NET-ZERO COMMITMENTS AND TARGETS FOR ASSET OWNERS - THE ASIAN CONTEXT

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TABLE OF CONTENTS

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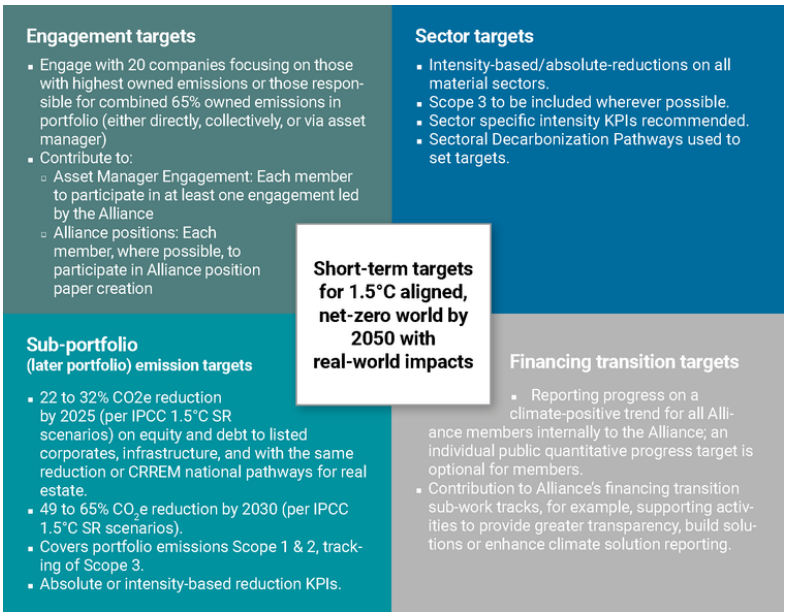
WWF is one of the world's most respected and experienced conservation organizations, with over 5 million supporters and a global network active in more than 100 countries. WWF's mission is to stop the degradation of the planet's natural environment and to build a future in which people live in harmony with nature. WWF has worked with the finance sector for more than a decade via innovative collaborations that seek to integrate ESG risks and opportunities into mainstream finance so as to redirect financial flows to support the global sustainable development agenda. Our approach to sustainable finance leverages WWF's conservation expertise as well as our partnerships with companies on key issues such as water, energy, climate and food to drive sustainability. Positioned at the cutting-edge of sustainable finance internationally, WWF contributes directly to leading initiatives, including the European Commission's Platform on Sustainable Finance and the development of an international green bonds standard. WWF also works directly with some of the largest asset owners in the world on decarbonizing investment portfolios. This has allowed us to strengthen lending and investment criteria for key industry sectors, provide insights and data on environmental and social risks, fulfil critical research gaps, help unlock innovations in sustainable finance products and convene key stakeholders to progress the sustainable finance agenda.

INTRODUCTION

De-carbonisation of the global economy needs to happen at an ever increasing pace for the global community to maintain its livelihoods, businesses and very existence. Already there is widespread recognition of the important role that the financial sector, in particular, investors and asset owners, plays to support a greener economy.

WWF-Singapore has continuously worked with Asian asset owners to support their efforts on this front. During our engagements with these organisations, we have sought to help bridge the gap between the asset owner's motivation for portfolio decarbonisation and actual implementation, as well as encourage greater Asian representation in international net zero alliances.



In this report we will be discussing selected key topics raised by Asian asset owners (sovereign wealth funds and insurers), regarding the net-zero commitments to be made under the Net Zero Asset Owner Alliance (NZAOA), specifically on the setting of targets under the second edition of the NZAOA Target Setting Protocol (TSP).

While this report does not aim to cover the full scope of the TSP, it serves to highlight common issues raised by Asian asset owners who may be at the early stages of setting net zero targets for their investment and are seeking clarity on the process prior to joining an alliance like the NZAOA. The structure of this report will be based on the Alliance four-part target-setting approach.

NET-ZERO ASSET OWNER ALLIANCE

Under the NZAOA, members are recommended to use "science-based ranges, targets, and methodologies' when planning their net-zero implementation strategies. The Alliance helps members to deploy Paris-aligned scenarios derived by the Intergovernmental Panel on Climate Change (IPCC) to align their investment portfolios towards their net zero goals. After the decarbonisation pathways and portfolio alignment strategies have been defined, members implement on their net-zero plans mainly by engaging with the investee companies, corporates and policymakers as well as providing the capital towards sustainable transition.

While the usage of science-based targets and methodologies are ideal for the average, globally invested asset owner, the NZAOA acknowledges that the "composition, structure, investment risks and opportunities, and return targets of a given asset owner will vary significantly".

