

RESPONSIBLE INVESTMENT

# Net Zero Asset Manager Initiative Commitment



*Across Quilter we have identified three thematic engagement priorities. This is part of our climate change theme.*

Climate Change is the defining issue of our time and we are at a defining moment. From shifting weather patterns that threaten food production, to rising sea levels that increase the risk of catastrophic flooding, the impacts of climate change are global in scope and unprecedented in scale. Without drastic action today, adapting to these impacts in the future will be more difficult and costly<sup>1</sup>.

## SDG Alignment



**“** *The world is reaching the tipping point beyond which climate change may become irreversible. If this happens, we risk denying present and future generations the right to a healthy and sustainable planet - the whole of humanity stands to lose.*”

*Kofi Annan, Former Secretary-General of UN*

<sup>1</sup> United Nations

In 2021 a wave of financial institutions stepped up to make net zero commitments in the run up to COP26, with different finance initiatives brought together under the Glasgow Financial Alliance for Net Zero (GFANZ). Just over a year on, there are now 301 signatories to the Net Zero Asset Manager initiative (NZAM), who have committed to manage an increasing proportion of their assets in line with net zero goals by 2050 or sooner. These signatories have a total of \$59 trillion in assets under management (AUM), with just over a third of that currently committed to be in scope of their net zero interim targets<sup>2</sup>.

This does not mean the full \$22.2 trillion<sup>3</sup> initially committed is ready to invest today in climate solutions like renewable energy or sustainable agriculture technology. While investment in climate solutions will increase over time, for that initial capital, asset managers are primarily committing to scrutinise, engage with and vote to encourage the companies to transition to low carbon business models on pathways consistent with net zero emissions by 2050<sup>4</sup>. This should then mean that asset managers see the greenhouse gas emissions of their investments reduce over time in line with their 2050 net zero commitments. Pushing for change across industries is as important as investing in climate solutions, given that only 16% of listed global companies are currently aligned with future warming of 1.5 degrees<sup>5</sup>.

After becoming signatories, asset managers have 12 months to set out the percentage of AUM they are initially committing, their approach to their chosen methodology, baseline data and their 2030 targets. While most managers are following one, or a combination, of the three currently recognised methodologies (see the explainer box below), the different challenges posed by the respective asset managers' businesses mean approaches vary in practice. For example, businesses may have different proportions of active versus passive investments, investment styles, proportions of AUM invested in different asset classes (where methodologies are still being developed for some asset classes like sovereign bonds), size of responsible / sustainable investment product ranges, levels of stewardship resource, degrees of sophistication of climate risk data analytics, and different client bases.

2022 saw an anti-ESG (environmental, social, governance) backlash gain powerful momentum, particularly in the US, which has made many asset managers more cautious when setting out their net zero commitments. Vanguard, for example, had committed just 4% of its \$7 trillion AUM, but withdrew from NZAM at year end citing the difficulty it will have in committing the 80% of its AUM invested in passive funds via its approach to its chosen methodology. NZAM has acknowledged the politicisation of ESG issues, the different regulatory and policy environments that asset managers operate in, and the challenge faced by asset managers with significant passive investments, which are typically tied to following their market benchmarks<sup>6</sup>.

At Quilter Cheviot, we believe a good NZAM plan is one that targets real-world change through a targeted engagement framework, including an escalation policy, in addition to reductions in portfolio emissions over time. These are some of the questions we are currently considering:

**Q Is the approach to net zero focused solely on specific emissions reductions targets or is the emphasis on real world change?**

**A** It is important that asset managers do not just sell out of all high-emitting company holdings simply to reduce their overall portfolio carbon footprint or their overall portfolio temperature alignment. These divestments would have no real-world impact because another investor – perhaps one less motivated to engage on net zero transition plans – would buy the shares in the secondary market. Also, variables like GDP growth and inflation can influence emissions calculations, so year-on-year change may for example reflect a slowing or accelerating economy rather than an intentional reduction in emissions.

**Q Does the asset manager have data systems to support the methodology it has chosen?**

**A** The SBTi (Science Based Targets initiative) sectoral decarbonisation approach, for example, is more data intensive than a SBT portfolio coverage approach.

