A portfolio in transition

How NEI is assessing corporate alignment to a net-zero pathway

NEI

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Introduction

Hundreds of investment managers around the world have made public commitments to reduce the greenhouse gas emissions attributable to their portfolios to net zero by 2050. NEI is one of them. Now that commitments have been made, the next stage of our transition to a low-carbon economy looms larger than ever. It's time to do the work required to get there.

NEI introduced its climate strategy in 2021 with the goal of driving real-world reductions in GHG emissions. Since then, we have been refining our commitments, setting targets, and analysing our portfolio to get an idea of our baseline position. At the same time, we have continued to engage with companies, regulators, and other stakeholders to advance the energy transition. But why are we progressing down this path in the first place?

At this point, it should be plain for all to see there is a need for investment managers to do their part to avoid the worst effects of climate change. The existential threat posed by rising waters, raging fires, droughts and other effects is not just at our doorstep, it is crashing over.

The threat to our investors is also real. They are the ones who rely on us (and who pay us) to be responsible stewards of their capital, so they can meet their goal of financial well-being. The way an investment manager fulfils that duty is by managing risk and uncovering opportunity in pursuit of long-term sustainable value. Climate-related risks are material. Opportunities are plentiful. We must manage them both to the best of our ability.

Proof that this is a globally recognized imperative comes in many forms. From asset manager collectives such as the Glasgow Financial Alliance for Net Zero with more than 650 firms from over 50 countries, to unified reporting standards from the International Sustainability Standards Board, and to surging sustainable debt issuance (US$1.6T in 2021 versus US$762B the year before, according to BloombergNEF), the investment community's commitment to tackling the systemic risk of climate change is apparent.

Our goal with this paper is to share our process for assessing corporate alignment to a net-zero pathway, and to emphasize the importance of engagement in moving companies along in their journey. We are hopeful that by going into detail on this topic others will gain insight into how they might build and refine their own alignment framework.

We cannot stress enough that the aim of this exercise is not to create a bulletproof framework with pages of data points carried out to the hundredth of a percent. Some companies will undoubtedly be mis-categorized. Results are open to interpretation, re-assessment, and source data revision, not to speak of the unknown unknowns lurking beneath the surface.

Our goal in assessing alignment is to give us a better understanding of where NEI's portfolio stands *generally* on its own path to net zero. Where are we to focus our attention? Which sectors? Which companies? Have we identified hidden risks and uncovered opportunities for our investors, so we remain true to our purpose of helping them achieve their financial goals? We believe our work to date puts us in a good position to offer preliminary answers to these questions.

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Developing the framework

Guided by NZIF

First, what does it mean to be aligned to a net-zero pathway? To set our definitions and framework, we used the Net Zero Investment Framework (NZIF).[1] NZIF's focus on enabling investors to drive down real-world emissions using the full suite of tools in their active ownership toolbox appealed to us. (Active ownership tools include corporate dialogue, proxy voting, and the filing of shareholder resolutions.)

... an investment strategy should prioritise engagement and stewardship and direct management where relevant), particularly for existing assets, as the primary mechanism to drive alignment. Portfolio construction can also be a relevant tool to weight portfolios towards assets aligned or transitioning towards net zero as an incentive for these companies to align. Selective divestment is recommended in specific circumstances as part of the toolbox for aligning a portfolio.[2]

Many companies have publicly committed to be net zero by 2050, in accordance with the goals of the Paris Agreement.[3] In practice, the existence of a net-zero company is still largely theoretical—as is, for that matter, the existence of a net-zero investor. Companies (including NEI) have a lot of ground to cover before they can credibly make that claim, and just buying carbon offsets to counter emissions from an existing business model does not, in our minds, constitute a net-zero business model.

Undoubtedly, we will learn many things on this journey that force us to reconsider how we measure alignment. But we do believe it is possible, worthwhile, and *necessary*, to assess whether a company's actions and commitments are putting them on a credible path. As of this writing, our definition of alignment is as follows: A company is aligned to a net-zero pathway if its commitments, actions, and performance put it on a trajectory of reducing its GHG emissions to net zero by 2050 or sooner.

