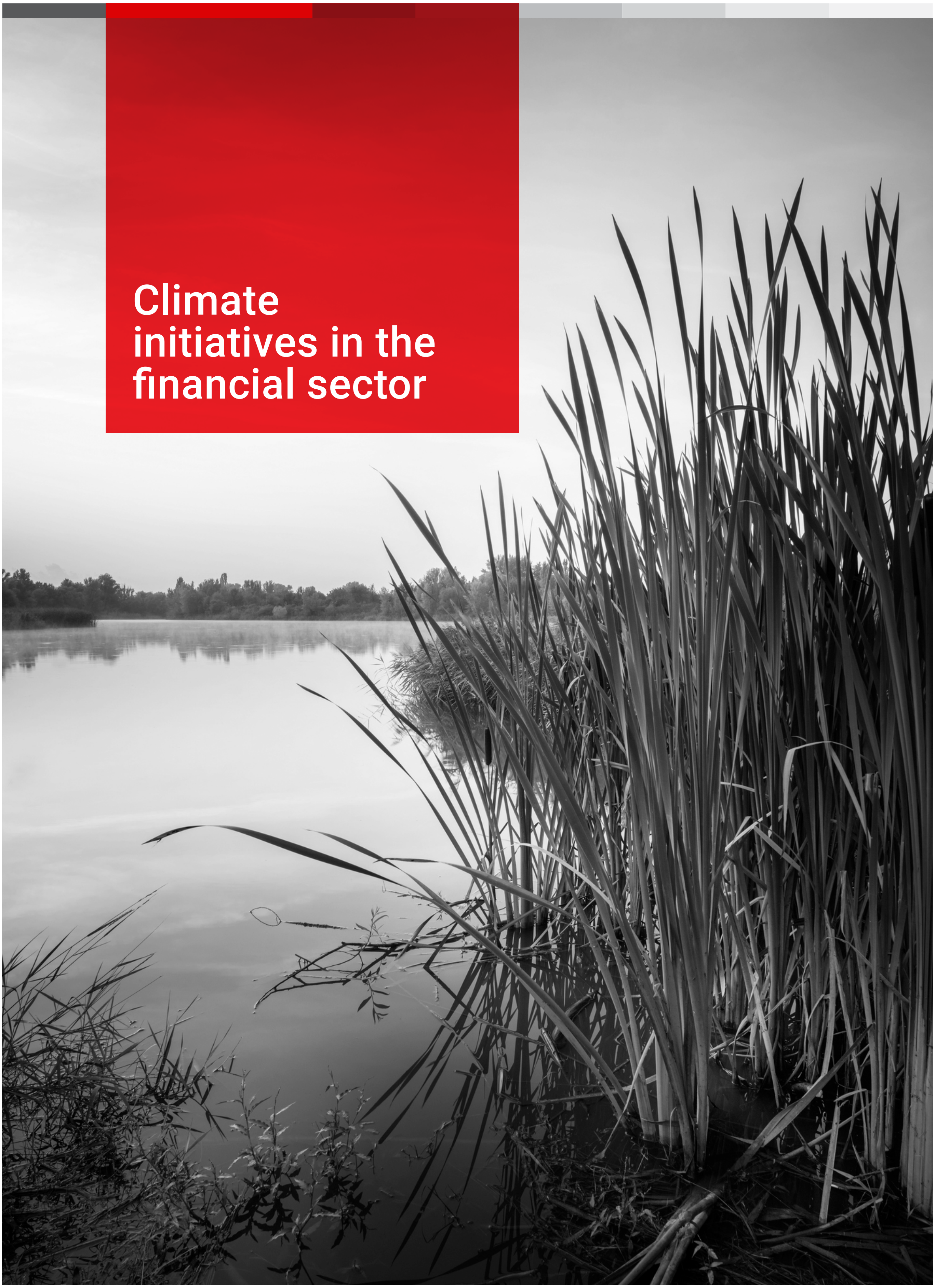
Climate initiatives in the financial sector



Climate initiatives in the financial sector

There has been a proliferation of climate initiatives and frameworks for the financial sector and, even within the industry, these can be difficult to navigate. This summary aims to assist clients by:

1. Identifying the climate initiatives and frameworks relevant to the **financial sector** and highlighting their primary objectives
2. Explaining some of the key initiatives available to **asset managers** in more detail
3. Discussing the extent to which Allan Gray follows each initiative's guidance

Table 1 provides a high-level overview of the various climate initiatives available to the financial sector. Those relevant to asset managers and banks are highlighted in pink, while those directed solely at asset managers are shown in green and those that apply only to banks are shown in blue.