<sup>2</sup> The Net Zero Asset Managers initiative – An international group of asset managers committed to supporting the goal of net zero greenhouse gas emissions

<sup>3</sup> NZAM update – November 2022 initial target disclosure – The Net Zero Asset Managers initiative

<sup>4</sup> AOA\_FAQ.pdf (unepfi.org)

<sup>5</sup> MSCI-Net-ZeroTracker-October.pdf

<sup>6</sup> NZAM update – November 2022 initial target disclosure – The Net Zero Asset Managers initiative



**Q How much AUM is being initially committed and how does this measure up with the approach being taken?**

**A** Ultimately, credibility and authenticity are more important than the initial percentage deemed in scope. If a firm commits a very low percentage of AUM, what is stopping them from committing a higher percentage? Does the percentage reflect bottom-up consideration of the portfolios and funds that are now being managed in line with reaching net zero by 2050? If the low percentage reflects solely the sustainable investment mandates / funds of the business, how does the asset manager plan to increase the percentage over time across the rest of AUM? Is it an active work in progress to work with clients to increase that percentage?

Equally, if a firm commits a high percentage of AUM, is this reflecting a high-level sum of investments in asset classes like equities? Is the approach then deep enough to be credible for that high proportion or does it reflect a business-as-usual approach while waiting for government and policymakers to act?

**Q Is there a focus on strategy, governance and engagement?**

**A** This includes considering whether asset managers are scrutinising company decarbonisation plans, engaging with companies where these plans are not ambitious enough or where capital expenditure plans do not align with net zero targets, and engaging with policymakers. Other questions are whether the asset manager has a framework in place for engaging with companies and tracking progress on key milestones, and whether the fund managers themselves engage with companies or if the central stewardship teams are the only ones engaging with companies. Given fund managers have often engaged with company management over many years and developed constructive relationships, we think it is helpful for them to be part of the climate related engagements. This demonstrates to a company that its net zero aligned transition plans are important for investment returns.

**Q The financial services industry also cannot act alone. Governments and policymakers need to provide credible strategies, regulation and policies aligned with 1.5 degrees.**

**A** This gives clear, long-term signals to companies of the upcoming demand for technologies and infrastructure that will deliver the governments' top-down strategies. An example of this in action is the UK government's commitment to ban sales of new petrol or diesel cars or vans from 2030. This provides a clear signal to consumers, auto makers, and those providing infrastructure and component parts, of the rise of electric vehicles and decline of the internal combustion engine. In the United States, Joe Biden's Inflation Reduction Act (IRA) and Bipartisan Infrastructure Law (BIL) are also examples, making renewable energy, energy efficiency and electric vehicles more affordable to American households, and providing certainty for renewables, energy storage, renewable energy infrastructure and carbon sequestration projects. NZAM acknowledges the need for governments to follow through on their own net zero commitments for signatories to deliver on their net zero goals.<sup>7</sup>

Overall, even if we have reservations about the detail of some of the commitments being reported, we think it is easier to engage with asset managers on their progress towards net zero when the manager is a NZAM signatory rather than for them to have no plan formally set out at all.

In 2023, Quilter Cheviot will continue its discussions with fund managers and sustainability teams to assess the approaches they are taking to NZAM commitments, percentage AUM committed, and progress on implementation.

Where we see a lack of consistency between NZAM commitments and broader behaviour by the firm or the fund managers we invest with, we have and will continue to engage with them. We will also continue to speak to asset managers that have yet to sign up to NZAM to understand their reasons and advocate why we believe a net zero commitment is important.

Our assessment of how managers are integrating ESG factors into their investment decision making is an ongoing process. So too will be our consideration of how managers are approaching and acting on their net zero commitments. The path to net zero involves a steep learning curve and no one is expected to have the perfect plan in place today for getting there. We recognise the significant challenges posed to asset managers by the anti-ESG backlash and will watch to see if and how NZAM adapts over time to support asset managers to remain signatories, while also watching for whether any allowances made by NZAM end up rendering the commitments meaningless.

While some are critical of the NZAM commitments, we believe they can help align AUM over time to critical decarbonisation goals as well as to the massive opportunity set presented by the energy transition. Time is slipping away to be able to limit warming to 1.5 degrees, so it is imperative for firms to progress from target setting to taking decisive action to deliver on the approaches they have set out to reach their net zero goals.

## Where are we now?

Currently, 40.7% of the third-party managers Quilter Cheviot invests in are NZAM signatories or are in the process of setting targets.

