ESG VIEWPOINT

Net Zero:
Best Practice and Engagement Approach
Our net zero commitment

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At a glance

- We are signatories of the Net Zero Asset Managers initiative and are adopting a Stewardship-led approach to delivering our net zero commitment.
- We have developed an eight component Net Zero Model that we believe offers a robust decarbonisation strategy and informs our target setting, engagement, and investment decisions.
- Analysis shows how our holdings rank versus our Net Zero Model and we argue for the merits of an approach based on active dialogue with our investee companies.

Engagement and voting efforts as well as expectations outlined in this Viewpoint reflect the assets of a group of legal entities whose parent company is Columbia Threadneedle Investments UK International Limited and that formerly traded as BMO Global Asset Management EMEA. These entities are now part of Columbia Threadneedle Investments which is the asset management business of Ameriprise Financial, Inc.

Introduction

Climate change is a priority issue for Columbia Threadneedle, and we have a comprehensive approach to managing risk and identifying opportunities, as set out in our TCFD report[1]. A key pillar of our strategy is our net zero commitment.

As a signatory to the Net Zero Asset Managers initiative, working in partnership with our clients, we aspire to reach net zero emissions by 2050 or sooner across all assets under management. We acknowledge that reaching this aspiration depends on the mandates agreed with our clients and their regulatory environments, as well as those of their managers.

Following industry best practice guidelines such as the **Net Zero Investment Framework**, we are taking a stewardship-led approach to implementing this commitment, which builds upon our years of engagement experience. This places active engagement, and the supporting use of stewardship tools like voting, at the heart of our approach. Engaging companies to actively transition and decarbonise is key for real world decarbonisation and true emissions reductions. It enables us to retain as extensive an investment universe as possible and act as a responsible steward of our clients' assets by actively mitigating the various regulatory, physical, reputational and transition risks investors and their holdings face.

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Introducing our Net Zero Model

How companies rank against our standards

Our conclusions

[1] Climate Change Report_TCFD_Nov22.pdf (columbiathreadneedle.com)

Our Net Zero Model

To assist with both engagement and our funds' net zero alignment efforts we have developed a Net Zero Model and published our methodology.

This model rates companies in up to eight components that we believe make up a robust decarbonisation strategy and informs our target setting, engagement and investment decisions. Our engagement best practice framework includes three extra components which are not included in our model due to a lack of consistent available data and measurement methodologies. Additionally, whilst the Net Zero Model does not yet currently cover financial institutions or services, our engagement framework does apply to them, along with specific sectoral expectations.

Best practice for corporate net zero strategies

8 metrics in NZ Model		Additional engagement themes
Ambition	+	Align capex with decarbonisation targets
Targets – Interim targets set		Produce accounts that reflect the global transition to a 1.5C pathway
Targets – Targets aligned		Incorporate Just Transition principles into decarbonisation strategy
Disclosure		
Strategy		
Policy engagement		
Governance		
Climate risk (TCFD)		

	Decarbonisation strategy component	CTI Net Zero Model component (s)
1	**Ambition to reach net zero emissions by 2050 or earlier**	
	Leading companies announce concrete ambitions to achieve net zero emissions by 2050 or earlier across their scope 1, 2 and material scope 3[2] emissions. Best practice targets are aligned with credible 1.5C scenarios and follow a framework such as the Science Based Targets Initiative's Net Zero Standard[3].	1. Ambition
2	**Set short-, medium- and long-term targets aligned with a relevant 1.5C pathway**	
	The most robust net zero ambitions are backed up by a series of targets covering short-, medium- and long-term timeframes to ensure immediate action, ongoing momentum, and a clear direction of travel. We acknowledge that some sectors face significant technological obstacles to emissions reductions, and that emissions reductions may take some years to achieve. Recognising this, net zero models[4] like the IEA's Net Zero by 2050 Roadmap, allow for a differentiated approach by sectors in terms of the overall ambition of shorter-term targets.[5]	2. Targets – Interim targets set 3. Targets – Targets aligned

[2] Material scope 3 emissions are defined as the categories of scope 3 emissions that contribute the most to a company's total emissions. Companies should follow the Climate Action 100+ Net Zero Benchmark guidance to define which sectors have material scope 3 emissions and the GHG Protocol's guidance on the description and boundaries of scope 3 emissions categories.

