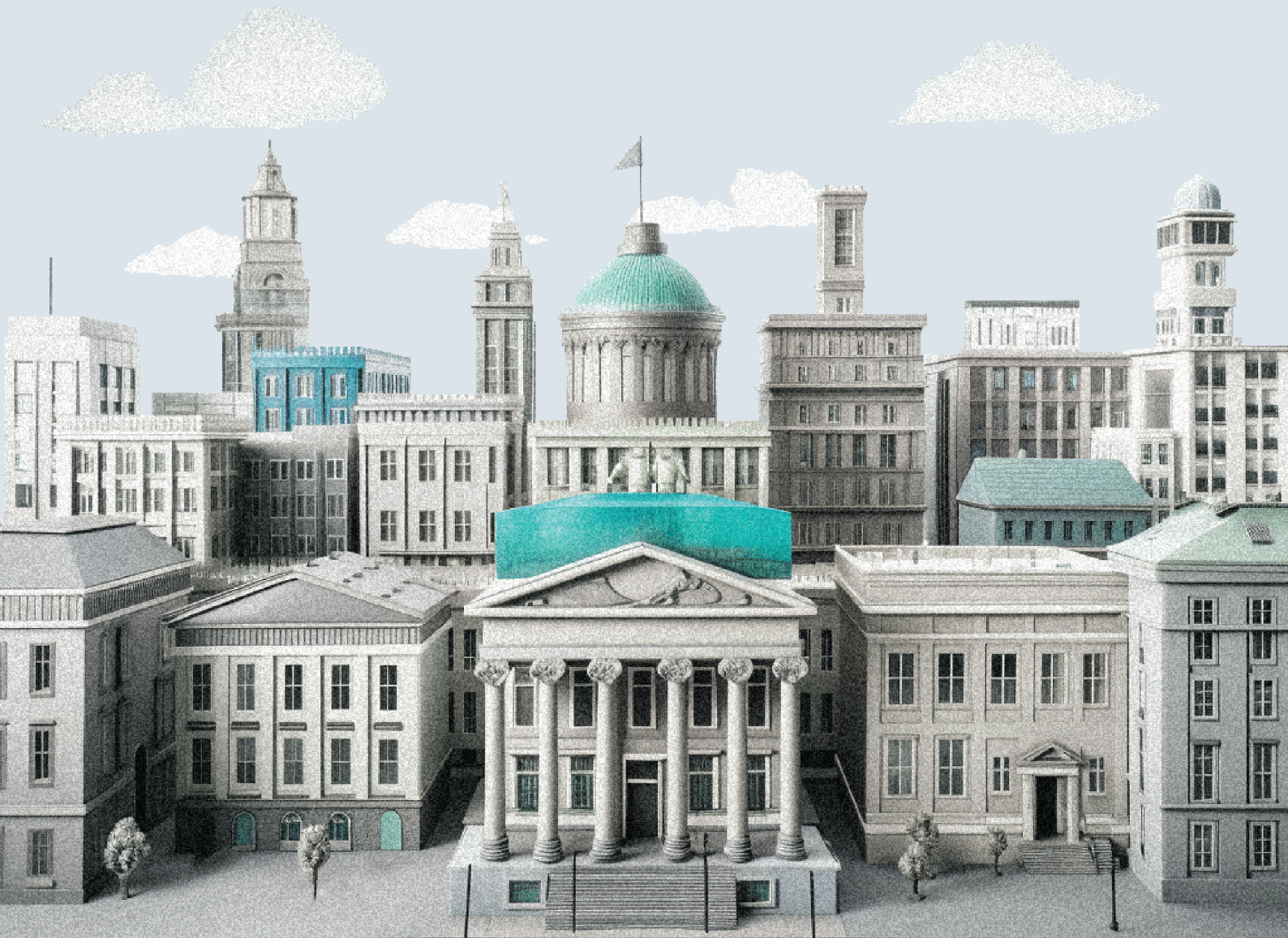


From Rhetoric to Reality:

INVESTIGATING FINANCIAL INSTITUTIONS' NET ZERO PORTFOLIO COMMITMENTS

September 2023



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SUMMARY

- As of July 2023, 37 of the world's largest 50 asset managers, 24 of the largest 50 asset owners, and 33 of the largest 50 banks have committed to net zero portfolio targets.
- There are questions with regard to the impact of net zero portfolio targets in driving financial institutions' climate action and how that relates to decarbonising the real economy. We focus on the world's 50 largest asset managers to underpin our analysis. We assess the integrity of net-zero portfolio commitments and compare it to a set of qualitative and quantitative metrics indicative of the financial institution's climate action.
- As they are, most of the analysed net zero portfolio commitments are unlikely to achieve what they intend or purport to – net zero real-world global emissions by mid-century. In most cases, net zero portfolio targets do not represent a shift towards serious climate action at the financial institution.
- Intensity-based sectoral targets may help reduce portfolio risk but are not particularly effective in supporting financial decision-making to drive a low-carbon transition. The same may also be true for absolute targets, where the underlying portfolio composition is changing without comprehensive re-baselining.
- Given the short-term focus of many investors and the long-term nature of financial institutions' net zero portfolio targets, it is questionable if such targets meaningfully contribute to reaching international climate goals. Short termism remains a barrier to drive comprehensive collective action.
- Instead, we recommend that financial institutions focus on supporting the transition of economies and economic actors by identifying, engaging, building coalitions to advocate for, and systematically supporting actors transitioning to more sustainable business models. Financial institutions should have an intrinsic interest in helping economies transition and contribute to net zero – especially universal owners, that hold large amounts of, and diverse, assets under management.
- More stringent oversight policies are needed to prevent greenwashing and avoid fragmented and ineffective climate action without any collective vision.

