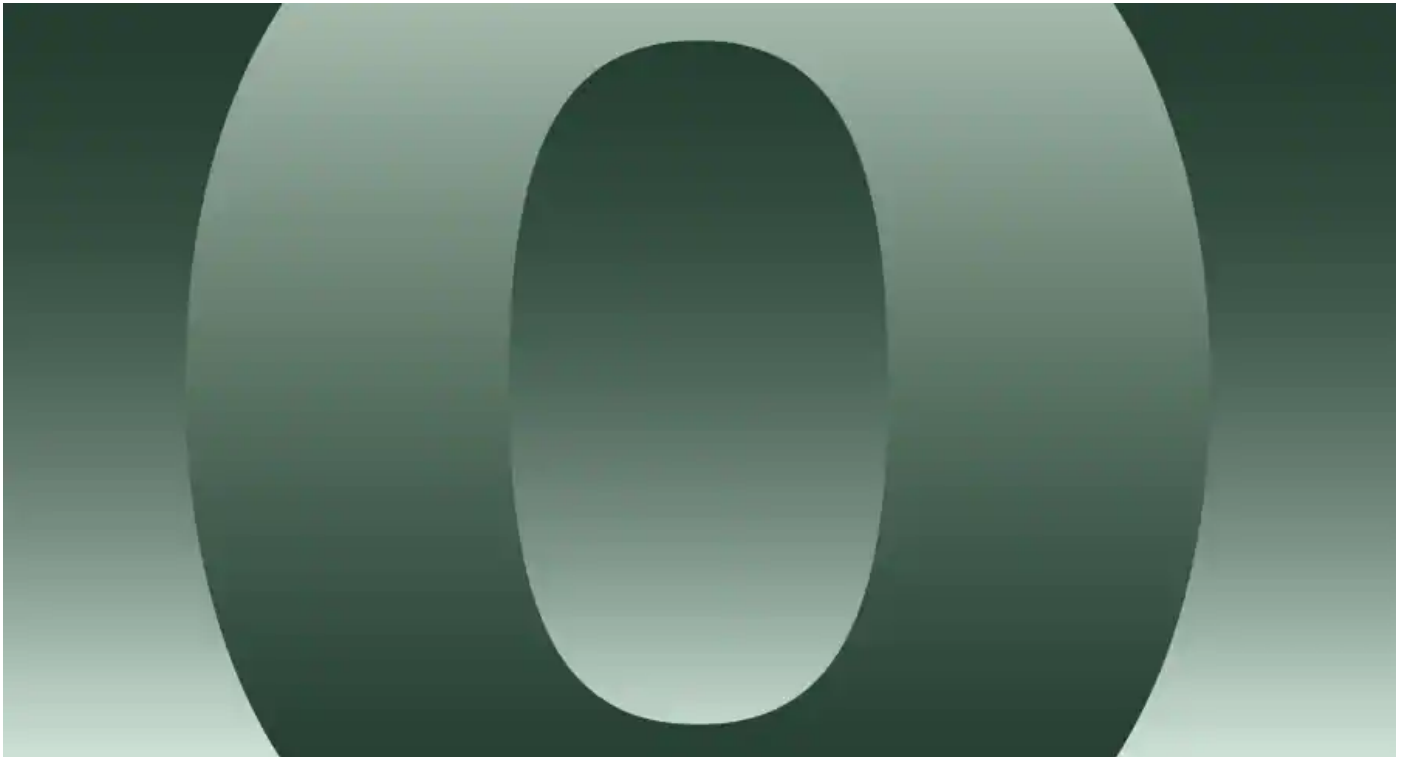

Environmental, Social and Governance

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Your Target: Net Zero

Commitment to the 2016 Paris Agreement and the [momentum from COP26](#) makes it imperative for investors to plan their [journey to net zero](#). We outline the key steps you can take to implement a Net Zero investment strategy.

Key Steps for an Effective Transition



1. Engagement

2. Exclusions

3. Asset Allocation

4. Reporting

1. Engagement

The Primary Tool to Drive Alignment

Investment strategies should prioritize engagement and stewardship as a mechanism to drive alignment. Direct engagement may be difficult for investors — there may be a lack of expertise or a significant learning curve required — and for most asset owners such engagement is often implemented by their asset manager.

Our Climate Stewardship Approach

Company Engagement

We engage with companies to understand their approaches to mitigating and managing the physical and transitional impacts of climate change.

Proxy Voting

We are committed to providing transparency on our approach to evaluating environmental shareholder proposals and on our voting decisions.

Thought Leadership

We aim to support our portfolio companies by publishing papers that provide insights into our thinking as well as sector-specific guidance

Policy and Regulatory Efforts

We utilise voting and engagement as effective tools to shape climate disclosure and practices on a company-by-company basis.

2. Exclusions

Divestment Can Be Useful

Engagement and stewardship actions are recommended as the main tool to achieve alignment. However, divestment and exclusion may be considered where there is climate-related financial risk, to escalate after unsuccessful engagement or where the

company's primary activity is no longer considered permissible in terms of credible net zero pathways.

Exclusions appear simple in terms of implementation but can rapidly become complicated as these are driven by strong visions where the route to engagement has been cut off. As climate change is a new and evolving topic it renders exclusion criteria difficult and may need to be revisited and reviewed over time.