The TSP allows an asset owner to combine approaches that best suit one's unique decarbonisation and engagement strategies within one's fiduciary duty to deliver risk adjusted investment returns.

In summary, members of the NZAOA have committed to firstly, transition their investment portfolios from current GHG emission levels to net-zero by 2050 that is consistent with a maximum temperature rise of 1.5°C above pre-industrial levels, by taking into account the best available scientific information including the findings of the IPCC, and secondly, to accomplish this primarily by engaging on relevant corporate and industry action, as well as on public policy. The complete scope of the members' commitments can be found here.

Ultimately the goal is to set "transparent and unique' targets, suited to individual institutions, whilst also being aggregable and measurable, enabling progress to be tracked". The TSP then elaborates on four areas, namely sub-portfolio, sectors, engagement and financing transition where such targets should be set.

SUB-PORTFOLIO TARGETS

Sub-Portfolio targets are set across the different asset classes in an investment portfolio. Alliance members are required to set targets across their listed equity, publicly traded corporate bonds, real estate, and infrastructure equity as well as infrastructure. Having assessed the IPCC no and low overshoot 1.5°C scenarios, the NZAOA has identified a global average absolute emissions reduction requirement in the range of -22% to -32% by 2025. Alliance members shall set targets, either on an absolute or intensity basis, based on this reduction range, keeping in mind impacts on the real economy and other member-specific considerations.

1. Making Pathways and Targets Relevant to a Local Context

Investment portfolios may be exposed to countries that require more economic support in order to suitably and sustainably decarbonise, or countries with greater economic reliance on high-emitting industrial sectors, as is often the case in Asia. While we recommend for asset owners to take reference from global pathways that are aligned with science-based targets, we do acknowledge the specific economic and industrial considerations in certain markets. On this, the Protocol provides for an asset owner to set targets that are better suited to its investment universe, while explaining the rationale for the deviation from general or global targets. More specifically, the TSP has stated, "For instance, specific targets may be driven by the fact that some members have higher or lower carbon intensity per their respective investment strategy or may opt to invest in the decarbonisation of hard-to-abate sectors. In all cases, Alliance members should apply pragmatic, science-based principles to their selection, explain their reasoning for how net zero can realistically be achieved without large temperature overshoot or unrealistic assumptions on carbon removal."

It is our recommendation that over time, that the asset owner nonetheless take active steps to engage with investee companies in the affected markets and steer the overall investment portfolio towards greater alignment with global science-based pathways.

2. The Role of Carbon Off-sets in Fulfilling Net-Zero Targets

It needs to be emphasised that carbon credits purchased by asset owners do not count towards the target achievement. Only qualified removals purchased by investee companies can be factored into the respective companies' (net) emissions.

Further guidance on the NZAOA position on carbon removal credits can be found in The Net in Net Zero: The role of negative emissions in achieving climate alignment for asset owners. Still, an asset owner should communicate its expectation on investee companies to commit to and implement abatement measures in their value chains over the next 5 to 10 years instead of primarily relying on carbon offsets.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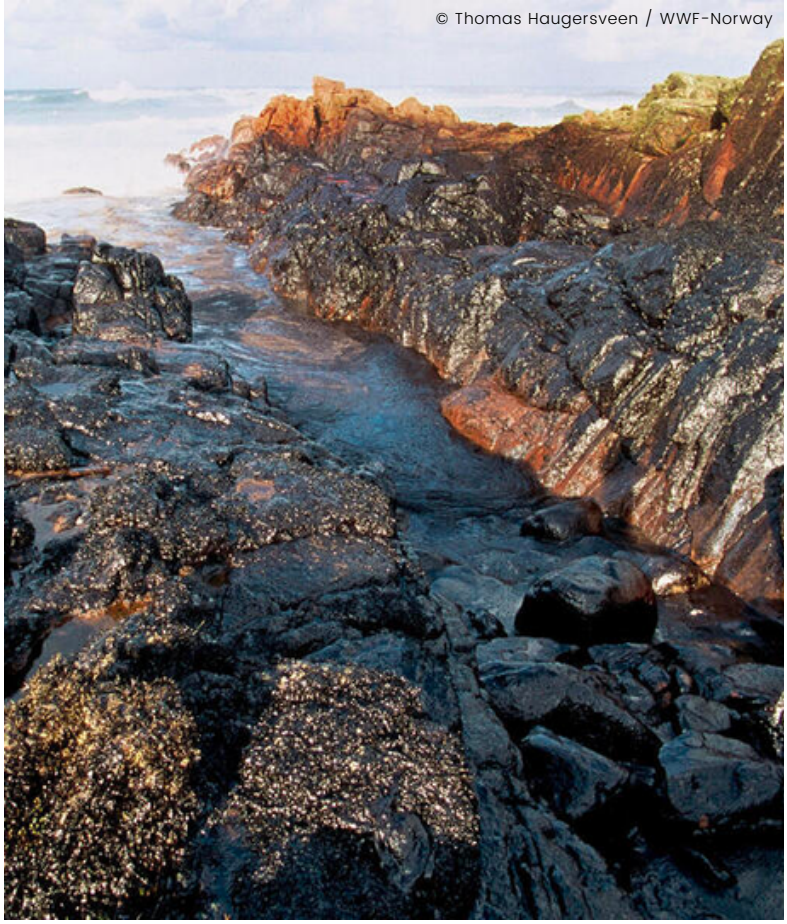
SECTOR TARGETS

