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ESG Now Podcast

“Net-Zero Tracker 2024”

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Mike Disabato: What's up everyone? And welcome to the weekly edition of ESG Now, where we discuss how the environment, our society and corporate governance affects and are affected by our economy. I'm your host Mike Deto, and this week we discuss the latest net zero tracker, a periodic report on the progress the world's listed companies are making toward curbing climate risk. Thanks as always for joining us. Stay tuned.

Mike Disabato: We put out this report periodically that's called the net zero tracker. It's like a report card for thousands of listed companies on how much progress they're making toward curbing climate risk. It looks at emissions, the state of disclosures, target setting, all of that. And we just published our most recent net zero tracker. And so for you all today, I call up one of the reports authors, a colleague of mine named Sylvan Vanston, and I asked him to take me through this year's report. And before he got into all the numbers, he immediately started telling me about how different this report was from the last one, mainly due to one reason this year they focused on what it's called, transition finance. Now what is transition Finance you say, and why the hell should I care? Well, I asked that very question to Sylvan.

Sylvain Vanston: The reason is it's because it's quite different from trying to do simple decarbonization strategy. So what is a decarbonization strategy? Typically, many investors have committed to transition to net zero transition, their investment strategy decision making to net zero by a given date. And for this, they have various strategies at their disposal and usually what happens is that they will be using what's called carbon footprint, which is a way to apportion the carbon emissions of a given set of issuers, say in a portfolio or in an index back to the actual investor and try to reduce those emissions, those finance emissions over time. Now, transition finance is a bit different because it is trying to support the transition to a low carbon economy by supporting players which are actually actively decarbonize decarbonizing their activities. That doesn't mean that they will lower their footprints today, their carbon footprints today, but will do so in the future.

Mike Disabato: That's a big difference because it means including unquote dirty companies in a portfolio that are working to become clean, IE less pollutive. And in doing so, you will build a portfolio around long-term sustainable considerations such as helping our economy reduce its emissions in a real way. This would move investors further away from the overly simplified idea that a company is bad if it pollutes and good if it doesn't pollute, and would instead encourage a more nuanced strategy where active decarbonize, if I can use that word, are an interesting investment opportunity as they are on the front lines of climate change. Now, contrast this with already low polluting like banking that doesn't have much to do to decarbonize their own operations, though they might get hit with transition risks via their own loan portfolios that are highly pollutive, but that's another conversation. What transition finance looks at are the sectors that are most difficult to decarbonize and are trying to do so such as cement, steel,

mining companies that have high emissions and absolute terms but are needed for building our society and don't have great substitutes at the moment that we can replace 'em with.

Mike Disabato: And what the tracker says is investors need to look at these industries and find out which ones are really working hard to reduce their emissions. Think of a cement company that's working to lower the emissions of its furnaces by installing more efficient ones. Now this can be quite hard. It can be costly. So positive investor tension would be useful for these companies to continue to transition to a lower carbon operation. That whole process of selection and identification is behind the idea of transition. Finance and investing with that idea is much easier said than done. First, you have to figure out which players are actually doing this in earnest because a company could theoretically just hide behind the shield of transition while continues business as usual. So you want to make sure you can understand which companies are making progress and which are not at the moment.

Mike Disabato: Luckily, the net zero tracker goes into some methods to do this. Three to be exact, there's the net zero investment framework or NZ developed by the Paris Aligned Investment Initiative. There's the number of companies setting science-based climate targets. You could look at how many companies those are, or you could use what are called temperature alignment metrics, which look at how the world would warm if everyone polluted like a specific company was polluting. Now, those are the three lenses that the net zero tracker looks at, but there's one method within those three that Silva and Juan to focus on today, and that is the net zero investment framework or commonly called NI.

Sylvain Vanston: So the NZI framework, what are we talking about? It's a classification framework. So all issuers in a given portfolio are classified along the lines of some sort of a maturity scale, which is broken down into five discrete buckets, five categories. They go from not aligning, committed to aligning, aligning to a net zero pathway aligned to a net zero pathway and achieving net zero. And obviously this is a progression. And now each of these five buckets is defined according to six criteria. So five buckets based on six criteria. Let me give you an example to be permitted to aligning. Obviously you need to have a long-term goal consistent with the global goal of achieving net zero by 2050, a stated public goal, and to be aligning to a net zero pathway, which is one bucket up. You need to also have a decarbonization strategy, which is a quantified set of measures, achieving short and medium term science-based targets. To reduce GHG emissions, you need to disclose all of your scope one, two, and three emissions. These are indirect emissions and so on. So each of those five buckets tick several criteria of

Mike Disabato: Course, and it's easy to get lost in five buckets with six criteria associated with them. So let me simplify it a bit. Think of this framework as a maturity scale, and you can use it to see how grown up your company is at the far end. You have the youngest, what Silvan is going to call the first bucket. A lot companies without a commitment to decarbonize in a way that can actually achieve net zero emissions. That's the first bucket. Saudi Aramco is a company that's in the first bucket. Then you travel along the maturity scale to companies that have a long-term goal. Dominion energy is in the second bucket there. Then you have companies which have a goal that has been verified by a reputable body like the science-based target initiative. That's the third bucket. An Airbus is in the third bucket, for example. Then you get a bit more mature and you have companies that have a goal, it has been verified, and they actually have an emissions track record which shows they're decarbonizing at a rate that could get them to net zero in 2050.

