TRANSITION
PATHWAY
INITIATIVE

HOW CAN INVESTORS USE THE TRANSITION PATHWAY INITIATIVE?

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CONTENTS

1. WHY SHOULD INVESTORS BE CONCERNED ABOUT CLIMATE CHANGE?

Under the 2015 Paris Agreement, countries commit to holding increases in global average temperatures to well below 2 °C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5 °C above pre-industrial levels. In November 2016, the Paris Agreement entered into force and, to date, over 160 countries have now made pledges – Nationally Determined Contributions (NDCs) – explaining how they intend to contribute to the Paris Agreement targets.

Delivering emissions reductions of the magnitude envisaged by the Paris Agreement will require considerable capital investment, by the public and by the private sector. Many institutional investors already have long track records of addressing the impacts that climate change may have on their portfolios. They have adopted climate change policies to guide their investment decision-making, they have invested in low-carbon strategies, they have made important contributions to strengthening corporate practice and reporting on climate change, and they have encouraged governments to adopt policy measures that accelerate the transition to a low-carbon economy.

Policy action on climate change at the national and international levels is also a source of investment risk. The transition to a low-carbon economy may affect company cash flows and profits. It may result in 'stranded assets', where the value of certain assets is significantly reduced because they are rendered obsolete or non-performing from a financial perspective. Energy intensive sectors, the fossil fuel-based industries and high greenhouse gas emitting sectors are particularly exposed to this risk. For example, in the electricity sector, coal-fired power stations may be stranded for a variety of reasons including increased use of renewable energy (which displaces electricity from coal), energy efficiency (which reduces demand for electricity) and direct regulation of GHG emissions (which may reduce operating hours or permitted electricity output). Investors and financial institutions would also need to consider whether, for example, constraints on the use of fossil fuels would affect the price of commodities such as coal and oil.

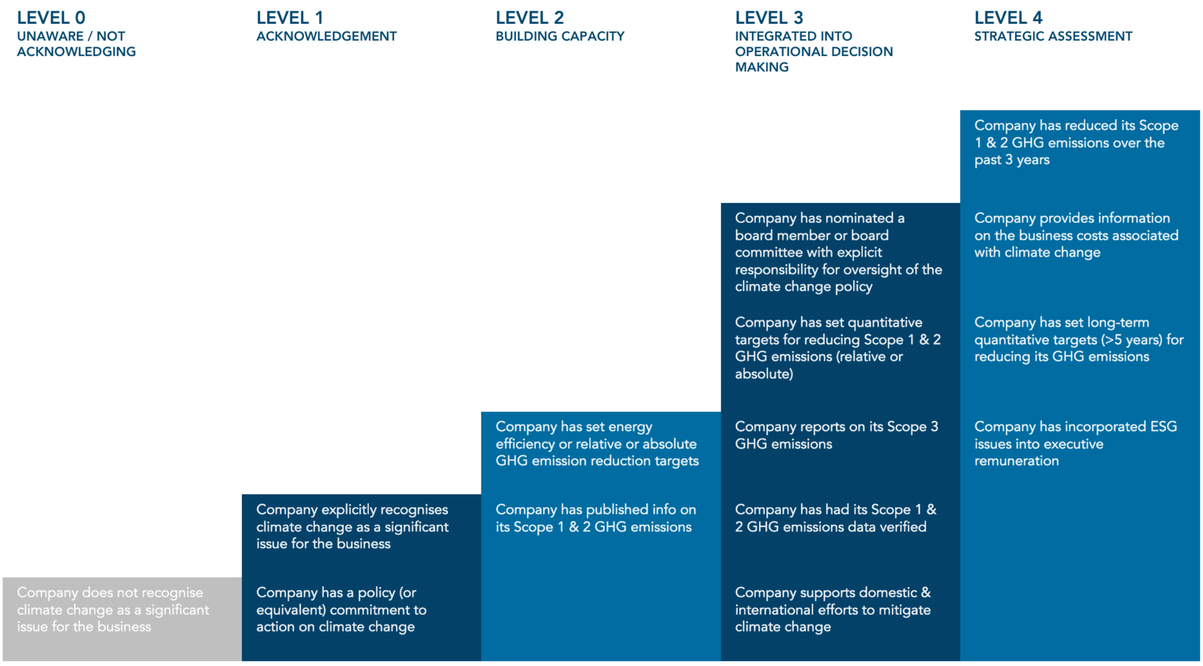
In assessing the risks and opportunities presented by the transition to a low-carbon economy, investors need to know if company strategies sufficiently address the climate risks that are embedded in many business models, and whether companies are positioning themselves appropriately for a low-carbon economy and to meet the goals of the Paris Agreement. Investors also need to be able to demonstrate – to beneficiaries, to clients, to stakeholders – that their interventions are making a meaningful contribution to the goals of the Paris Agreement and that they are effectively managing the risks and the opportunities presented by the transition to a low-carbon economy.