Other custom divestments can be made based the volume of CO2 emissions (in millions of tons) owned by a company, indirect ownership of companies involved with fossil fuels, or other particular metrics or indicators. However, determining appropriate thresholds for some of these metrics can prove complicated.

Examples Climate-Related Divestments

- Oil extraction and power generation
- Natural gas extraction and power generation
- Thermal coal extraction and power generation
- Shale extraction
- Oil sands extraction
- Arctic oil and gas exploration

Engagement vs. Divestment

The debate around engagement and divestment is nuanced and it should be clear that it is not an either/or matter. There is room for both approaches, depending on an investor's objectives. When evaluating the two approaches to address climate change, it is important to differentiate between immediate improvement in portfolio climate metrics and creating long-term environmental and societal investor impact. Divestment can be an immediate solution to reduce specific ESG and climate risks. However, it fails to address the systemic, long-term impacts of climate change.

Divestment also abrogates responsibility for tackling climate change to another party. Therefore, an investment approach purely founded on divestment is not desirable in our

view. To sell companies within the fossil fuel value chain with immediate effect would forego the opportunity to engage with these companies, to help them adapt and ultimately be a part of the climate solution. However, we expect divestment to remain an option for certain activities (like thermal coal) whose ESG thesis will remain unconvincing.

3. Asset Allocation

Public Markets

Strategic asset allocations for liquid portfolios encompasses asset classes ranging from sovereign bonds to equity markets. The weighted allocation will typically be derived risk return assumptions for a given horizon.

In addition the asset owner's climate change policy will need to be implemented which requires the definition of measurable parameters at the underlying company level which can be aggregated, evaluated and monitored at the total portfolio level. Climate change parameters can be characterized as being linked to mitigation or adaptation, or alternatively said as being historical or forward looking.

Historical Parameters

Examples of historical parameters are a company's current carbon intensity, green assets or brown assets. In order to aggregate, for example, the carbon exposure for an equity portfolio it makes sense to work with greenhouse gas (GHG) intensities, such as GHG per unit of revenue or per unit of EVIC (this is the enterprise value plus cash; cash is added so that the number remains positive). This allows normalization of the emissions of a small company versus those of a large company.

For a **corporate fixed income portfolio or high yield** portfolio these metrics still work as the bond issuance can always be linked to the parent company.

For **sovereign bonds** such definitions don't apply. In addition there is the issue of double-counting, assuming that a country's carbon emissions is the sum of the carbon emissions produced by the country's companies. Still intensities can be calculated such as GHG per unit of GDP or capita. Here another double counting issue arises, as GDP is the sum of Domestic, Imports and Exports.

Forward-Looking Parameters

In terms of a forward-looking metric this is typically associated with the transition path of **greenhouse gas emissions** between now and a net zero value targeted in the second half of this century. The choice of transition paths is endless, generated by many models. Initiatives, like the sectorial TPI or the SBTi, provide the investor with transparency and support for the evaluation of the company's proposed transition pathway. In addition there are models that allow for a forward looking assessment at the aggregate level such as Implied Temperature Rise model or the Climate VAR model.

For **sovereign bonds** a country's current planned policies and its NDC would all be part of a forward looking evaluation. In its implementation guide the Paris Aligned Investment Initiative [7] suggests a country scoring methodology as developed by the CCPI index [10].

For **green bonds** we assume zero carbon emissions, even if issued by a high emitter. This is to encourage green bond issuance, however a very rigorous framework should be applied for a strategy to be categorised as a green bond. In this context we can mention the Climate Bond Initiative, of which State Street Global Advisors is a partner.

Ultimately the investor may wish to align the portfolio to a transition path according to its Climate change policy. This can be done for example by favouring companies that have a transition plan. If the allocation is well chosen then the portfolio will have minimal exposure to potential stranded assets while at the same time decarbonization occurs automatically.

Simply allocating the portfolio to low carbon emitters defeats the purpose of a smooth transition from a fossil fuel energy derived economy towards a clean energy economy.

Private Markets

The asset owner may decide to allocate some investment to illiquid alternative vehicles. This can be for example private debt, private equity, direct real estate or infrastructure. Evaluation of climate change alignment for illiquid investments is still much a work in progress. Reporting is typically not standard and not necessarily transparent, engagement has a central role.

4. Reporting

An Essential Element

Reporting is a vital component in a successful Net Zero strategy. State Street Global Advisors can provide reports and assessments of clients' investment portfolios that include several ESG components, including **TCFD metrics** and **climate profiles** such as:

- Carbon intensity
- Weighted average carbon intensity
- Scope 1 and 2 carbon emissions
- Total reserves of carbon emissions

In the event that additional climate metrics such as **green revenue and brown revenue share** and/or **climate adaptation scores** are integrated, we can report on these as well. Lastly, we are also able to provide **climate scenario analysis** results via specialized third-party analytics tools. In summary, we are able to provide covering the following areas:

- Carbon emissions-related data (including TCFD aligned metrics)
- Climate data (including fossil fuels, brown/green revenues, adaptation score)
- General ESG scoring using our proprietary R-Factor framework
- Engagement highlights
- Climate scenario analysis via third-party reporting tools