Asia Investor Group on Climate Change (AIGCC)

Key insights from Asia's institutional investors on climate scenario analysis, decarbonisation, and fossil fuel policies

February 2024

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AIGCC
ASIA INVESTOR GROUP ON CLIMATE CHANGE

Asia Investor Group on Climate Change (AIGCC) convened a series of closed-door investor dialogues in 2023 to enable candid conversations among Asian institutional investors on their views and approaches across various climate themes, and the resulting portfolio implications.

The discussions were held under Chatham House rules. However, this Memorandum summarises the key insights that emerged from them. The topics covered in the dialogues included[1]:

1. Views on the use of climate scenario analysis.
2. Net zero implementation experiences in Asia, comprising:
    a. corporate engagement for decarbonisation and net zero and low carbon economy in Asia.
    b. Asian investor perspectives on setting net zero targets.
3. Perspectives on fossil fuel policies and managed coal phaseouts in Asia.

THE CONTEXT

The investor dialogue series was launched in early 2023 as a forum for investor members to engage with industry peers on various climate topics. The topics were selected based on member requests and in response to the evolving climate/net zero investing landscape in Asia. While certain sessions were invitation-only, others were held as part of AIGCC's working groups or monthly member meetings, in the form of virtual panel discussions followed by Q&A from attendees.

Recognising that there is no 'one-size-fits-all' approach to the above topics, due to regional geopolitical, social, and environmental nuances, AIGCC aimed to encapsulate as many investor viewpoints as possible. Consequently, each dialogue included perspectives from both asset owners and asset managers, either regionally headquartered in Asia or internationally headquartered with large investments in Asia.

These conversations were intended to strengthen the case for climate/net zero investing among different types of institutional investors, by recognising shared experiences, acknowledging unique differences in investment challenges, gaining market-specific insights, and identifying areas suitable for multi-stakeholder collaboration.

[1] An additional summary of outcomes on integrating deforestation issues into the investment process is available in the AIGCC Forest and Land Use working group – Year-in-review report.

INSIGHTS FROM PARTICIPANTS

CLIMATE SCENARIO ANALYSIS

Discussion centred on the usefulness of scenario analysis tools from a practitioner's perspective, as institutional investors respond to more stringent regulatory frameworks, and to growing sophistication in climate science and modelling tools. Key insights are set out below.

- Most investors utilise and benefit from commercially available tools, but climate scenario analysis is rarely the key driver in decision-making.
- Investors see the benefits of climate scenario analysis as a reference tool to evaluate and identify higher climate risk exposures in their portfolio companies.
- Climate scenario analysis generally needs to be consistent and repeatable, and needs to provide actionable insights.
- Despite certain benefits in commercially available tools, investors often work with trade-offs between 'model comprehensiveness' and 'agility assumptions'. For this reason, some investors opt to devise simpler and more flexible scenarios.
- The useability of climate data in investment decisions is influenced by the assumptions built into a scenario pathway, and the level of expertise available to interpret the information.
- Investors agree that transition climate risks are easier to cover in their assessments than physical risks, with asset-level data being especially valuable for investment decisions.
- Although most investors adopt a bottom-up integration approach for climate scenario analysis, some have also advocated complementing this with a top-down approach that serves different purposes, such as responding to regulatory frameworks and screening outliers and risks.
- Investors tend to use NGFS, IPCC, and IEA scenarios to analyse the alignment of their investment portfolios with a 1.5°C pathway.
- Investors want more robust near-term views in scenario pathways, because this would improve their capacity to set net-zero targets.

NET ZERO IMPLEMENTATION EXPERIENCE IN ASIA

Two sessions were held on net zero implementation, one focusing on corporate engagement, and the other dealing with Asian perspectives on setting net zero targets.

a. **Corporate engagement in Asia on decarbonisation.**

Discussions focused on corporate engagement approaches to net zero or low-carbon investing (dependent on investment beliefs), key policy drivers, implementation practices when setting net zero targets, and how progress is communicated to stakeholders. Key insights are set out below.

