

Asset managers facing the energy transition

An overview of challenges, opportunities
& required actions



Colofon

Vereniging van Beleggers voor Duurzame Ontwikkeling (VBDO)
Pieterstraat 11, 3512 JT Utrecht
+31 (0) 30 234 00 31 | info@vbdo.nl

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Dutch Association of Investors
for Sustainable Development

Lead
Stijn Scholten

For more information, please contact VBDO

Tel: 030 – 234 00 31

E-mail: info@vbdo.nl

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Foreword

For some, the recent COP27 has been a success. For most, it has been a major disappointment. On a positive note, a loss and damage fund will be created for vulnerable countries that are being hit hard by climate disasters. However, no new plans for large greenhouse gas (GHG) reductions have been made¹. A recently published IPCC report made clear that “unless there are immediate, rapid and large-scale reductions in greenhouse gas emissions, limiting warming to close to 1.5°C or even 2°C will be beyond reach.² For this reason, everyone, including financial institutions, is urged to take immediate action to reduce global GHG emissions.

At VBDO, we have been extensively benchmarking asset owners, such as pension funds and insurance companies, on their responsible investment strategies. While it is very important that asset owners ask asset managers to invest responsibly, we also believe that asset managers are ultimately responsible for facilitating responsible investments. For this reason, it is good to observe that, globally, 291 of them, representing 66 trillion USD assets under management, have signed the Net Zero Asset Managers Initiative (NZAMI).³

The energy sector is responsible for 73% of global GHG emissions⁴. Therefore, asset managers should aim to accelerate the energy transition, and this way, contribute to society reaching net-zero. At VBDO, we recognise that, since there is no single, overarching energy transition strategy, acting on the energy transition might be difficult. However, the world is changing rapidly and the number of initiatives that help asset managers to contribute to accelerating the energy transition is rising. The fact that more investors are willing to collaborate and together contribute to solving today’s challenges is heartening. Moreover, multiple courageous asset managers are showing themselves to be front runners in responsible investment and daring to challenge the traditional way of doing finance.



At the same time, however, other asset managers still seem to struggle with contributing to the energy transition. Short- and long-term demands from shareholders and society can conflict, and achieving a successful energy transition is complex and requires systemic changes. Therefore, with this report, VBDO seeks to assist by setting out how they can contribute to the energy transition. We congratulate those asset managers that are already front runners and encourage them to continue their work. Ones that are still struggling are urged to follow the example. By acting ambitiously and quickly, asset managers can make a real difference.

In the coming years, we want to continue our research and collaboratively evaluate how we can limit the average global temperature rise to 1.5°C. I would like to thank all asset management firms and organisations that have participated in our research. We are well aware that our surveys can be demanding, but without them, this study would not have been possible. I hope that asset managers can use this report as a guide on how to take responsibility for accelerating the energy transition. It will not be easy, but nevertheless, there is no time to wait.

Angélique Laskewitz
Executive Director of VBDO

Executive summary

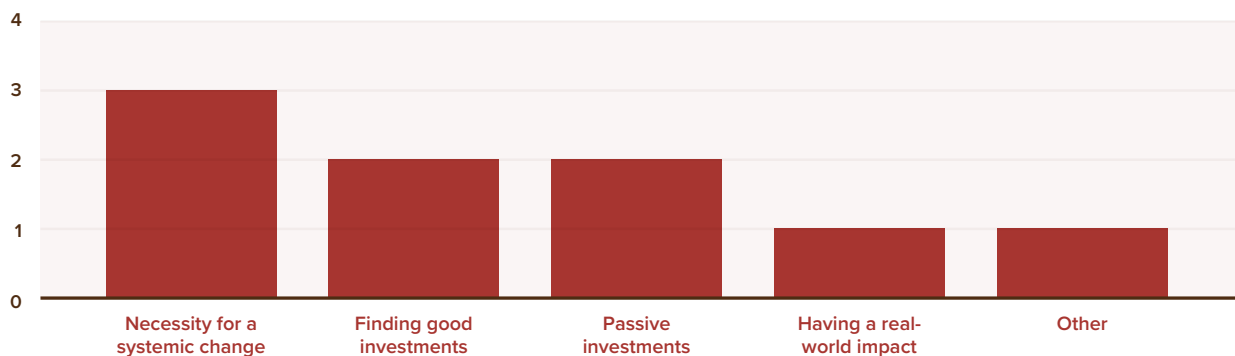
To limit global warming to 1.5°C compared to pre-industrial levels, immediate global GHG reduction is necessary. The energy sector is responsible for 73% of global GHG emissions⁵. For this reason, the International Energy Agency (IEA) concluded that between now and 2050, current global energy demand must decrease from roughly 80% fossil fuel reliance to 20% reliance⁶. In 2021, roughly 87% of the Dutch energy demand was reliant on fossil fuel⁷. Therefore, massive changes in the energy sector are required. To realise this, annual investments in renewable energy generation and infrastructure should increase significantly. At the same time, companies should invest in making their production processes more sustainable. Asset management firms can contribute to accelerating the energy transition via (1) portfolio building and (2) engagement.

This report is based on a survey conducted with 9 asset managers representing around €4.3 billion assets under management (AUM), along with interviews with several of those asset managers. In it, we explore (1) how asset managers contribute to the energy transition, (2) what their challenges are, and (3) how they can overcome some of these challenges.

We are pleased to observe that, globally, 301 asset managers, representing 59 trillion USD assets under management, have signed the Net Zero Asset Managers Initiative⁸. With this initiative, asset management firms

commit to reducing their portfolio's GHG emissions by at least 50% by 2030 and to be net-zero by 2050 on scope 1, 2 and 3 emissions. Currently, there are many initiatives that help asset managers in reaching these climate targets. For example, the Climate Action 100+ initiative helps asset managers to engage with high GHG-emitting companies⁹. Also, the Transition Pathway Initiative (TPI) helps asset managers by publishing how companies currently operate and how they should operate if they are to follow a 1.5°C pathway¹⁰. At the same time, as seen in figure 1, there are still many challenges to overcome.

Figure 1 | What is for your organisation the largest challenge to accelerate the energy transition?



A systemic energy transition: companies need to act now

Of the surveyed asset managers, one third stated that the complexity of the energy transition and the necessity for a systemic solution is their largest challenge. Our global economy is still dependent on fossil fuels, and we cannot completely stop using fossil fuels immediately¹¹. However, it is necessary to decrease fossil fuel reliance. In order to facilitate the energy transition, many companies across several different sectors will need to adjust their production processes. All these independent actors need to coordinate their strategies to create a new energy system. However, by using, for example, the energy transition roadmap of the IEA or the TPI, a company can develop a tailored transition path. Asset managers can contribute to the energy transition by engaging with companies on the development of these transition paths.

It is good to observe that all surveyed asset managers are engaging with oil and gas companies on setting

targets that are aligned to the Paris Agreement. Moreover, 71% of the surveyed asset managers that could vote at Shell's 2022 AGM, supported a climate resolution that asked Shell to set Paris-aligned targets. At the same time, based on the Climate Action 100+ progress reports¹², surveys and interviews, it is also concluded that more engagement is necessary. For example, asset managers are encouraged to engage with both fossil fuel energy providers and with heavy industry companies on changing their processes towards producing and using, for example, green hydrogen instead of gas. Moreover, high GHG-emitting companies should commit and act soon rather than delaying. Only one of the 153 companies included in the Climate Action 100+ benchmark has capex budgets that are aligned with their climate commitments¹³. If companies do not have aligned capex budgets, their climate strategy cannot be considered credible. For this reason, more engagement on setting and publishing aligned capex budgets is necessary.

Finding (impact) investments: dare to deviate from traditional forms of finance

Asset managers can contribute to the energy transition via impact investments. Current annual investments in renewable energy only represent 40% of the amount necessary for the transition¹⁴. However, 22% of the surveyed asset managers indicated that their biggest challenge is finding investments in renewable energy that are scalable and have acceptable risk-return rates. At the same time, 78% of the surveyed asset managers said that they offer impact investments in renewable energy and measure the impact of these investments. These front runners and other asset managers are encouraged to continue with and upscale their impact investments in renewable energy. To realise a successful energy transition, much more AUM needs to be directed to impact investments.

Passive investments: asset managers remain responsible for what they offer

Since adjusting a benchmark is costly and makes investments riskier, 22% of the surveyed asset managers named passive investments as their largest challenge when it comes to accelerating the energy transition. These asset managers argue that clients measure their performance against a benchmark, and therefore, deviating from a benchmark is difficult. However, whilst, understandably, asset owners and managers like to track against a broad index, actively managed passive investments (e.g. a Paris-aligned index) are becoming more popular. Also, asset managers are ultimately the ones that decide what financial products they sell and do not sell, and so they are urged to take responsibility for their financial products.

Having a real-world impact: look beyond absolute GHG reduction

Currently, many asset managers focus on reducing their portfolio's GHG emissions. However, there is a difference between GHG reduction caused by divesting and reduction caused by changes in a company's operations. If asset managers decide to divest from



Raychel Sanner

sectors such as utility, oil and gas, and heavy industry, significant GHG reductions are realised. However, not much has changed in the real world. Therefore, asset managers are urged to look beyond their portfolio's current GHG emissions alone and consider how companies are planning to reduce their GHG emissions. By investing and engaging with companies that have, or show a willingness to, develop credible transition strategies, asset managers can exert influence. A credible transition strategy is a strategy that includes commitments on both absolute and relative carbon reduction targets in scope 1, 2 and 3, and a capex budget that is in line with these commitments.

Conclusion

Many asset management firms recognise their responsibility for contributing to the energy transition. Whilst there are challenges that hinder asset managers from fully taking responsibility, the survey and interview results show that some asset managers are working hard on overcoming these challenges. Nevertheless, despite all the climate commitments and the hard work of some front runners; current global warming predictions, the current investment gap in the energy transition, and (the lack of) short-term actions by high GHG-emitting companies, make it very clear that not enough is being done. Therefore, everyone is urged to accelerate the energy transition by transforming long-term climate commitments into short-term climate actions.

