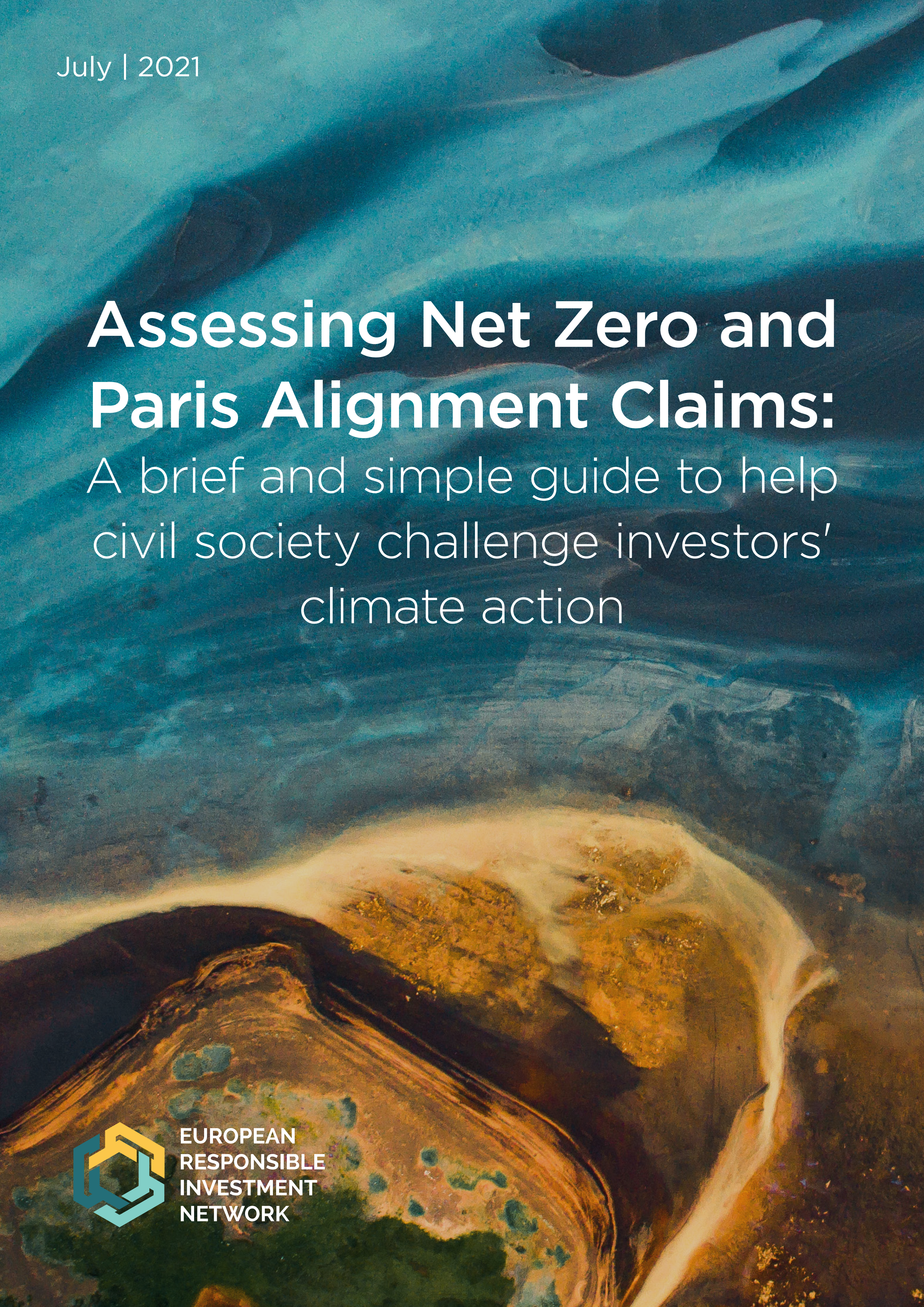

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Assessing Net Zero and Paris Alignment Claims:

A brief and simple guide to help civil society challenge investors' climate action

EUROPEAN RESPONSIBLE INVESTMENT NETWORK

Asset owners (such as pension funds, universities and churches) may claim that their investment portfolios are on track for Net Zero, or are Paris Aligned (for most purposes these are broadly the same thing). Here are some quick ideas for how you can check out their claims, grouped into key areas of concern. The document does not tell you how to make a portfolio Net Zero, but instead provides a quick list of questions that should be used to gauge and drive improvements in investor impact. This piece is primarily intended for campaigners, but may equally be of value to policy-makers, asset owners and others.

This topic is exploding in size and complexity – and we're not yet at a stage where there is consensus around the way that many terms are being used. Asset owners will use terms such as scenarios, trajectories, models, stress tests and benchmarks. These are different things, but don't get snarled up in the terminology as usually the questions you need to ask are the same.

This document was created by the Net Zero working group within the European Responsible Investment Network (ERIN) – a network of European civil society organisations working on sustainable finance. We support each other to evaluate asset owner Net Zero commitments and welcome new additions to the group.

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Aims and ambitions

Though aims, ambitions and goals are important, it is actions which have an impact on absolute emissions that really count. Make sure that commitments made are clear targets with milestones (i.e., SMART). The target institution should be aiming to limit warming to 1.5C at worst. To be effective, these should not backload all the effort (with most emissions cuts taking place close to 2050 or beyond), and instead the focus should be on 2025 & halving of emissions by 2030, in line with the IPCC recommendations. Often asset owners use targets focusing on the intensity of emissions, but these are insufficient on their own as they can allow absolute emissions to increase. It is also important to understand the likelihood of keeping within a target temperature. An institution may use a scenario that says 1.5C, but where the likelihood of going over 2C is still quite high, e.g., the IEA Net Zero Emissions scenario (May 21).