TABLE OF CONTENTS

01	Introduction	1
02	Real world value of net zero portfolio targets	6
03	Internal value and prioritisation of climate from net zero portfolio targets	11
04	Recommendations: exploring alternative approaches for financial institutions in climate action	20
	Appendix	23
	References	25

LIST OF FIGURES

Figure 1	Overview of major regulatory and other sustainable finance developments and the uptake of net zero targets within financial institutions	3
Figure 2	Geographical location and AUM of the world's 50 largest asset managers	12
Figure 3	Comparison total AUM and AUM that are subject to a net zero portfolio target by asset managers that have publicly set a net zero portfolio target	13
Figure 4	Types of asset managers' net zero portfolio interim targets	15

LIST OF TABLES

Table 1	Target types and integrity	14
Table 2	Current practices of asset managers with an official engagement target	18
Table 3	Overview of analysed asset managers	24

LIST OF BOXES

Box 1	Emergence of net zero portfolio targets	4
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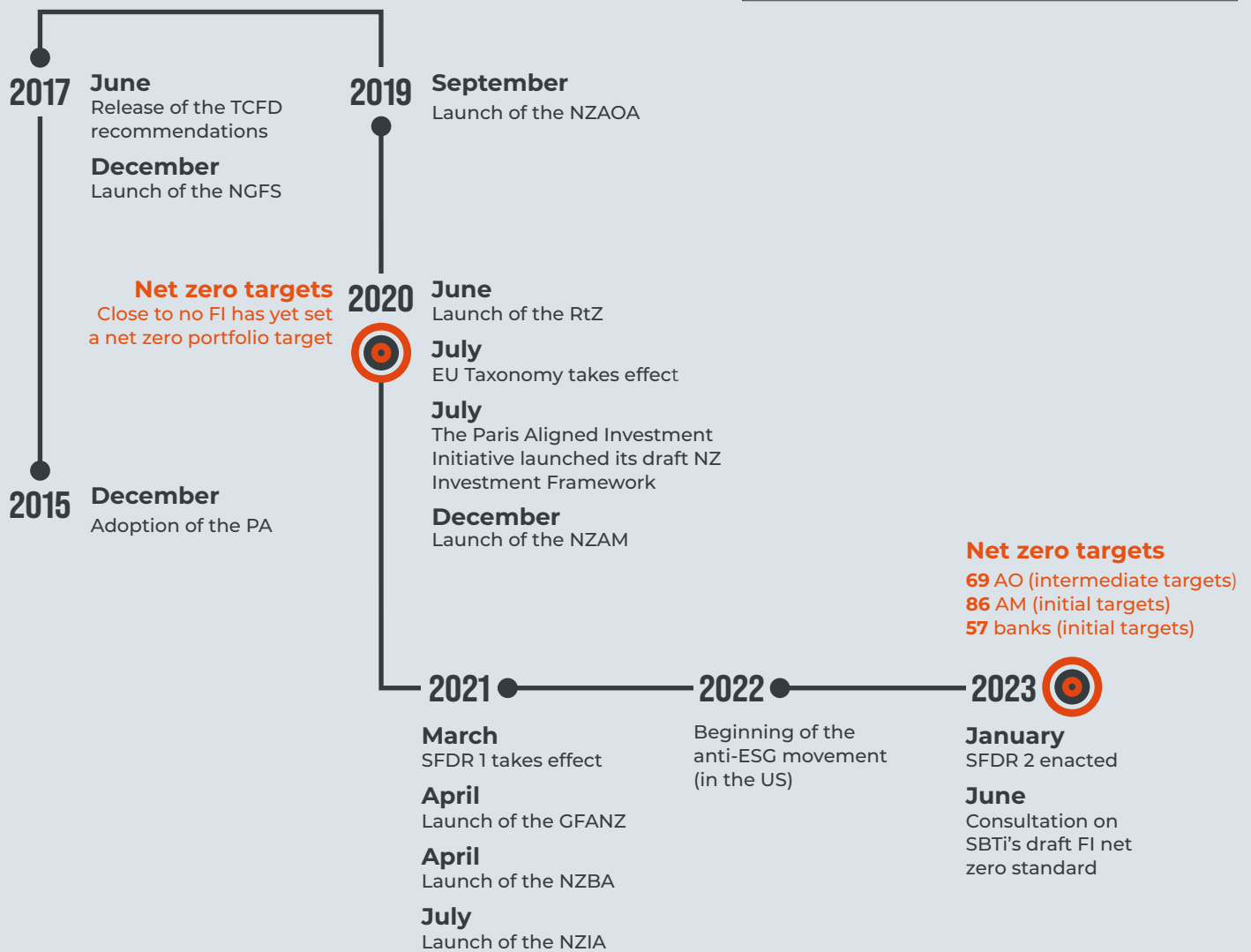
➤➤ 01 INTRODUCTION

Despite recent pushback on the environmental, social, and corporate governance (ESG) agenda in some jurisdictions, climate change remains solidly on the radar of financial institutions, with continued growth of net zero targets (→ **Figure 1**). A large majority of those net zero targets cover portfolio emissions. Portfolio emissions are the emissions from financial institutions' on- and off-balance sheet activities covering lending and investing as well as other facilitated emissions from their underwriting, securitisation or advisory services, among others (SBTi, 2023). They are by far the largest source of emissions for financial institutions, with financed emissions outweighing direct GHG emissions by a factor of 700 (CDP, 2020).

This report aims to shed light on net zero portfolio targets' **internal climate prioritisation value** (Do they drive financial institutions' climate action?) and **real-world impact value** (What can we expect from those targets? How useful are they to achieve international climate goals? Do we need them?). We place a specific focus on the world's 50 largest asset managers to illustrate our messages, given their steering function and large volume of assets under management, and recent trends in target setting and implementation. Finally, we propose a few next steps for financial institutions and regulatory bodies, looking also at alternatives to net zero portfolio targets.

Figure 1

Overview of major regulatory and other sustainable finance developments and the uptake of net zero targets within financial institutions



Box 1**Emergence of net zero portfolio targets**

A series of events and factors have led to the growing popularity of financial institutions' net zero targets. One pivotal event was Mark Carney's influential speech on the "Tragedy of the Horizon," in 2015 when he was governor of the Bank of England and chairman of the FSB, which drew attention to the threat that climate crisis poses to financial stability (Carney, 2015). This led to the establishment of the Task Force on Climate-related Financial Disclosures, fostering greater awareness of climate-related risks for financial institutions and the overall financial system (TCFD, 2021). Financial institutions are already experiencing both physical and transition risks associated with climate change, and these risks are projected to intensify in the coming decades. As a result, financial regulators in various jurisdictions have recognized climate change as a potential systemic risk and have advocated for climate stress tests and non-financial disclosure mandates.