Recommendations

Developing ambitious engagement programmes is crucial

- Engage on setting Paris-aligned capex budgets
- Engage across sectors (e.g. with energy suppliers and heavy industry companies)
- Engage together with other asset managers
- Develop a comprehensive engagement strategy that includes an escalation strategy (e.g. voting or divestment)

Consider absolute GHG reduction as a means to an end, and not as an end in itself

- Seek to reduce the absolute GHG emissions of your portfolio by engaging with investee companies to reduce their GHG emissions, rather than solely through divestment
- Analyse whether the activities of investees are in line with transition paths (e.g. no additional investments in new or extended coal mines or oil fields)
- Consider whether investee companies have credible transition strategies (e.g. absolute and relative GHG-reduction short-term targets in scope 1, 2 and even scope 3, and an aligned capex budget)

Dare to deviate from traditional forms of finance

- Investigate how the transition towards renewable energy can be incorporated in the portfolio via various asset classes and investment strategies
- Promote the use of transition-proof benchmarks for passive investments
- The energy transition asks for a holistic approach, with a clear vision on the real-world impact. This requires an investment approach across and beyond asset classes

Join, support and contribute to collaborative responsible investment initiatives

- Collaborate with development banks and other stakeholders to enable (impact) investing in renewable energy in emerging markets
- There are many initiatives that can help asset management firms with taking responsibility for accelerating the energy transition. We encourage asset managers to share knowledge with other asset managers and collaborate with expert organisations, as well as with companies and governments

1. Introduction

In 2015, 196 countries signed the Paris Agreement: a legally binding international treaty on climate change. It has been agreed that countries will set climate goals that limit global warming to well below 2°C, and preferably below 1.5°C, compared to pre-industrial levels. Additionally, the responsibility of financial institutions is explicitly mentioned in the Paris Agreement. Financial institutions are urged to make their financial flows consistent with a sustainable pathway that leads to a decrease in GHG emissions that is Paris aligned¹⁵. Whilst much has changed since the Paris Agreement, the average global temperature is still rising. As seen in figure 2, in order to reach the Paris Agreement's objectives, current GHG emissions must be reduced quickly. Therefore, the IPCC concluded that: "Unless there are immediate, rapid and large-scale reductions in greenhouse gas emissions, limiting warming to close to 1.5°C or even 2°C will be beyond reach."¹⁶

As seen in figure 3, the energy sector is responsible for more than 73% of global GHG emissions. To reduce global GHG emissions, energy demand must be reduced rapidly, and global energy supply must become more sustainable. However, emerging markets are expected to grow massively. This will lead to a significant increase in global energy demand. Therefore, if energy demand in other countries is not decreased and if energy is not produced more sustainably, achieving the set climate goals will be beyond reach. For this reason, a quick energy transition is necessary if the planet is to achieve a 1.5°C global warming scenario.

Figure 2 | Climate scenarios^A

- Each pathway comes with uncertainty, marked by the shading from low to high emissions under each scenario.
- Warming refers to the expected global temperature rise by 2100, relative to pre-industrial temperatures.

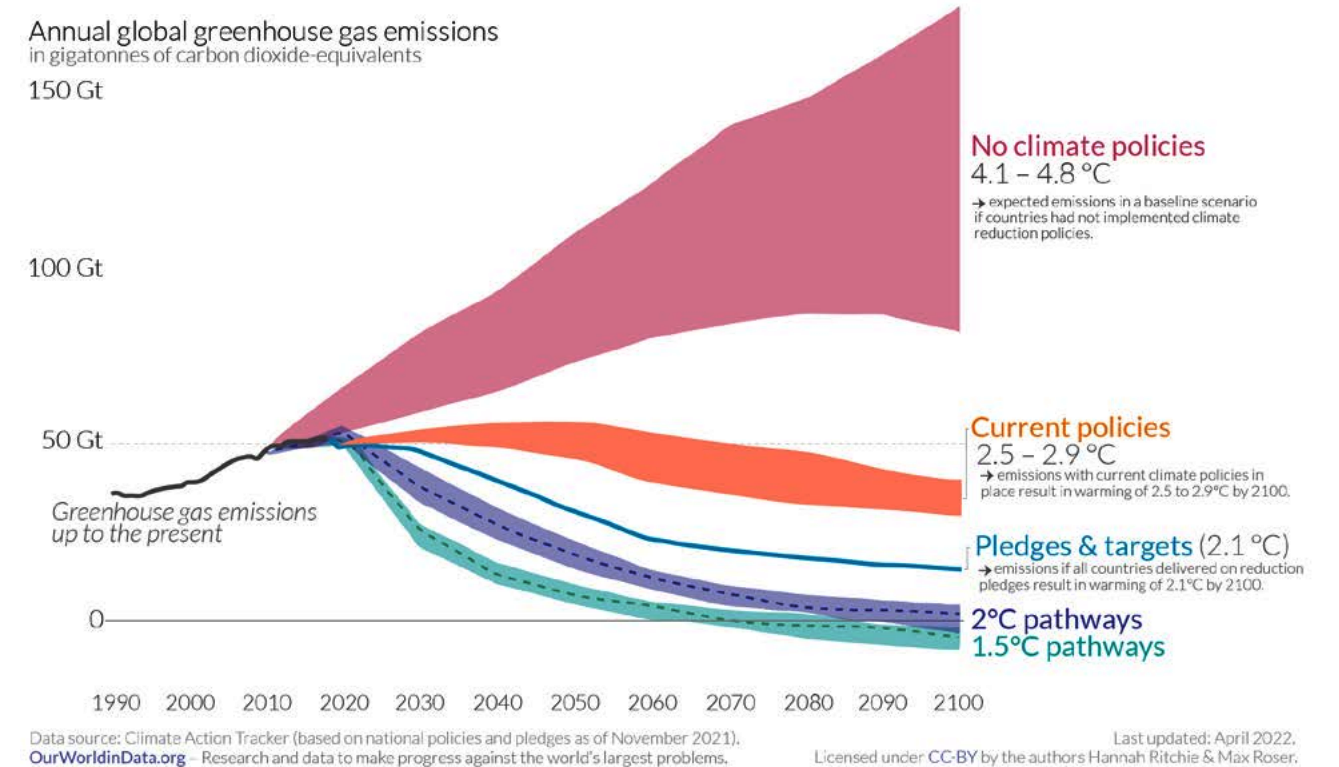
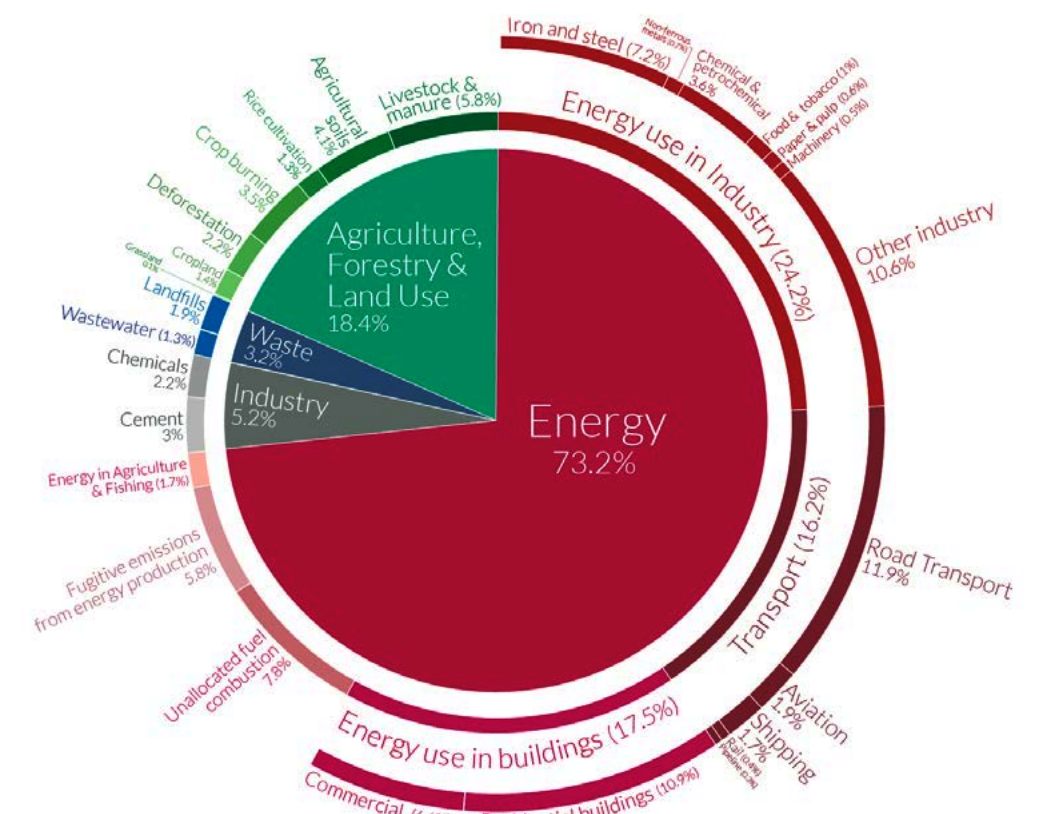


Figure 3 | Emissions by sector^B

This is shown for the year 2016 – global greenhouse gas emissions were 49.4 billion tonnes CO₂eq.



OurWorldinData.org - Research and data to make progress against the world's largest problems.
Source: Climate Watch, the World Resources Institute (2020).
Licensed under CC-BY by the author Hannah Ritchie (2020).