[3] Science Based Targets Initiative's Net Zero Standard and Science Based Targets Initiative criteria

[4] Key pathways used in our analysis are provided by the Transition Pathway Initiative and IEA's 1.5C scenario

[5] CTI paper: Principles for carbon offsetting

3	**Disclosure of Scope 1, 2 and material Scope 3 emissions**	
	Climate leaders disclose full details of the emissions, including up and downstream emissions were material. Where possible, we encourage the disclosure of past performance and future projections to help investors understand company trajectories. Emissions scopes have different levels of importance for certain sectors, e.g., Scope 3 emissions are by far the most material for financial services and represent ~85% of oil and gas companies' emissions.	4. Disclosure
4	**Disclosure of a clear Decarbonisation Strategy**	
	Disclosure of a clear and detailed strategy for how companies will meet their emissions reductions targets is vital, just like investors require the disclosure of any other long term business plans. Good quality plans[6] include details of the specific actions companies will take to reduce emissions, changes in operations, products or spending, and major shifts in their value proposition. Through our engagement we also ask companies to consider the links between climate change and nature loss[7], encouraging them to include details of how they are integrating other relevant environmental factors into this strategy, such as water management and biodiversity loss. It is important for companies to manage physical climate risks and demonstrate how they are tackling interdependent environmental issues in a holistic way.	5. Strategy
5	**Align capital allocation with decarbonisation targets**	
	The alignment of capital expenditure[8] with a company's stated decarbonisation journey is key for ensuring resilience, avoiding stranded assets and allocating capital efficiently. Leading companies are explicitly committing to aligning capital allocation to their decarbonisation targets and a 1.5C scenario and demonstrating how they are measuring this alignment. This component applies differently to the financial sector[9], and is more focused on assessing the resilience of and risks posed by clients in high carbon sectors and providing funding that supports decarbonisation.	Pending methodology development We are also investigating how to incorporate the Transition Pathway Initiative's draft framework on banks into our model
6	**Demonstrate how policy engagement is aligned with the company and global goal of net zero**	
	Companies are increasingly aware of the benefits of assessing how the actions of the trade associations they support, and fund are aligned with their own stated net zero goals and the Paris Agreement. The most proactive companies encourage climate-friendly policies as well as taking action against trade associations impeding rapid climate action. Leaders on this issue detail how they assess alignment, material misalignments found and a clear framework for action to mitigate these issues.[10] They provide annual updates and highlight when material breakthroughs or changes occur.	6. Policy engagement

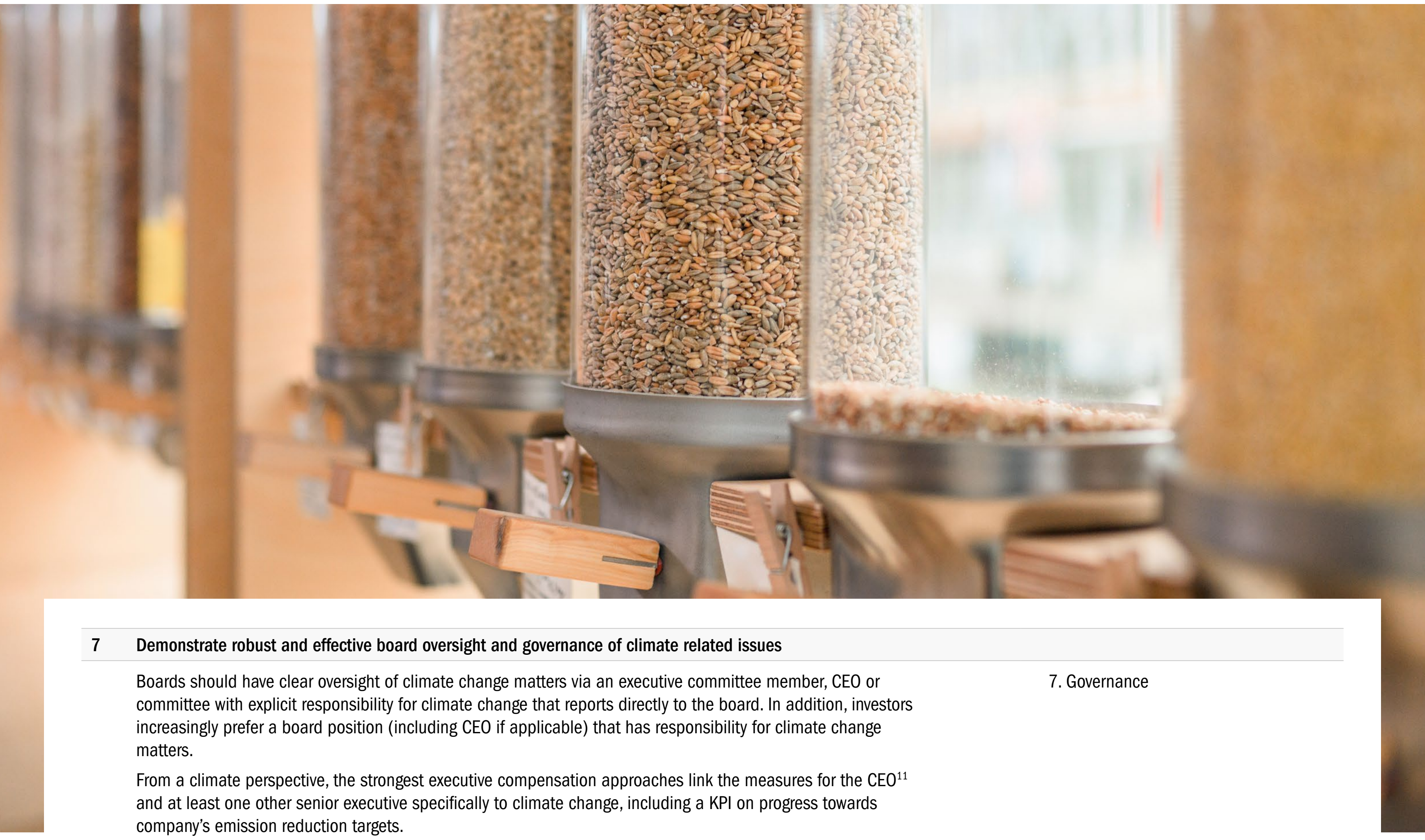
6 Corporate Net Zero transition plans standard

