THE PRINCIPLES FOR RESPONSIBLE INVESTMENT PODCAST TRANSCRIPT

IMPLEMENTING NET ZERO IN LISTED EQUITY PROTFOLIOS

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Michal Bartek

Welcome to the PRI podcast. My name is Michal Bartek and I'm the Senior Lead Listed Equity here at the PRI. Global Greenhouse Gas emissions are continuing to rise at a time when they need to be falling. It's increasingly accepted that reaching NetZero is absolutely vital for the planet. So an increasing number of asset managers and asset owners are implementing their Net Zero commitments in their portfolios. At the PRI, we've looked into various aspects of the Net Zero implementation, and we've published case studies on the topic case studies authored by our asset manager and asset owner signatories. Today we will share some practical elements of how the various aspects of the NetZero commitment are being implemented in the relevant portfolios. And for our discussion, I'm delighted to be joined by two guests, Anna Cala, assistant Vice President, ESG ClearBridge Investments.

Anna Cala

Thank you for having me.

Michal Bartek

And Maia Becker, Senior Director Corporate Governance and Responsible Investment RBC Global Asset Management.

Maia Becker

Thanks Michal. It's great to be here.

Michal Bartek

So, can I turn to you, Anna, can you briefly describe what your organization's position is on net zero?

Anna Cala

Yeah, absolutely. So, we committed to setting a net zero target in 2021 and published our target in 2022. So, at ClearBridge, we really believe that asset managers who are, you know, overseeing trillions of dollars of capital have a critical role to play in the decarbonizing of the global economy. You know, so this transition, you know, it's going to result in a complete transformation of many industries, ultimately creating new winners and losers in that process. So, managing those risks and capitalizing on those opportunities now was really a big part of why we chose to set a net zero portfolio target. And then, you know, being able to set this target through the Net zero Asset Manager's initiative or NZAM, we really liked that it provided us the industry, this fairly consistent approach for, you know, measuring the climate performance of our portfolios, tracking that progress over time, and then being able to communicate that progress to our clients.

Michal Bartek

Okay, thank you. Can I, can I turn to you, Maia, please?

Maia Becker

Yes, thank you. RBC, absolutely recognizes the importance of the global goal of achieving net zero emissions by 2050 or sooner, as it is critical to mitigating climate related risks and certainly ensuring that we are taking into consideration the transition risks and the physical risks of climate change. So while climate change has been part of our approached responsible investment for quite a number of years now, in 2021, we did publish our net zero ambition, which is our commitment to net zero and to climate change and articulates the actions that we're taking in support of that. So some of those actions that we're taking across our firm are integrating material climate risks and opportunities as part of investment decision making across RBC. We're also engaging with issuers on climate change to understand what is their governance oversight of climate change, if climate is material to them, do they have targets, do they have strategies and how are they implementing those over time? We also use proxy voting as one of those tools for sharing our views on climate change. And certainly, very importantly, we make sure that we are measuring monitoring and then publicly reporting both the carbon emissions of our assets under management, but also the net zero alignment of those assets and all of that make part of our net zero ambition.

Michal Bartek

Thank you. Thank you both. I would now like to explore what metrics you chose to use to measure net zero alignment of the companies and relevant portfolios and why.

Maia Becker

Yes, and it's such a great area to talk about because really this is particularly challenging in terms of how do you start to measure the impact of climate change on an issuer and an issuer's impact on climate change. So, at RBC gam, both at a firm, a portfolio and at an issuer level, we leverage a suite of different climate metrics, both current and forward looking metrics to really understand where an issuer is positioned today, but also where they may be positioned in the future. So, we generally start by looking at the greenhouse gas emissions or carbon emissions profile of an issuer or portfolio, but that type of metric is inherently static and backwards looking. So, we also want to understand not just where an issuer has been, but where they'll be going in the future. So that's where we also look at what type of commitments have an issuer made, what type of emission reduction targets do they have, and are those emission reduction targets science-based or net zero aligned?

Maia Becker

And this is where we look to the Science-based Targets initiative, SBTI as an independent entity that verifies whether issuer targets are science-based and we look at what percentage of our assets under management as well as whether issuers have science-based targets. So those are two metrics we look at. But while greenhouse gas emissions and issuer targets provide a view and an issuers emissions and performance and commitments, we also want to take a forward-looking view where we then also consider an issuer's temperature alignment. So this is essentially a modelled forward-looking metric that tells us if the entire global economy looked like an issuer or a portfolio, what temperature pathway would we be on? Is it a below two-degree pathway aligned with the Paris agreement? So, we both measure monitor, but also report publicly on what the temperature alignment is of our assets under management of portfolios.

