Using the Net Zero Investment Framework to develop an effective engagement programme: KBI Global Investors

Background

KBI Global Investors is an investment manager specialising in equities, based in Ireland but with a global client base. We have a long-standing commitment to Responsible Investing and launched our first dedicated thematic ESG strategies almost 25 years ago.

Although we had been active in engagement for many years, our decision to adopt the Net Zero Investment Framework (NZIF) in 2021 encouraged us to formulate specific numerical targets for engagement. We also needed to put in place a framework for monitoring the proportion of portfolio companies which were aligned or aligning with net zero.

In this brief case study, authored and provided by KBI, we set out below the process we went through to develop the numerical targets recommended by NZIF, as well as how we monitor progress towards those targets, and – perhaps most importantly – we describe how useful this has been to us in terms of developing our engagement programme.

Setting an Engagement Target

Process

We signed the Net Zero Asset Managers Initiative in 2021. This was a straightforward decision, at least in principle, as KBI has always been a strong supporter of climate-related collaborative engagements, for example joining Climate Action 100+ at a very early stage.

We decided that NZIF was the obvious methodology for our organisation to adopt. This principally recommended us setting four main targets, focussing on emissions reduction, climate solutions investment, alignment, and engagement.

The focus of this case study is on the engagement target:

An engagement threshold *which ensures that at least 70% of financed emissions in material sectors are either assessed as net zero, aligned with a net zero pathway, or the subject of direct or collective engagement and stewardship actions.*

NZIF recommends that 70% of financed emissions[1] in material sectors are from companies which are either already assessed as net zero, or aligned with a net zero pathway, or the subject of engagement, and further sets out that the 70% threshold should rise to 90% by 2030 at the latest.

1 Note that the engagement requirement relates to the percentage of financed emissions in material sectors, and not the percentage of AUM, or of investee companies, in material sectors. Oddly enough, perhaps, this means that companies which achieve net zero, and thus have no net emissions, will fall out of the denominator and no longer be relevant for this calculation. Thus, the engagement target will remain relatively challenging even for investment managers whose portfolios are heavily invested in companies that have already achieved net zero. But that issue is not likely to arise for quite some time given the very small number of companies that have already eliminated all emissions.

Our first step was of course to look at where we stood in 2019 (the base year for this project). We were unable, for data availability reasons, to calculate the percentage of *financed emissions* in material sectors that were considered net zero, aligned or aligning. However, we established that 14% of our *AUM* in material sectors achieved the criteria, while 28% of material sector AUM was subject to direct or collective engagement. We will use *financed emissions* for our target, as recommended by NZIF, with AUM being used as a proxy for the baseline. Note that the base year is not relevant for this target in any case – the engagement target is an absolute, forward-looking metric, and is not measured relative to a base year.

Combined, therefore, we had 42% of material sector emissions that were net zero, aligned, aligning, or the subject of engagement, estimated using AUM, in the base year. This was well below the 70% target recommended by NZIF at the end of the first five-year period.

A key consideration here was our ability to monitor, measure and report on the proportion of our material sector financed emissions that qualifies as net-zero aligned or aligning. With investments in close to 1,000 different listed companies around the world, it would clearly not be possible to monitor this manually – a data solution was required. Our data supplier supplied us with information on whether a company had a Science Based Target Initiative-approved net zero target in place. We used this data to build a monitoring system so that various internal and external parties, including most importantly our Portfolio Managers, could easily check the proportion of financed emissions considered to be aligned to a net zero pathway.

Targets

Next, we looked at the trend in that number. As mentioned, the 2019 baseline was 14% considered net zero, aligned or aligning. By 2021, that number had already increased substantially. In 2022, we set separate 2025 alignment and engagement targets, equalling the 70% recommend by NZIF:

- **Alignment:** 40% of financed emissions in material sectors will be net zero or aligned actions by 2025; 50% by 2030.
- **Engagement:** A further 30% of financed emissions in material sectors are subject to direct or collective engagement and stewardship actions by 2025; 40% by 2030.

It's worth pausing for a moment to note the very large increase in the proportion of assets that were considered aligned to a net zero pathway in our portfolios between 2019 and 2021. While there were multiple factors at play, it's fair to assume that pressure from investors, particularly through – but not limited to – the work of Climate Action 100+, played a role in this. Through Climate Action 100+, the climate performance of high-emitting corporates rose up the engagement agenda for many investors, driven by the need to create long-term shareholder value.

Returning to the target setting process, we had already decided that we would commit to having at least 40% of financed emissions aligned to a net zero pathway, and, under NZIF, we were recommended to scale this to a total of 70% when including engagement. It was a relatively easy decision to set a minimum target of 30% for engagement. No rocket scientists were needed to calculate that number!

We were also very aware, of course, of the need to go still further than 70%. We therefore set a target of 90% by 2030 at the latest.

Consequences

We all know that "*what gets measured gets managed*". The creation of a public target for the proportion of material sector financed emissions that is on a pathway to net zero, or is the subject of engagement, can impact an investment manager in two ways.

Portfolio construction: It may lead to portfolio changes, such as divestment from companies that are not aligned. While at KBI we recognise that divestment is required in some circumstances, it is generally not our preferred option for several reasons, including that we then lose our ability to generate positive change in the company.

Incentivise engagement: The second channel is that the target may help boost the level of engagement with companies in material sectors that are not aligned. This was, and remains, our preferred way to reach our 70% combined target by 2025.

Ramping up engagement

So how can an investment manager ramp up their engagement activity? KBI is fortunate in that we have been active in climate-related engagement for many years, so this was not a particularly difficult challenge for us. We joined Climate Action 100+ in 2017 and have been part of the investor group leading engagements with four CA100+ target companies. We are active in CDP and participate in its annual "Non-Disclosure" and Science-Based Targets campaigns. We are also involved with the ShareAction Chemical Decarbonisation Investor Coalition and the IIGCC Net Zero engagement initiative.

Additionally, we have been active in other climate-related collaborative engagement groups, such as a group engaging with audit committee chairs and auditors – we encourage auditors to make sure that audited accounts and annual reports contain enough disclosures on climate issues to allow shareholders to make an informed judgement on the risks and opportunities facing the company. And we continue to engage directly (one-to-one) with specific companies from time to time. However, we generally see collaborative engagements as being more effective.

What has changed since we committed to this target, though, has been a sharper focus on net zero. In the early years of our climate-related engagement, we often focussed on disclosure of climate data, principally emissions, as such disclosures were far too limited. Today, merely disclosing emissions is not nearly good enough.

In our engagements, we are now pressing for companies to commit (via SBTI) to net zero. And looking forward, we expect a further evolution of engagement, away from encouraging companies to "set" net zero targets, and towards a focus on developing transition plans to ensure companies achieve those targets.

Conclusion and next steps

Adopting NZIF and setting targets for net zero alignment and engagement activity was a relatively straightforward process for KBI, giving us an extra focus to our work on climate. It allowed us to shift the focus of our engagement, over time, from mere the backward-looking disclosure of GHG emissions to a more forward-looking approach regarding the adoption of credible net zero targets.

The next step along this road will be to put in place good systems for monitoring how companies that have set net zero targets are progressing towards achieving those targets.