7 CTI paper: Nature as an ally: tackling the climate-nature nexus

8 Carbon Tracker capital allocation alignment methodology (for oil and gas and utilities) and 2Degrees Investing Initiative's capital allocation alignment methodology (for utilities, cements, autos, steel, aviation, cement)

9 Aligning the Banking Sector with the Goals of the Paris Agreement

10 Aligning with CA100+ Net Zero Benchmark indicator 8 and InfluenceMap methodology document for assessing lobbying disclosure



7	**Demonstrate robust and effective board oversight and governance of climate related issues**	
	Boards should have clear oversight of climate change matters via an executive committee member, CEO or committee with explicit responsibility for climate change that reports directly to the board. In addition, investors increasingly prefer a board position (including CEO if applicable) that has responsibility for climate change matters. From a climate perspective, the strongest executive compensation approaches link the measures for the CEO[11] and at least one other senior executive specifically to climate change, including a KPI on progress towards company's emission reduction targets.	7. Governance
8	**Commit to implement TCFD recommendations and conduct scenario analysis**	
	The Task Force on Climate-related Financial Disclosures (TCFD)[12] has now penetrated regulatory frameworks and requirements worldwide, however the standard of disclosure varies. Leading companies fully implement TCFD recommendations in relevant reports, including a 1.5C scenario analysis. The best scenario analyses cover all operations, and disclosure includes key assumptions and variables used, and the key risks and opportunities identified. Narrative on how this analysis impacts the overall decarbonisation approach and overall company strategy is also included.	8. Climate risk (TCFD)
9	**Produce accounts that reflect assessment of the global transition to a low carbon pathway**	
	As a material financial risk, directors and auditors at leading companies are looking at how they can deliver accounts that demonstrate a full assessment the impact of a low carbon pathway on a company's assets, liabilities, profits and losses. Best practice[13] also includes auditor assurance that accounts incorporate material climate risks and indicate whether assumptions used support the company's own targets. This is a growing area of investor and regulator[14] concern, with numerous resolutions and regulatory guidance on the topic reinforcing its importance and materiality.	Pending methodology development
10	**Incorporate Just Transition principles into decarbonisation strategy**	
	The social dimension of climate change and the energy transition is most frequently addressed by leaders by explicitly recognising the Just Transition as a relevant issue and committing to decarbonising in line with the Just Transition principles. The best approaches[15] commit to following the Paris Agreement text on this issue or the International Labour Organisation's (ILO's) Just Transition Guidelines[16].	Pending methodology development

[11] ESG Viewpoint – Should 'doing good' pay out? Linking executive pay to ESG metrics