The Paris Agreement mainstreamed the idea of achieving "a balance between anthropogenic emissions by sources and removals by sinks of greenhouse gases", which has inspired many to advocate for the adoption of net zero targets. Article 2.1c specifically calls for aligning financial flows with the goals of the agreement (UNFCCC, 2015). Additionally, several net zero financial alliances, many of them backed by the United Nations, as well as industry-led standards provided by the Science Based Target initiative (SBTi) and others were established, marking a major milestone in the push towards net zero targets (SBTi, 2022). These alliances have significantly contributed to and encouraged financial institutions to calculate their portfolio emissions and set specific targets to address climate-related challenges.

While financial actors initially set net portfolio zero targets mostly to mitigate financial risk (driven by the TCFD), increasingly more and more set targets also to create an impact on the real economy. In fact, the financial net zero alliances explicitly highlight and strongly encourage prioritising real-world impact. Still, a bias towards the accounting exercise of going to net-zero rather than driving impact remains.

GROWING CRITICISM OF FINANCIAL INSTITUTIONS' NET ZERO TARGETS

There are growing concerns about the credibility and integrity of financial institutions' net zero targets, with growing accusations of greenwashing. In 2022, InfluenceMap found that financial institutions undermine their own net zero targets by effectively continuing funding for fossil fuels and lobbying against ambitious sustainable finance policies (InfluenceMap, 2022). In March 2023, ShareAction reviewed asset managers' interim net zero targets (including but not limited to net zero portfolio targets) and argued that the effectiveness of those targets to contribute to meeting the Paris Agreement goals is questionable due to serious divergence and limitations with regards to asset coverage, target construction methodologies, portfolio composition, and target ambition (ShareAction, 2023). In June 2023, Reclaim Finance demonstrated how 30 big asset managers, mostly

from Europe, contribute to aggravating the climate crisis instead of following through on their public climate commitments (Reclaim Finance, 2023). In August 2023, InfluenceMap published a report highlighting a significant disparity between the growing net zero promises made by major asset managers and their lack of meaningful near-term climate actions, indicating stagnant stewardship efforts resulting in portfolios misaligned with climate goals and insufficient policy backing (InfluenceMap, 2023).

>> 02 REAL WORLD VALUE OF NET ZERO PORTFOLIO TARGETS

The real-world value of net zero portfolio targets is determined by the impact that those targets have in driving GHG emission reductions in the real economy. Achieving tangible emission reductions through portfolio targets is not straightforward. While financial institutions bear responsibility for their financed and facilitated emissions, they have only limited and indirect say regarding their investee's GHG emissions (Kölbel et al., 2019; Kachi and Marquardt, 2022). This is fundamentally different from real economy corporate actors which, through the implementation of credible climate targets in their value chain, can directly reduce emission. Yet, all financial sector alliances highly encourage their members to prioritise or to aim for real-world impact when setting net zero portfolio targets (NZAM, 2021).

To date, there is no robust evidence that net zero portfolio targets are an effective and comprehensive solution for driving the necessary transformations in the real economy to achieve the Paris Agreement goals (Caldecott et al., 2022). Financial institutions cannot independently reduce their portfolio emissions. This links back to the indirect impact chain between portfolio targets and emission reductions in the real economy, which can only be achieved by investee companies over which financial institutions have only indirect, and seldom full control (Koelbel et al., 2019). This raises questions about the extent to which net zero portfolio targets can effectively shape real-world emissions and bring about deep transformation of the economy.

Financial institutions play a fundamental role in transitioning the economy to achieve the Paris Agreement goals. As an intermediary between in the financial system, it is their responsibility to allocate capital efficiently. At the same time, they also have a fiduciary duty to protect the savings of their customers and therefore must consider the risk return profile of their investments or loans, which in turn impacts capital allocation.

Climate change poses an imminent threat to financial stability and many companies' business models. To achieve the international climate goals, the scale of investments required needs to be substantially increased, ranging from two to eight times current levels, depending on the specific country (Lankes and Robins, 2023). Most of these investments are needed to drive the transformation of the economy, turning "grey" assets into "green" or displacing them altogether, alongside funding for Paris-aligned activities and projects. It is essential to critically assess whether net zero portfolio targets, with their focus on portfolio emissions, are the most suitable instrument for facilitating such transformative changes. The challenge lies in ensuring that these targets adequately address the conversion of existing "grey" assets and investments into environmentally sustainable "green" assets.

In a world where the real costs of climate change are not (yet) priced into corporate business models and predictions, nor financial decision-making, nor the evaluation of assets – setting net zero portfolio targets may seem a good way to align financial

flows with a 1.5°C pathway. This theory of change assumes that by aligning the carbon intensity and overall GHG emissions of portfolios with the Paris Agreement goals, financial institutions can contribute to reaching those goals.

However, it is crucial to critically examine the assumptions underpinning this theory of change, particularly concerning the concept of net zero portfolio targets. Several key assumptions warrant closer scrutiny:

- Effectiveness of exclusion, engagement, divestment, and other strategies to drive corporate action.
- Sufficient understanding in the financial industry of the complex impact chain, notably the relationship between achieving targets and creating impact.
- Using net zero corporate targets as a reliable indicator to achieve financial institutions' own net zero portfolio target.