Sector targets help to link portfolio-level reductions to the decarbonisation requirements of a particular sector, and consequently, real world outcomes from carbon reduction and transition of that sector. The focus should start from the highest-emitting sectors and progressively extend to less critical sectors.

The NZAOA seeks to issue positions on sectors that warrant greater attention. The thermal coal sector being one of the highest-emitting sectors, is currently covered under the NZAOA Thermal Coal Position paper. It should be highlighted that NZAOA members are required to set coal phase out policies in line with the Alliance coal position paper. An oil and gas position paper would also be issued in the future.

Rationale for Separate Sub-Portfolio and Sector Targets

By setting sector targets, an asset owner can better focus on the higher emitting sectors within an investment portfolio. Prioritising these sectors within a portfolio alignment process enables better achievement of short and medium term net zero targets.



1. Availability of Data for Sector Target Setting

Data availability can be a challenge to proper sector target setting. Where data may not be available to set absolute emission targets, the TSP recommends the use of carbon-intensity targets in conjunction with absolute emission targets. Such flexibility reduces barriers to setting sector targets and in turn reduces the inclination of asset owners towards straight out divestment without going through the due engagement process, due to challenges in obtaining suitable data to set and monitor sector targets.

Currently NZAOA members are required to set sector targets for scope 1 and 2 emissions. Scope 3 emissions are to be included where data is available

2. Use of Local/Regional Pathways to set Sector Targets

Under the Paris Agreement principle of "common but differentiated responsibilities," while the duty lies on all countries to take action on climate, the extent and type of action each takes will depend on their individual national circumstances. The TSP acknowledges this point. Hence, "in the short-term, some Alliance members may choose lower range reduction targets (following an 's' shaped curve, rather than a linear pathway to net zero) in order to support the transition in the real economy." This would be relevant in an Asian context where local governments may set localised pathways that cater better to their specific transition considerations that balance out other socio-economic factors.

Where an Alliance member has opted to follow local sectoral pathways and targets, they should still track these pathways against global pathways to monitor extent of alignment and account for these differences when reporting on the portfolio's net zero progress.

ENGAGEMENT TARGETS

The TSP requires an asset owner to set three out of the four targets or otherwise explain. Within these four targets, the setting of Engagement targets is mandatory.

It would require the asset owner to identify either twenty companies focussing on those generating the most owned emissions, or companies responsible for at least 65% of owned emissions in the investment portfolio; and thereafter, engage with these companies directly, or through collaborative initiatives or indirectly through their appointed asset managers' engagement activities. The asset owner is also required to engage with its appointed asset managers and set up a structured engagement process that incorporates the selection, appointment, and monitoring activities of asset managers.

1. Ambit of Effective Engagement

In addition to bilateral engagement with investee companies and collaborative engagement through collective initiatives like CA100+, the TSP lists out other forms of engagement that should be done concurrently.

These include sectoral and value chain engagement, where investors collectively engage with industry players from the same sector or value chain, the issuing of position papers individually or jointly on climate topics, as well as proper asset manager engagement to evaluate the manager's climate risk management, mitigation efforts and overall alignment of stewardship activities with the long term position of the NZAOA on climate change.

The Guidance for Alliance Engagement Ambitions section in the TSP provides more details on the expectations of members on their engagement activities with companies and asset managers in order to ensure alignment with the Alliance ambition. Within the Asian context, there may be regulatory constraints around collective engagements or with policy makers. The TSP gives members the flexibility to determine the appropriate course of action and "does not expect its members to act in a certain way where this would not be possible or feasible with a view to regulatory requirements".

FINANCING TRANSITION TARGETS

The objective of these targets is to support development of climate solutions through investments and financing. The Alliance track on Financing Transition focuses on assessing climate solution investments such as blended finance vehicles and structures, carbon removal instruments (nature-based and technical solutions) and climate solution technologies, which avoid, remove, or sequester emissions.

In addition, content development under sub-tracks, for example, on target setting and reporting, climate benchmarking and carbon markets also count towards fulfilment of this target category.