Mike Disabato: Nestle is in that bucket. That's the fourth bucket. And finally, you have the most mature, most accomplished bucket. The companies that are already at net zero, and sadly no company is in this bucket. Now the ends, if those are the five buckets I just talked about, part of the ends, if this is a framework for investors, it's for them to think about decarbonization. It hasn't gone out there and done all the categorization of publicly listed companies for investors to go look at and assess. But as you could tell by me being able to give you some examples of companies that are in each individual bucket, we've been able to do that for you.

Sylvain Vanston: So earlier in the year, what we did is we developed this mapping tool and then we applied it to one of our biggest index, which is the MSCA acqui IMI, over 10,000 issuers listed issuers. What we found is that the bulk of the issuers of the world's largest listed issuers fall into the very first category of not aligning. So that's 84%. That's what we found as of May, 2024, 84% of MSCI Acquia in my issuers, don't even only make it to the first bucket, which is you don't take any of the six criteria. So that obviously is a bit of a disappointment, but considering that the criteria to achieve the first layer committed to align, you need to have at least one climate goal consistent with net zero by 2050 for a start. This is not for everybody. And then if you go down the list, you see obviously for example, 8% of issuers are falling to this first bucket, committed to aligning 3% only aligning to a net zero pathway, 5% aligned to net zero pathway and so on. If we focus on the largest, the 100 largest listed issuers, then obviously we see a lot more progress. We find that we only 43% fall in the first bucket of not aligning, and then the rest follows. So there's a lot more, let's say, alignment with the climate goals as defined by the Ns. If when you go up the market cap

Mike Disabato: Rule, and that may be due to the bias of resources where larger companies are going to be able to draft out their decarbonization plan in a much more robust manner than smaller companies. But besides all that, let's go back to the broad statement that Silvan just said about global companies where 85% of them are in that first maturity bucket, meaning they are not aligned with any spectrum of the net zero pathway. Now that is tough, but what about for those sectors that I said were the most important to think about for transition finance, the ones that are the hardest to decarbonize and those that investors might benefit most from by allocating capital their way if they're making progress? Well, if you look at the industrial sector where many of those hard to decarbonize companies are grouped like minings in the industrial sector for example, you see that over 80% of them are not aligned with any spectrum of the net zero pathway, and it basically follows the global numbers for the other ends of buckets. Basically, the hard to decarbonize sectors have made about as much progress as the global economy has made, which means investors don't have many companies to choose from that are doing what is necessary to move up that maturity spectrum as defined by the net zero investment framework, niv, which when I brought this problem up to silvan, I was kind of concerned about it. I thought it would complicate things, but he didn't feel the same way.

Sylvain Vanston: It doesn't necessarily complicate, but the way people might use this is, for example, they will have as an investor, I mean I'm not talking here about the corporates themselves, the issuers, but as an investor, some of our clients, for example, some investors have developed targets that are based on the niv. So for example, we have a testimony in the net zero tracker, French asset manager est, they have a specific goal to achieve X percent of issuers in their portfolio to achieve X, Y, Z levels within the Ns I and to do this to support that goal, obviously they will reallocate, they will shift their portfolio, but they will also engage. So we should really view the NI framework, not so much just as a bucketing or categorization effort, but also as an engagement, a tool for engagement.

Mike Disabato: What Sylvan is saying here is that a large asset owner that was net zero conscious could figure out which companies are responsible for the largest portion of the emissions in their portfolio, and then they could engage with them and point to the net zero investment framework and get them to try to move up the maturity scale and become more aligned with net zero principles. And if that didn't work, they could decide to move their assets toward companies that are already moving up the maturity scale on their own. And in keeping with the transition finance theme, they could make sure that those movers are the big polluting companies that we need to decarbonize if we want the slow climate change. And the theory is with all that, that an investor could capture the growth opportunities at a company that was decarbonizing and thus innovating. It will of course be difficult at first. There aren't a lot of companies to choose from. Even broadening our discussion away from the net zero investment framework and looking at the other net zero lenses, the Tracker talks about, we see there aren't really many companies setting verified targets to the carbonize or actively reducing their emissions to the point where we could keep our world below two degrees Celsius warming. There's more out there than last year. Sure, but the list is still pretty short.

Sylvain Vanston: Every time we publish a tracker, we see progress, but also lack of progress. In some areas, we see progress when it comes to disclosures, when it comes to target setting, we always see this, but we also see record, high record high emissions. So that's not a fatality. I mean, it might go another way, but that's what needs to change.

Mike Disabato: What might be needed for it to go another way are policies that produce a level playing field and a mix of decarbonization activity in the real economy that investors can actually capture and support. Maybe with the net zero investment framework with NIV that we spent basically the entire episode on, there can be an easier identification process for investors to find the companies that are doing just that. And with attention can come growth and with growth, then maybe we could see more than a quarter of companies with a strong net zero track record in the coming years. Who knows? Time will tell. All remain optimistic else. I'll go mad. And that's it for the week. I wanted to thank Ban for talking to me about the news with the sustainability twist. I wanted to thank you so much for listening. If you like what you heard, don't forget to rate and review us and subscribe wherever you get your podcasts. Thanks again and talk to you soon.

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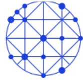
MSCI 

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