

RESPONSIBLE INVESTMENT

What does a good climate transition plan look like?



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

Climate Change is the defining issue of our time and we are at a defining moment. From shifting weather patterns that threaten food production, to rising sea levels that increase the risk of catastrophic flooding, the impacts of climate change are global in scope and unprecedented in scale. Without drastic action today, adapting to these impacts in the future will be more difficult and costly¹.

SDG Alignment



“ There is no going back - no matter what we do now, it's too late to avoid climate change and the poorest, the most vulnerable, those with the least security, are now certain to suffer”

Sir David Attenborough

One of the notable achievements of the COP26 gathering in Glasgow last year was the agreement to strengthen the national emissions reductions targets for 2030, agreeing they would have to fall by 45%. A large part of the responsibility for these national commitments to limiting global temperature increases to 1.5 degrees by 2050 (also known as net zero²) falls on the shoulders of companies, and by extension active owners of these entities.

Climate change is one of Quilter Cheviot's stewardship priorities. We have engaged with some of the largest carbon emitters within portfolio holdings with the aim of better understanding corporate climate strategies, and where lacking, encouraging alignment with best practice. This is an ongoing dialogue that will require systematic monitoring to ensure companies walk the talk – but it is worth sharing some of our learnings so far and what, in our opinion, constitutes a good transition plan.

¹ United Nations

² Net zero emissions are achieved when human-caused emissions of greenhouse gases to the atmosphere are balanced by removals over a specified period. Scenarios that limit global warming to 1.5°C with no or limited overshoot reach global net zero CO₂ emissions around 2050 accompanied by rapid reductions in non-CO₂ GHG emissions. (Source: IPCC)

The good

Our engagements have spanned varied industry groups including industrial gases, cement manufacture and utilities, but unsurprisingly most conversations were held with oil & gas majors and diversified miners. Despite the breadth of business processes there is cross-industry progress and every company we engaged had a carbon reduction strategy, with the majority having some form of net zero aligned targets.

Oil & gas companies have been under intense pressure to reduce carbon emissions and change is taking place, particularly amongst European majors. Companies like BP, Total Energies and Shell have committed to ambitious scope 1 (emissions from direct activities) and scope 2 (emissions from electricity purchased and used) targets; with BP and Total committing material amounts of future capital expenditure to renewable revenue streams, proposing to transform into low carbon integrated energy companies in the long-term.

Diversified miners see greater opportunities in minerals that will contribute to the electrification of the economy and are moving away from thermal coal. Ambitious plans to electrify mining fleets are under way and for those involved in aluminium manufacture (a high emissions activity), like Rio Tinto, capital is being committed to early-stage electrified or hydrogen-power smelting processes. Green hydrogen manufacture and use is an increasing focus for industrial gas producers like Linde, but also US utilities companies such as NextEra Energy which is launching early-stage projects with the aim to replace natural gas power generation with green hydrogen as part of the goal to decarbonise the US grid by 2035.

Climate transition plans are company and sector specific, but it is encouraging to see carbon reduction timelines built into strategic planning and that preparations for a lower carbon economy are underway. External validation of these targets and strategies are very much on the agenda. Most companies are either participating or closely monitoring frameworks like the Science Based Targets initiative³ as high emitting sectors move towards more comparable and verifiable disclosures and target setting.

The not so good

The pathway to net zero emissions requires a rapid and radical transformation of the economy. As defined by the 2015 Paris Climate Agreement, a net zero trajectory is also largely absent of the use of carbon offsets (such as tree-planting) and focuses on absolute emissions reductions (unlike carbon neutral strategies). A lot of companies have made high level commitments to achieving net zero by 2050, however, in many cases it is not obvious how this will be achieved, with strategies either relying on significant use of carbon offsets or technologies that are not yet scalable.

Action over the next ten years is critical to maintaining an emissions reduction trajectory to limit global temperature rises to 1.5 degrees. In some cases, we found targets were piecemeal or didn't align with a net zero trajectory.

Linde proposes to be carbon neutral by 2050 and NextEra Energy has promised to cut absolute emissions by 40% by 2025 and become 'fossil fuel free' by 2035, but nothing beyond this. These carve outs can make comparisons difficult. Instead of an absolute emissions reductions target, some companies rely on carbon 'intensity' measures (i.e., carbon emissions per \$ revenue). This is not best practice and can allow for energy companies to increase fossil fuel production as low carbon activities are introduced into activities, while claiming alignment with reduction targets.