EFFECTIVENESS OF ENGAGEMENT AND DIVESTMENT IN DRIVING CORPORATE ACTION

Financial institutions need to be able to influence investee companies to increase the likelihood that these actors effectively decrease their GHG emissions. To do so, they have several instruments at hand, including engagement, exclusion/divestment and directing capital towards specific investment opportunities, for example to enable portfolio companies to decarbonise. The effectiveness of these instruments to influence company behaviour is complex, with many variables affecting whether an investee company will effectively reduce its emissions, including timing, liquidity of markets, regulatory environment, type of asset (class) and the engagement potential of investee companies (Kachi and Marquardt, 2022). An important limitation of portfolio targets is that they only focus on emission reductions in a financial institution's portfolio, while not accounting for aggregate impacts in the real economy. As a result, in some cases, divestment may for example lead to a reduction in a financial institution's portfolio emissions, but to higher overall GHG emissions in the real economy. This counterintuitive outcome may occur when high-emitting assets are transferred to other investors that are less motivated or responsive to decarbonisation pressures. In such cases, the reduction in emissions achieved by divestment could be offset or even surpassed by the increased emissions resulting from the new owners' less sustainable practices (GFANZ, 2022b). Moreover, it is questionable what individual voluntary net zero portfolio targets can achieve considering the ongoing profitability of fossil fuels at least the short term, despite the long-term risks associated with climate change. This market failure could only be overcome by collective action among financial institutions which, however, has proven difficult (see relationship of GFANZ and the Race to Zero and the withdrawal of several financial institutions from GFANZ

following concerns regarding the alliance's strict membership requirements). Regulation on behalf of fiscal and monetary policy makers as well as financial oversight bodies not only to improve disclosure but also to reevaluate risk for emissions intensive securities, as well as clear frameworks such as standardized green taxonomies and corresponding incentives, are critically needed to shift from voluntary incentives towards broader meaningful change.

• **UNDERSTANDING THE CHAIN OF IMPACT FROM NET ZERO PORTFOLIO TARGETS TO REAL ECONOMY EMISSIONS**

It is sometimes assumed that financial institutions effectively target and know how to (contribute to) achieve real-economy emission reductions. The stated goal of net zero portfolio targets is to achieve emissions reductions in the real economy. However, achieving those emission reductions is highly challenging for financial institutions given the complex and multilayered impact chain described above. The lack of understanding of impact channels and contribution mechanisms leads to challenges for financial institutions to claim (and calculate) impact on GHG emissions in the real economy. Instead, financial institutions are advised to revisit assumptions of what happens to emitting assets when they are no longer in their portfolios, invest much more on engagement combined with coalition building and escalation strategies, which can bring about shifts in corporate behaviour.

A visualisation of the complex impact chain between net zero portfolio targets and real economy emissions can be found here: [Making finance consistent with climate goals](#).

ROLE OF NET ZERO CORPORATE TARGETS

A number of financial institutions are currently aiming for and encouraging their investees to set science-based emissions targets with a view to meet their own portfolio targets. While this may be a welcome development, the devil lies in the details. To determine the ambition of investee emissions reductions targets, many financial institutions rely on external data providers or check whether an investee has a science-based target, such as those given by the Science Based Targets initiative (SBTi). However, not all SBTi target-setting methodologies share the same rigour and ambition. While the SBTi's Corporate Net Zero Standard may offer a broadly recognized framework for long-term emissions reductions targets, their target setting approaches are still evolving and are often an issue of debate among climate experts. For example, most sectoral standards completely exclude scope 3 emissions from the temperature alignment, are outdated or allow the use of offsetting under the guise of 'insetting' (Carton et al., 2022; Bjørn et al., 2023). And even if financial institutions pushed for SBTi's corporate "net zero standard", they would need to check whether such targets had been indeed verified and endorsed by SBTi the initiative (currently many submitted targets have not yet been verified at

all and only “committed”) and also monitor continuous progress towards reaching the target (Day et al., 2023). Moreover, while other net zero corporate standards exist as well, they still diverge on several aspects, which limits comparability.

NET ZERO PORTFOLIO TARGETS: A DEFICIENT THEORY OF CHANGE

Overall, the net zero portfolio targets are conceptually abstracted from the way decision making regarding investments in emissive and decarbonising assets are made. Its theory of change can be challenged, and its impact has yet to be demonstrated. We believe that the energy and resources that are currently spent towards the adoption and increasingly the implementation of net zero portfolio targets would be better re-directed towards activities that are clearly more likely to have an impact on real-economy emission reductions and are also more aligned with the key roles and responsibilities of financial institutions in achieving the objectives of the Paris Agreement. In addition, financial institutions should carefully consider the limitations and challenges associated with relying (solely) on net zero portfolio targets to influence real-economy emissions and pursue a low-carbon trajectory. To some extent this is subject to a growing discussion, for example with the GFANZ work stream on high emitting assets. In the meantime, ambitious financial actors should also urgently take action to push for better climate plans and better business practices across their portfolio, backed up with an escalation strategy.

**>> 03 INTERNAL VALUE
AND PRIORITISATION
OF CLIMATE FROM
NET ZERO PORTFOLIO
TARGETS**

EXAMINING THE ACTION OF LEADING ASSET MANAGERS IN THE NET ZERO MOVEMENT

The internal value of net zero portfolio targets herein is defined as the extent to which net zero portfolio targets drive effective climate action at the financial institution. Net zero portfolio targets describe net zero targets set by financial institutions that (partly) cover financed and facilitated scope 3 (category 15) emissions. We focus on asset managers because of their large size and corresponding role in steering finance flows. With an estimated 115 trillion USD in assets under management, they control a significant amount of global capital (PwC, 2023). We concentrate on the 50 largest asset managers who, together, control around 86 trillion USD or close to 75% of the world's managed assets (→ **Figure 2**).

HEADQUARTER GEOGRAPHICAL LOCATION AND AUM'S OF THE 50 LARGEST ASSET MANAGERS

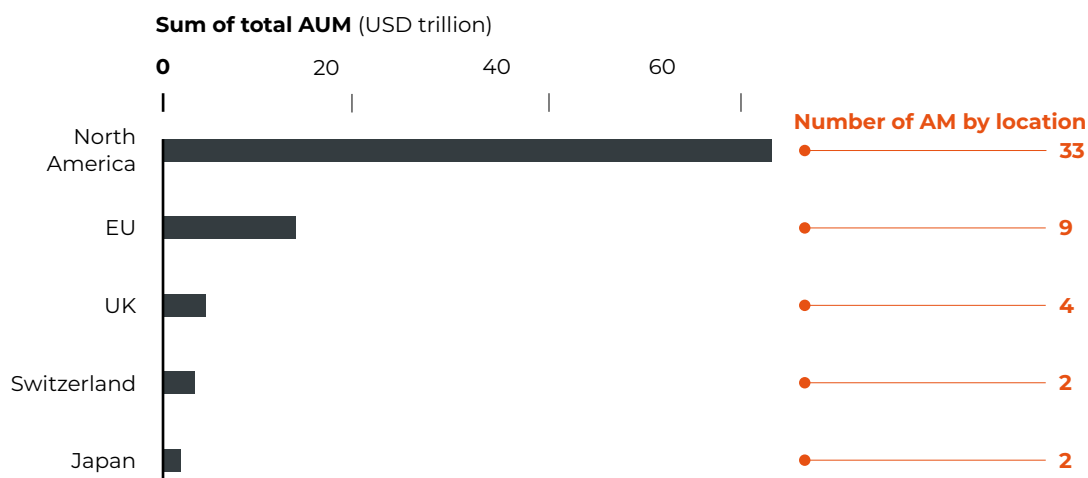


Figure 2
Geographical location and AUM of the world's 50 largest asset managers (based on latest available data)