- **Approaches vary on decarbonisation and setting net zero targets.**
    - Several asset managers that have set net zero targets may be signatories to the Net Zero Asset Managers Initiative (NZAM), and their targets set under NZAM may only cover certain asset classes, which they intend to expand over time once data quality and methodologies improve, using an iterative asset coverage approach.
    - Investors that have not, or do not intend to establish net-zero targets emphasise practical decarbonisation perspectives. In these circumstances, the focus tends to be on gaining tangible environmental impact by investing in companies that are transitioning from high-carbon to low-carbon, and/or providing green solutions.
- **Policy and implementation perspectives vary in a region as diverse as Asia, and more dialogues between investors will be helpful to understand nuances for addressing climate as a systemic risk.**
    - Investors highlighted the importance of flexibility in the adoption of climate policies due to the different geopolitical environments that influence the operation of Asia's developed and developing economies.
    - Investors should be cognisant that physical and transition climate risks are increasing exponentially but are improperly priced, and that social elements, such as a 'just transition' and the concept of a 'fair share', also need to be considered.
    - On engagement, investors emphasised the importance of not just relying on one indicator to determine how much progress companies are making. For example, a company may appear as a laggard based on weighted-average-carbon intensity (WACI), but may have a high percentage of CAPEX focussed on renewables.
    - Scope 3 should be a high priority for most investors, but they must be cognisant of the practicalities in requesting that corporates provide this information. It is hard to make progress towards a net zero or low-carbon economy without quantifying these emissions where possible. However, investors need to consider the extent to which companies can extract this data from their value chains.
    - There are challenges in engaging with companies to implement net zero targets and/or strive for a transition towards a low carbon economy. These challenges include the lack of sector-specific pathways in Asia, the complexities of engaging with companies about going beyond what's required to meet national policies, difficulties in properly assessing a company's transition commitments and the availability of technological solutions, and challenges in assessing the credibility and financial feasibility of transition across different markets in Asia.
    - It can be difficult to have conversations on transition with companies that primarily sell into local markets with a predominantly local investor base, where advocacy and proxy methods may have less impact.

- To encourage companies in their low carbon transition, a gradual approach based on engagement is important, rather than binary allocations into 'aligned' versus 'not aligned'. Comments were made that increased levels of engagement can be a better alternative to divestment, particularly for companies in hard-to-abate sectors.

- **Investors should examine the spectrum of investment opportunities and issues that affect trajectory pathways to net zero.** These include the take-up of electric vehicles and other enablers of decarbonisation, the extent to which companies are in transition, and stranded asset risks.
- **Investors are keen to spotlight companies** in the region that have made progress, and to demonstrate their own progress against targets, within their net zero and stewardship reports.

b. *Asian investor perspectives on setting net zero targets*

In the context of the preliminary results of the *State of Net Zero Investment report in Asia* shared with AIGCC members, this discussion reflected on the reasons for setting net zero goals, steps involved in target-setting, and the implementation process. Key insights are set out below.

- **Setting net zero goals improves the strategic direction of investments across the portfolio and catalyses time-bound action on addressing systemic climate risks**. It is also a response to increasing regulatory pressures and client demands, and is aided by evolving industry frameworks that support investors with net zero targets.
- **Internal education and capacity building on climate risks and opportunities is labour intensive but necessary for investors.** At the board level and within investment teams, across technology, compliance etc, and in conjunction between asset owners and asset managers need to make a considerable investment in staff and systems to respond to evolving expectations on target-setting and performance monitoring. Continuous and sustained resourcing is required to address climate change properly.
- **Climate targets and objectives should be actionable and implementable.** With nuance at the country level, the focus should be on achieving real-world emission reductions, for example by focusing on hard-to-abate and high-impact sectors within portfolios, or on setting goals to increase allocations of transition and climate solutions finance. Progress depends on assessing the credibility of corporate climate transition plans and using these to drive stewardship. Investors should make their own assessment of companies' net zero alignment, which should be informed by internal research and engagement that can fill gaps and complement reported data.

Investors commented that acting to mitigate systemic climate risks where feasible is part of the fiduciary duty they owe to beneficiaries and clients. Investors are seeing the incorporation of climate objectives and net zero ambition in investment mandates, which clarifies their duty to consider climate change.

PERSPECTIVE ON FOSSIL FUEL POLICIES

- Participants discussed investors' internal fossil fuel policies in the context of enabling managed coal phaseouts in Asian markets. There are diverse approaches on fossil fuel policy. In implementing action, different incentives or mandates need to be considered for asset owners and asset managers, and the views and actions of broader stakeholders – such as corporates and governments – are also important.
- **In an environment where Asia's energy demand and share of decarbonisation will continue to rise,** investors are encouraged to continue scaling green finance, to stop expanding high-carbon assets such as new coal, and to transition existing brown assets.
- **Development and focus on fossil fuel policies has evolved in Asia.** While exclusion policies play a role, many investors are moving away from pure exclusion policies across parts of the portfolio to a more dynamic approach involving engagement for transition planning/ responsible early retirement and escalation.
- **Creating an enabling environment for managed coal phaseout should consider** the pace of investment in renewable energy, the potential for stranded assets caused by a managed phaseout, just transition aspects, and national policy and strategy. Investors who finance early-retirement projects may also consider reporting these financed emissions separately. Although the financed emissions have increased in the short-term in order to finance necessary fossil fuel phaseouts, the investors could also demonstrate the intended impact by retiring the coal assets earlier that its useful lifetime and they would not otherwise be funding these assets.
- **Managed coal phaseouts are not an issue that can be decided by a single company nor investor, and government strategies as well as an economy's supply of energy will influence investor actions.**
    - Investor actions are signals to society that take account of government coal policies. In this light, several investors commented on the role of engagement initiatives like the Asia Utilities Engagement Program (AUEP) and energy transition roundtable discussions that support more in-depth conversations and engagement between investors and governments to facilitate financing structures that allow investors to assist companies to transition away from coal.
    - Carbon pricing and carbon levies could be considered.