If companies are falling short in one or more areas, our framework captures that and flags the names for engagement. And to be clear, companies we determine to be aligned under this framework are not ready to raise the mission accomplished banner just yet. Rather, their relatively strong position will allow us to deprioritize them for engagement, so that we can direct our finite capacity toward companies that require more attention.

Committed to NZAM

Our framework is built around our commitment to the Net Zero Asset Managers initiative.[4] In order to achieve the targets set out below, we must be able to *define* and *measure* alignment across our portfolio.

- By 2025, 70% of financed emissions in material sectors are net zero, net-zero aligned, or the subject of engagement.
- By 2030, 90% of financed emissions in material sectors are net zero, net-zero aligned, or the subject of engagement.
- By 2040, 100% of financed emissions in material sectors are net zero or net-zero aligned.

Let's break this down.

Financed emissions are the GHG emissions tied to the investment and lending activities of financial institutions. Think of them as the carbon footprint of an investment manager's portfolio, or a bank's lending book. In NEI's case, as an investment manager, we sum the emissions of all the issuers in our portfolio and calculate the proportional share attributable to each issuer based on how much of them we own, whether equity or debt. The calculation is provided by the Partnership for Carbon Accounting Financials (PCAF).[5]

[1]Paris Aligned Investment Initiative, *Net Zero Investment Framework Implementation Guide*, version 1.0, March 2021, 16-19. [2]NZIF, 13. [3]https://unfccc.int/sites/default/files/english_paris_agreement.pdf. [4]https://www.netzeroassetmanagers.org/. [5]PCAF (2022). *The Global GHG Accounting and Reporting Standard Part A: Financed Emissions*. Second Edition.

Material sectors in this context refer to "high-impact sectors" identified by NZIF[6]. We explain more in the methodology section, but generally we are considering energy, materials, industrials, utilities, and select sub-industries such as automobile manufacturing and consumer electronics within the consumer discretionary sector, and electronic equipment and hardware manufacturing within the information technology sector. Eventually, over years, we will expand into the non-high impact sectors of our portfolio.

You will see there are three ways our financed emissions can be categorized: 1) as net zero, 2) as net-zero aligned, 3) as the subject of engagement. The third category is the simplest. If we spoke with a company in the 24-month period up to December 2021, they are a subject of engagement. The first category is also relatively straightforward. To whatever extent NEI's portfolio is removing and/or offsetting the GHG emissions it is financing through its investments, either through the efforts of issuers themselves or through NEI's own initiatives, that portion of our financed emissions can be categorized as net zero. The second category, net-zero aligned, is the most complex, and the subject of this paper.

The target percentages are taken from NZIF guidance.[7]

Note that for our 2040 target we no longer include the engagement category. If a company is not on a credible pathway to net zero or already there, they are extremely unlikely to achieve the final target of net zero by 2050. That is not to say we do not expect to engage these companies between 2040 and 2050. Far from it. There will be much work to do helping issuers maintain their trajectory in the final ten years—and beyond.

The "D" word

The exercise of assessing our holdings for net-zero alignment has been rife with challenges in the availability and reliability of one very important component: data.

The limitations associated with climate data are many, and for the most part, they are known. There are large gaps, different estimation methodologies, coverage issues, inconsistencies, incompatibilities (getting multiple platforms and systems to "talk" to each other), internal capacity and unfamiliarity with platforms and definitions of metrics and applicability, and more.

And yet we cannot throw our hands up and declare the task impossible because of data challenges. It is incredibly important that we continue to iron out the kinks. After all, the increasingly irrefutable numbers provided by climate scientists is what is driving the visceral sense of urgency we feel to act. We will only improve the data and associated models by continuing to embrace their use.

We must acknowledge how far we've come, and how much is now available that wasn't even on investors' radar just two or three years ago. Yet climate reporting is in its infancy, and largely voluntary; we can't be surprised that the underlying data required to fulfill reporting obligations is concomitantly limited, as is our ability to compile it, interpret it, and make short- and long-term investment decisions based on it. In other words, proceed with caution.