The following sections explore five essential areas linked to the prioritisation of climate across financial institutions' business lines:

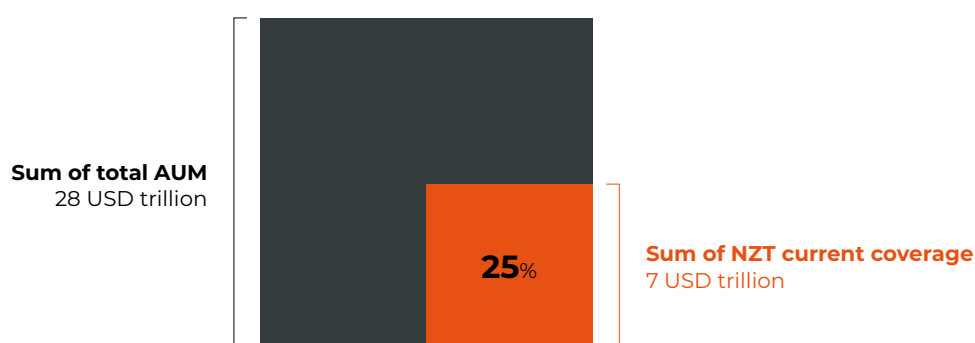
- Net zero target coverage as one proxy for long-term ambition.
- Interim targets to determine credibility and accountability.
- Transition and related plans to assess the likelihood of implementation.
- Engagement and stewardship to assess intention and seriousness to achieve targets.
- Escalation strategies as a proxy for readiness to act.

NET ZERO TARGET COVERAGE

A comprehensive net zero portfolio target would need to cover all financed and facilitated emissions, which includes also emissions of investee companies (Scope 3, category 15) (UN HLEG, 2022), and follow an emissions pathway that is aligned with science. The “materiality” of some scope 3 emissions is still however hotly debated, and while some jurisdictions are moving to call for better reporting, clear global standards have yet to emerge (Temple-West, 2023).

Nevertheless, 37 out of the analysed asset managers have set a net zero portfolio target. But on average this target currently only covers 25% of their managed assets (→ **Figure 3**). This figure varies widely and ranges from a portfolio coverage of 2%, which demonstrates a clear misalignment between stated ambition and actual ambition, to a portfolio coverage of 64%. Asset managers generally intend to expand their target coverage, citing data challenges and insufficient target setting methodologies for certain asset classes as primary reasons for low initial coverage. Yet, without further information on what exactly is covered by such targets it is impossible to judge the ambition of these targets. In fact, even if the coverage seems high at face value, an asset manager may still be able to hide “dirty” emissions-intensive assets in the non-covered share (Universal Owner, 2021; Reclaim Finance, 2023).

Figure 3
Comparison total AUM and AUM that are subject to a net zero portfolio target by asset managers that have publicly set a net zero portfolio target
 (based on latest available data)



Interim targets

Of the 37 asset managers with a net zero portfolio commitment, 33 have also set interim targets (with respect to their 2050 net zero claims), with 29 of the 33 (88%) having set 2030 as their interim target year. Only 4 of the 33 asset managers (12%) have set an absolute emissions reduction interim target (specific CO₂e reduction relative to a baseline). A little less than half (15 out of 33 asset managers with

interim targets, i.e. 45%) have only set intensity targets (a target set relative to an economic metric, usually emissions per dollar invested) (→ **Figure 4**). While intensity targets facilitate comparisons between different financial institutions/peers, they do not necessarily lead to absolute emissions reductions and thus are unlikely to be sufficient to achieve a low-carbon economy in line with the Paris Agreement (GreenPortfolio, 2023). As has been pointed out in the literature (e.g. (Sierra Club, 2022)), a net zero portfolio target that is only intensity-based is not a robust one. Investee emissions might increase or decrease because of many different reasons (e.g., change in output) that might have no effect on the investee total emissions. Financial institutions can achieve their intensity targets without ever really reducing or contributing to reducing any emissions in the real economy. Increasing investments in companies that can grow without proportional increases in emissions reduces the carbon intensity of the financial institution's portfolio. However, support for such investee companies would still likely increase absolute emissions in the real economy (→ **Table 1**).

From an ambition perspective, most asset managers replicate the 2030 IPCC target (50% reduction relative to 2019 levels) through either intensity or absolute reduction targets, with very few opting for less or more ambitious emissions reduction targets, i.e., with significantly more or less ambitious reduction targets as compared to the 2030 IPCC target.

Target type	Coverage	Usefulness for (internal/ external) analysis and steering	Impact on real economy emissions
Intensity-based targets	Full portfolio	None.	Unclear. No impact through NZ portfolio target, impact on FI's climate risk exposure also unclear.
	Sectoral	Allows for comparison of emission intensity between different FIs for a given sector or between different sectors.	Unclear. No impact through NZ portfolio target, but could help reduce an FI's climate risk exposure.
Absolute targets	Full portfolio	Only if regular portfolio 're-baselining' is conducted.	Unclear. Unclear whether impact, could help reduce FI's climate risk exposure.
	Sectoral	Can provide helpful information and actionable guidance on FI's mitigation impact for a given sector.	Possible. Impact unclear, could decrease FI's climate risk exposure.

