Rigorous, open-access analysis and data can drive business towards net zero

Achieving a net zero transition requires co-ordination and concerted effort by multiple stakeholders across the economy, including investors. Discussing the Transition Pathway Initiative at the Grantham Research Institute at LSE, **Carmen Nuzzo** *explores how robust, independent assessment methodologies and data can support the financial decisions necessary to realise a low-carbon economy.*

Net zero trackers and other tools to assess companies' climate ambitions and plans proliferate in both the private and in the not-for-profit sector. However, when the Transition Pathway Initiative (TPI) was launched in 2017, there was little that investors had at their disposal to evaluate what the transition to a low-carbon economy looked like for their investee entities.

Tired of being presented with inch-tick glossy publications filled with charts that were trying to demonstrate that companies knew what they were doing on climate change, and that investors needed not to worry because their investments were safe, the TPI founders (spearheaded by the Church of England National Investing Bodies and the Environment Agency Pension Fund) wanted to understand what to make of company climate action claims in their own terms.

They were looking for a framework to determine whether they could retain their investment confidence in a company and/or continue to support its leadership through their vote. They needed a way to assess corporate carbon pathways and governance practices to ensure that the firms they were investing in were prepared to address the net-zero transition, transform their business models to make them sustainable and, ultimately, protect the assets they were investing on behalf of their beneficiaries.

Fast forward to today, the TPI has 145 supporters with ~$60tn of assets under management and advice. It now has a dedicated LSE TPI Centre (with Prof. Simon Dietz as Research Director), a 20-strong team, and is an independent, authoritative source of rigorous, analytical methodologies, research and data on the progress that corporates

and sovereigns are making in the transition to a low-carbon economy.

Assessing entities in investor terms

What distinguishes the TPI outputs and makes them useful? They are open source, based on publicly available information, intuitive and easy to use, accessible online and designed to be investment-decision useful. Furthermore, they are aligned to existing initiatives, such as CDP and the Taskforce for Climate-related Financial Disclosure, to not add unnecessarily to the corporate reporting burden. Importantly, its tools are backed by rigorous, transparent methodologies, which are subject to academic peer-review, public consultations, and investee entities can review their assessments before they are published.

To maximise impact, the TPI began by evaluating what the transition to a low-carbon economy looks like for companies that have a high impact on climate change, such as electricity utilities and oil and gas producers, choosing them by market capitalisation. Large, listed companies are subject to public disclosure requirements and climate-related ones are increasing in many jurisdictions. (e.g. UK; EU, Australia).

The TPI corporate methodology comprises two pillars:

Management Quality (MQ): through a set of 23 indicators and using a Level 0-5 scoring system, this pillar evaluates and tracks the quality of companies' governance/management of their greenhouse gas emissions (GHG) and of risks and opportunities related to the low-carbon transition. In collaboration with the TPI data partner FTSE Russell, an LSEG company, TPI assesses management practices, such as whether a company has a climate-change policy in place, to what extent it discloses its emissions, whether the company has allocated board responsibility for climate change, and the credibility of its action plans (Fig.1).