2. Background information

THE ENERGY TRANSITION

The International Energy Agency's road to net zero

'How to achieve a more sustainable energy sector' is a complex and technical question, and unfortunately, there is no one clear solution. This makes it more difficult for asset managers to contribute to the energy transition. However, fortunately, there are widely respected initiatives that help asset managers in accelerating the energy transition. For example, the IEA has published a roadmap entitled 'Net Zero Emissions by 2050'.¹⁷

Whilst the IEA describes a road to net zero, it is important to be aware that this road is one possible road, and not necessarily the only road. Moreover, there are many challenges to overcome, such as the need for mass behaviour change, and the reliance on technologies that are still in development. Despite these uncertainties, it is clear that the immediate and large-scale deployment of all available clean and efficient energy technologies is necessary. Whilst the global economy is expected to double by 2050 compared to today, it needs to be using 8% less energy than it is today. Therefore, an enormous push for energy efficiency is necessary. Moreover, global energy supply must be transformed. In 2050, the majority of global energy supply must be renewable energy coming from wind, solar, bioenergy, geothermal and hydro sources. In this regard, electricity will become the dominant form of energy, and many sectors should prepare themselves to transition to electric processes.

The importance of significantly reducing global coal demand

In a recent IEA report, it is concluded that: "achieving a swift reduction in global coal emissions is the central challenge for reaching international climate targets".¹⁸

Coal is still the largest source of energy generation, and also the largest emitter of carbon dioxide (15 Gt in 2021). If global coal production is not decreased significantly, the emissions from coal assets alone would increase global warming above 1.5°C. Therefore, global coal demand should be decreased by 90% by 2050. This means that the power sector of advanced economies must be completely decarbonised by 2035, and other countries much follow suit by 2040.

The role of oil and gas companies

The IEA concludes that to become net zero by 2050, it is not necessary to fully abolish fossil energy. Between now and 2050, global energy demand must shift from roughly 80% fossil fuel-based energy to (at most) slightly more than 20% fossil energy. In 2021, roughly 87% of the Dutch energy demand was reliant on fossil fuel.¹⁹ Some fossil-based energy is expected to be necessary for the production of goods such as plastic, or in sectors where there are limited options for low-emissions technology. However, fossil fuel reductions must be realised quickly. The scale of reduction needed makes it absolutely clear that no new oil or gas fields, coal mines or coal mine extensions should be approved. Only a very limited number of the most efficient oil and gas producers will be able to supply the required oil and gas. Therefore, oil and gas companies are advised to use their expertise in energy to transform their business model to the production of green hydrogen, CCUS systems or offshore wind energy. If they do not transform their business model, they will risk not having a place in the 2050 economy and becoming a stranded asset.²⁰

As discussed in textbox 2 and 3, another challenge is how to ensure that the energy transition happens in a just and fair way.

Box 1 - The challenge of carbon capture, utilisation and storage (CCUS) systems

In the IEA's roadmap to net zero, it is assumed that, in the future, CCUS systems will be used effectively. However, the effectiveness of CCUS technologies is still uncertain. These technologies are in the demonstration and prototype stages and are not yet scientifically proven. The

absence of these technologies would have major impacts on the feasibility of the IEA's roadmap to net zero. This is especially the case for heavy industries, such as the cement industry, which will find it very difficult, if not impossible, to completely reduce their GHG emissions.^C

Financing the road to net zero

To finance the energy transition, current capital flows should shift more towards the energy sector. The IEA predicts that current global annual investments in energy should increase from 2 trillion USD annually to 5 trillion USD annually by 2030 and 4.5 trillion USD annually by 2050. In particular, the electricity generation sector and technologies that facilitate electrification processes require massive investments. For example, the amount that is invested annually in electricity generation needs to rise from 500 billion USD to 1,600 billion USD, and the amount that is invested annually to facilitate electrification processes needs to rise from 260 billion USD to 800 billion USD.²¹

A particular challenge is how to finance renewable energy projects in emerging markets. During the recent COP27, it was decided that a loss and damage fund will be created for vulnerable countries that are being hit hard by climate disasters.²² As well as discussing how

to increase the flow of public money from high-income countries to low-income countries, the responsibility of asset management firms was also discussed at COP27. To reach a successful energy transition, private money needs to flow to emerging markets. Otherwise, the energy generation and electrification systems that are needed cannot be built. Therefore, Mahmoud Mohieldin, the previous Senior Vice President for the 2030 Development Agenda at the World Bank Group, argued that: "We now need a creative collaboration between project developers and public, private and concessionary finance, to unlock this investment potential and turn assets into flows."²³

To sum up

To limit global warming to well below 2°C, and preferably below 1.5°C, compared to pre-industrial levels, significant GHG reductions in the energy sector are necessary. Whilst the energy transition is complex, the IEA provides a roadmap that asset managers can

Box 2 - The just transition

Along with the fact that the energy transition requires massive changes from companies, it also heavily impacts people's livelihoods. For example, people may become jobless or not be able to afford their energy bills or the cost of making their homes more energy efficient. Indigenous people may be asked to move from their ancestral territories or be affected in other ways. However, the impact of the energy transition on people

is likely to differ across countries and sectors. Therefore, it is important that companies consider and map the impact of their climate strategies on people, and ensure that these strategies are executed in a just way. This can be done by, for example, consulting with relevant stakeholders and developing strategies to compensate for, and minimise, negative externalities.^D

Box 3 - Responsible mining

To facilitate the energy transition, it is necessary to build clean technologies. To do so, many raw minerals, such as copper, lithium, bauxite and nickel, are needed. Due to the energy transition, lithium demand, for example, is expected to increase by a factor of 30. The mining of raw minerals often harms (drinking) water quality, biodiversity and local communities in countries such as Madagascar,

the Philippines, Ghana and Indonesia. Therefore, mining companies are urged to mine responsibly and investors are encouraged to engage with mining companies on this topic (e.g. on implementing the Initiative for Responsible Mining Assurance (IRMA) standards or those of the Global Reporting Initiative).^E

use as a guide for accelerating the energy transition. Global energy demand should be decreased, and global energy supply changed. Currently, roughly 80% of global energy supply is fossil-based, but this should be limited to around 20% of global energy supply. This requires a shift in both energy generation and energy infrastructure. Therefore, a significant increase in (renewable) energy investments is necessary. Finally, to facilitate the energy transition, both energy-supplying companies and energy-demanding companies need to invest in adjusting their production processes.

ASSET MANAGERS AND THE ENERGY TRANSITION

Net zero pledges

Over the last few years, many asset managers have signed net zero commitments. For example, globally, 291 asset managers, representing 66 trillion USD of assets under management, have signed the Net Zero Asset Managers Initiative.²⁴ By doing so, these asset management firms have committed to becoming net zero by 2050, and thereby, to be aligned with a 1.5°C pathway. To reach this target, asset managers need to reduce their portfolios' GHG emissions by an average of 50% before 2030. This reduction includes scope 1, 2 and 3 reductions.

Responsible investing

Since the energy sector contributes to 73% of global GHG emissions, and considering that asset managers are committing to achieve net zero by 2050, asset managers should take responsibility and aim to accelerate the energy transition²⁵. As seen in figure 4, asset managers can invest responsibly by (1) building a responsible investment portfolio, and by (2) trying to improve the ESG performance of investee companies. As previously mentioned, the energy transition is complex, and there is not one single road to net zero. However, there are initiatives (e.g. the TPI and the Climate Action 100+ initiative that can help asset managers with developing a credible climate strategy.

INTEGRATING THE ENERGY TRANSITION INTO THE PORTFOLIO

There is much discussion on how to build a portfolio responsibly. For example, some asset managers integrate ESG data in the portfolio selection. This way, asset managers minimise ESG risks. However, due to the single materiality of ESG investments, the positive real-world impact of these investments could be criticised. A high ESG score indicates that an investment poses limited ESG-related risks for financial

Figure 4 | What is responsible investment?^F

Considering ESG issues when building a portfolio (known as: ESG incorporation)			Improving investees' ESG performance (known as: active ownership or stewardship)	
ESG issues can be incorporated into existing investment practices using a combination of three approaches: integration, screening and thematic.			Investors can encourage the companies they are already invested in to improve their ESG risk management or develop more sustainable business practices	
Integration	Screening	Thematic	Engagement	Proxy voting
Explicitly and systematically including ESG issues in investment analysis and decisions, to better manage risks and improve returns.	Applying filters to lists of potential investments to rule companies in or out of contention for investment, based on an investor's preferences, values or ethics	Seeking to combine attractive risk return profiles with an intention to contribute to a specific environmental or social outcome. Includes impact investing.	Discussing ESG issues with companies to improve their handling, including disclosure, of such issues. Can be done individually, or in collaboration with other investors.	Formally expressing approval or disapproval through voting on resolutions and proposing shareholder resolutions on specific ESG issues.

Box 4 - Climate Action 100+

The Climate Action 100+ initiative is an investor-led initiative that aims to ensure that the world's largest corporate greenhouse gas emitters take urgent action on climate change and contribute to a 1.5°C scenario. One way the initiative does this is through its Net Zero Company Benchmark, in which it assesses the largest corporate GHG emitters on their progress on transitioning to net zero by 2050. The benchmark includes company-specific progress on the key indicators that need to be met in order for companies to achieve net zero by 2050.⁶

returns, but it does not indicate that the respective investment contributes positively to the environment or society.²⁶ Moreover, other asset managers apply a negative screening filter to their portfolios, and this way, exclude companies from their portfolios based on their preferences, values or ethics. For example, PME applies a negative screening filter for oil and gas companies.²⁷ Finally, asset managers can decide to explicitly invest in companies or projects that create a positive impact on an environmental or social topic, for example, by financing renewable energy projects.