For this paper and for our forthcoming climate strategy progress report, data sources include MSCI, Sustainalytics, Institutional Shareholder Services (ISS), and Bloomberg. As data improve over time, we will revise our alignment framework accordingly.

The investment industry should not be seduced by increasingly complex quantitative models that look good on a screen but may have a tenuous connection to real-world outcomes. As Derek Thompson, a writer for *The Atlantic* so eloquently put it, "Economic models of the future are perhaps best understood as astrology faintly decorated with calculus equations."[8]

[6]NZIF, 26-27. [7]NZIF, 10. [8] https://www.theatlantic.com/ideas/archive/2023/08/recession-doomers-economy/674900/ (Paid).

Net-zero alignment framework

Three pillars, seven metrics, one alignment score

We took a conservative approach to defining what constitutes a net-zero aligned company, setting the bar relatively high. We felt this was appropriate based on our concerns around data quality. It also felt intuitively right, as our engagement experience tells us that most companies are *not* currently aligned with a net-zero pathway. It would not have made sense for the framework to reveal that a large number of companies in our portfolio are already aligned.

The framework is supported by three distinct pillars: Performance, Targets, and Management & Disclosure (Table 1), with seven underlying metrics feeding into them. Companies must meet our minimum expectations across all three pillars to be considered for alignment. The Performance and Target pillars have a slightly higher weighting in the scoring calculation (0.35 for each, versus 0.30 for Management & Disclosure) to reflect our view that a company must first and foremost *project* (Targets) and *demonstrate* (Performance) a negative GHG emissions trajectory to be considered aligned.

It took multiple round trips to the data trough and several providers to settle on the seven metrics we felt were appropriate for the task at hand. The decision to use multiple providers was intentional, helping to avoid reliance on a single perspective. While not perfect by any stretch, we are confident the framework meets our core requirements, which are to identify issuers that are ahead of peers in aligning their business with a net-zero pathway, and to prioritize issuers for corporate engagement.

Table 1: *NEI net-zero alignment framework supported by three pillars, seven climate metrics*

Net-zero alignment framework

	Performance (How is the company doing?)		**Targets** (How rigorous are their targets and/or ambitions?			**Management & Disclosure** (What does oversight and disclosure look like?)	
Metric (MSCI, ISS, Sustainalytics)	Absolute emissions trend	Intensity emissions trend	Science-based targets	Target ambition	Sustainable Development Scenario (SDS) alignment	GHG reduction plan	TCFD alignment
Description	Three-year trend in absolute emissions (tonnes)	Three-year trend in emissions intensity (tonnes/$M revenue)	Company targets approved by the Science Based Targets initiative (SBTi)	Target ambition (if no SBTi)	Degree of alignment with SDS	Company has programs, processes and plans in place to meet GHG reduction targets.	Company disclosures aligned with all four TCFD pillars.
Why did we choose this metric?	Companies with declining emissions are seen as successfully implementing GHG reduction targets and strategies. Only companies with a negative emissions trend (absolute or intensity) are included; scoring is weighted toward steeper reductions.		Companies that have set science-based targets are more likely to be targeting a net-zero path.		SDS alignment increases likelihood that business strategy is aligned over the long term.	Company needs to show evidence of programs and that dedicated resources are in place to meet their ambitions.	Robust disclosure is a foundational element of GHG emissions management.

Data set and methodology

Baseline year:	2021
Assets in scope:	Listed equity and corporate bonds (77% of total AUM)
High-impact assets:	35% of in-scope assets
Companies assessed:	449
Data sources:	MSCI, ISS, Sustainalytics, Bloomberg
Assessment dates:	August–September 2023

Per NZIF, our assessment captures only companies operating in high-impact sectors. These are companies with significant emissions associated with their business model, such as companies in the energy and materials sectors. There is a limit to the amount of in-depth engagement any investment manager can reasonably take on, so prioritizing companies that are contributing the most to our financed emissions makes sense. This does not mean we can (or do) ignore other sectors when it comes to net zero. On the contrary, some companies operating in non-high impact sectors, such as banks (more on banks below), have a critical role to play in influencing high-impact names. In the end however, emissions reductions ultimately need to come from the truly high-impact issuers.