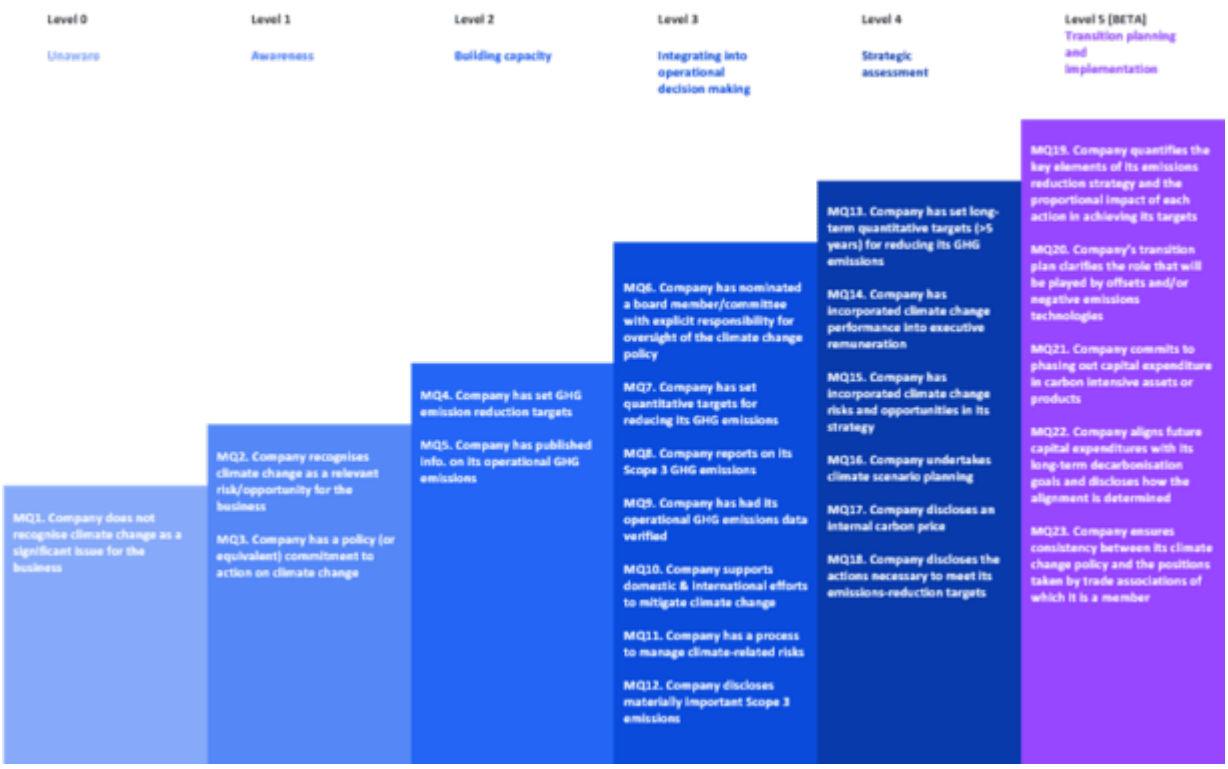

Fig.1: Management Quality, Companies' governance of greenhouse gas emissions, and the risks and opportunities arising from the low-carbon transition. More detail: [TPI's methodology report: Management Quality and Carbon Performance](#).

Carbon Performance (CP): this pillar assesses companies' carbon emission pathways against different climate scenarios consistent with the UN Paris Agreement, including the aim to limit global warming to 1.5°C above the pre-industrial level. TPI evaluates this by comparing companies in high-emitting sectors against each other and against sector-specific benchmarks (Fig.2). Data again come from company disclosures as well as CDP responses where necessary.

In essence, MQ assessment focuses on processes, while CP on decarbonisation ambition/commitment.