Impact investing

In our report on impact investing, VBDO describes impact investing as: "Active investments whereby the investor has a specific intention of improving sustainability or clearly offering added value for sustainable development. It is also crucial to measure and evaluate the actual environmental and social impacts of impact investments.²⁸" As seen in figure 5, there are three important criteria for impact investing: (1) intentionality, (2) additionality and (3) measurability. (1) 'Intentionality' means that there must be a drive to identify themes or development areas that you want to actively contribute to with your investment. (2) 'Additionality' means that the impact investment must lead to additional financial (e.g. return rates), non-financial (ESG improvements) or development (exceeding the previous target) benefits that would not have occurred without the investment. (3) 'Measurability' means that the impact must be measurable.

Box 5 - Transition Pathway Initiative

The Transition Pathway Initiative Global Climate Transition Centre (TPI Centre) is an independent, authoritative source of research and data on the progress of the financial and corporate world in transitioning to a low-carbon economy. The TPI Centre's analysis considers corporate climate governance and carbon emissions. Its data can be used to assess the performance of large corporate GHG emitters, as can that of, for example, Climate Action 100+.^H

The VBDO study concludes that many Dutch pension funds struggle to embed impact investments in their mainstream investment decisions. Pension funds mentioned that impact investments cannot always meet the demanded risk/return rates, are not scalable, and have limited track records. At the same time, the interest in impact investing is growing, and the available standards and instruments that asset managers can use for impact investing are growing as well.

Figure 5 | Criteria impact investments^I





Finally, as aforementioned, there is an exceptional need for (impact) investments in renewable energy in emerging markets. Whilst these investments sometimes fall short in terms of short-term returns and are sometimes perceived as risky, there are possibilities to upscale them. Impact investments in emerging markets can become less risky by using co-finance. With co-finance arrangements, such as blended finance, public and private financial flows are combined.²⁹ This results in less risky investments. Therefore, more private capital can be attracted. By collaborating with development banks, asset managers can integrate impact investments in emerging markets as one of their investment strategies. This way, asset managers can make a real-world difference.

RESPONSIBLE STEWARDSHIP

Besides portfolio building, investors can take responsibility through active ownership/stewardship. In this regard, asset managers are encouraged to join initiatives such as the Climate Action 100+. When asset managers cooperate on engagement, they can exert more influence on companies. Moreover, the Climate Action 100+ benchmark and data from the TPI initiative can help asset managers to set clear objectives. Finally, when companies do not show sufficient change, asset managers are encouraged to escalate engagement. One way to escalate is by supporting a relevant climate resolution, such as the resolution put forward by Follow This (see textbox 6).

Box 6 - Follow This

Follow This aims to change oil and gas companies from the inside by filing shareholder resolutions, and asking other investors to support these resolutions. Through these shareholder resolutions, Follow This asks oil and gas companies to commit to net zero and publish strategies that are aligned with the Paris Climate Agreement.¹

Engagement with oil and gas, is it worth it?

Despite attempts by asset managers to engage with oil and gas companies, these companies do not, on the whole, appear to be taking the urgent actions necessary to combat climate change. From an ethical and policy standpoint, it would seem to be a wise decision to divest from these companies. For example, PME now applies a negative screening method to oil and gas companies because, as stated on PME's website: "In the last years, we spoke extensively with oil and gas companies, encouraging them to start using renewable energy sources. Those talks have not led to a reduction in fossil energy production. From now on, we will focus on large energy-consuming companies. It is relatively easy for them to start using cleaner energy. In the years to come, we will do our best to make this happen."³⁰

However, the moment you divest from oil and gas companies, you lose the possibility of engaging with them. For this reason, you can argue that it is better to invest in oil and gas companies that show a willingness to change and use engagement as a tool to foster this change. Whilst this is a reasonable argument, it should not be used as an excuse for investing in oil and gas companies that show no willingness to change. Therefore, VBDO urges asset managers to prove that they engage with oil and gas companies on becoming Paris aligned, and ideally, have an escalating and divesting strategy if insufficient progress is made.

3. Results on responsible investing and the energy transition



Viewpoint: investors should focus on companies' climate targets and capex budgets

Alix Chosson, Lead ESG Analyst at Candriam

Climate strategies and fossil fuels For over 15 years now, Candriam's ESG analysis has embedded climate mitigation and adaptation across our sustainable investment strategies. In line with this commitment to the fight against climate change, Candriam has joined the Net Zero Asset Managers Initiative (NZAMI). Thereby, we commit ourselves to securing a 50% reduction in emissions across a significant share of our investment portfolios by 2030 and to transiting to net zero by 2050 or sooner.

With regard to the transition to net zero, a central issue is that of reducing fossil fuels. In fact, in order to have a credible climate strategy, asset managers must have a strategy on fossil fuels. At Candriam, this strategy means that all our investments exclude companies that generate more than 10% of their revenues from thermal coal. Across our sustainable strategies, we apply an even stricter approach, excluding any companies that generate more than 5% of their revenues from thermal coal. This 5% revenue threshold is in line with a transition path. In fact, a lot of companies in the utility sector or electricity production sector still have some assets in coal. However, for the most part, these must be closed by 2030 to achieve net zero by 2050. Thus, the revenue threshold

is necessary so as to not automatically exclude most of the utility sector and to recognise companies' transition paths.

As per our SRI policy, we do not invest in companies that derive more than 5% of their revenues from oil and gas in any part of their value chain. This means that we exclude not only oil and gas producers but also intermediaries in the value chain, such as companies involved in their transport. In addition, we also look at companies' transition strategies. The only means by which a company can still be included in our sustainable portfolios is by having a credible transition strategy. This requires a company to dedicate at least 15% of its capex budget to low-carbon activities, such as renewables and electric mobility. Moreover,

it needs to be committed to net zero by 2050 and have proper reduction targets for 2030.

FOCUSING ON DECARBONISATION ONLY IS INSUFFICIENT

Decarbonising a portfolio can be very easy. Currently, if you divest from sectors and economic activities such as utilities, energy, transport and industrials, and instead invest in banks and media, for example, the result is that you decarbonise. However, such an approach does not have any real-world impact. So instead, our approach is to look at sectors that are compatible with a net zero scenario and to select companies that invest in climate mitigation and adaptation solutions. An illustration: a climate action fund that invests only in companies that contribute to climate solutions, such as renewables and hydrogen, is a fund with a high carbon footprint, because it invests in utilities and industry. This shows the limitations of the carbon footprint as an indicator for the climate position of a fund. Therefore, in our approach, the carbon footprint is not the only determinant and we do not evaluate the climate performance

of a company solely based on its carbon footprint. Instead, we follow a range of sector-specific indicators that show how a company is decarbonising and transforming to a net zero path.

ANALYSING THE SHORT- AND MID-TERM TARGETS AND CAPEX BUDGETS OF COMPANIES IS KEY

In accordance with our SRI strategy, we invest in a company only if, according to our analytical models, the company can meet specific climate criteria that we have set in our ESG framework. Here, we follow the framework of the IIGCC and analyse the credibility of a company's climate commitments. In this regard, a commitment to reach net zero by 2050 is not sufficient on its own. We look for an additional commitment of 50% GHG reduction by 2030. Clear short- and mid-term targets are, to a certain extent, more important than a company's statement that it will be net zero by 2050.

Furthermore, it is important to us that reduction targets are both relative and absolute. We have seen companies set relative targets, for example in terms of the carbon intensity of their sales. When they massively increase their sales, their relative carbon intensity drops, but their total emissions skyrocket.

Moreover, we analyse whether the target pertains not only to scopes 1 and 2, but also to scope 3. If a company's climate strategy

does not include a strategy on scope 3, whilst the majority of its emissions come from scope 3, the climate strategy is simply not credible. Therefore, when companies' climate strategies are not in line with this framework, we generally vote against their says-on-climate resolutions.

Finally, an important indicator is capex budget, in particular to help us to observe change over time. In fact, capex speaks louder than words. Take the example of an oil and gas company that declares it will be net zero by 2050. If that company's capex budget for 2030 is still 80% focused on oil and gas and only 20% on renewables, it is difficult to believe that the company will be net zero by 2050 and have phased out fossil fuel exposure. Currently, companies in the Climate Action 100+ benchmark are making a lot of progress on setting short- and mid-term targets and being transparent and aligning with the Paris Agreement. However, for a certain number of them, capex budgets are still not aligned.

REAL-WORLD IMPACT VIA ENGAGEMENT

Currently, there is significant noise around the concept of net zero, but emissions are still rising. While discussions around this concept are of course useful, as mentioned before, it is important to look not only at the carbon footprint but also at how decarbonisation is implemented and at what the path towards net zero

looks like. And one key question is how to understand exactly the impact we have as investors.

When looking at this question of impact, engagement is an important piece of the puzzle. In fact, engagement can help to encourage companies in their adoption of better ESG practices and in improving disclosure on extra-financial metrics. One example of this is the engagement done via IIGCC with oil and gas companies. Around six or so years ago, many of these companies were reluctant to disclose data on their carbon emissions, with some of them worried that such information might be too competitively sensitive, that the public would not understand it, and that it would not give an accurate representation of their environmental impact. Today, in part through engagement, progress has been made, with oil and gas companies now committing to decarbonisation, scope 3 reductions, additional renewables capacity etc. So, while the results are difficult to quantify, engagement has had some positive impacts, at least in terms of the communication and focus of those companies.

Of course, this is not yet enough. None of the traditional fossil fuel companies are Paris aligned at the moment. A lot of work remains to be done.

3.1. Integrating the energy transition into the portfolio

Many asset management firms have signed pledges to become net zero by 2050. However, decarbonising the energy sector is complex and much will need to change. Therefore, it is important to evaluate how (1) asset management firms are integrating the energy transition into their portfolios, (2) what the challenges are regarding integrating the energy transition, and (3) what opportunities there are to overcome these challenges.