As can be seen in Figures 1 and 2, the contribution of high-impact issuers to our financed emissions far exceeds their relative contribution to NEI's assets under management. Despite representing only 35% of AUM in 2021, high-impact names contributed 85% of our financed emissions.

Stepping outside the high-impact analysis for a moment and looking at our entire in-scope assets, data tell a remarkable story about the concentration of emissions. Out of a portfolio of approximately 1,200 names, only 25 companies, or 2% of them, represent roughly 57% of our portfolio's entire financed emissions.

This data point raises the obvious question of why we don't just eliminate the highest emitters to make a huge reduction in our GHG emissions. The short answer is that it would not help reduce emissions in the real world—it would be a reduction on paper only. Our goal is to drive *real-world emissions reductions*.

Having said that, stock selection and surgical divestment will inevitably play a role in portfolio alignment, as we do see genuine risk in investing in companies that cannot or will not align to meet the timeline. Companies that find themselves in this category would do well to recognize they pose a target for divestment consideration.

Figure 1: *Assets under management*

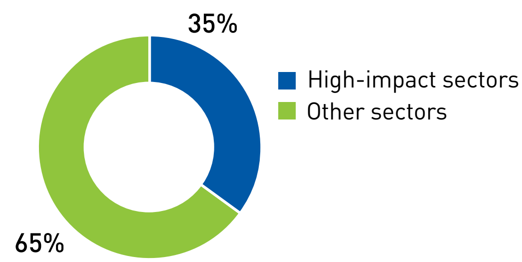
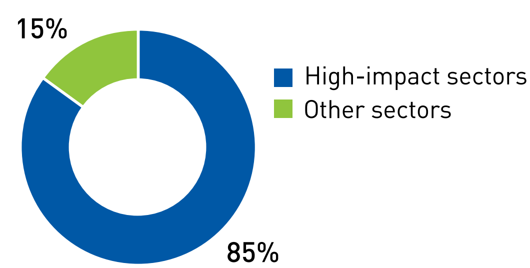


Figure 2: *Financed emissions as a percent of assets under management*

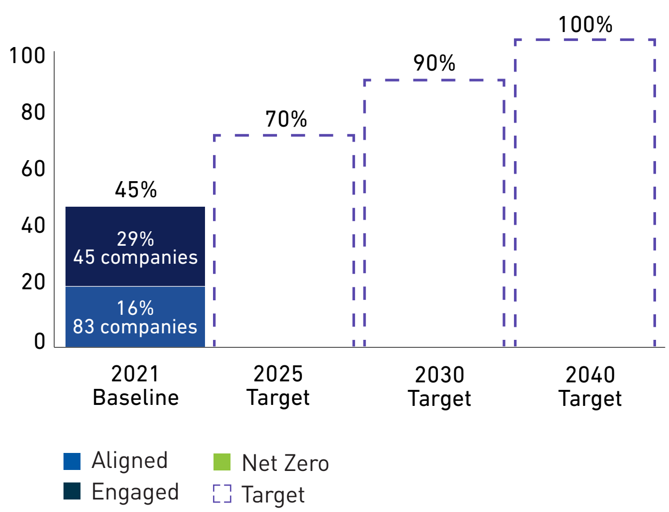


Results

Key findings

The output of our analysis indicates the framework is largely on point, with three key takeaways. First, as anticipated, the majority of high-impact companies in our portfolio are not currently aligned with a net-zero pathway. Second, despite the first point, we found more companies in our portfolio showing data-based evidence of progress toward net zero than we had expected. Third—and something we were fairly confident of going into the analysis—we are already engaging many of the top emitters and have been for years.