Table 1: Climate initiatives for the financial sector

Covered in this report?	Initiative	High-level commitment to act	Measuring financed emissions	Target-setting	Scenario analysis	Strategy development	Taking action	Disclosing
	United Nations Environment Programme Finance Initiative (UNEP FI) Principles for Responsible Banking (PRB): Collective Commitment to Climate Action	●						
	Climate Action in Financial Institutions	●		○	○	○	○	
	Investor Agenda: Investor Climate Action Plans (ICAPs)	●						
	United Nations Global Compact: Business Ambition for 1.5°C	●		○		○		
Yes	Partnership for Carbon Accounting Financials (PCAF)		●					○
	UN-convened Net-Zero Asset Owner Alliance			●	○	○	○	○
Yes	Net Zero Asset Managers Initiative			●	○	○	○	○
Yes	Science Based Targets initiative (SBTi) for Financial Institutions			●	○	○		
	IIGCC Paris Aligned Investment Initiative (PAII)			●	○			
	Carbon Risk Real Estate Monitor (CRREM)				●			
	Transition Pathway Initiative (TPI)				●	○		
	2DII Paris Agreement Capital Transition Assessment (PACTA)			○	●	○		
	RMI Center for Climate-Aligned Finance			○	○	●	○	
Yes	Climate Action 100+						●	
	Climate Safe Learning Lab						●	
	Powering Past Coal Alliance (PPCA) Finance Principles	○					●	
	Bankers for Climate						●	
	2DII Evidence for Impact Working Group						●	
	ClimateWise						●	
Yes	CDP Financial Services Questionnaire							●
Yes	Task Force on Climate-related Financial Disclosures (TCFD)	○	○	○	○	○	○	●

Applicable to:

- Asset managers
- Banks
- Asset managers and banks
- ● Focus of initiative
- ○ Other elements covered by the initiative

Source: PCAF, 2020; PCAF, 2021; Allan Gray research

Task Force on Climate-related Financial Disclosures

Final recommendations published in 2017, with subsequent enhancements

The Task Force on Climate-related Financial Disclosures (TCFD) provides **recommendations for companies on climate-related disclosures**, with the goal to make this reporting consistent, comparable and reliable. The recommendations are structured around four pillars – governance, strategy, risk management, and metrics and targets – as shown in Appendix 1. Supplemental guidance is provided for various sectors, including asset management.

Since its launch, the TCFD recommendations have been widely implemented and are now considered global best practice for climate-related disclosures. Although the recommendations are voluntary in nature, TCFD-based regulation is growing across the world. For example, the Financial Conduct Authority in the United Kingdom has made TCFD-aligned disclosures mandatory for in-scope asset managers and asset owners, with the first such disclosures expected in 2023. From 2024, the IFRS Foundation's International Sustainability Standards Board (ISSB) will assume responsibility for monitoring the progress of companies' climate-related disclosures, taking over from the Financial Stability Board's TCFD.

Is Allan Gray a TCFD supporter?

We have not expressed formal support of the TCFD. However, we consider the TCFD guidelines in our reporting and strive to meet some of its key recommendations. Some of our efforts are described below:

- We disclose how we have assessed climate-related risks for top holdings in our portfolios. Most recently, in our 2021 Stewardship Report, we provided an update on how our clients' top 10 equity holdings were performing with regard to climate commitments.
- We disclose the weighted average carbon intensity (WACI) of the top holdings in the Allan Gray Balanced Fund, our largest unit trust, in the 2019, 2020 and 2021 editions of our Stewardship Report. We have expanded the scope of assets under (AUM) covered by our carbon reporting for 2022, and disclose the results separately from our Stewardship Report, in our 2022 Carbon accounting report, in light of the increasingly technical nature of the information. This aligns with the TCFD's "metrics and targets" pillar, which includes supplemental guidance for asset managers and recommends the disclosure of the WACI of each product or investment strategy, together with other carbon footprinting metrics.
- In 2023 (for the 2022 reporting period), we started reporting on the carbon emissions to value invested, also known as the relative carbon footprint or economic emissions intensity, of our local equities and corporate fixed income holdings. This is an ownership-based metric (as opposed to WACI, which is efficiency-based), first recommended by the Partnership for Carbon Accounting Financials and subsequently supported by the TCFD. These methodologies are further explained in our Carbon accounting primer.
- At the end of 2021, we announced a target in relation to engaging with investee companies to set science-based greenhouse gas (GHG) reduction targets, together with other environmental, social and governance (ESG)-related targets for achievement by 2025. We discuss this further under the Science Based Targets initiative below.