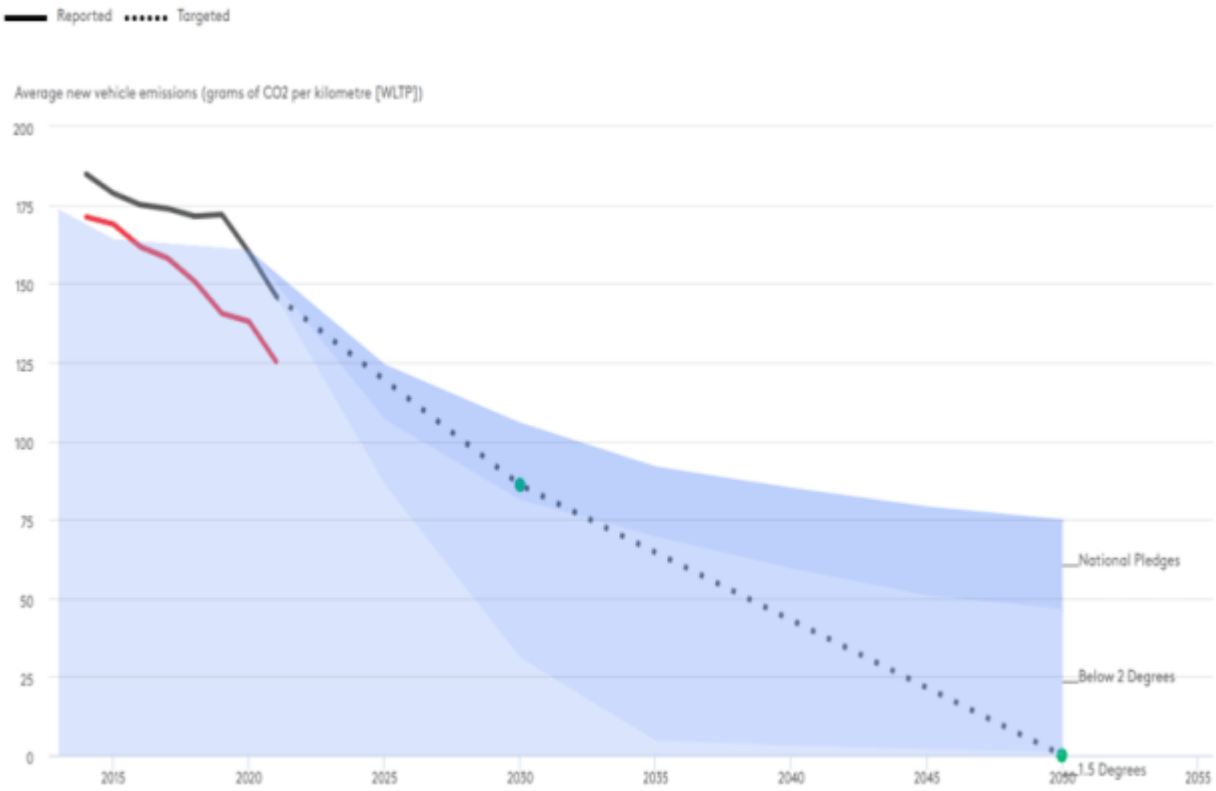

Fig.2: Carbon Performance Quantitative benchmarking of companies' emission pathways against different climate scenarios. More detail: TPI Explainer: Interpreting TPI's emissions scenarios and benchmarks.

Ideally, companies with robust, well-developed MQ would adopt business strategies that increase their rate of emissions reduction, and there is some research suggesting this is the case. However, there are examples of companies with good carbon management systems that nonetheless have high emissions (e.g. in the oil and gas sector). There are also cases where companies have set ambitious targets but lack the knowledge, management systems or capacity to implement them; or companies that lack suitable disclosure for the TPI to assess targets (e.g. in the food sector).

From risk assessment to net zero alignment

TPI is not prescriptive about how its data can be used. Investors use it in different ways to make their own decisions. For example:

- **ESG integration**: Many investors want to understand the risks that their investee

entities face as a result of the transition to adequately price them. Therefore, they may use TPI data for portfolio construction or risk management processes.

- **Voting**: Shareholders with voting rights may use the TPI outputs to shape approaches to proxy voting and for filing resolutions.
- **Engagement:** Investors may discuss TPI results with investee entities to gain better insights into company transition plans. Ultimately, this could lead to divestment decisions, if such discussions do not result in the progress that investors expect. Such engagements can be done individually or collaboratively. Indeed, the TPI data feed into the investor-led Climate Action 100+ initiative.
- **Screening:** Investors may use TPI outputs to restrict their investable universe, through exclusion lists or via positive screening, i.e. by investing in high-emitting companies that show decarbonisation progress.
- **Product creation:** Investors use TPI data to create climate-sensitive financial products or invest in indices such as the FTSE TPI Climate Transition Index Series.
- **Demonstrating commitment**: By being TPI active members many investors show their beneficiaries or stakeholders that their asset allocation and investment decisions are meaningfully contributing to the goals of the Paris Agreement.