1. The Balance Between Supporting Transition and Maximising Risk-Adjusted Returns

Asset owners have a fiduciary responsibility to seek the best risk-adjusted returns on their investments within their investment mandate. Accordingly, the risk/return expectations of climate solution investments should also abide by such requirements. The TSP has expressly stated that "no investments in the green transition and climate solutions should be conducted if they are expected to give a loss or perform worse than other investments. "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CONCLUSION

In order to achieve the 1.5-degree goal globally, we all need to set credible net zero goals and ensure implementation under these commitments.

That said, it is acknowledged that organisations including asset owners are not equal in terms of regulatory requirements, economies of scale and investment objectives. As shown above, the TSP provides for these differences in their recommendations on target setting to allow for greater collective setting and implementation of net zero targets by all asset owners despite differences in economic, social and political environments.


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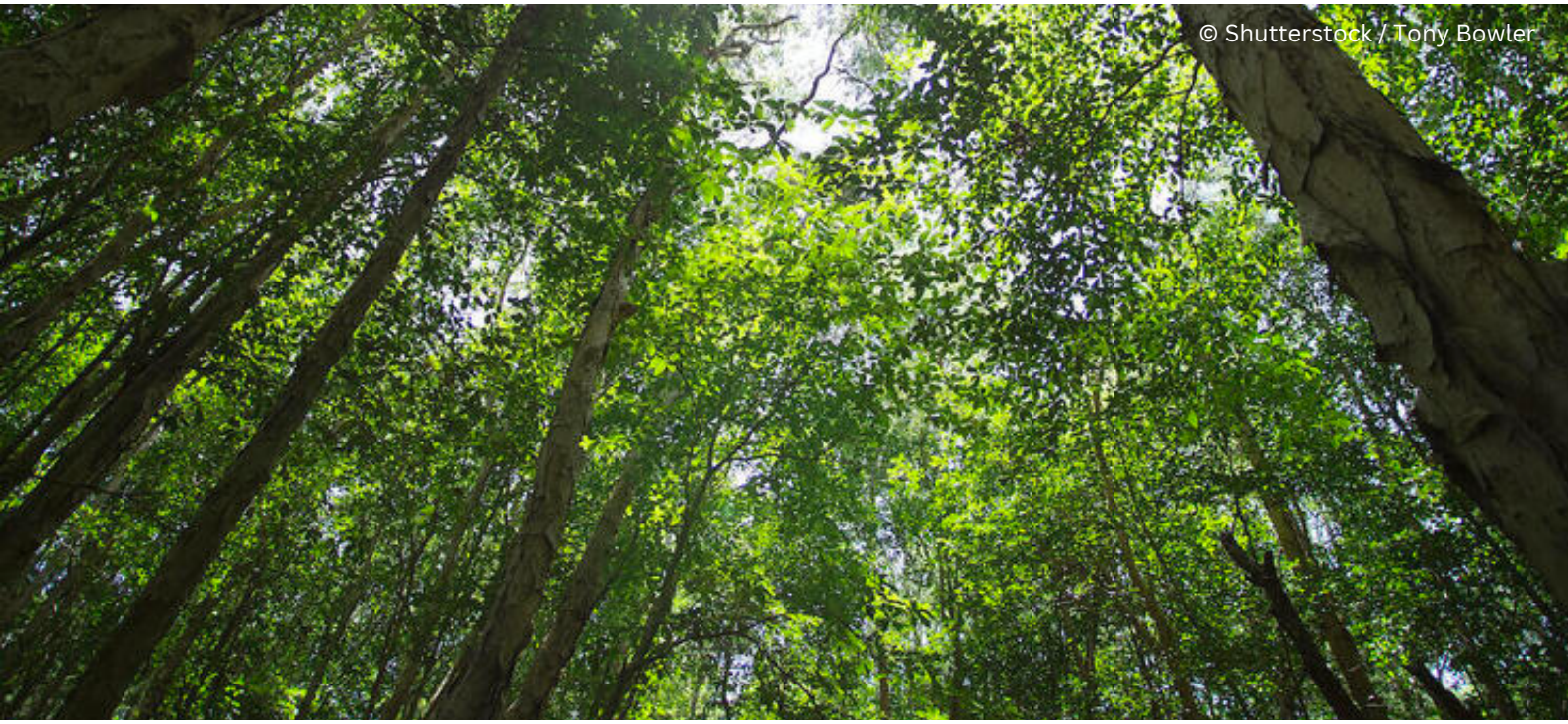
We hope that report can better guide Asian asset owners towards understanding how these net zero commitments may be effectively implemented in the lead-up to becoming NZAOA signatories.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