Figure 3: *Results of alignment assessment; financed emissions in high-impact sectors*



For 2021, we found that 16% of the financed emissions in high-impact sectors met our definition of alignment, produced by 83 companies (out of 449). While the number of companies may seem low, it exceeded our expectations. We were initially pessimistic that we could point to many names in these sectors as being on a credible pathway. Still, most companies are *not* in that category, underscoring the need for investors to engage with purpose.

A total of 45 companies responsible for 29% of financed emissions were actively engaged on the topic of climate change in the 24-month period ending December 2021, excluding the companies engaged that were *also* aligned. To be clear: our NZAM target treats these as mutually exclusive categories, allowing us to sum them with no overlap. We did engage four of the companies that also met our definition of alignment; they are included in the results as "aligned," not as "engaged."

All told, when adding the categories and removing overlap, we are at 45% of financed emissions covered either by alignment or engagement. Not surprisingly, no company in our portfolio was deemed to be net zero—although we expect that category to make up a growing portion of assets over time, though perhaps not for some years.

Table 2: *Top aligned companies*

Company	Financed emissions*	Sector	Country
Siemens Gamesa Renewable Energy	3	Industrials	Spain
Schneider Electric	135	Industrials	France
Georg Fischer	891	Industrials	Switzerland
Stantec	67	Industrials	Canada
Siemens	102	Industrials	Germany
Spirax-Sarco Engineering	26	Industrials	U.K.
Skanska	12	Industrials	Sweden
Aptiv	150	Consumer Discretionary	Ireland
Ingersoll Rand	11	Industrials	U.S.
Keysight Technologies	17	Information Technology	U.S.

Table 3: *Top contributors to financed emissions*

Company	Financed emissions*	Sector	Country	Aligned	Active engagement
Suncor Energy	17,018	Energy	Canada	No	Yes
Canadian Natural Resources	13,667	Energy	Canada	No	Yes
Air Liquide	13,071	Materials	France	Yes	No
Linde	12,294	Materials	U.K.	No	No
Vistra	9,859	Utilities	U.S.	No	No
AltaGas	8,983	Energy	Canada	No	Yes
Waste Management	8,895	Industrials	U.S.	No	No
Westrock	8,593	Materials	U.S.	No	No
Veolia Environment	8,410	Utilities	France	No	No
Nutrien	8,033	Materials	Canada	Yes	Yes

*Tonnes per US$1M invested

Schneider Electric (France), an industrials name that is a well-known leader in sustainability, is a good example of what we deem to be aligned. In addition to having a business strategy focused on providing clients low-carbon solutions, the company had a double-digit absolute and intensity emissions reduction trend in 2021, has an approved science-based target, aligns with the Sustainable Development Scenario, and has exemplary management and disclosure.

Siemens Gamesa Renewable Energy (Spain) was one of the few renewable energy names that made the list (see below for more on renewables). Like Schneider, the company had a double-digit emissions reduction trend on both an absolute and intensity basis, an approved science-based target, is fully aligned with the Sustainable Development Scenario, and has excellent management and disclosure.

You will note that even our top aligned companies still may be contributing substantial financed emissions to our portfolio, though they are not among the highest contributors, as shown in Table 3. Alignment does not equal no or even low levels of emissions. It means there is a credible pathway to get there.

The top two contributors to our financed emissions were Suncor Energy and Canadian Natural Resources, both Canadian energy names and both major players in the oil sands. This is not a revelation to us and is the main reason the companies have been such a major focus of our engagement program. But their alignment assessment is telling, and showed a pattern that carried throughout the energy names in our portfolio. While both companies were assessed to have good disclosure and strong reduction programs in place, and both have had some level of absolute or intensity reductions, their assessment on the robustness of their reduction targets and their alignment with the Sustainable Development Scenario (SDS) both scored poorly. This reflects the biggest challenge for these firms: they have a business model that is not aligned with a net-zero pathway, and they lack ambition when it comes to setting reduction targets. On the latter, the key sticking point is that both companies' substantial scope 3 emissions are not considered in their targets.

