether it aligns with their goals," MacArthur said.

Griffiths emphasised the importance of an open approach with clients.

"Transparency is key, both for stakeholders to hold investors to account but also for investors to hold themselves to account. Describing why emissions have gone up on a portfolio, for example, could be necessary at a given point. There could be a good reason for the rise, but it needs to be appropriately explained." he said.

"Adding in some flexibility is key, too, so that investors can move the dial if required and make sure their strategy is future-proofed."

After exploring other sub-themes linked to sustainable investing, such as the role emerging markets have to play in the energy transition, and the value or otherwise of carbon credit trading systems, the discussion concluded with overarching thoughts about how investors can help clients understand their sustainable investing aims.

Core elements included ensuring clients are clear on why they want what they are asking for, and whether they just want to decarbonise their investments or to have a real-world impact.

Flexibility was also viewed as key, with investors urged to use the best mixture of strategies to help clients achieve their aims.

Gosrani added that it was important to think about climate change and not just net zero.

"It's also important to think about nature, as we cannot achieve our climate goals without achieving our nature goals," she said.

And Quant felt that clear regulatory progress could help ensure sustainable investing flourished.

"Ultimately, it feels like some top-down, regulatory intervention is needed to support a bigger shift towards creating an ESG ecosystem that means investors can feel confident that sustainability is the industry's direction of travel," he said.

"That would mean asset managers could invest in line with that, and it would help support clients' long-term objectives and potentially remove a real area of nervousness around regulatory uncertainty."

Roundtable Participants

Maria-Elena Drew

Director of Research, Responsible Investing

Personal Profile

Maria-Elena Drew is a director of research for Responsible Investing at T. Rowe Price Associates, Inc. (TRPA). In her current role she leads the Responsible Investing team, which serves as specialists for incorporating environmental and social considerations into TRPA's research process.

Maria is on the Investment Advisory Committees of the Emerging Europe Equity, Emerging Markets Discovery Equity, Global Growth Equity, Global Value Equity, International Value Equity, Latin American Equity, and Asia ex-Japan Equity Strategies.

In addition, she is a vice president of T. Rowe Price Group, Inc., T. Rowe Price International Ltd, and T. Rowe Price Global Funds.

Company Profile

T. Rowe Price is an asset management firm focused on delivering global investment management excellence that investors can rely on—now, and over the long term. Founded in 1937, Baltimore-based T. Rowe Price Group, Inc. is a global investment management organization with $1.54 trillion in assets under management.*

T. Rowe Price is committed to responsible investment and its disciplined investment approach is rooted in proprietary research. T. Rowe Price's experienced investment professionals around the globe actively seek to identify investment risks and opportunities, with ESG factors as one of many considerations in its investment process. T. Rowe Price believes its principled investing approach helps the firm pursue better outcomes for its investors over the long term.

*Data as of May 31, 2024. Subject to adjustment. Firmwide assets under management include assets managed by T. Rowe Price Associates, Inc., and its investment advisory affiliates.

Oliver Macarthur

Associate Partner, Impact Research Lead

Personal Profile

Oliver serves as an Associate Partner, Impact Research Lead in Aon's Investment Manager Research (IMR) team.

After joining Aon in 2018, Oliver is responsible for sourcing, evaluating, conducting due diligence, and monitoring sustainable and impact equity funds on a global basis. In addition, Oliver coordinates impact investing activities within IMR across the suite of Aon's asset class coverage.

Prior to Aon, Oliver worked at Church Commissioners for England, a charitable endowment to support the work for Church of England, and the Royal Bank of Canada. Oliver is a CFA Charterholder.

Jordan Griffiths

Associate, Senior Sustainable Investment Consultant

Personal Profile

Jordan is a Senior Sustainable Investment Consultant at Barnett Waddingham. He joined Barnett Waddingham in 2021, after previously working at an investment consultancy.

Prior to this, Jordan has worked as a financial trader and also within the National Accounts team at the Office for National Statistics.

He is heavily involved in both providing a sustainable research capability and helping clients formulate, develop and implement their sustainable investment aims. Sustainability means different things to different clients. As such, Jordan focuses on developing pragmatic solutions which consider both risk and opportunity, to allow clients to best incorporate sustainability into their investment frameworks.

Jordan holds the CFA designation and has gained the Diploma in Investment Management (Environmental, Social and Governance (ESG)).

Roundtable Participants

Sarita Gosrani, CFA

Director of ESG & Responsible Investing

Personal Profile

Sarita leads bfinance's ESG advisory unit supporting investors globally on their RI/impact journey. Sarita has extensive experience in ESG and impact approaches across public and private markets and provides dedicated expertise to the research teams as well as creating the overall due diligence frameworks. She has more than a decade of experience in investments, financial services and pensions.

Sarita was formerly Head of ESG Research at XPS Pensions Group where she led the firm's ESG strategy with clients and internally. Sarita was also an Investment Consultant providing advice to clients on the investment strategy. This experience allows her to position ESG and impact within the wider fiduciary duties of investors.

At bfinance, she leads the firm's sustainability initiatives, sits on the firm's Responsible Investment Committee. Sarita is a panel member for the CFA UK Impact Investing Certificate. She is CFA Charterholder, CFA ESG Certificate holder and has a BSc with a double major in Economics & Human Geography, University of Toronto.

Ryan Allison

Senior Climate Investment Risk Manager

Personal Profile

Ryan is a Senior Climate Investment Risk Manager at Phoenix Group, and member of the Sustainable Investments team. He is responsible for developing the Group's suite of climate investment risk metrics to measure and manage the transition of the Group's investment portfolio to net-zero.

Ryan is involved in the design and implementation of climate and nature investment strategy and research, including climate modelling approach, climate scenario analysis, and ESG data.

He is also responsible for the delivery of carbon footprinting of the Group's financed emissions. Prior to joining Phoenix, Ryan spent 7 years at EY working with a range of insurance, pension fund and asset management clients.

Ryan is a Fellow of the Institute and Faculty of Actuaries.

Alex Quant

Head of ESG Research and Investment Consultant

Personal Profile

Alex is Head of ESG Research at XPS Investments. Alex is responsible for assessing and engaging with investment fund managers to make sure they take into account ESG when making investment decisions, and working with pension schemes to help them effectively review and further embed sustainability in their investment portfolios.

Moderator

Elizabeth Pfeuti

Chief Client Officer

Personal Profile

Former Dow Jones staffer Elizabeth Pfeuti is Rhotic's Chief Client Officer and a member of the Rhotic Media executive leadership team.

A highly-decorated journalist, Elizabeth has been in financial journalism for around 15 years. At Dow Jones, she covered the asset management, investment banking and investor services beats for Financial News, where she also wrote on a wide range of regulatory themes

She was previously the European Editor for CIO Magazine and boasts an exceptional contact book of buy-side and in-house institutional CIOs and asset management executives. More recently she has worked on corporate briefs for pension consultants, investment banks and asset management groups.

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