Partnership for Carbon Accounting Financials

First established in 2015 and scaled up globally in 2019

The Partnership for Carbon Accounting Financials (PCAF) is an investor-led initiative that was established to develop a harmonised global standard for the financial industry to **measure and disclose the GHG emissions of loans and investments**. Previously, financial institutions used different approaches, methodologies and reporting metrics, leading to inconsistent assessments of their climate impact.

In 2020[1], PCAF published the Global GHG Accounting and Reporting Standard, commonly referred to as the Financed Emissions Standard. It covers *Scope 3 Category 15: Investment emissions* as defined by Greenhouse Gas (GHG) Protocol[2], by building on the GHG Protocol Corporate Value Chain (scope 3) Accounting and Reporting Standard's reporting requirements. The Standard provides detailed methodological guidance for measuring the emissions attributable to certain asset classes, while continuing to broaden its scope in terms of asset class coverage. The Standard is considered a step for financial institutions to set science-based targets and align their portfolios with the Paris Agreement – an international treaty on climate change.

1. Second edition published in December 2022.
2. GHG Protocol is the world's most widely used GHG accounting standard. Over 90% of Fortune 500 companies use GHG Protocol for their emissions reporting.

Has Allan Gray signed up to join PCAF and measure and disclose its financed emissions according to the PCAF methodologies?

While we agree that greater standardisation of climate-related measurement and reporting is certainly needed, both at an issuer and an investor level, to to enhance comparability and decision-usefulness for end users, we are not yet fully committing to PCAF. This is because, in our view, carbon accounting methodologies, including those prescribed by PCAF, still have shortcomings – as acknowledged by the teams behind these initiatives themselves.

We have thoroughly researched the PCAF Standard and have incorporated its methodology into the 2022 analysis of our investments (disclosed in 2023), by calculating the carbon footprint of our overall portfolio, to the extent possible with the data available. Prior to this, we were only disclosing the WACI of our top holdings.

Our Carbon accounting primer discusses the prevailing methodologies and the pros and cons of each. The PCAF methodologies are relatively new, with the methodology for calculating emissions attributable to sovereign debt (relevant to some of our clients' portfolios) only published in 2023, for example. We will monitor their implementation globally and use learnings to decide on our own approach.

Accounting for financed emissions across multiple asset classes and multiple client portfolios is an extremely resource-intensive exercise, explaining why global asset managers typically use third-party data providers. Apart from the high cost of external providers, we have some concerns around data availability and accuracy for our investment universe after recent trials undertaken. Based on a cost-benefit analysis, we believe our time is currently best spent on the following:

- Requesting improved, more standardised disclosures from issuers. For financed emissions reporting at the investor level to be accurate, we first need accurate input data.
- Remaining abreast of carbon accounting methodology enhancements. This space is evolving rapidly, and we continuously monitor developments to ensure our stance remains current.

We remain open to joining one of these initiatives in time.

CDP (formerly the Carbon Disclosure Project)

Established in 2000

CDP is a not-for-profit entity that runs a globally accepted disclosure system for investors, companies, cities, states and regions to report on their environmental impacts, including climate impact.

In 2020, CDP developed an inaugural climate change questionnaire for the financial services sector based on the TCFD recommendations. This includes a request for financial institutions to disclose their scope 3 category 15 emissions, i.e. emissions from investments, with a breakdown by asset class, sector and geography. CDP and PCAF collaborate closely, with CDP naming PCAF as a key framework for the measurement and reporting of these financed emissions.

Does Allan Gray report to CDP?

We do not. While we have derived value from using CDP reports for material emitters in our portfolios, the reporting requirements are extensive and would place a significant resource burden on our small team. We perform all ESG research within our Investment team and currently prefer to report on climate-related matters in our annual Stewardship Report. We remain committed to continuously improving our reporting.

Science Based Targets initiative

Launched in 2015

The Science Based Targets initiative (SBTi) is a partnership between CDP, the United Nations Global Compact, the World Resources Institute (WRI) and the World Wide Fund for Nature (WWF). It sets climate standards for corporates and financial institutions, which includes providing voluntary guidance, tools and criteria for companies to use in setting targets and time frames for GHG emissions reduction. Companies are expected to provide documentation demonstrating how these were calculated and estimated. The SBTi Validation team assesses submissions to determine conformance with SBTi standards and issues a judgement to the company. SBTi validation has become widely viewed as an important independent verification of companies' claims around Paris-aligned GHG reduction targets, with over 2 000 organisations globally now setting GHG reduction targets through the SBTi.