Table 1
Target types and integrity

Eight out of the 33 asset managers that have set interim targets (24%) have either only sectoral intensity targets or a mixture of absolute and intensity sectoral targets, which are likely more useful for steering because they are more actionable given their sector-specific focus (Theia Finance Lab, 2023) and also more effective in achieving real-world impact. In addition, they can also create more transparency and accountability. Of those sectoral targets, 75% are only intensity-based. Intensity-based sectoral targets can be useful if the asset manager’s objective is to reduce climate risk at the portfolio level (and assuming emissions-heavy sectors are included in the target). However, if the asset manager’s objective is to claim impact or an active contribution to a transition of the economy, sectoral intensity targets are hardly the right choice of instrument. In fact, sectoral intensity targets come with an inherent risk of free riding, where investee companies reduce their emissions for unrelated reasons, for example a reduction in output. The same can also be true for absolute targets at the portfolio level if targets are achieved through a simple re-allocation of assets, and if no regular portfolio ‘re-baselining’ is conducted (Theia Finance Lab, 2023).

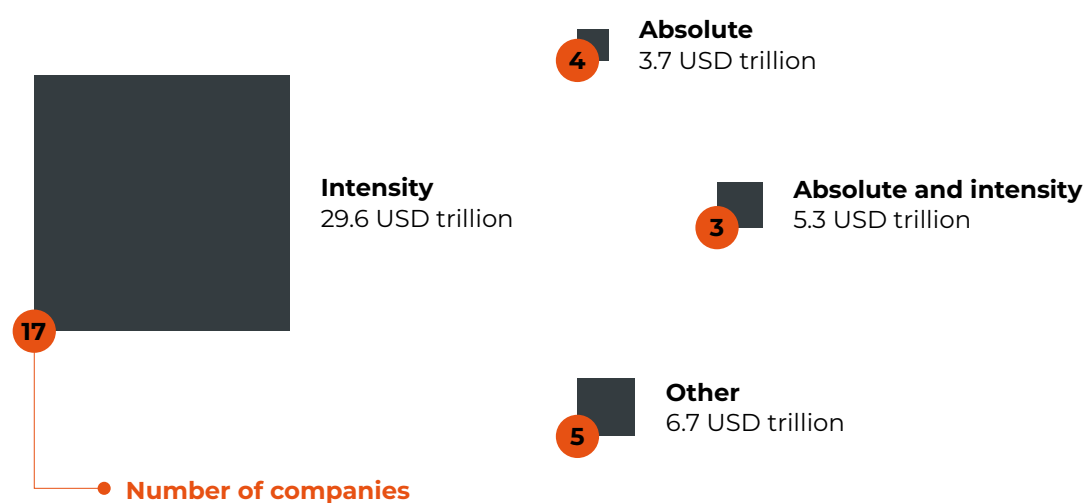


Figure 4
Types of asset managers' net zero portfolio interim targets

Note: Other refers to interim targets that do not directly refer to the financial institution's financed emissions, i.e. a target for the share of investee companies with net zero targets

Moreover, there seems to be an implicit understanding that reaching carbon intensity targets is an effective instrument for steering a financial institution's strategy and activities towards a low-carbon economy. However, this assumption might not hold true unless net zero portfolio targets encompass all the financial institution's managed assets, which, at least in the near term and as demonstrated earlier, is not the case. The incomplete coverage of managed assets by such targets raises doubts about their ability and credibility to truly drive the desired low-carbon transformation across the entire financial institution's portfolio.

FINANCIAL INSTITUTIONS' TRANSITION PLANS

Transition plans can serve multiple purposes. They can increase credibility and transparency, and increase the likelihood that medium and long-term targets are met, among others. While the debate on what those plans should contain exactly is not yet settled, there seems to be consensus that at the minimum they need to contain a high-level target, as well as interim targets and specific actions or activities to achieve those targets.

In a number of jurisdictions, including the EU and the UK, regulation mandating the publication of transition plans is under discussion and/or has already been announced (Government of the UK, 2021; Fox, Grandjean and Geirneirt, 2023). A new obligation proposed by the EU Commission confirmed positions of the European Parliament and the Council, and would require banks to adopt climate transition plans as part of a broader ESG management approach (Hilke, 2023).

Only one (Prudential plc) of the world's 50 largest asset managers has published a dedicated climate transition plan, although 9 out of the top 50 asset managers (18%) have published some form of management framework around the setup of interim targets and policies and strategies around those, and another one promised to disclose one by end of the year (HSBC) (Bloomberg Law, 2023). Of those asset managers with net zero portfolio targets (37), 70% of which have not yet published anything. This raises the question of the credibility of those targets.

More importantly maybe, it is questionable if these transition plans, focusing on how to implement the portfolio target in practice, can be useful in bringing about deep transformations of the economy that are needed to reach international climate goals.

ENGAGEMENT AND ESCALATION STRATEGIES

Engagement is usually considered the most effective strategy to achieve impact in the real economy and contribute to the transformation to a low-carbon economy. Engagement is also strongly encouraged by GFANZ and all financial net zero alliances (GFANZ, 2022a). Where engagement is not fruitful, financial institutions can choose to escalate their asks, such as for example by voting against managers and resolutions proposed by the management, through public press, or even through litigation. To assess the seriousness and likelihood of successful engagement, we consider a number of variables, including the number of engagement staff, total number of ESG or climate engagements, and the share of ESG proposals supported (→ **Table 2**). Findings suggest that even for financial institutions with concrete engagement targets, a lot of variation in practice remains (see for example differences in the support for environmental resolutions in → **Table 2**).

While over 90% of the sampled top 50 asset managers have an official engagement policy with a focus on climate, only 54% of those clearly describe their escalation policy. As pointed out in recent literature, these escalation strategies are hardly ambitious and only very few asset managers go beyond high-level climate expectations and detail clear and actionable demands (Reclaim Finance, 2023). However, by neglecting the full escalation potential they command, they miss an important opportunity to contribute to creating real-world impact by influencing corporate behaviour. Unsurprisingly, only 6 asset managers report on the impact of their engagement activities.

Engagement can either be conducted individually or collectively (e.g. through CA100+). Both have their merits and disadvantages, and an asset manager needs to carefully weigh out which strategy is most appropriate, also considering investment mandates and objectives. For example, while systemic issues might be best addressed through collective engagement, which may sometimes also be more cost-efficient, coordination might be time-intensive and tailored engagement is generally not possible (UNPRI, 2018b). For asset managers aiming to claim impact, it may also be more difficult to attribute impact of collective engagement (UNPRI, 2018a).