SURVEY RESULTS: INTEGRATING THE ENERGY TRANSITION INTO THE PORTFOLIO

Investments in fossil fuel and renewable energy companies

Not all asset managers (fully) answered the following question: what percentage of current and previous (last five years) total AUM is directly invested in fossil fuel and renewable energy companies?

Only two asset managers provided an overview of the average percentage of AUM that has been invested in fossil fuel companies over the last five years. For one of

the asset managers, the percentage invested remained stable; the other asset manager reduced its percentage. Additionally, five asset managers shared the current average percentage of AUM that is invested in fossil fuels, and two did not provide such information. The current average percentage of fossil fuel investments ranges between 0.5% and 10.6%.

Furthermore, seven surveyed asset managers only provided the current average percentage of total AUM that is invested in renewable energy. This ranges from 0.5% to 4.2% of their total AUM. The relatively wide range of investment percentages in renewable energy

indicates that asset managers can invest a significant percentage of their AUM in renewable energy, but that many asset managers do not do this yet. This signals that there might be room to fill the current investment gap in renewable energy via, for example, impact investments.

Impact investments in renewable energy

As seen in figure 6, 89% of the surveyed asset managers offer their clients the opportunity to make impact investments that accelerate the energy transition. This very high rate is promising and indicates that it is possible to have impact investments that meet acceptable risk/return rates and accelerate the energy transition. However, it is important to note that this data does not suggest anything about the size of the impact investments. Moreover, as seen in figure 8, two asset managers said that their biggest challenge relating to accelerating the energy transition is finding scalable impact investments with an acceptable risk-return rate. As seen in box 7, the fact that finding scalable impact investments is considered challenging is confirmed by recent VBDO research on impact investing. However, it is good to observe that the vast majority of asset managers included in this report's scope provide impact investments. We encourage these 'front runners' to increase their impact investments in renewable energy, and to build a credible track record. This way, they will contribute to accelerating the energy transition.

Box 7 - Conclusions from VBDO's impact study^K

- Impact investing in illiquid markets has not yet taken off
- Climate change is a core investment theme, but there is a growing interest in other impact themes and asset classes
- Pension funds struggle to embed impact in mainstream investment decision making
- Measuring impact remains a challenge
- Front runners dare to stretch traditional financial strategies

As seen in figure 7, 87% of the surveyed asset managers that offer impact investments said that they measure the impact that they make with these investments. Interestingly, the data showed that asset management firms use a variety of ways to measure their impact. As previously mentioned, VBDO's definition of impact investing includes measurability; 78% of the surveyed asset managers provide impact investments and measure their impact. Two main methods of measurement were named by multiple asset managers; 57% measure the positive impact of their impact investments by

Figure 6 | Does your organisation offer asset owners the possibility of impact investing with the aim to foster the energy transition?

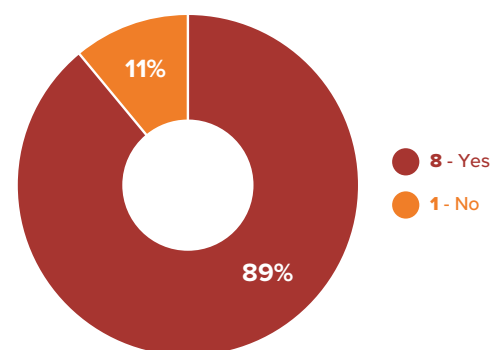


Figure 7 | Does your organisation measure the impact of your impact investments?

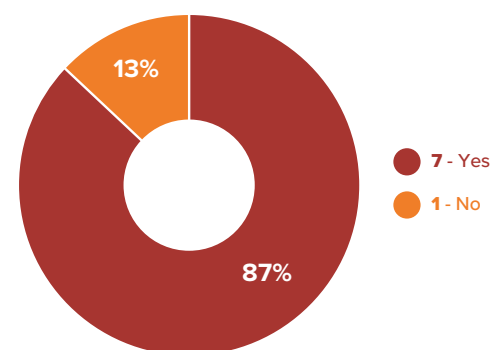
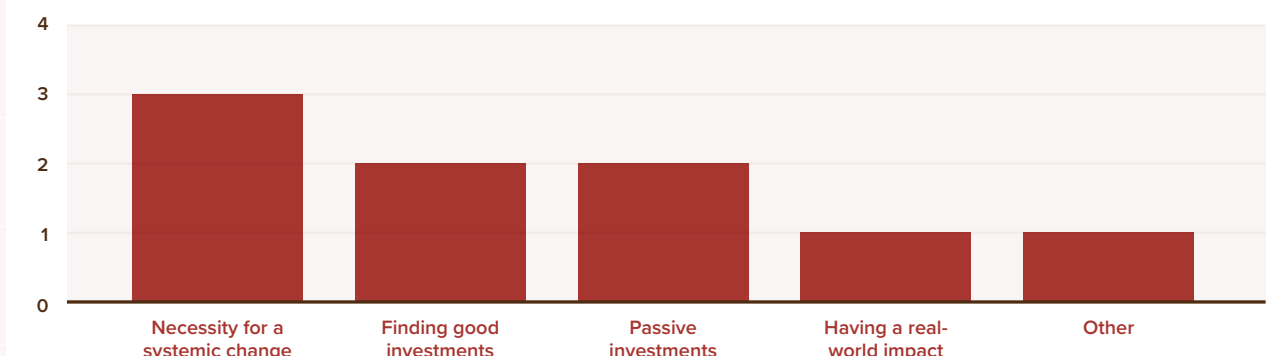


Figure 8 | What is for your organisation the largest challenge to accelerate the energy transition?



evaluating how their investments contribute to the UN Sustainable Development Goals, and 57% measure the negative impacts prevented (i.e. carbon emissions avoided) due to their impact investments. There is no one 'best' method to measure the impact of impact investments. However, asset managers are encouraged to measure the impact of their investments using a certain unit, such as the amount of GHG emissions prevented. These measurements are more informative than just linking an investment to a Sustainable Development Goal.

CHALLENGES AND OPPORTUNITIES: INTEGRATING THE ENERGY TRANSITION INTO THE PORTFOLIO

Making a real-world impact on the energy transition

33% of the surveyed asset managers feel that the energy transition is complex and requires systemic change. A further 11% said that making a real-world impact is difficult. Whilst these are two separate challenges, the reasoning behind them is similar. To make a real-world impact, companies need to adjust their operations. Whether companies do this depends on many variables and needs to happen systemically. This makes it more difficult to create an effective investment strategy. For example, just divesting from the oil and gas sector is not necessarily the most effective strategy. First, there is still a dependence on gas and oil. Second, whilst divesting from a sector makes it in theory more expensive for companies in this sector to attract capital; in practice, this effect is questionable. Therefore, changing a portfolio by excluding, for example, utility, heavy industry or oil and gas companies leads to a significant reduction of a portfolio's carbon emissions, but it does not necessarily lead to changes in the real world. For this reason, it is useful to make a distinction between a portfolio's GHG reduction due to divesting and a reduction due to a company's climate improvements.

Based on the above reasoning, it should not be concluded that it is not possible to have a real-world impact. Instead, asset managers are encouraged to invest private equity that contributes directly to accelerating the energy transition. Moreover, when it comes to investing in

Box 8 - How to analyse the credibility of a company's climate strategy

1. Does the company set commitments?
2. Do the commitments include both absolute and relative carbon reduction targets?
3. Do the commitments include scope 1,2 and 3?
4. Are the commitments aligned with capex budgets?

public markets, asset managers can invest in, and engage with, companies that show they already have a credible transition strategy or are willing to develop one. Evaluating a company's climate strategy can be done by analysing the short-, mid- and long-term targets and commitments of the respective company. These carbon reduction targets should be absolute and relative and include scope 1, 2 and 3 emissions. Also, these targets should be backed by aligned capex budgets.

Finding 'good' investments

Of the surveyed asset managers, 22% gave finding (private equity) impact investments in renewable energy that have a good risk/return rate as their largest challenge for contributing positively to the energy transition. Since impact investing is relatively new, it does not have a long track record. Also, many necessary impact investments in, for example, the commercial building sector, are relatively small and have high transaction costs. Furthermore, while there is a major investment gap in renewable energy in emerging markets, these investments are perceived as even riskier than impact investments in Europe. Additionally, there is currently a shortage of investable projects in emerging markets. For all these reasons, finding good risk/return impact investments in renewable energy is considered to be difficult.

Whilst impact investing in, for example, the commercial building sector, is considered to be difficult, the fact that some asset managers do provide the opportunity for these impact investments shows that it is possible. Moreover, by continuing with a pioneering mindset in impact investing, creative solutions can be found. For example, as mentioned by Nienke Maas from TNO: "Due to split incentive problems for renewable energy and energy saving projects, upscaling is difficult. But, there are new innovative business models and financial schemes that can deal with this." A potential solution for the shortage of investments in sustainable energy is the creation of new innovative financial products. As mentioned by Matthew Halstead from TNO: "Standardising key documentation and processes, such as energy performance contracts and the risk assessment procedures of financiers, can help to facilitate aggregation of sustainable energy projects. Cashflows can then be bundled, securitised and sold to investors who otherwise might not be able to invest. This is by no means the silver bullet to scaling and accelerating financial flows to sustainable energy, but it could overcome the hurdle of high transaction costs associated with smaller, individual investments."

Asset managers could contribute more by increasing impact investments in renewable energy in emerging markets. They can collaborate with development banks via, for example, blended finance. This way, investments in renewable energy in emerging markets become less risky. If asset management firms show willingness and commitment to invest in renewable energy in emerging markets, governments of low- and middle-income countries also have more incentive to support the development of energy projects that need to be financed. This way, supply creates its own demand.

In the end, as concluded by VBDO's study on impact investing and confirmed by the fact that many of the surveyed asset management firms are making impact investments, there are some front runners that dare to venture away from the traditional way of doing finance. These front runners are encouraged to keep leading the way, and by doing so, build a good track record for impact investing and take responsibility for financing the energy transition.