The SBTi framework for the financial sector specifically enables financial companies to align their investment and lending portfolios with the goals of the Paris Agreement. Financial institutions that decide to set science-based targets following the SBTi's Sectoral Decarbonization Approach must measure their financed emissions to identify a baseline from which targets may then be established.

Has Allan Gray set a science-based target, as verified by the SBTi?

We have not officially committed to an SBTi target. However, we have set a target to engage with investee companies to set science-based GHG emission reduction targets, with the objective that at least 30% of the financed emissions of Allan Gray's top 40 local equity holdings must be subject to science-based targets by 2025, preferably verified by the SBTi (if not, on an explain basis). We believe this is a tangible short-term goal that keeps the focus on real-world impact. That is, we engage with investee companies to set responsible emission reduction targets, as opposed to setting portfolio-level carbon intensity targets which could be adjusted by simply divesting higher carbon intensity stocks without achieving any positive real-world outcomes.

Climate Action 100+

Launched in 2017

Climate Action 100+ (CA100+) is an investor-led initiative where investors selectively engage with 171 of the world's largest GHG emitters (accounting for around 80% of global corporate industrial GHG emissions) to spur action on climate change, improve their GHG disclosures and strengthen climate-related governance. As of 2023, over 700 investors representing US$68 trillion in AUM have committed to CA100+. The intention is to collaborate with other investors so that joint engagements apply more pressure to act.

Is Allan Gray a member of CA100+?

We are not. Of the 171 CA100+ companies, only six have South African listings. These are Anglo American, BHP, Eskom (fixed income), Glencore, Sasol and South32, most of which are dual listed. Within our client portfolios, Glencore and Sasol represent large equity positions and we have engaged extensively with each on their climate strategy. As an Eskom bondholder, we called for a focused meeting with Eskom on its air pollution, during which we discussed its Just Energy Transition strategy to reduce both air pollution and GHG emissions.

Below are some short case studies on constructive engagements with companies on their climate strategies and disclosures, which are in support of the same objective as that of CA100+.

- **Sasol:** We wrote a letter to the former joint-CEOs in 2018, which focused on numerous ESG disclosure and performance recommendations. One of these was for Sasol to set a long-term GHG reduction stretch target to show proactivity in relation to climate change, which Sasol has subsequently incorporated, together with some of our disclosure recommendations. We are reluctant to take full credit for this as Sasol has numerous stakeholders and engagements, but we believe that our letter, together with our many ESG-focused engagements with Sasol over the past five years, meaningfully contributed to its improvement in climate strategy. Importantly, Sasol has also become proactive about approaching shareholders to review its climate strategy – another suggestion we made.

- **Glencore:** We engaged with Glencore's board and management over many years on its thermal coal assets and how they are managed. In 2019, we also held a meeting with Glencore's coal modelling expert to understand how meaningfully Glencore was evaluating climate-related transition risks. Glencore has committed to a 50% reduction in its scope 1, 2 and 3 GHG emissions by 2035. While this has attracted some criticism for not being ambitious enough, we believe it is sufficiently stretching. We continue to engage on Glencore's climate strategy; for example, discussing in detail the modelling used to set current GHG reduction targets, as well as why the SBTi is not able to verify the GHG reduction pathways of diversified miners. We were pleased to see Glencore provide more detail on how its GHG reduction commitment compares to Paris-aligned pathways in its 2022 Carbon accounting report, published in March 2023.

- **Standard Bank:** In 2022, we held a detailed engagement with Standard Bank's head of Group Corporate Citizenship on climate-related issues. This included asking about the East African Crude Oil Pipeline (EACOP) project, for which Standard Bank is a transaction adviser, and how Standard Bank evaluated its environmental and social impacts. We also requested further detail on Standard Bank's financed emissions accounting, loan portfolio targets and the choice of climate scenario used for its analysis, in light of criticism from civil society. Finally, we asked for more detail on the challenges it faces in terms of signing up to the SBTi. Based on these conversations, we are comfortable with the work that Standard Bank is doing but continue to monitor developments.

As the above example demonstrates, climate-related considerations and strategies are extremely nuanced. We prefer to maintain flexibility in how we approach each engagement, whereas being part of a large collaboration with multiple stakeholders does not always allow for this.