Maia Becker

And what percentage of those assets under management are in fact below two degrees. I think one piece I'd add to that is those are the metrics that can be used to assess net zero alignment and climate change. But our individual investment teams, they also go much further than that. So, they do a deeper dive for material sectors and issuers to understand again, what is a governance oversight of climate change and climate performance? What is their historical emissions performance and how are they doing over time? What is their decarbonization strategy, their capital allocation alignment? And really providing them with a comprehensive view of how issuers are a complex topic. And that's often a good launch point for engagement with companies as well.

Michal Bartek

Can I turn to you, Anna for an explanation of what metrics are used at ClearBridge?

Anna Cala

Yeah, I mean Maia gave a great intro to what they're doing at RBC and I think there's some overlap to our approach at ClearBridge as well. So, I'll try not to be too repetitive here, but you know, we have also chosen to measure the progress of our, of our target through our portfolio's alignment to a net zero pathway. So we're calculating this through assessing our portfolio company's decarbonization targets. So, we're considering a company on a net zero aligned or on a net zero pathway if they have set a target that is verified as science based. And so, organizations were looking to, similar to what Maia pointed out was the SBTI is sort of that gold standard. We also look to add a little flexibility into our approach. So, we also look at climate act 100 plus for those higher emitting companies, science-based SBTI doesn't currently have guidance for oil and gas.

Anna Cala

So, we really look to Climate Act 100 plus to kind of fill that gap. We also look at, well, it makes up a smaller percentage now, you know, we also look at climate solution providers and consider them in our net zero aligned bucket. We want to give credit to companies whose products or services are really contributing to that global reduction of emissions. So overall we really, we chose this approach and we felt comfortable with this approach because we felt like it aligned to our job as investors, which is ultimately understand which companies have the best chance of outperforming in the future. And so, understanding a company's plan to succeed and a decarbonizing economy is a very big piece of that.

Michal Bartek

So now that we've heard about the commitments and the frameworks and the metrics let's explore the actual actions or steps that your teams have taken in, in support of the net zero ambition. And also, perhaps what have you learned from the process or what have you seen change since you started implementing Net Zero?

Anna Cala

The big focus of our approach to net zero is around these high touch engagements with our portfolio companies, how we're implementing this and to help us prioritize these engagements and measure our, where we are on that progress to net zero is through bucketing our companies into four categories. So, one I had already kind of briefly touched on was companies that were considering aligned to a net zero pathway. So those that have set verified science-based targets or are climate solution providers. The second bucket are companies that have made a formal commitment to SBTI to set a science-based target. So, through that formal commitment, they're saying within two years they'll have their target verified, they'll set and have it verified. And then the last two categories are really the companies that we're looking at and paying the most attention to and focusing our engagements on.

Anna Cala

These are companies that have not set any type of target yet for decarbonization or companies that have set a target, but we're not considering them aligned to a net zero pathway. So, either their target is covering a smaller portion of their emissions or they've set a net zero ambition, but we're not seeing that short or medium term target to, you know, really show us how they plan to get to net zero. And like I said, these two last two categories, that's really how we're prioritizing our engagements at this time. So, once we look at what companies are falling into those two buckets, we then see okay, who are the higher emitting companies who are our larger holdings? And that's where we're focusing a lot of our attention. You know, you asked about kind of learnings from this process, you know, setting this net zero target has helped us develop a more formalized framework around these conversations that we've really been having for years.

Anna Cala

Well, companies may be at different stages from not, you know, no disclosure to technology challenges. We really now have one common goal to guide these conversations and you know, the analysts are having some great conversations so far. We're having a lot of learnings from, you know, sector specific challenges. One example I can give is, you know, we were recently talking to a large logistics company and they were discussing how they're not comfortable yet setting a net zero target because a large portion of their business relies on aviation in the aviation industry. You know, it's very reliant on future technologies, you know, sustainable aviation fuel is not scalable among other issues. And so, you know, that's just something we're going to be taking into account on a case by case basis as we're developing these engagement strategies. You know, so we'll look for that company example. We'll continue to engage with them over I'm sure many years as we're long-term equity holders, you know, so we'll look, are they decarbonizing the other portions of their business that they've set targets and then monitor how are they staying on top of the progress of the aviation industry and how are they going to you know, utilize those technologies as they come to market.

Michal Bartek

Thank you very much, Anna. Can we turn to Maia to explain the steps taken by RBC Asset Management?

