



## Decarbonisation strategies: How can asset owners transition portfolios?

**While 50% of institutional investors globally have committed to reaching net zero, only 29% have taken action to meet their targets, according to a recent survey<sup>1</sup> by asset manager Schroders. With the Intergovernmental Panel on Climate Change (IPCC) warning global carbon pollution must decrease by 48% from 2019 levels by 2030 to achieve net zero emissions by 2050, how can asset owners address this shortfall?**

The first hurdle is that many firms are still wary of making decarbonisation commitments, especially relating to net zero, suggests Pete Drewienkiewicz, CIO, global assets at Redington. Firms' net zero ambitions must align to a 1.5°C science-based target while achieving carbon neutrality is a less onerous process.

"The number of asset owners with decarbonisation strategies in place is increasing but they're not yet in the majority," he says. "We've seen less progress than we might have hoped for over the past few years. People are wary of making ambitious commitments, particularly earlier than 2050."

### Making a commitment

Companies are found to reduce emissions at a faster rate when they have credible climate transition plans in place and link decarbonisation to financial opportunities, according to research<sup>2</sup> by Bain & Company and CDP.

Federated Hermes has stated it is targeting 80% alignment with the 1.5°C goal of the Paris Agreement by 2030 across its public market portfolios.

Owen Tutt, manager – engagement, EOS, Federated Hermes, explains: "We are expanding our active engagement on climate change to cover more companies in the portfolio. We are focusing on the companies setting targets and transition plans aligned with 1.5°C, implementing the enabling governance structures and public policy advocacy to deliver on these transition plans, and assessing and responding to the rising physical risks of climate change."

Consulting firms such as Mercer are now advising clients on how to reduce the carbon emissions in their

portfolios, but as Angelike Delen, Mercer's global head of impact investing, points out, they need to walk the walk.

"We're drawing up plans with clients on how to reduce carbon emissions and shape portfolios, so we also need to have a commitment to addressing climate change. At Mercer we have committed to a target of net zero absolute carbon emissions by 2050 in the UK."



<sup>1</sup> <https://www.schroders.com/en-gb/uk/institutional/institutional-investor-study-2023/>

<sup>2</sup> <https://www.cdp.net/en/articles/media/press-release-pace-of-decarbonisation-by-uk-businesses-falls-by-a-third-with-businesses-set-to-miss-paris-targets-bain-company-and-cdp>

## Rules of engagement

As fossil fuels account for over 75% of global greenhouse gas emissions and close to 90% of all carbon emissions, they are top of the agenda when it comes to tackling climate change. Indeed, last week at a G7 meeting ministers agreed to phase out coal-fired power plants by 2035. In the meantime, should asset owners divest from fossil fuels? Not necessarily. As Hermes' Tutt points out, divesting from fossil fuels may produce a "quick win" for portfolio emissions but is unlikely to contribute significantly to real world decarbonisation.

"Real-world emissions reductions will not be driven – and may even be hindered – by an exchange of ownership between investors," he says. "Meanwhile, divestment will mean missing out on the opportunities created by those oil and gas companies now putting considerable capital into lower-carbon technologies."

Anna Moss, senior sustainability analyst at abrdn, agrees, asserting engagement and active ownership are more powerful for an effective energy transition than an absolutist approach to simply divesting from high-impact sectors.

Moss explains that abrdn uses a credibility framework to assess its top-financed emitters on key principles, rather than accepting company targets and strategies at face value. These include: a clear and transparent decarbonisation plan; policy support; investments in

net zero-enabling technologies; and green capital expenditure dedicated to environmental initiatives.

According to CDP<sup>3</sup>, a not-for-profit charity that runs a global disclosure system, the market demand for environmental disclosure is growing. CDP claims over 23,000 companies – representing two thirds of global market capitalization – disclosed through the charity in 2023, while more than 700 financial institutions representing north of \$142trn in assets are requesting 33,000 companies to disclose to them through CDP in 2024.