Passive investments

22% of the surveyed asset managers indicated that passive investments hinder them from contributing to the energy transition. Among asset owners, passive investment is popular since it is a relatively cheap and low-risk investment method. Adjusting a benchmark by, for example, excluding companies, is costly, and makes the passive investment riskier. However, all of the companies or other assets that are included in a benchmark do not always have (credible) climate strategies. Therefore, if clients of asset management firms want to track a benchmark, it is more difficult for them to invest responsibly and to become net zero by 2050.

The conflict between, on the one hand, the attractiveness of passive investments, and on the other hand, a willingness to contribute to the energy transition, is difficult. However, in the end, the asset manager is always responsible for the created and sold benchmark. They decide to offer their clients the possibility of investing in companies that are heavy emitters of GHG and that are not planning to change this. However, a shift towards more active adjusted passive investments has been noticed.³¹ Over recent years, more sustainability-linked indices have been developed. Behind these 'passive' indices, there are active choices. For example, there are Paris-aligned indices that exclude ESG-controversial companies.³²



Viewpoint: accelerating the energy transition via impact investments in renewable energy is necessary and possible

Raquel Criado Larrea, Head of Sustainable Investments at a.s.r.

HOW A.S.R. ASSET MANAGEMENT IS CONTRIBUTING TO THE ENERGY TRANSITION

Decarbonising the global economy and accelerating the energy transition touches all aspects of economic and social life and is linked to issues such as equality and justice. Those who will be hit hardest by the physical impacts of climate change (e.g. today's young people and developing nations) have contributed the least to its emergence as a global threat. Climate targets for a long-term steward of capital should take this into account. A too narrow focus on reduction percentages and carbon emissions causes tunnel vision and could lead to a misalignment with the broader agenda of the UN Sustainable Development Goals. It also makes it harder to ensure a just transition to a more sustainable economy and society.

a.s.r. asset management, therefore, believes it is important to define specific carbon-reduction approaches and definitions for each asset class, in order to realise real-world decarbonisation impacts (as opposed to 'simply' decarbonising the balance sheet). This approach entails finding a workable balance between exclusion and positive selection. It also requires active ownership and opting for measures that fit our investment approach, our funds and our investments in both public and private markets.

On the road to reaching net zero emissions in 2050, we see our role as follows:

1. Reducing the footprint of our investment portfolios by excluding those sectors, countries and/or companies inconsistent with the goals (and the science) of the Paris Agreement. We set our first climate-related exclusion thresholds in 2016. Since then, we have measured the carbon footprint of our portfolios and in 2018, we set the goal

of measuring at least 95% of the investment portfolio by 2021. We succeeded in doing that and in December 2021, we communicated our target of achieving a 65% reduction of the carbon footprint of our investment portfolio (equity, corporate bonds, government bonds, real estate and residential mortgages) by 2050 compared to 2015 (which is when the Paris Agreement was signed). By 2050, we want to have net zero CO₂ emissions.

2. Continue engagement with those high emitting sectors, countries and/or companies not yet aligned with the goals of the Paris Agreement, but who have credible transition plans and opportunities. After having phased out all securities in companies generating any revenue from the mining of coal (including anthracite, bituminous, subbituminous or lignite) used for any purpose (thermal or metallurgical) and mined through any method (moun-

taintop removal, open surface, open pit or strip mining), we are reviewing, engaging and monitoring the transition plans and strategies of companies still involved in the extraction of other fossil fuels and their plans to achieve the Paris goal. In order to leverage our impact in doing so, we have joined the Dutch Climate Coalition, a group of Dutch like-minded investors, to engage oil and gas companies to prove that their strategies will contribute to a global decline in emissions by 2030 in line with a 1.5°C warming pathway. As a coalition, we have three key recommendations: (1) boost the availability of low-carbon solutions; (2) explain how natural gas acts as a transition fuel; and (3) do not use high oil prices as a reason to increase oil investments.

3. Investing in climate adaptation and mitigation solutions, with a focus on low-carbon energy, increasing energy efficiency, and/or commercialising credible negative emissions technologies.

HOW A.S.R. IS PLANNING TO INCREASE IMPACT INVESTMENTS

While setting targets for the coming period, we focused on a.s.r.'s ambition to reduce our negative carbon footprint (via the CO₂ reduction target) and to increase our positive carbon footprint (via the impact investing target). In

2018, we set the target of making €1.2 billion of impact investments by the end of 2021. We greatly over exceeded this target so set a new ambition to further increase the impact investment portfolio to €4.5 billion by the end of 2024. A significant portion of that figure is being invested in solutions for the energy transition, which has been one of the (three) focus themes in our investment policy since 2015. We make investments in listed companies (through buying their shares or debt following a clear set of green indicators). We also make more direct investments, in real assets (such as wind or solar farms), by subscribing to debt finance for private companies (mainly small and medium-sized European enterprises) or through acquiring the equity of innovative start- or scale-ups (through a dedicated impact fund). We report on the status of this portfolio on a quarterly basis and at the end of the year it is audited with reasonable assurance by the external accountant in the a.s.r. annual report. Each of these strategies aims to generate attractive investment income and return on capital. Investments are assessed based on both their financial and environmental return, which provides the confidence that both returns go hand in hand. We see that an important opportunity for scalability lies with renewable energy projects. Still, we also consider smaller scale investments in pioneering new technologies and energy efficiency to be equally important in the path to an innovative and sustainable energy transition.

MORE REGULATION IS NECESSARY FOR ACCELERATING THE ENERGY TRANSITION

The further development and implementation of regulatory frameworks such as the EU SFDR will help to align the market towards the solutions that are needed for the energy transition. We are hopeful that it will also incentivise increased investments in these solutions. Many companies have committed to be 'net zero' by 2050, which requires the amount of sustainable and Paris-aligned investments to be increased significantly. The development of more stringent legislation around managing, assessing and minimising ESG risks will also lead to more divestment in carbon-intensive companies and so generate more funds available for greener investments. Last but not least, we also acknowledge that there is more demand for sustainable products from customers and stakeholders. To realise the energy transition, all forces must be used, not just the 'stick' (e.g. regulation and even harder measures such as carbon taxes), but also the 'carrot'. In other words, all stakeholders must seek to make use of the opportunities that net zero ambitions make possible.



Viewpoint: unnecessary perceptions of high risks coupled with low-risk appetites hinder investments in renewable energy in emerging markets

Yvonne Bakkum, Managing Director at FMO Investment Management
Geert Fijnaut, Manager for Energy Asia and Eastern Europe at FMO

THE RISK PERCEPTION OF FMO'S INVESTMENTS

FMO is a development finance institution (DFI) with a banking licence and a return objective. Therefore, the investments of FMO need to have a realistic risk-return rate and thus we ask for market conform rewards. However, the risk profiles of FMO's loans and private equity investments differ. The highest risks are allocated to government funds. Plus, thanks to good recovery rates, actual losses are moderate. We also provide market conform loans because we want to show the market that we are a commercial partner that analyses risks. However, what should be discussed is the risk perception of our investments. We find that we have a different risk perception because we have been active

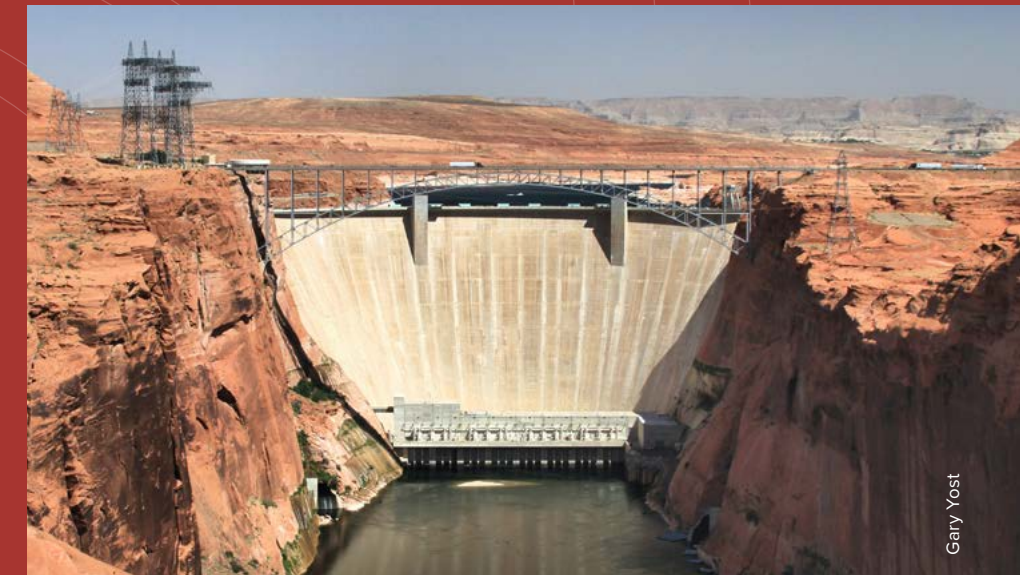
in emerging markets for more than 50 years. For this reason, it is easier for us to understand emerging markets and, thereby, map the risks of investing in these markets. We can imagine that this might be more difficult for other asset managers. These asset managers often review the country ratings and decide not to invest in countries with low ratings because they consider such investments to be too risky. Despite the fact that you can exclude some risks when assessing country ratings, some asset management firms overestimate the risk of investing in low-rated countries. In those cases, we believe that investments in countries perceived as being high risk can be responsible and in line with an acceptable risk-return rate. In fact, supported by our track record, we have managed to convince asset managers to successfully invest in countries that they first deemed too risky.