Maia Becker

Yeah, and I think there are a lot of different types of pieces that come together here, and I'm going to try and maybe address each of them in turn. I think one piece of it is when you're looking at how are you approaching climate change, how are you recognizing the potential impacts of climate related risks and opportunities? There's a certain element that needs to start with understanding the materiality of that to a particular sector, to a particular issuer. As Anna described very well there. Whether it is a company in aviation, whether it's an oil and gas company, a mining company, a consumer staples company, the types of climate related impacts that they may face will be different. Their business model will in many ways drive what types of actions they can and potentially should be taking to address those risks. And it's really starting to understand that full picture, a holistic view on an issuer-by-issuer basis of how they may be impacted and then what actions they're taking in order to position themselves for that future low-carbon economy.

Maia Becker

And so very much the approach we take is investment led and based on materiality where we bring together a few different pieces. So, one of the pieces is really in depth climate data and analysis. So one of the pieces here that we've certainly built and expanded over the last several years is we have an interactive online ESG data platform that utilizes technology to bring together a suite of ESG and climate data withholdings data to enable both ourselves as well as investment teams to do some very deep dive analysis on individual issuers by sector and by portfolio around how they may be impacted by climate risk. And this isn't just looking at carbon emissions or some of the net zero alignment metrics we talked about, but looking at investment in low-carbon patents, revenue sources, capital expenditures, and how those capital expenditures may then be driving decarbonization strategies.

Maia Becker

So, bringing in a significant amount of data from different sources to understand the physical impacts of climate change as well, which we haven't really talked about here. So that first piece is really being able to do that deep dive data and analysis utilizing that technology platform. But then the other piece of it is really understanding on an individual case by case basis, what does that mean for an issuer? And that's also where engagement comes in, where our investment teams are constantly engaging with issuers on a range of topics including climate change. And we use both the direct as well as collaborative engagements to further those conversations. So again, understanding what are the challenges that issuers are facing if they have put in place emission reduction targets, but they are not yet net zero aligned or science-based, what are the impediments to that and what do they see as the opportunities moving forward?

Maia Becker

Quite often those conversations talk about technology developments that need to happen in order to able enable them to do that. And those conversations are incredibly informative to then drive investment decisions about whether in investing in these issuers is in fact going to continue to advance our ultimate objective as ensuring investment risk is managed. And that includes risk related to climate change, but also ensuring we are managing clients' assets in line with the investment mandates and objectives that they have set. In terms of what's changed or what we've learned throughout this, I think what we have learned certainly is that significant progress has been made in terms of depth and breadth of the type of climate data and input available. It's also incredibly complex. So this is not simple and this is not simple for any sector, any issuer. This is a transition and a transformation that must happen across all sectors. So that complexity is very clear. I would echo perhaps something Anna said, which I think the depths and sophistication of conversation with issuers has certainly continued to evolve over time, where we're really able to have some deep conversations with issuers on how they're looking at this issue and seeing a significant progress with issuers in terms of their understanding their thought process and the actions they're taking on climate change.

Michal Bartek

So you know, last year at the PRI, we, we held a number of workshops actually with dozens of our signatories where we looked into a range of issues or challenges or hurdles arising when assessing portfolio alignment with net zero. And so, the challenges we heard about include, you know, issues with lack of or poor quality of data or lack of decarbonization pathways available for particular sectors. Do those challenges resonate with you? What do you think about those challenges and what hurdles or issues are actually relevant but not perhaps considered that frequently?

Maia Becker

Yes, and I think certainly those challenges do resonate with us and I think there I would go maybe deeper on a few of them and there are also others as well. So, I think one that we hear often is around data availability, disclosure, quality of data that is available on an issuer level related to climate change. But I think the piece that I would expand on there is often there has been a focus on equities and I think we really need to go further in understanding how we can get better data for corporate sovereign fixed income for real estate, for infrastructure in some of these other asset classes. And I think that's the next frontier of development that needs to happen from a climate data perspective. I think another challenge that exists is agreement on in consistency in terms of methodologies for measuring climate related risks and opportunities and impacts.

Maia Becker

And I think we are seeing right now a regional and jurisdictional divide where we need to come to a place where when we're talking the same language, regardless of what jurisdiction, what region we're in, in terms of what it is that we are measuring, what that measurement standard or practice is, because that's ultimately then what's going to drive in investment decisions is what do you do with that information for both our clients as well as ourselves, and we need that consistency there. And then I think there's another area that we maybe haven't touched on yet is that there continue to be different strategies or approaches for measuring net zero alignment in investment portfolios. And I think there needs to be additional research that takes place on understanding the implications of different approaches and methodologies to investment risk and return. And then how do we manage those.

