

## HEADING TOWARDS RAVENOUS ESG DEMANDS ON NET-ZERO AND NATURAL CAPITAL

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### Overview

Escalating and ubiquitous expectations on climate change are now calling for hard actions – gone are the days of boilerplate statements and gentle nudging. This February, BlackRock Investment Stewardship (BIS) published its engagement priorities encompassing five topics, where one of them is climate and natural capital<sup>1</sup>.

Thanks to the interdependence between climate change and net-zero, a surging number of institutional investors are directing portfolio companies to move towards net zero emissions by 2050, together with medium-term targets for an unambiguous carbon emissions reduction trajectory. The Net Zero Asset Managers initiative (NZAM), one of several different coalitions associated with net-zero, is an international group of asset managers committed to supporting the goal of net zero greenhouse (GHG) gas emissions by 2050 or sooner, a target which is in line with global efforts to limit warming to 1.5°C. NZAM has 236 signatories, representing over USD 57.5 trillion in assets under management<sup>2</sup>.

BIS further specified three major areas consisting of biodiversity, deforestation, and water, due to the intrinsic complexity and interconnectedness of natural capital. BIS believes they can impact the long-term financial returns of certain corporates<sup>3</sup>.

Sustainable mutual funds and ESG-focused exchange-traded funds rose globally by 53% last year to \$2.7 trillion, with a net \$596 billion flowing into the strategy, according to Morningstar Inc. Riding on the accelerating influx of ESG funds, institutional investors are stepping up their engagement with corporates to ask their strategies and actions on a spectrum of ESG topics such

as net-zero, board oversight of ESG issues, natural capital and so on.

### Charting an Unambiguous Net-Zero Roadmap

#### Net-Zero 101

Science-based Target Initiative (SBTi) published the SBTi's Corporate Net-Zero Standard, which provides systematic guidance to corporates in setting net-zero targets, with the following key steps<sup>4</sup>.

- I. Select a base year
- II. Develop a full GHG inventory, including Scope 1, 2 and 3 GHG emissions
- III. Set target boundaries
- IV. Choose a target year
- V. Calculate near-term and long-term science-based targets

#### Actions to Realize Net-Zero Targets

Garnering data and calculating Scope 3 emissions is challenging, as data availability is low and extensive communication with internal departments concerned and external stakeholders along the value chain is needed. Still, constructing the Scope 3 emissions inventory is merely the midst of the net-zero journey. Heading towards near-term targets and the net-zero target, engaging with internal departments concerned, assigning internal targets to departments or business divisions concerned, and managing renewable energy procurement are of prime importance.

<sup>1</sup> BIS Engagement Priorities, February 2022.

<https://www.blackrock.com/corporate/literature/publication/blk-stewardship-priorities-final.pdf>

<sup>2</sup> <https://www.netzeroassetmanagers.org/>, 31st December 2021.

<sup>3</sup> BIS Commentary - Our approach to engagement on natural capital, February 2022.

<https://www.blackrock.com/corporate/literature/publication/blk-commentary-engagement-on-natural-capital.pdf>

<sup>4</sup> Science-based Targets Initiative, SBTi Corporate Net-Zero Standard, Version 1.0, October 2021.

<https://sciencebasedtargets.org/resources/files/Net-Zero-Standard.pdf>

Key internal departments which influence internal carbon emissions and those emissions from external suppliers should be identified and prioritized. Generally, suppliers and service providers such as goods suppliers and logistics vendors usually contribute a significant portion of Scope 3 emissions, while the primary contact point is likely the procurement department, rather than the internal sustainability department. Dedicated and ongoing engagement is needed, even though decarbonizing along the value chain is more daunting than slashing carbon emissions in a corporate's own operations.

A carbon reduction target is similar to a revenue target. Determining what portion of the target should be owned by each department can be challenging and could ultimately become an obstacle to progress, leading to slippage. However, if yearly internal departmental targets have not been well defined, continuous progress monitoring could not be exercised effectively.

Utilizing renewable energy constitutes a pivotal action for achieving net-zero. There are, as a minimum, eight options for renewable energy procurement, including procurement from on-site installations owned by a supplier, green electricity products from an energy supplier, and so forth<sup>5</sup>. Given that the renewable energy market is evolving, setting procurement criteria with timely updates and monitoring the market price fluctuation drive effective progress in this regard.

### *Prepare for a Fresh Challenge, Natural Capital*

#### Basics for Natural Capital

Natural capital is related to natural assets including water, air, and all living things. Natural capital affects economic activity to different extents. For instance, polluted air leads to health consequences, which thus expands market needs for air purifying equipment. Simultaneously, customers look for areas (e.g.,

commercial building) covered by ventilation systems with enhanced air purifying features. Additionally, natural capital plays a role for climate change, such as forestry absorb carbon dioxide from the atmosphere in a process known as carbon sequestration<sup>6</sup>.

#### Solidifying Disclosure Recommendations

In March 2022, The Task Force on Nature-related Financial Disclosures (TNFD) published the beta version of its nature-related risk and opportunity disclosure framework for consultation, which provides an outline of fundamental concepts and definitions, draft disclosure recommendations, and guidance on performing nature-related risk and opportunity assessments and incorporating the assessments into risk management processes. By developing an integrated nature-related risk and opportunity assessment process called LEAP (Locate, Evaluate, Assess, Prepare), it provides guidance for a corporate to dictate its strategy and implementation for this fresh challenge. Nature can be understood through four key realms, namely, land, ocean, freshwater and atmosphere, encompassing a total of 30 biomes<sup>7</sup>. This serves as a good starting point for a corporate to conduct its assessment.

#### Conclusion

The ESG universe is continually expanding. Corporates should identify the latest institutional investor ESG priorities, and reshape their strategies and approach to shareholder engagement to meet these expectations.

Alliance Advisors will continue to provide ESG updates as newsworthy items are released. [Contact us today](#) if you would like to formulate an institutional investor engagement plan and be well prepared for their upcoming ESG demands.

<sup>5</sup> RE100, RE100 Technical Criteria, March, 2021.

[https://www.there100.org/sites/re100/files/2021-04/RE100%20Technical%20Criteria%20\\_March%202021.pdf](https://www.there100.org/sites/re100/files/2021-04/RE100%20Technical%20Criteria%20_March%202021.pdf)

<sup>6</sup> Schroders, Investing in Natural Capital - Benefits and Barriers, November 2021.

<https://www.schroders.com/en/sysglobalassets/digital/insights/2021/11-november/natural-capital-investing/2021-nov-investing-in-natural-capital-dl.pdf>

<sup>7</sup> Biomes are various regions of our planet distinguished by the type of plant life that they support in response to average rainfall and temperature patterns. TNFD, The TNFD Nature-related Risk & Opportunity Management and Disclosure Framework, Beta v0.1 Release, March 2022.

<https://tnfd.global/wp-content/uploads/2022/03/220315-TNFD-beta-v0.1-full-report-FINAL.pdf>