[12] TCFD Recommendations

[13] Investor Expectations for Paris-aligned Accounts

[14] IFRS Guidance on climate-related disclosures

[15] Climate change and the Just Transition guide

[16] International Labour Organisation's Just Transition Guidelines

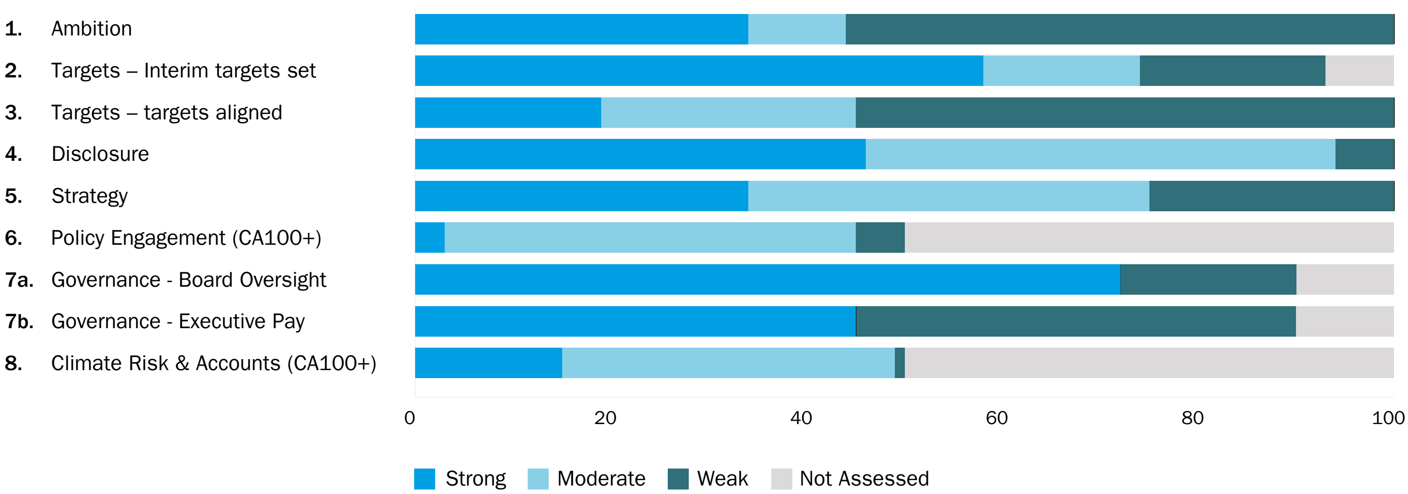
Company performance against Net Zero best practice standards

To help us understand how our investments align with this best practice framework, we have used our Net Zero Model to assess the alignment status of our total equity and fixed income holdings, rating the alignment status of some 16,000 securities across 4,700 issuers[17].

We now have a good view of how our total equity and fixed income investments perform against the 8 components that we include in our Net Zero assessment. When combined with our analysis on the additional three engagement themes, we can develop a clear picture of how an individual issuer is decarbonising their business.

[18]Alongside giving us a company-specific view of progress towards net zero alignment, we can also aggregate the data to assess the performance of specific funds and our overall portfolio, and the coverage of our stewardship programme. 70.7% of Columbia Threadneedle's financed emissions were attributed to issuers either classed as "Aligned" or "Engaged", by us or the Climate Action 100+ (CA100+) initiative. We currently co-lead 8 CA100+ engagements and collaborate on a further 40.

A. % of public equity and fixed income issuers aligning with each component of our Net Zero Model



Source: Columbia Threadneedle Investments, January 2023

[17] We were able to assess the alignment status of 68.4% of our total equity and fixed income investments. We were not able to assess the remainder as it is invested in sovereign debt, where there is not currently an accepted market approach to assessing net zero alignment, or in financials which we do not currently rate, or in companies where climate change is less material and lack good quality carbon data. Our reported figures are as a percentage of the portion of our holdings for which we are able to assess the alignment status. Data excludes Pyrford International.

[18] The strength of a company's scores depends on factors like whether material scope 3 emissions are covered (e.g. for targets and disclosure) and the quality of the strategy disclosed (using data sources like the Transition pathway Initiative and CDP to help scoring). Our methodology can be found here.

> Despite progress in the management of climate change issues there is still a significant way to go to fully align with the 1.5C trajectory.