IMPACT-RISK-RETURN RATHER THAN RISK-RETURN

FMO talks about risk-return, but we also use the term 'new IRR', which stands for impact-risk-return. The impact side of an investment is very important for us and also determines where and how we invest. We are a public-private organisation, and we put a great deal of effort into realising a positive impact and mitigating negative impact. For example, we work with local partners and seek broad community support. Interestingly, these activities also bring financial benefits. Private parties, such as asset management firms, can and do work with us, and in this way make use of our knowledge and expertise to realise good risk-return investments. Due to these collaborations, investments that traditional asset managers may first see as non-investable, become investable.

THE SCALABILITY OF INVESTMENTS IN RENEWABLE ENERGY IN EMERGING MARKETS

To make investments scalable, more capital is needed. As many asset management firms have committed to net zero, they will need to allocate capital to renewable energy in emerging markets. Therefore, it is expected that if asset managers act on their goals of becoming net zero, there will be enough capital to create scalable investments. However, a major problem is the current lack of larger renewable energy projects in emerging markets. The energy infrastructure in emerging markets often lacks quality and needs to be up scaled. At the same time, there is a lack of knowledge, experience and sometimes good governance. For these reasons, it is difficult to create renewable energy projects in emerging markets that these asset managers can directly invest in. FMO is, together with its partners and capacity development initiatives, trying to overcome these problems, and this way, create a more solid foundation for more investable projects in the future. This is not always an easy task and much work is still to be done, but progress is certainly being made.



Gary Yost

Whilst governments of emerging market countries need to adjust their policies, asset management firms can influence this process by clearly signalling their willingness and commitment to invest in emerging markets. This way, governments of emerging markets are incentivised to foster the realisation of large-scale renewable energy projects as demand creates supply. Another way asset managers can take a leading role is via blended finance. With blended finance, donors take the early-stage risks, DFIs take the construction risks, and commercial parties finance the operational assets. Other forms of risk sharing are also possible. We believe that if asset management firms truly want to have a long-term vision, they

should commit to such initiatives. By doing so, they can help to create renewable energy projects in emerging markets. We hope that more asset management firms will take responsibility and approach us so we can analyse together how to increase the deal flow of renewable energy projects in emerging markets. If asset managers dare to take a more long-term perspective and invest in early-stage projects, for example, via FMO's infrastructure fund, we can make a considerable impact together. This way, asset managers can take responsibility for financing the creation of their own projects, and thereby, their own profits.

3.2. Responsible Stewardship

Asset managers can, as shareholders, on behalf of asset owners, influence the direction of a company. To realise the energy transition, it is vital that companies that emit a significant amount of GHG, such as fossil fuel and heavy industry companies, start to change their business approach to a more sustainable one. Therefore, this section focuses on (1) how asset management firms handle their stewardship responsibility, (2) what their challenges are in this regard, and (3) what engagement opportunities there are.

On a positive note, all surveyed asset managers engage with fossil fuel companies on setting Paris-aligned targets and all provided at least one example of how they do this. All of the asset managers are members of the Climate Action 100+ initiative, and many engaged with Shell on its climate strategy and had some success with this. Shell announced that it will, for example, set targets and develop a climate strategy to become net zero on the manufacturing of its products (only scope 1 and 2) by 2050.³³ Despite the progress made with Shell and other fossil fuel companies on setting climate targets and developing climate strategies, their current activities are not Paris-aligned.³⁴ Therefore, dialogue alone does not seem to be sufficient active ownership,

so asset managers are urged to escalate via, for example, supporting a climate resolution.

CHALLENGES & OPPORTUNITIES: ACTIVE OWNERSHIP

Passive investment

As aforementioned, there has been a trend for passive investments. As a consequence, portfolios can become very diversified and include many companies in which asset managers only have a very small stake. Generally, this limits the effectiveness of engagement processes. However, if asset managers collaborate with each other, they can engage more effectively. A well-known and previously discussed example is the Climate Action

Figure 9 | Does your organisation engage with oil and gas companies on setting standards that are in line with a 1.5°C pathway?

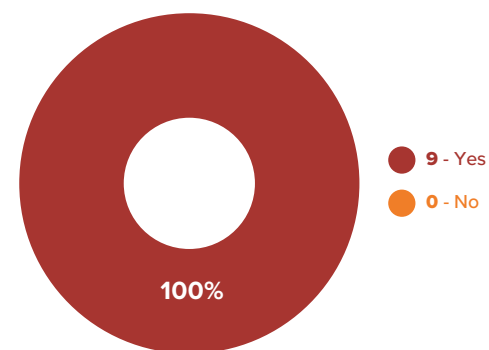
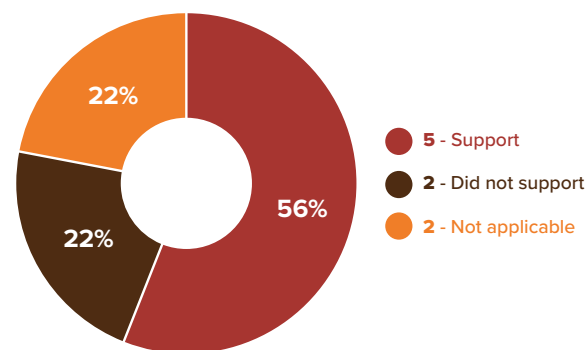


Figure 10 | How did your organisation vote at the Follow This shareholder resolution at the 2022 AGM of Royal Dutch Shell plc?



100+ initiative. Another example is the Dutch Climate Coalition.³⁵ This is a group of Dutch institutional investors with combined assets of more than €1.5 trillion. The coalition issued a joint statement where they urged oil and gas companies to prove that their activities are Paris aligned. Via such collaborative coalitions, asset managers can strengthen their pressure on companies, and this way, they can more effectively engage with companies on becoming Paris aligned.

Besides joining collaborative engagements, asset management firms can also decide to adopt a more long-term and sustainable investment strategy that includes managing passive investments more actively by, for example, divesting from companies that are not expected to align with a 1.5°C path. By having such a long-term focus, asset managers signal to companies responsible for large quantities of GHG emissions that to remain investable, change is required. We do, however, recognise that asset management firms with smaller portfolios may find it easier than those with larger portfolios to engage with investee companies, especially if they partner with other asset managers in order to apply greater pressure.

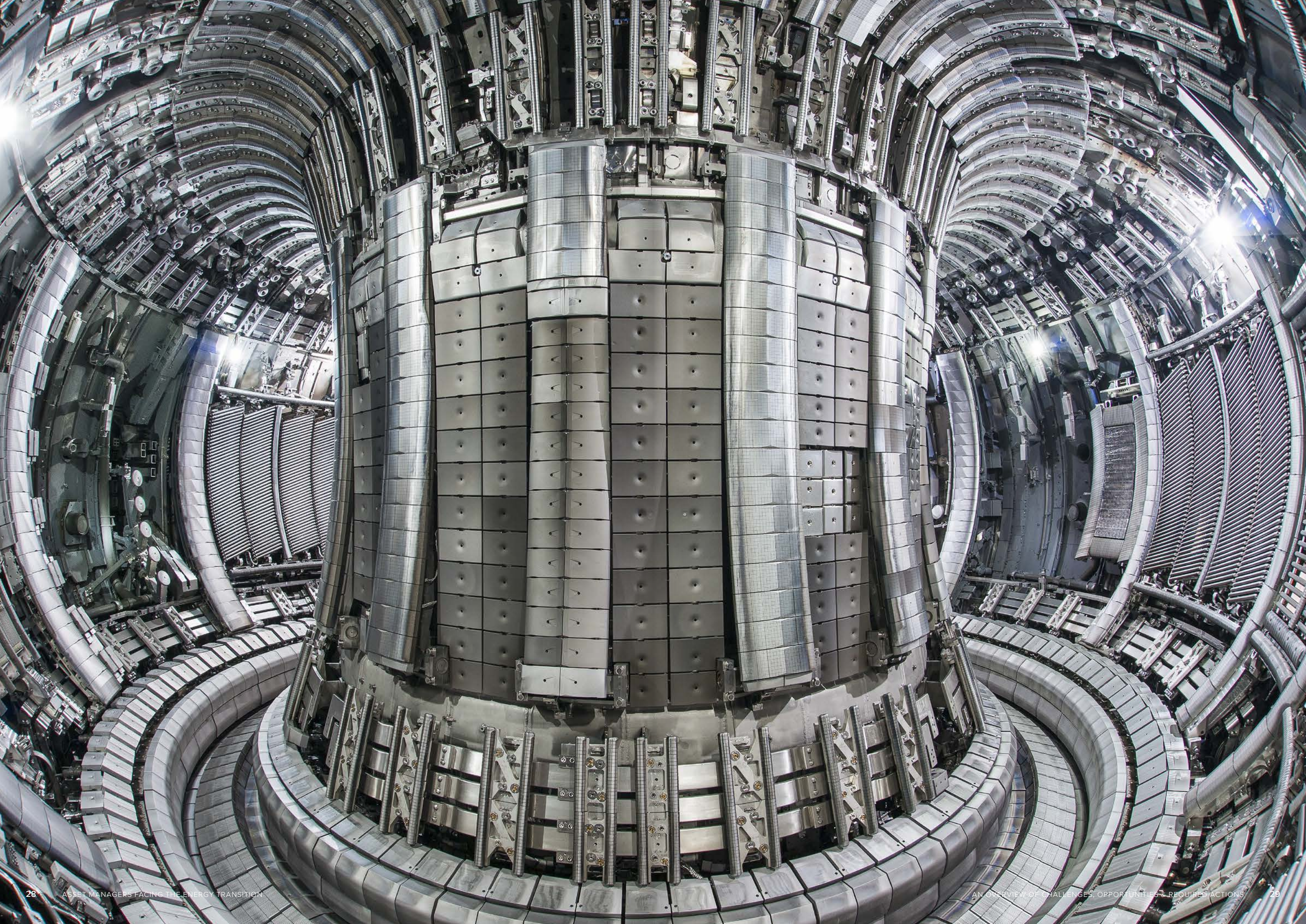
The energy transition requires a holistic approach

Another challenge mentioned by multiple surveyed asset managers is that the energy transition requires a holistic and sectoral approach. The energy transition is complex and multiple actors within a value chain need to adjust their operations in a coordinated way.