Engagement is no silver bullet and will not work on all occasions. For example, engagement might often be more effective (although less common) if it targets both fixed income and equity investments, especially if highly emissive companies are the subject of engagement. This is due to the fact that highly emissive companies increasingly use fixed income instruments to raise funds, and financial institutions are often directly able to influence a bond's terms (Kachi and Marquardt, 2022). Engagement also tends to be less effective with companies that operate in jurisdictions with weak climate policy (Choi, Gao and Jiang, 2020).

Financial institutions should aim to expand their engagement efforts to cover all investee companies in material sectors. Few financial institutions, however, formalize their engagement objectives by setting engagement targets (**→ Table 2**). Cost and resource constraints can be barriers to increasing the intensity, spread, and quality of engagement. While responsible for a large number of investee company relations and engagements, few of the top 50 asset managers have engagement teams of more than 100 people.

Asset manager	Engagement target	Target year	Engagement team size	Climate or ESG engagements	Support for environmental resolutions
Aegon N.V.	25 direct engagements, 20 collaborative engagements, 10 sector and value chain engagement.	2025	19 (Responsible investment team)	185 climate-relevant engagements out of 596 total engagements (2021)	90%
Amundi	1000 additional business engagements per year versus 2021.	2025	16 (ESG research & Engagement team)	1448 ESG or climate-relevant engagements out of 2115 total engagements (2022)	93%
AXA Group	90% of financed emissions in material sectors to be subject to engagement in 2030.	2030	71 (Responsible investment analysts and specialists)	167 climate-relevant engagements out of 596 total engagements (2022)	73%
BNP Paribas	Commitment to increase engagement with investee companies towards net zero.	Ongoing	30 (ESG experts)	150 ESG or climate-relevant engagements out of 373 total engagements (2022)	99%
Federated Hermes	90% of financed emissions subject to direct or collective engagement by 2025.	2025	60 (Stewardship and responsibility team)	666 ESG or climate-relevant engagements out of 2465 total engagements (2022)	89%
Franklin Resources	70% of financed emissions in material sectors being considered net zero or aligned or being subject to direct or collective engagement by 2030.	2030	34 (ESG analysts)	161 ESG or climate-relevant engagements (2022)	57%
Invesco Ltd	90% of financed emissions in material sectors being considered net zero or aligned, or being subject to direct or collective engagement by 2030.	2030	22 (Global ESG team)	1590 ESG or climate-relevant engagements out of more than 3000 total engagements (2021)	47%
Legal & General	Engagement targets as part of climate impact pledge.	Ongoing	26 (Investment stewardship team)	636 ESG or climate-relevant engagements out of 1224 total engagements (2022)	86%
State Street Global Advisors	90% of financed emissions in material sectors are either assessed as net zero, aligned with a net zero pathway, or the subject of direct or collective engagement and stewardship actions.	2030	n/a	331 ESG or climate-relevant engagements out of 956 total engagements (2022)	29%

Note: Climate or ESG engagements are based on latest available data, latest year in brackets. Support for environmental resolutions is based on ShareAction.

Table 2
Current practices of asset managers with an official engagement target

Divestment may also be part of an escalation strategy to reach net zero portfolio emissions. In our sample of the top 50 asset managers, 18 asset managers include divestment as escalation strategy (36%). While divestment can be a credible threat if used in the right circumstances. Its actual impact on the cost of capital for companies depends on the liquidity of markets, the asset class and type of market. Only under specific circumstances does it represent an effective means of influencing company behaviour and reducing GHG emissions (Green and Vallee, 2023). In other cases, divestment movements might also have unintended consequences, potentially leading to overall increases in GHG emissions in the global economy (GFANZ, 2022b) (→ **Chapter 3**). Instead, in primary markets, exclusion or denial of re-entry, specifically in fixed income markets may be more effective (Kachi and Marquardt, 2022).

COMMITMENTS ARE NOT LEADING TO AN INCREASED PRIORITISATION OF CLIMATE WITHIN FINANCIAL INSTITUTIONS

Most net zero portfolio commitments of the sampled asset managers are unlikely to achieve what they intend or purport to – net zero real world global emissions by mid-century. Albeit with often good intentions, the climate value of current net zero commitments is low. This is because of several reasons. First, the coverage of targets is generally poor. Second, only a small minority of asset managers have emissions reduction targets which may effectively contribute to international climate goals, while the majority rely on portfolio intensity targets which are insufficient to achieve a low-carbon economy in line with the Paris Agreement. Only one sampled asset manager has published an official transition plan, despite concrete discussions around regulation, while a few asset managers have been working on them recently. Without actionable transition plans, net zero portfolio targets are not credible and most likely unachievable.

Regarding engagement strategies, they are deemed the most effective means to influence companies' climate strategies and thereby contribute to achieving the asset managers' net zero portfolio targets. Depending on their mandate and investment strategies, asset managers can vote against management, drive collective action, as well as use divestment where it is a credible threat. Unfortunately, not many asset managers use these escalation channels to their full potential. While most engage their investee companies in one way or another, few seem to be really pushing for better climate action from their investees and few formulate concrete asks. This raises the question of how serious asset managers are about their stated goals and whether asset managers are failing to account for medium to long-term transition risks due to imperfect information. Engagement without consequences is simply words.

**>> 04 RECOMMENDATIONS:
EXPLORING
ALTERNATIVE
APPROACHES
FOR FINANCIAL
INSTITUTIONS IN
CLIMATE ACTION**

Based on the analysis above, we doubt that net zero portfolio targets are useful either from a purely risk perspective nor from an impact perspective. They tend to also hold very limited value for steering company processes and decision-making. Instead, we recommend financial institutions to re-focus on supporting the transition of economies and economic actors. While one may argue that financial institutions' main role is to facilitate liquidity and ensure an efficient allocation of funds, thereby maximising profits and minimising risk, financial institutions should have an intrinsic interest in helping economies transition and contribute to net zero. This is especially true for the world's largest financial institutions who, because of their amount of assets under management and the diversity of assets they hold, can be defined as universal owners (Universal Owner, 2021).