The next two names in the list tell a different story. Air Liquide (France) and Linde (U.K.)—aligned and not aligned, respectively—are both industrial gases companies in the chemicals industry that we invest in precisely because of their significant contribution to the goal of achieving net zero, as they are both developing business strategies to deliver key low-carbon solutions such as clean hydrogen and carbon capture. Both names have an approved science-based target, strong alignment with the SDS, exemplary disclosure and strong GHG emissions management in place. However, both have substantial emission profiles that are only just starting to come around; in fact, Air Liquide barely made it onto our list of aligned companies because of a declining intensity trend. We will need to the company's absolute emissions start to decline for them to remain in the aligned category.

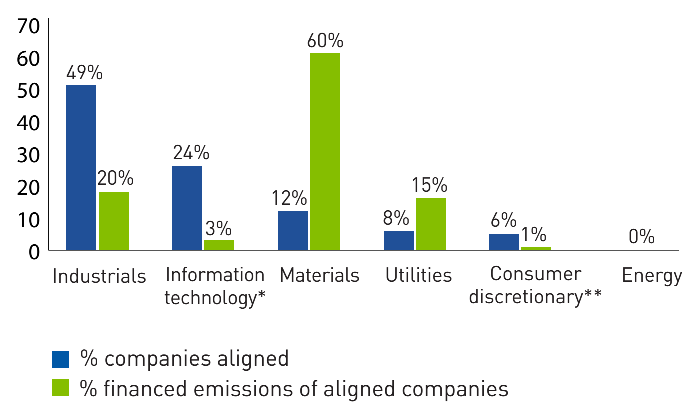
Renewable energy, where are you?

One finding that may be counterintuitive was the low number of renewable energy companies that landed in our aligned category, despite their growing position in our portfolio. It does exemplify our concern about relying too heavily on a strictly quantitative approach, in that it would be hard to argue their business models are not aligned with a net-zero pathway when the products they create are foundational to a net-zero energy system. And yet, the metrics we chose and the companies' performance against those metrics indicates these companies are not yet where they need to be.

Companies focused on climate solutions (such as renewable energy) are often younger, with rapidly growing businesses that may not have developed the disclosure maturity displayed in other sectors. It should not be surprising to see them not yet aligned with the TCFD, for example. As well, the act of building low-carbon technologies is inherently energy intensive, and we expect to see the emissions profiles of these companies rise as they grow. This is one of the few occasions where an increase in emissions at the company level could mean a reduction of emissions at the societal level. For future alignment assessments we will consider how to better capture this reality, particularly as we seek to increase our exposure to these names.

Industrials, information technology, materials

Figure 4 : *Financed emissions of aligned companies by sector*



* Electronic equipment, technology hardware
** Automobile manufacturers, consumer electronics

The industrials sector had the most companies deemed to be aligned, with 49% of our aligned holdings operating in that sector (Figure 4). Information technology was next, with 24% of aligned names coming from high-impact industries (electronic equipment, technology hardware) within the sector. The materials sector was an interesting case. Despite representing only 12% of aligned companies, the sector accounted for a whopping 60% of financed emissions within the category.

The prevalence of names from the industrials and technology sectors reflects the fact that those sectors are more likely to have business models conducive to alignment. Generally lower in absolute emissions than other high-impact sectors, the services and equipment they sell are increasingly focused on helping other companies reduce their emissions. In fact, our portfolio's increased exposure to the industrials sector (80% higher in 2021 than in 2019) is in part a result of the growth in fund assets that target companies offering solutions to the low-carbon economy. That said, because they typically have a lower level of financed emissions, their contribution to our alignment goal is less material—though it is important. The more intensive sectors—materials, energy, and utilities—will have a harder time reducing emissions, though their eventual alignment will contribute the most toward NEI's portfolio decarbonization effort.