Maia Becker

So, this is an area where we've been doing quite a bit of work internally to do research on the differing methodologies and approaches the implications of that from an investment risk and return perspective. And we feel that this is particularly important because we are an asset manager, and we have a duty to manage our assets in line with the investment mandate or the investment objective provided to us by clients. And certainly, certain clients do have investment mandates where they would like to put in place climate targets and objectives, and we need to make sure that we are able to provide sufficient guidance direction to them, the implications of that for their investment mandates when they request this. So, I think those are some of the areas I would focus on.

Michal Bartek

Okay, thank you. Anna, would you like to add anything to that?

Anna Cala

Yeah, so I think Maia touched on a lot of the major challenges in the industry right now. You know, maybe I'll just add on data quality because I think that's the biggest challenge right now. You know, regulation is coming out and so hopefully the amount of data we have, the quality of the data will improve over time. But you know, Michael, you had mentioned sector decarbonization pathways, so hopefully as that data improves, those will continue to evolve and become more granular and ultimately more useful for us and our issuers. You know, I had mentioned oil and gas doesn't even have a pathway right now, so that's a major gap that we need filled. And then further, you know, we're talking to all these companies about setting targets many companies already have, and so we're going need that data to start monitoring progress. And so I think making sure that, you know, they're doing what they're saying, we're being honest about challenges they're running into is going to be really important in these conversations as kind of that stage two of this approach.

Michal Bartek

Okay, Thank, thank you very much. It, it's obvious that, you know, challenges are not going anywhere. You know, we will be seeing, I guess evolution of those issues, hurdles and, and, and challenges you know, going forward and hopefully we'll find some solutions over time. When I imagine, you know, a listed equity portfolio that needs to be brought into alignment with the desired pathways I can think of a number of levers that are available to investors to, to get there and you know, hopefully the company's stations themselves will be doing, will be making progress with decarbonization. I've heard about engagement that you've mentioned. Obviously one can also tilt the portfolio and potentially even divest stocks. So, I would like to ask, you know, what, what role does divestment play in addressing climate change or net zero from the point of view of listed equity portfolios? Anna, would you like to, you know, respond to that?

Anna Cala

Yeah, I mean, look, divestment is a tool every asset manager has. We're buying and selling stocks all the time for many different reasons, but net zero aligned investing doesn't mean simply selling high carbon assets from our portfolios. This just shifts emissions from our portfolio to someone else's rather than reducing global emissions, which is really the goal here. You know, I think better practice and, and we've, we've kind of talked about this throughout this time, but I think better practice is formalizing a multi-year escalation policy, making management aware of your asks and utilizing your proxy votes and engagement as, as we've kind of gone into depth about divestment, if it were ever to actually come to that, you know, it would be around this material risk that we're seeing the company not addressing, but it would certainly be part of the broader discussion around the company being held in our portfolios with our investment team.

Maia Becker

I think Anna's covered it really well, and I would maybe just echo the view that she shared in that divestment is an option that is and must always be available for portfolio managers. However, when we're talking about net zero and if the objective of an investor is to reduce emissions in the real economy, which is ultimately what we need for the world to achieve net zero emissions by 2050, then again, simply divesting of that high emitting asset will not achieve that the high emitting asset will continue to produce emissions, and there is in fact the potential that that company or that issuer will have even less incentive to reduce its emissions or make hard strategy decisions because the owners of that company are no longer asking those questions and having those expectations related to climate change. And so while divestment has to always be an option there and certainly needs to be part of the decision making in terms of whether that is the right option or not, from the perspective of climate change and what it means to net zero active stewardship in our view, is certainly a more effective way for investors to have those conversations with issuers and to ultimately drive real world economy-wide emission reductions because it's a transition.

Maia Becker

So, when we talk about the transition to net zero, that's what it is, a transition from where we are today to where we need to be in the future. And that transition is a transformation and companies in many sectors across sectors will need to transform their businesses and to do so will require change and will require that active engagement of owners and issue with issuers.

Michal Bartek

Thank you very much. So to, conclude, let me say that, you know, in an ideal world, if we were to be aspirational, then all beneficiaries, asset owners and asset managers would have, you know, net zero implement implementation as one of their core objectives. But we know that, you know, implementation is far from straightforward given the challenges that we face. We've touched on some of those and we're working with signatories to do our best to help the industry overcome those hurdles. The NetZero listed equity case studies, both those authored by our guest teams and those contributed by other signatories can be found on our website unpri.org. And we continue to add to the list of the case studies, and we have lots hosts of resources available on our website, which we hope people will find useful. Thank you for your time today, Anna and Maia and thank you for listening. If you've enjoyed the podcast, then please rate, and subscribe. We will see you next time.