The world has committed to reaching the Paris Agreement goals. And while it makes perfect sense for real-economy actors to work towards that goal by setting ambitious and credible emissions reductions targets in line with international climate goals, it does not for financial institutions. Instead, given their role in the economy, financial institutions should focus on helping companies achieve that transition and create the right enabling conditions to support them to achieve this. We find financial institutions' net zero portfolio targets to not effectively contribute, and in some cases potentially even distract from this goal.

We therefore recommend financial institutions to:

- Make a conscious and transparent decision on their investment strategy and what they aim to achieve (e.g. Busch et al., 2021). This choice should guide their approach to engagement and stewardship and the level of ambition they set in driving climate action. Clearly defining their stance and acting accordingly will enhance credibility and align their actions with their stated goals.
- Acknowledge the objective of the need for "rapid global decarbonisation" with drastic reductions by 2030 for the whole portfolio, as well as own responsibilities towards this objective, rather than "net zero portfolio emissions by 2050".
- At a minimum, establish specific climate-compatible investment targets for the whole institution. These targets should be aligned with the goals of the Paris Agreement and aim to contribute to the global efforts in reducing GHG emissions and / or creating resilience against the impacts of climate change. If an asset manager aims to actively contribute to climate action beyond climate-compatible investments, it should explicitly state its intentions and provide a clear plan on how

it intends to achieve these additional climate impacts. Transparency in this regard is essential to build trust and confidence in the institution's climate commitments.

- Re-focus energy and resources on how to best support companies in achieving the transition to a low-carbon economy. This involves actively engaging, pressuring, and collaborating with investee companies to support them with the necessary tools and guidance and further develop and promote dedicated financial products.
- Set ambitious and credible engagement policies that incorporate withholding debt roll-over as a powerful tool to influence the climate strategies of investee companies. By linking continued financing to climate performance, financial institutions can drive stronger climate commitments and actions from the companies they invest in.
- Include and transparently state clear expectations in all interactions with investee companies. Make more frequent and greater use of instruments to influence company behaviour, such as direct and indirect engagement including comprehensive shareholder stewardship.
- Regularly disclose and monitor progress towards stated targets by focusing on impact in the real economy rather than at the portfolio level, using, where applicable impact focussed metrics.
- Divestment should be a last resort after a concerted engagement effort, including excluding new capital (denying re-entry to debt markets).
- In the absence of stronger incentives to take the real cost of climate change into account, engage with policy makers on more ambitious and credible climate policies (macro engagement), including policies targeting corporates' decarbonisation efforts.

For governments specifically:

- Enact more stringent oversight policies to prevent greenwashing and avoid fragmentation. Reporting requirements should be harmonised between financial institutions and real-economy companies. Both should ideally report on outside-in and inside-out (double materiality) aspects of sustainability (Green Central Banking, 2023). Companies should develop robust transition plans for which they can be held accountable.
- Develop economic and industrial policies that create an economy that presents aligned investment opportunities / clear policy signals.

APPENDIX

The analysis of the world's 50 largest asset managers (→ **Table 3**) and their targets was conducted through desk research. We primarily evaluate asset managers' own reporting, as well as commitments published by the Net Zero Asset Manager initiative. The analysis was partly conducted with AI-assisted tools, given the magnitude of reports and publications we had to consider. It is possible that the descriptive statistics presented here entail some degree of measurement error, for example where targets or policies were not communicated clearly or have been recently updated. This should, however, have little impact on the general conclusions we draw from the descriptive statistics we present here.

Asset Manager	Headquarter	Net zero target
BlackRock	US	Portfolio
Vanguard Group	US	Own operation
Fidelity Investments	US	Portfolio
State Street Global Advisors	US	Portfolio
Morgan Stanley	US	Portfolio
JPMorgan Chase	US	Portfolio
Goldman Sachs	US	Portfolio
Credit Agricole	France	Portfolio
Allianz Group	Germany	Portfolio
Capital Group	US	NA
Amundi (Division of Credit Agricole Group)	France	Portfolio
Bank of New York Mellon	US	NA
UBS Group	Switzerland	Portfolio
PIMCO (Autonomous subsidiary of Allianz Group)	US	NA
Edward Jones	US	NA
Deutsche Bank (Including its asset manager arm DWS)	Germany	Portfolio
Invesco Ltd	US	Portfolio
Legal & General (Including its asset manager arm LGIM)	UK	Portfolio
Bank of America (Including its asset manager arm Merrill)	US	Portfolio
Franklin Resources	US	Portfolio
Prudential Financial	US	Portfolio
Credit Suisse (Now belongs to UBS)	Switzerland	Portfolio
T. Rowe Price	US	Portfolio

Asset Manager	Headquarter	Net zero target
Northern Trust Corp	US	Own operation
BNP Paribas	France	Portfolio
TIAA (Nuveen)	US	Portfolio
Natixis Investment Managers (Subsidiary of BPCE Group)	France	Portfolio
Wellington Management Company	US	Portfolio
HSBC Holdings	UK	Portfolio
AXA Group	France	Portfolio
Sun Life Financial	Canada	Portfolio
Ameriprise Financial (Including its asset manager arm Columbia Threadneedle)	US	Portfolio
Blackstone Inc	US	NA
Power Corporation	Canada	NA
Geode Capital Management	US	NA
Schroders plc	UK	Portfolio
Sumitomo Mitsui Trust Holdings	Japan	Portfolio
Manulife Financial	Canada	Portfolio
Brookfield Asset Management	Canada	Portfolio
Insight Investment (Subsidiary of BNY Mellon)	UK	Portfolio
Aegon N.V.	Netherlands	Portfolio
Royal Bank of Canada	Canada	Portfolio
Equitable Holdings	US	NA
Schwab Asset Management	US	NA
New York Life Insurance Company	US	NA
Federated Hermes (Including its asset manager arm Federated Investors Inc)	US	Portfolio
Generali Group	Italy	Portfolio
Nippon Life Insurance Company	Japan	Portfolio
AllianceBernstein	US	Portfolio
Affiliated Managers Group	US	NA

Table 3
Overview of
analysed asset
managers

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