Net Zero Asset Managers initiative

Launched in 2020

The Net Zero Asset Managers (NZAM) initiative consists of a global group of asset managers that have voluntarily committed to support the goal of net-zero GHG emissions by 2050 or sooner, by supporting investing aligned with this goal. It has quickly gained popularity, with NZAM signatories representing over 55% of global managed assets at the end of 2022. Broadly, signatories commit to:

- Work in partnership with clients on decarbonisation goals, consistent with an ambition to reach net-zero GHG emissions by 2050 or sooner across all AUM
- Set an interim target for the proportion of AUM to be managed in line with the attainment of net-zero GHG emissions by 2050 or sooner (the target should be no later than 2030)
- Review the interim target at least every five years, with a view to rachet up the proportion of AUM covered until 100% of assets are included

Within the above, NZAM members commit to creating investment products aligned with net-zero emissions by 2050, as required, and to publishing TCFD disclosures, including an annual climate action plan to be submitted for review. Within a year of becoming a signatory, asset managers must disclose the initial percentage of their portfolio that will be managed in line with net-zero, their "fair share" interim targets for these assets and the target date, as well as the methodology used.

At the end of 2022, NZAM signatories had committed on average 39% of their assets to achieving net-zero by 2050. While the NZAM commitment requires that signatories must increase compliant AUM to 100% over time, this highlights the current challenges in committing full AUM to this goal. The ability to do so depends on mandates with clients, the prevailing regulatory environment and the development of target-setting methodologies for all asset classes, for example, methodologies for private equity and infrastructure are yet to be established.

Has Allan Gray joined the Net Zero Asset Managers initiative?

We have not, for various reasons:

- We are monitoring carbon accounting methodologies as they evolve and striving to improve our climate-related disclosures year-on-year. However, we remain mindful of the shortcomings of existing carbon accounting metrics.
- A concern is that we may join an initiative based on a set of commitments espoused at the time of joining, but that these are then changed or strengthened at a later point in time to become inconsistent with our view or practically difficult to achieve. For example, the initiative may require members to divest from all companies with coal businesses, which we do not consider an effective method to address climate change. We have already seen examples of high-profile companies exiting climate initiatives when criteria change or the global environment changes to avoid litigation risk for potential breaches.
- Achieving the commitment depends on whether underlying companies decarbonise successfully, and as much as we can engage, we cannot force change.
- This is a resource-intensive commitment, particularly considering that asset managers must submit an annual climate plan for review. Currently, we prefer to focus on our research and engagement commitments outlined above.

Table 2: Summary of Allan Gray's alignment with various climate initiatives

Initiative	PCAF	TCFD & CDP	SBTi	CA100+	NZAM
Objective	Standardise the **measurement** of financed emissions	Frameworks for climate-related **disclosures**	Set science-based **targets** for emissions reductions	Collaborate on climate **engagement** with top emitters	Set **targets** for net-zero by 2050 investment portfolios
Does Allan Gray align with this initiative?	From 2023, we are incorporating PCAF methodologies into our annual carbon footprint analysis.	We already disclose in line with some of the TCFD recommendations and aim to improve this year-on-year.	While we have not committed to these initiatives, we have committed to engaging with investee companies to set science-based GHG reduction targets. These targets should, where possible, be verified by an independent organisation, such as the SBTi.		

Appendix 1: TCFD-recommended disclosures

Governance	Strategy	Risk management	Metrics and targets
Disclose the organisation's governance around climate-related risks and opportunities.	*Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning where such information is material.*	*Disclose how the organisation identifies, assesses and manages climate-related risks.*	*Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.*
Describe the board's oversight of climate-related risks and opportunities.	Describe the climate-related risks and opportunities the company has identified over the short, medium and long term.	Describe the company's processes for identifying and assessing climate-related risks.	Disclose the metrics used by the company to assess climate-related risks and opportunities in line with its strategy and risk management process.
Describe management's role in assessing and managing climate-related risks and opportunities.	Describe the impact of climate-related risks and opportunities on the company's businesses, strategy and financial planning.	Describe the company's processes for managing climate-related risks.	Disclose scope 1, scope 2 and, if appropriate, scope 3 greenhouse gas emissions, and the related risks.
	Describe the resilience of the company's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	Describe how processes for identifying, assessing and managing climate-related risks are integrated into the company's overall risk management.	Describe the targets used by the company to manage climate-related risks and opportunities and performance against targets.

Source: TCFD

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ALLAN GRAY

1 Silo Square
V&A Waterfront
Cape Town
8001
South Africa

P O Box 51605
V&A Waterfront
Cape Town
8002
South Africa

Client Service Centre
T 0860 000 654 or +27 (0)21 415 2301
E info@allangray.co.za
www.allangray.co.za