Utilities showing positive trend

The utility sector had relatively few aligned names (Figure 4), but analysis of the data suggests positive change is in the offing. Despite a 50% increase in exposure to the sector between 2019 and 2021, the financed emissions associated with utilities *dropped* by more than 16%. This is evidence partly of our sub-advisors' security selection process as they seek to invest in utility companies with lower emissions, and partly of the secular trend of emissions reductions at companies that have made substantive shifts in their energy generation mix, the primary change being the phase-out of coal. The utilities sector is under significant pressure to serve as the backbone of the energy transition as governments around the world look to electrify many of the roles filled by fossil fuels. Governments in the European Union, U.S. and Canada are expecting the industry to achieve net zero well before 2050 in order to enable *other* sectors to meet *their* goals.

We anticipate the number of utility companies that meet our alignment criteria will grow in the relative near term, with the sector becoming a substantial contributor to our 2025 target. Our priorities for the sector are to continue to build our exposure to companies shifting their energy mix to renewables and supporting them to improve their climate reporting, while engaging more aggressively with those companies that have yet to set ambitious targets.

Perhaps the biggest question for us is the role of natural-gas fired electricity generation and natural gas utilities. Natural gas has an important role to play in the transition, but at what point does it turn from being an enabler to a barrier? There will be a near-term focus on encouraging companies to set ambitious targets that address methane in particular, while also ensuring that lobbying efforts are aligned with the goals of achieving net zero.

Big challenges facing the energy sector

Perhaps it is no surprise there was not a single energy company we deemed to be aligned (Figure 4). Notably, the sector still does not have an SBTi methodology for setting a science-based target. That raises the complicated question of what a properly ambitious target is for the sector, and what alignment would look like for a company whose entire business model relies on fossil fuel production.

What's an investor with a net-zero commitment to do? The materiality of energy company emissions demands attention, as does company prominence and importance in maintaining the current energy system. Traditional energy has been the subject of renewed interest from companies and investors since the war between Russia and Ukraine drove up prices, shining a spotlight on the problem of energy security. With the world once again hungry for fossil fuels in the short-term(?), it seems companies and markets are prioritizing the old model over longer-term transition planning.

Companies that made ambitious transformation goals just a few years ago have scaled back those ambitions, though to be fair, they have maintained their net-zero commitments—at least on paper. Announcements by major players such as Shell, BP and Suncor, stating they would be refocusing on their core business of oil and gas production, appear to have been well-received by the market. The decision to funnel windfall profits of rising oil prices to dividends and share buybacks, not low-carbon opportunities, has been greeted even more warmly (perhaps no surprise).

We are at a critical juncture in energy dialogues, made real by the need to assess the alignment of oil and gas business trajectories. Should investors push energy companies to leverage their existing strengths to diversify and become the future leaders of our low-carbon economy, or should they push for a responsible wind-down of their assets? It is a complex and divisive question.

We feel it is premature to throw in the towel on the goal of energy company transformation, though we acknowledge that investors have not found a way to appropriately value the companies' transition strategies. The stark fact remains that achieving net-zero emissions globally means a fundamental transformation of our energy system and the eventual elimination of unabated fossil fuel use for energy. That will not happen overnight, and no one expects it to. But it will almost surely happen faster than we anticipate, whether we find our way there in an orderly fashion or a disorderly one. That presents an existential risk to energy companies focused on fossil fuels, and we believe a long-term diversification strategy is the only option to address it. The lack of market appetite for this approach points to the need to make a better case to investors that this is not only a viable but a *necessary* path. Absent this option (and frankly even with it) there is likely to be a contentious and polarizing conversation about how to avoid serious harm to the industry if and when demand destruction picks up speed. Without some kind of agreed pathway to a responsible wind-down of traditional fossil fuel assets, and in the absence of a business model that can prosper in a net-zero economy, the rapid decline of company fortunes could leave billions of dollars in environmental liabilities and unpaid debts. It may also lead to continued resistance to transformative policies for the sake of forestalling this daunting outcome. Surely, we can be more thoughtful than that.

The critical role of banks

One aspect of our framework scheduled for future attention is that it currently does not provide a way to account for our dialogues with companies outside the high-impact sectors, such as banks. These financial sector engagements are an important point of leverage with high-impact names, but the lack of visibility in our assessment will have to be accounted for elsewhere.