As phrased by Matthew Halstead from TNO: "Relevant stakeholders across the sustainable energy financing value chain, need to come together, collaborate, or at the least better understand each other's challenges and needs. Win wins need to be created across the entire value chain, with risks and returns distributed fairly, and visions and objectives shared, if we are going to successfully transition to a sustainable energy system." Therefore, asset managers are encouraged to start to engage with multiple parties along a value chain to make coordinated necessary investments in the energy transition. An investor that has been consulted for this report suggested the following example of cross-sectoral engagement: "By engaging both the supply and demand side of the energy system, we want to create a strategy where, for example, energy suppliers start investing in green hydrogen, and energy demanders invest in adjusting their production processes so they can use green hydrogen instead of gas. This can only be achieved if companies from different sectors start working together and provide certainty to each other."

Transforming commitments into actions

Finally, it is unclear whether companies will live up to their climate commitments. It is good that companies are setting long-term net zero targets, but if in the short-term companies are not changing their business approaches, achieving these targets will be extremely difficult. For this reason, asset managers should, besides engaging on a company's climate targets, also engage on their short-term actions. The best way to do so is by analysing the capex budgets of companies. As explained by Alix Chosson, lead of ESG analysis at Candriam: "Capex speaks louder than words". If the short-term capex budgets of companies are not aligned with their commitments, there is no certainty that companies are on a transition path and will be Paris aligned. Of all the 153 companies that are included in the Climate Action 100+ benchmark, only one has a capex budget that is Paris aligned, and only 10% of the companies have committed to aligning their capex budgets with their GHG reduction targets.³⁶ Therefore, asset managers should engage with companies on their capex budgets and ensure that words lead to deeds.



Appendix I – Methodology

The study design

This thematic study aims to provide an overview of how asset management firms contribute and can contribute to accelerating the energy transition. VBDO approached relevant asset management firms within the Dutch financial market and asked for their voluntary participation in this study. The questionnaire on which this report is based is focused on how asset management firms invest, how they execute their stewardship role, and what their challenges are. Data derived from this questionnaire was self-reported by respondents and has not been validated by VBDO. Responses have been aggregated and processed anonymously. The response rate for this study is 36%. This represents over €4.3 trillion in combined assets under management. For more information, please contact VBDO at info@vbdo.nl.

The survey included the following topics:

- Average percentage of investments in fossil fuel companies
- Average percentage of investments in renewable energy
- The provision and measurement of impact investments
- Engagement objectives
- Voting decisions
- Challenges experienced

The following survey respondents agreed to be listed:

- ACTIAM
- APG
- a.s.r.
- CTI
- Robeco
- UBS

The following people also contributed to this report via an interview:

- Matthew Halstead, Senior Project Leader at TNO &
- Nienke Maas, Senior Advisor for Sustainable Energy at TNO

Appendix II – VBDO's activities

About VBDO

The Dutch Association of Investors for Sustainable Development (VBDO) is a not-for-profit multi-stakeholder organisation. Our mission is to make capital markets more sustainable. Members include insurance companies, banks, pension funds, asset managers, NGOs, consultancies, trade unions and individual investors. VBDO is the Dutch member of the international network of sustainable investment fora. VBDO's activities target both the financial sector (investors) and the real economy (investees) and can be summarised as follows:

Engagement

For more than 27 years, the core activity of VBDO has been engagement with 40+ Dutch companies listed on the stock market. VBDO visits the annual shareholders' meetings of these companies, asking specific questions and voting on environmental, social and governance (ESG) themes. The aim of this engagement is to promote sustainable practices and to track progress towards the companies becoming fully sustainable, thereby providing more opportunities for sustainable investments.

Thought leadership

VBDO initiates knowledge building and sharing of ESG-related issues in a pre-competitive market phase. Recent examples of this include: three seminars on climate change related risks for investors; the development of guidelines on taking natural capital into account when choosing investments; and organising round tables about implementing human rights in business and investor practices. Also, we regularly give training on responsible investment both to investors and NGOs.

Benchmarks

Benchmarks are an effective instrument to drive sustainability improvements by harnessing the competitive forces of the market. They create a race to the top by providing comparative insight and identifying front runners, thus stimulating sector-wide learning and the sharing of good practices. VBDO has extensive experience in developing and conducting benchmarking studies. VBDO has conducted annual benchmarking exercises, for example, since 2007 on responsible investment by Dutch pension funds, and since 2012 on responsible investment by Dutch insurance companies. This has proven to be an effective tool in raising awareness of responsible investment and stimulating the sustainability performance of pension funds and insurance companies. VBDO is one of the founding partners of the Corporate Human Rights Benchmark, which ranks the 500 largest companies worldwide on their human rights performance and makes the information publicly available to drive improvements. VBDO's Tax Transparency Benchmark ranks 104 listed multinationals according to the transparency of their responsible tax policy and its implementation.

For more information about VBDO, please visit our website: www.vbdo.nl/en/

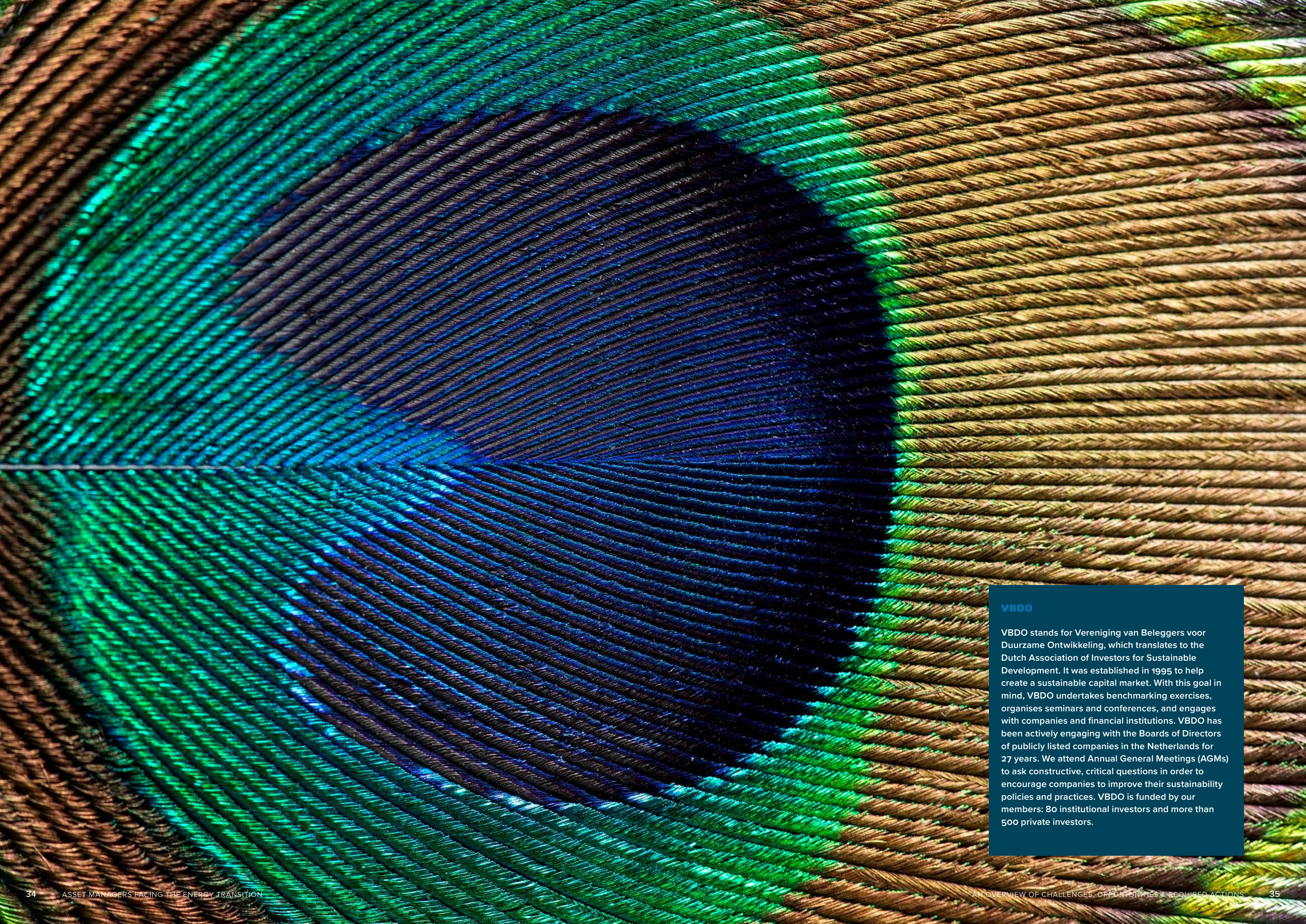
Endnotes summary

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- 5 <https://ourworldindata.org/emissions-by-sector>
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VOETNOTEN VAN FIGUREN EN BOXES

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VBDO

VBDO stands for Vereniging van Beleggers voor Duurzame Ontwikkeling, which translates to the Dutch Association of Investors for Sustainable Development. It was established in 1995 to help create a sustainable capital market. With this goal in mind, VBDO undertakes benchmarking exercises, organises seminars and conferences, and engages with companies and financial institutions. VBDO has been actively engaging with the Boards of Directors of publicly listed companies in the Netherlands for 27 years. We attend Annual General Meetings (AGMs) to ask constructive, critical questions in order to encourage companies to improve their sustainability policies and practices. VBDO is funded by our members: 80 institutional investors and more than 500 private investors.