And although TPI was developed with investors in mind we have seen civil society institutions use the data as part of corporate due diligence processes and suppliers to help them align climate policies across a global value chain. Finally, TPI also contributed to the Transition Plan Taskforce, set up by the UK HM Treasury to develop the gold standard for private sector climate transition plans.

A broadening TPI universe to increase impact

Since its inception, the universe of entities that the TPI evaluates has expanded significantly: over 1,000 companies now have a public MQ score and more than 400 have a CP assessment using 11 sectoral benchmarks. This year, it also assessed 26 banks for the first time, based on a new banking net zero framework.

Finally, the TPI Centre, as the academic partner of the investor-led ASCOR project (Assessing Sovereign Climate-related Opportunities and Risks), has also developed a framework for sovereign entities, to assess countries' progress on managing climate change, and published the first results for 25 nation states, representing nearly 70% of

GHG emissions and 50-80% of the main sovereign bond market indices (see Fig.3).

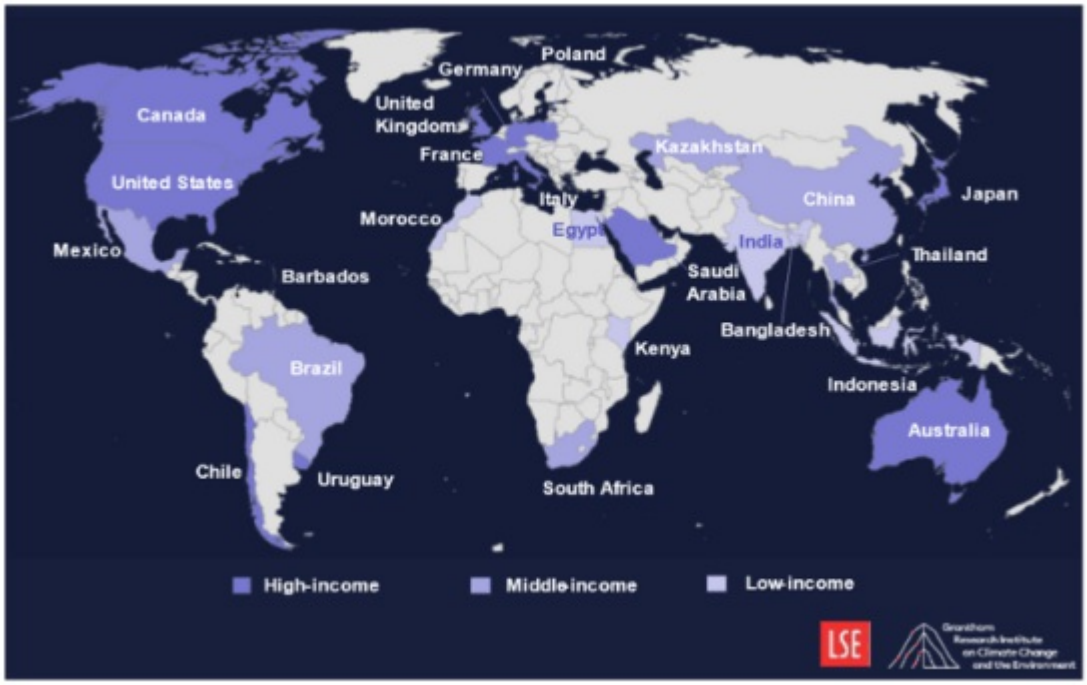

Fig.3: Map of the world showing countries covered by the initial ASCOR assessment that represent 70% global greenhouse emissions and 50-80% of the main sovereign bond market indices. (Incoming groupings based on World Bank lending group categories).

Transitioning to net-zero requires what Professor Lord Nicholas Stern describes as “the biggest economic transformation ever seen in peacetime”. It needs changes in financial analysis, policy and regulation, as well as shifts in financial practice across the US$386 trillion in assets in banking, capital markets, pension and insurance funds as well as asset managers. The TPI empowers investors by providing unique, publicly available online resources backed by rigorous analysis, to support the net zero transition whilst navigating the associated risks and opportunities.

Readers can find more information and resources on the TPI website: www.transitionpathway.org.

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