For example, we have been engaging all the major Canadian banks on their financing of the oil and gas industry. We do not expect them to cease financing activities altogether, but we do expect that if they are servicing the industry, they will be setting increasingly stringent expectations regarding net-zero alignment of their clients. Banks can be a key source of capital to help energy sector companies decarbonize, but the current lack of tangible evidence that this is happening undermines that stance.

Banks have set reduction targets for their oil and gas portfolios, which is an important foundation, though we continue to engage with them to raise the ambition of those targets, and to increase the transparency on their expectations for the sector. Ensuring they are not financing greenfield development that is not aligned with a net-zero pathway is another key request. And so, while not considered among the high-impact names themselves, banks are indeed central to a high-impact engagement strategy.

Next steps

So, what does all this mean for our responsible investment program and our commitment to achieve net zero by 2050?

We take comfort knowing that while there is room to improve, our approach to active ownership has been effective in identifying and addressing the material risks of climate change at the companies we invest in. As intended, our alignment analysis has given us a useful tool to refine our approach and prioritize our engagement objectives.

The immediate outcome of our analysis therefore will be to inform our 2024 Focus List discussions, currently underway. (Our annual Focus List identifies our top engagement themes for the year, as well as the companies we intend to speak with about priority issues. In addition to climate change, we engage companies on major themes such as human rights, inequality, and nature.)

We will also look to integrate our alignment framework into our company evaluations model, as well as explore the utility of the framework for companies outside the high-impact sectors. Assessing new investment opportunities through the lens of alignment and flagging inconsistencies at this early stage will support our net-zero ambitions, particularly as they relate to product development.

The alignment data underlying our Management & Disclosures pillar indicates it is critical for us to continue engaging with standard-setters such as the International Sustainability Standards Board, and with regulators such as the Canadian Securities Administrators and U.S. Securities and Exchange Commission. Mandatory climate-related disclosures are ultimately what is needed for investors to grow their confidence in the data and to make informed decisions. Consistent, standardized disclosures will not solve all the challenges, but they will provide a strong foundation for future analysis.

The framework and analysis results will also provide important new inputs for our conversations with sub-advisors. Some of them are working on their own alignment frameworks, and we are in the habit of exchanging ideas and processes as we all drive forward on our respective commitments. We look forward to their feedback and to discussions about implications for their investment processes and security selection.

Final thoughts

We believe that investor capital will ultimately start to flow to those companies that are aligned—certainly from investors who have made net-zero pledges and need to fulfill them. But the lack of a critical mass of net-zero aligned names at this time represents a real and growing investment risk.

Currently, the net-zero pathway is still very broad, meaning that because of the distance to the goal, alignment definitions can afford to be looser, capturing more companies who are at the early stages of transformation. As we get closer to interim target years, company profiles will have to look more and more different to remain on the narrowing pathway. Without a significant uptick in the number of companies aligned, the investable universe for investors adhering to their net-zero commitments will shrink. As some business models fade, new ones will rise to prominence, and we do expect those positive developments to offset some of the risk.

Still—a broad investable universe will always be better for investors than a narrow one. It behooves us therefore to do our best to engage with companies so they can find their way to alignment as soon as possible, so that as investors, *we create for ourselves and our clients* the opportunities required to advance the energy transition, and to capitalize on it as well. Where market forces are not driving this change fast enough, investors must support policy and regulatory developments that in effect shape the market for us.

The science of climate change is complex, as is the exercise of mapping net-zero pathways. But the priorities for investors need not be. Perhaps we do not need a better algorithm or a more artful model to guide tangible actions. Those are undoubtedly coming, and will be useful, but in the meantime, we have the tools and enough information to make a real impact on reducing emissions while meeting our clients' financial goals. We know we need to actively engage the companies we own to help them align to a net-zero pathway. We know we need to meaningfully increase the amount of capital we allocate to the companies creating low-carbon solutions. And we know we need to engage and inform policymakers and regulators to ensure we have the architecture in place to support the previous two actions. That feels like more than enough to get us all started.

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