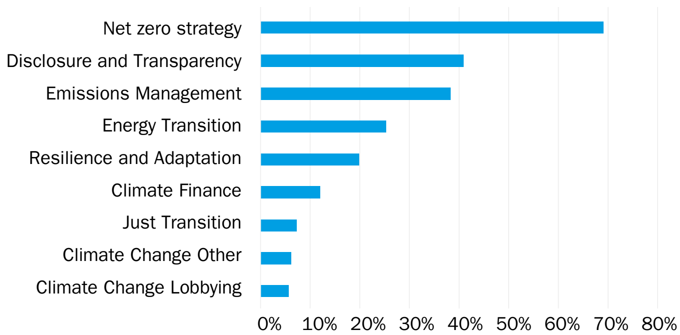
When weighted by contribution to Columbia Threadneedle's financed emissions, it is evident that the companies we invest in are performing best at setting interim targets, disclosing emissions data and ensuring board oversight of climate change. Companies tend to find it easier to fulfil these softer requirements, than setting targets clearly aligned with a 1.5C pathway or disclosing clear strategies for achieving emissions reduction goals.

Despite seeing progress in the management of climate change issues across the portfolio, there is still a significant way to go to fully align with the 1.5C trajectory upon which our net zero and interim targets are based. As chart A shows, progress on each of the components of a robust net zero plan is uneven and despite the majority of our financed emissions coming from "aligned" or "engaged" emitters, there is much more progress needed.

Driving this progress is a key priority for our Responsible Investment team, who lead our engagement-driven approach and conducted 924 engagements on climate change with 507 different issuers in 2022. In 69% of those engagements, we engaged the company specifically on net zero strategy; highlighting best practice, pushing for greater alignment with low carbon scenarios and our framework, or asking for improved clarity on their approach and resilience. We believe that a robust decarbonisation approach must contain all the elements of the framework described in this paper, so climate engagements tend to address multiple interdependent issues in each interaction, explaining why the percentages below add up to more than 100.

As investor and corporate understanding of climate issues has progressed the dynamic and content of these engagements has changed over the past five years. Many engagements have moved on from encouraging companies to acknowledge climate change as a risk and setting preliminary targets into the technicalities and nuances of decarbonisation pathways for the sector or region in question. We are in dialogue with companies in hard-to-abate sectors such as cement and steel about some of the technical barriers, and how they are working to overcome these. Topics like Climate Change Lobbying and Climate Finance are also receiving increasing attention as we seek to ensure our holdings' lobbying practices and allocation of capital are aligned with their stated climate targets.

Chart B: Climate change topics covered in engagements in 2022



Each engagement may cover multiple climate topics.
Source: Columbia Threadneedle Investments, January 2023

Conclusion

As a UN report released just before COP27 hammered home, it is clear that whilst progress has been made, countries that have committed to net zero emissions by 2050 are only on course for a 68% reduction by then (vs 2019) based on their current strategies[19].

Many national plans postpone critical action into the future, a trend reflected by many corporates, making both ambition levels and associated timelines a focus of our engagements.

More widely, the acknowledgement in the international climate negotiations of the importance of sustainable forest management and nature-based solutions supports the consideration of nature and climate change issues together. This reinforces our holistic engagement approach, with 48% of our climate engagements in 2022 also covering additional environmental issues like biodiversity and sustainable waste management.

Using a consistent framework for measuring holdings and funds alignment, analysing voting decisions, prioritising engagement issues and informing investment decisions is starting to show its benefits. Being able to provide companies and clients with a consistent description of our approach and definition of alignment reinforces our message. However, we are under no illusions that more work must be done.

Just as the international climate negotiations are focusing on implementation, so too is our stewardship approach to climate change. By engaging companies on the key components outlined here we hope to drive the application of best practice and alignment with a net zero scenario, supporting Columbia Threadneedle's own commitment as part of the Net Zero Asset Managers Initiative, and the wider investor effort to tackle climate change.

Using a consistent framework is starting to show its benefits.

[19] https://unfccc.int/news/climate-plans-remain-insufficient-more-ambitious-action-needed-now

Get to know the authors

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Harry joined the Responsible Investment team in 2022 and covers engagement with extractive and heavy industries, focusing on climate change and natural capital. He previously worked on environmental strategy and engagement at the Church Commissioners for England, having previously set up the Capgemini Group's sustainable innovation and consulting programme. He enjoys running, water sports and exploring the great outdoors with his dog, Woody.

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Joe joined the Responsible Investment team in 2021 and is focusing on climate change and biodiversity. Before joining us, Joe worked as a sustainability consultant with a range of private and public sector clients. Outside work he enjoys playing sport, hiking and birdwatching.

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