Another complexity is scope 3 emissions (indirect emissions from supply chains and products sold). Among miners and energy companies, scope 3 emissions tend to make up over 90% of the overall emissions, but many of the more detailed net zero strategies only account for scope 1 or scope 2 emissions. Others, such as Rio Tinto, do not have net zero targets that include scope 3 emissions. While there are legitimate challenges in allocating responsibility for these emissions, the question of who owns them looms large; accountability of ownership and accurate measurement are essential prerequisites for the targeted reductions needed to achieve the goals set out in the Paris Climate Agreement.

Finally, there is an overreliance on carbon offsetting through nature-based solutions and carbon capture & storage (CCS) technology. Many of the companies we speak to laud CCS projects as one of the ways they are tackling climate change but, in most areas, the technology is not yet commercially viable and corporate strategies should not be reliant upon this making up a structural component of medium or later stage reduction efforts. Shell is an example of a company which has made a significant commitment to nature-based carbon offsetting solutions (such as afforestation), but again, a viable Paris-aligned transition plan should focus on absolute emissions reductions with minimal use of offsets to 'mop-up' harder to reduce residual emissions.

³ Ambitious corporate climate action - Science Based Targets

The US

During this initial stage of engagement, company responsiveness was high, and we were encouraged by the commitment to speak to shareholders. The notable exception was Chevron, who did not respond to requests for dialogue. US oil majors have not echoed the ever more ambitious commitments made by European peers. Exxon and Chevron both made high-level ambition statements to be net zero - by 2050, but how this will be achieved is unclear. Chevron has gone further in announcing a 2028 emissions intensity target, which is welcome progress, but is not comparable to the detail being provided by peers and not aligned with the Paris Climate Agreement.

Despite company specific progress in areas like utilities, conversations with US companies had less of a focus on net zero, clearly differing from European peers which currently face a higher level of government, investor and public scrutiny. With the US government recommitting to the Paris Agreement, we expect this to change and the level of US company engagement with external validation providers such as the Science Based Targets initiative to become a positive trend.

What does a good climate transition strategy look like?

Understanding the credibility of a climate strategy and measuring progress towards stated aims (as well as the Paris-aligned targets) will be an ongoing process. Moving forward we are looking for:

- A focus on the next ten years with specific short and medium-term targets (2050 goals are welcome, but action over the next decade is critical).
- A reduction in absolute emissions. This includes scope 3 metrics and is largely absent of carbon offsets. Carbon intensity measures can be supplemental but should not be the main target.
- A target reduction aligned with 1.5 degrees warming limit pathway. This is the crux of a net zero commitment. Some companies have declared 2 degrees alignment or carbon neutrality, this is not the same thing.
- Actions that demonstrate alignment of capital expenditure with transition targets - and consideration of Paris Climate goals into significant capital expenditure projects.
- Limited use of carbon offsets. Residual emissions may be abated with offsets and carbon capture and storage, but use should be specific with clear end dates. This should not be a structural element of reduction targets. There isn't enough land to plant our way to net zero and a lot of the existing carbon capture technologies exist at a level that is not scalable.
- The linking of executive remuneration to internal carbon reduction targets to help integrate transition planning into company strategy.
- A reassessment of participation in industry associations that lobby governments to soften GHG (greenhouse gas) reduction legislation.
- A willingness to take ownership of scope 3 emissions and building these into carbon reduction targets.

As an investor our role is to engage with these companies in order to encourage actions. A summary of the positions can be found below:

Company	Main metric	Absolute 2030 goal	2050 goal	Scope 3 included in targets
Energy				
Total Energies	Absolute emissions of products sold in Europe	Yes	Net zero (all emissions)	Yes (2030 target)
BP	Absolute emissions from oil and gas products	Yes	Net zero (all emissions)	Yes (2050 target)
Shell	Emissions intensity of all products	Yes	Net zero (all emissions)	Yes (2050 target)
Chevron	Oil & gas operational* emissions intensity	No	Net zero (scope 1 and scope 2)	No
Diversified miners				
BHP	Absolute - operational* emissions (plus shipping)	Yes	Net zero (scope 1 and scope 2)	No
Rio Tinto	Absolute - operational* emissions	Yes	Net zero (scope 1 and scope 2)	No

Company	Main metric	Absolute 2030 goal	2050 goal	Scope 3 included in targets
Utilities				
National Grid	Absolute emissions (all activity)	Yes	Net zero (all emissions)	Yes (2030 target)
NextEra	Operational emissions intensity	Yes	Aim to be fossil fuel free by 2035	No - but not as relevant to sector
Other				
Linde	Absolute - operational emissions	Yes (2035 target)	Carbon neutral	No
CRH	Operational emissions from cementitious products	Yes	Net zero (scope 1 and scope 2 for cementitious products)	No

*Operational - scope 1 and scope 2 emissions.
Source: Quilter Cheviot



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