However, there is a time and a place for divestment, as Lisa Stonestreet, head of communications and charity impact at the EIRIS Foundation explains. "We have seen a great deal of evidence that engaging with fossil fuel companies and encouraging them to move towards renewable energy is not happening at scale or fast enough, so it's hugely important to have the threat of divestment on the table.

"We've seen examples of divestment, such as the Church of England Pensions Board offloading its stake in Shell last year. The CofE Pensions Board engaged with Shell over the past decade but reached the point where they decided to move away from that approach because it wasn't getting the results they needed."

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<sup>3</sup> <https://www.cdp.net/en/companies>



## Sector specifics

While the energy transition offers many opportunities for investment in the infrastructure needed for achieving net zero, not all decarbonisation technologies will succeed or offer the desired returns for asset owners, warns Hermes' Tutt, so understanding the complexities of the transition and being selective will be key to success.

He adds private markets in particular offer “a great opportunity for investors to support the buildout of essential low-carbon infrastructure, while benefitting from attractive returns”, a sentiment widely shared in the institutional market. Indeed, commenting on the findings in the Schrodgers Institutional Investor Study, Nils Rode, CIO, Schrodgers Capital, noted investors are “aware that private assets are plugged directly into durable trends of disruption and progress that will be catalysed by rapid improvements in AI tech, the ongoing energy transition and decarbonisation, as well as demographic change.”

Mercer's Delen is also a proponent of investing in private markets: “There are many ways to invest sustainably, for example via green bonds and infrastructure equity funds on the listed side. But the beauty of private markets is that you can tailor investments to your needs and values. If you're interested in renewable energy, you can decide if that's solar or wind parks, or providing people with access to renewable energy, or investing in technology. A transition is long term and that's what speaks to private markets because their profitability is long term.”



## Power to the people

In addition to transitioning portfolios, investors also have a vital role to play in promoting regulation and legislation that accelerates the transition to a decarbonised economy, says Tessa Younger, better environment lead at CCLA.

“This can be done in conjunction with investor industry groups such as the Institutional Investor Group on Climate Change, but also by keeping an eye out for consultations where the investor voice may be less well represented, such as the Department of Transport's consultation on developing infrastructure projects for road and rail networks.”

The consensus is policymakers need to do more. While policies such as subsidies or tax incentives for climate solutions already exist, Federated Hermes' Tutt says policymakers should provide greater guidance and commitment on the development of public policy in the coming years. Indeed, the Schrodgers Institutional Investor study found 51% of global respondents across all markets recognised the need for more support in measuring and tracking net zero targets.

However, there are pockets of optimism. Dr Rory Sullivan and Robert Black, CEO and head of responsible investment at Chronos Sustainability respectively, are more upbeat on the level of policymakers' ambition globally, citing examples such as the US Inflation Reduction Act, the European Union's Fit for 55 and RePowerEU plans, Japan's Green Transformation (GX) policy, and China's 1+N policy framework.

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“Climate change is starting to move from a standalone policy issue to one where policymakers are now thinking about how to make climate policy an integral part of long-term economic development,” they said.

In the UK, the government recently ran a call for evidence on scope 3 or indirect greenhouse gas emissions reporting in the UK. CCLA responded by advocating for mandatory disclosure for UK-listed companies.

Younger says: Having comprehensive emissions data across all scopes would allow investors to effectively engage with and encourage high-emitting companies to commit to science-based decarbonisation strategies.”

## Conclusion

Once asset owners have outlined their goals – whether they are pursuing carbon neutrality or have net zero ambitions – it is advisable to promptly establish credible climate transition plans. While decarbonisation can be linked to financial opportunities it is worth bearing in mind that not all decarbonisation technologies are equal. Furthermore, the real-world implications of divestment from high-impact sectors versus engagement should be carefully considered and monitored. Alongside active ownership, asset owners can accelerate the transition to a decarbonised economy by supporting and promoting green regulation.

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