Key questions:

- What are your decarbonisation and alignment targets for 2025, 2030, 2035 and 2040? Are they SMART targets?
- What asset classes or financial activities are covered by your targets? Is the scope commensurate with the transition risk you are exposed to?
- What sectors are covered by your targets? Do they include highest emitting sectors, such as oil and gas and power and utilities, as well as those sectors you have most exposure to?
- What measures do you use beyond targeting intensity reductions (absolute targets, sector-specific targets such as no new capex, etc.)?
- What temperature change is your strategy aligned with, and what is your projected degree of likelihood of exceeding 1.5C and 2C? Do your targets allow for a buffer in light of these uncertainties?
- Do the plans integrate a fair/just transition, support the SDGs and respect the rights of indigenous peoples?

Emissions scenarios

The most prevalent emissions scenarios and models are those produced by the International Energy Agency (IEA) in their World Energy Outlook (WEO), which is considered to be the most authoritative publication on energy, and is used to inform both investment and policy decisions globally. Although these scenarios are the most common, even their Net Zero scenario is based on conservative assumptions about development of renewable energy and suffers from many of the other issues highlighted in this document. If your target institution is using IEA scenarios unadjusted, then they are not Paris aligned.

Key questions:

- What scenarios are you using to benchmark your targets?
- If you are using IEA models or scenarios, how have you adjusted them to ensure that they align with the goals of the Paris Agreement?
- Do your scenarios integrate climate impacts on economic activity? Many scenarios assume that GDP growth is unaffected by heat stress, rising sea levels, or extreme weather, for example.
- Do you support efforts to ensure the IEA improves its Net Zero Emissions by 2050 scenario, and makes it the main scenario of the WEO?

Negative emissions, carbon capture and storage (CCS), and offsets

Most models used by investors rely heavily on unproven technologies for capturing carbon dioxide and storing it where it cannot do harm. Make sure the target institution uses scenarios that focus on reducing emissions, rather than being too reliant on simply mopping them up afterwards. Reflecting this, emissions reductions targets should be gross or real zero targets. This is key to ensuring that we are moving towards real change, rather than business as usual. Look out for scenarios that are overly reliant on CCS and negative emissions technologies (NETs) such as direct air capture (DAC). Some NETs, such as BECCS (bio-energy with carbon capture and storage) should not be relied on at all as it remains unproven at scale, and poses serious social and environmental risks.

Key questions:

- At a general level, what is your understanding of NETs and their role in the decades leading to 2050?
- Can you distinguish your gross-zero targets from your net zero targets?
- What proportion of your scenario framework depends on the use of CCS, and other offsets?
- If you assume CCS in your chosen scenarios, are you investing in CCS technologies?
- How do the scenarios used account for NETs when establishing decarbonisation/alignment pathways?
- What CCS technologies are included in the scenarios used, and what assumptions are made about pricing and cost recovery?
- How do you differentiate between net zero targets based on permanent carbon storage (like CCS), and those based on temporary offsets?

Portfolio composition

Often Net Zero targets are more spin than substance. We can use the portfolio holdings as the best test of how real a Net Zero strategy is. A credible Net Zero portfolio should invest in companies implementing Paris-compliant cuts, and include new investments in the infrastructure and technologies needed for the low-carbon economy. A portfolio on the way to Net Zero will have reduced exposure to the high risk carbon-intensive sectors, particularly those at most risk of asset stranding (assets that suffer from an unanticipated or premature write-down, devaluation or conversion to a liability) such as fossil fuel production, industrialised livestock and aviation.

Key questions:

- How do you see your holdings changing during your pursuit of your Net Zero goal?
- What action are you taking to identify and finance the low-carbon innovation and scaling which experts agree is necessary to meet the goal of 1.5C?
- Can you identify any past examples in which investor engagement has led to a company successfully changing their core business activity and business model?
    - If yes, how are you taking those past examples as a model for your engagement?
- If not, what companies and/or sectors are you divesting from (and when), and what time-bound engagement and escalation strategies are you using in your engagement to drive the remaining carbon intensive companies to align with the temperature goals of the Paris Agreement (such as voting and filing resolutions at AGMs)?
- What is your process for recruiting, reviewing and replacing your fund managers, investment consultants, actuaries, etc, based on their climate expertise? Do these advisors all have a credible Net Zero commitment that aligns with yours?

Accountability

To ensure Net Zero goals remain high on the list of priorities, accountability for these targets and changes should sit with a senior member of staff.

Key questions:

- Who in the organisations is accountable for targets to be achieved, and to whom do they report to?
- Is the remuneration of portfolio managers, executives and the CEO linked to the achievement of decarbonisation and alignment targets?
    - If yes, to what extent?
- Do you report publicly on your progress against targets and milestones?

Transparency

It's very hard to evaluate Net Zero claims without transparency. Action on portfolio alignment with the Paris Agreement is also more impactful when it sends strong market signals. Furthermore, Paris alignment is not possible if asset owners, their asset managers and the companies in the portfolio are all lobbying against the required climate action. This is often carried out via trade associations or political funding.

Key questions:

- What steps are you taking to inform others - particularly investors, government bodies and your clients or members - about your intentions and actions, in a way that is clear and understandable to them?
- Do you regularly publish a full list of your holdings,so all stakeholders can evaluate your Net Zero claims?
- Do you publicly and promptly publish how you voted on all climate resolutions related to the companies you hold?
- Do you publish the scenarios used for your portfolio, and how these are adjusted for climate risks and opportunities?
- How do you ensure all lobbying activities support your Net Zero target, and definitely don't work against it?

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