## Explainer

### Q What is net zero?

**A** Under the 2015 Paris Agreement, countries agreed to cut greenhouse gas emissions with a goal to limit global warming to well below 2, preferably to 1.5 degrees Celsius compared to pre-industrial levels<sup>8</sup>. To limit warming to any level, we must reach net zero emissions – that is, reduce greenhouse gas emissions to as close to zero as possible with any remaining emissions re-absorbed from the atmosphere. 1.5 degrees is considered as a planetary boundary after which the risk greatly increases of setting off negative feedback loops that speed up the pace of warming and of crossing various tipping points that will make the warming irreversible<sup>9</sup>. But with emissions still rising, the scale and the time frame of the challenge is huge – emissions need to stop increasing by 2025 and to then fall by 45% by 2030, reaching net zero by 2050. To restate the words of former US Vice President Al Gore, what is required now is a global sustainable revolution on the scale of the industrial revolution but at the speed of the digital revolution.

### Q What is the NZAM initiative?

**A** Intensive collaboration and action across all industries is needed to stay within 1.5 degrees of warming. The Net Zero Asset Managers initiative (NZAM) was launched in December 2020 to enable and accelerate the role asset managers play in helping to deliver the goals of the Paris Agreement and to ensure a just transition. NZAM sits alongside net zero initiatives for other parts of the financial system like the Net Zero Banking Alliance, Net Zero Insurance Alliance and Net Zero Asset Owner Alliance. These initiatives come together under the Glasgow Financial Alliance for Net Zero (GFANZ).

As of 31 December 2022, NZAM has 301 asset manager signatories with a combined AUM of \$59 trillion<sup>10</sup>.

### Q What does the NZAM initiative involve?

**A** NZAM has three recognised methodologies (see below) for asset managers to follow and after becoming a signatory, each asset manager is given 12 months to set out their chosen approach, their interim targets for 2030, and any other targets. Asset managers must also specify how much of their AUM they are initially committing to their approach. This amount is expected to increase over time until their AUM is fully committed to achieving net zero by 2050. In practice, these have ranged from low single digits to 100% of AUM. Each asset manager must then disclose and report on progress on an annual basis.

<sup>8</sup> The Paris Agreement | UNFCCC

<sup>9</sup> Aviva Investors - climate emergency roadmap

<sup>10</sup> The Net Zero Asset Managers initiative - An international group of asset managers committed to supporting the goal of net zero greenhouse gas emissions



**Q What are the three recognised methodologies?**

**A** NZAM sets out the following three methodologies. A combination of these approaches is also permitted, as is a customised approach subject to the Institutional Investors Group on Climate Change (IIGCC) approval or the approval of one of the other six network partners.

**1. Net Zero Investment Framework (NZIF).**

This combines several different pillars including emissions reduction targets, targets for investments in climate solutions, engagement and policy advocacy. A key element is implementing an engagement goal to ensure 70%+ of financed emissions in material sectors are either aligned to a net zero pathway or aligning and subject to direct or collective engagement and stewardship actions. NZIF has so far been the most popular methodology chosen by asset managers.

**2. Science Based Targets initiative (SBTi).**

There are three approaches for financial institutions for listed equities and bonds, and private equity. The approaches for asset classes like sovereign bonds are still being developed.

- Sectoral Decarbonisation Approach (SDA): net zero pathways are translated into benchmarks for different sectors against which the performance of individual companies can be compared. A portfolio decarbonisation reference target is set. SBTi's guidance for some sectors is still being developed.
- Portfolio coverage: this involves looking at what proportion of investments are invested in companies that have set Science Based Targets and then setting a target to ensure that 100% of AUM has set Science Based Targets by 2040.
- Temperature rating: the asset manager uses the reported greenhouse gas emissions reduction targets of their investee companies to assess the overall portfolio temperature trajectory and then target a long-term temperature goal.<sup>10</sup>

**3. Net Zero Asset Owner Alliance.**

Members are expected to set out targets on four main pillars: sub-portfolio emission targets, sector targets, financing transition targets (including tracking climate solution investments) and engagement with the highest emitting companies as well as with policymakers.



**Melissa Scaramellini CFA**  
ESG Fund Research Lead

<sup>10</sup> Temperature Rating Methodology ([sciencebasedtargets.org](https://sciencebasedtargets.org))

To find out more about Responsible Investment at Quilter Cheviot visit our **website**.  
A glossary of terms can be found **here**.

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