Way Forward

The insights gained from these investor dialogues contributed to a shared understanding of the evolving policy and investment landscape in Asia, and investors' approaches and perspectives on various climate themes.

Importantly, these conversations are also intended to provide investors with a safe space to share views on challenges, and avenues to overcome these, through candid conversations that identify and facilitate collaboration and multistakeholder engagements.

AIGCC intends continuing these dialogues in 2024, with the aim of exploring new topics, as well as deepening understanding of existing topics.

Acknowledgements

We would like to express our appreciation to all participants in our investor peer to peer dialogues, who have provided their insights on important climate themes.

These peer-to-peer sessions were attended and participated by a range of AIGCC members. For more information on current AIGCC members, please visit our webpage. Among those who are willing to be named, we would like to thank: AIA, Cathay Financial Holdings, Fidelity International, Generation Investment Management, Manulife Investment Management, MFS Investment Management, Neuberger Berman, and Schroders.

ABOUT AIGCC

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The Asia Investor Group on Climate Change (AIGCC) is an initiative to create awareness and encourage action among Asia's asset owners and asset managers about the risks and opportunities associated with climate change and low-carbon investing. AIGCC provides capacity for investors to share best practice and peer-to-peer learning on sustainable investment, risk management, corporate engagement and policy advocacy. With a strong international profile and significant network, AIGCC represents the Asian investor perspective in the evolving global discussions on climate change and the transition to a greener economy. AIGCC has over 70 members from 11 markets and with over USD 35 trillion in assets under management.

APPENDIX

GUIDING QUESTIONS ACROSS ALL INVESTOR DIALOGUES

Views and applications of climate scenario analysis

1. An overview on climate scenario tools currently used by respective investors.
    - Which tools or combination of tools are used?
    - What is the main purpose for using these tools?
    - Are they fit for purpose?
2. What do investors really think about existing climate scenario analysis tools (pros and cons)?
    - What are the limitations of the tools / which elements are not addressed?
3. What additional functions would you like to see in these climate scenario analysis tools?

Net Zero Implementation in Asia

a. Corporate engagement for a net zero and low carbon economy

1. An overview on net zero positioning by respective investors. What kind of investor are you/which asset classes do you invest in? Have you set net zero targets? Why or why not?
2. Can you comment on the key drivers for setting net zero targets, and what challenges and limitations have you experienced when doing so in Asia?
    a. Policy perspective – what macro-drivers are impacting your net zero targets?
    b. Implementation – how do you align net zero targets with portfolio construction and engagement? Do you have a watchlist, and can you comment on the mechanisms you use, and your annual engagement priorities?
3. What are the pros/cons from your perspective of implementing an (interim) net zero target in your portfolios across Asia?
    - What are the main gaps and challenges for setting the targets across Asia? how do you align expectations for net zero alignment with the Nationally Determined Contributions of different Asian markets?
    - What asset classes or target types are you covering?
4. For those involved in AUEP and CA100+, what are the complementary themes / topics that would be useful when engaging with companies on net zero targets? Does that differ across markets / sectors?
5. How has the idea of net zero affected your decision-making in portfolio company assessment?

b. Asian Investor perspectives on setting net zero targets

1. Why did your organisation decide to set net zero targets and what was the trigger point?

2. What were the primary challenges in setting a target and how did you overcome them?
3. What specific actions and strategies is your institution implementing to achieve your net zero target?
4. How have these actions/strategies evolved over time?
5. How does your institution ensure accountability in relation to your net zero target? (e.g. governance structures, executive remuneration, disclosure and transparency)
6. How does your organisation think about scaling up investments to net zero by setting climate solutions targets, investing in renewables etc? Are there any particular investment opportunities you are exploring in this space?
6. How does your organisation view emerging/developing markets in line with net a zero strategy?
7. How are you considering and managing deforestation and nature-related risks? What is your deforestation strategy/ targets etc?

Perspectives and Approaches to fossil fuel policies and managed coal phaseout in Asia

1. Setting the scene – where we are in Asia in terms of energy transition/managed phase-outs?
2. How do different investors with different mandates think about managed coal phaseouts in terms of:
    a. Policy (e.g. we won't invest a policy),
    b. Integration approach (how are NDCs and climate regulation changing, are there sufficient incentive in those geographies to undertake a managed phase-out)
3. What are the incentives for asset owners as a stakeholder?
    a. What are the asks from their constituents regarding coal phaseouts? Is it more from a materiality perspective?
    b. What is the thinking from asset owners on coal policy for asset managers?
    c. Are they applying a managed phase out by country or by company and asset level (i.e. how macro or micro is the view)?
4. How much of what corporates are willing to do is ring-fenced by governments? Where are the pockets of under-appreciated risk?
5. What would create the political motivation to phaseout coal faster?
6. Where is Asia on all of this?