2. ABOUT THE TRANSITION PATHWAY INITIATIVE

The Transition Pathway Initiative (TPI) is an asset owner-led initiative which has been established to address the questions above, and to support investors in their reporting to beneficiaries, to clients and to stakeholders. It aims to define what the transition to a low-carbon economy looks like for companies in high-impact sectors such as oil and gas, mining, and electricity generation. This will then enable asset owners and other stakeholders to make informed judgements about how companies with the biggest impact on climate change are adapting their business models to prepare for the transition to a low-carbon economy. TPI:

- Evaluates, using the framework presented in Appendix 1, the quality of companies' management of the greenhouse gas emissions associated with their business ('Management Quality').
- Evaluates how companies' planned or expected future carbon performance compares to international targets and national pledges made as part of the Paris Agreement ('Carbon Performance').
- Reports this information publicly through an online tool hosted by the Grantham Research Institute on Climate Change and the Environment at the London School of Economics and Political Science (LSE).

TPI released its first set of data in January 2017. It published Management Quality assessments for 20 large companies in the oil and gas sector and for 20 large companies in the electricity utilities sector. These companies were categorised into one of five levels as illustrated below.



TPI will release further assessments in 2017. By the end of 2017, TPI will have published Management Quality and Carbon Performance assessments for between 120 and 150 companies across a range of high impact sectors (including electricity utilities, oil and gas, diversified mining, pulp and paper, cement, iron and steel, aluminium and automobiles). In 2018, TPI intends to increase the number of companies covered in these high impact sectors, and to broaden the sectoral coverage to include medium and low impact sectors.

This Briefing Paper describes how investors and other stakeholders may consider using the data and information provided by the TPI.

3. USING THE TRANSITION PATHWAY INITIATIVE

The data and information provided by TPI can be used by investors in a variety of ways, including those set out in Table 1 below. It should be emphasised that investors will inevitably make their own decisions on how to use data provided by initiatives such as TPI, and that TPI does not impose any obligations on supporting organisations to use TPI data in any particular way. It is for individual organisations to determine the most appropriate ways that TPI can be helpful to their internal processes.

Table 1: How Can the Transition Pathway Initiative be Used?

Potential Activity	Possible Application
Organisational Climate Change Policy	TPI provides investors with a practical tool to develop, implement and monitor the climate change policies that guide their investment strategy. Investors could consider: • Explicitly referencing or supporting the TPI on their websites, as a tangible signal of their commitment to understanding how climate change affects portfolios. • Committing to addressing the transition to a low-carbon economy as part of their investment principles • Using the TPI to frame clear, quantifiable goals for their climate change engagement (e.g. 'to encourage specific companies in high impact sectors to make progress through levels on the TPI's Management Quality assessment'). • Using TPI to help inform their investment risk management processes.
Develop internal processes	Investors could use the data and information provided by TPI to: • Define and track goals for their investment portfolios (e.g. setting a target for the proportion of companies in their portfolio, or in a particular sector, that they expect to be at a particular Management Quality level). • Define and track engagement goals (e.g. identifying a group of companies that they hope will achieve a particular Management Quality level within a specified timeframe). • Inform portfolio management, such as investing in companies that achieve better quality of management assessments. • Ask more nuanced questions in company and service provider meetings about company management quality and performance. • Report to beneficiaries or clients on the composition of their investment portfolios or on the effectiveness of their engagement. In turn, this allows beneficiaries and clients to better understand the characteristics of their portfolios, the exposure of these portfolios to climate transition risks, and the effectiveness of the measures being taken to manage and mitigate these risks. This information could also be used as an input into decisions on manager selection and appointment/reappointment.

	• Support internal capacity-building and training (e.g. trustee or board member training on climate risk).
Market signalling	By supporting TPI investors can: • Signal to other investment actors (e.g. asset owners, asset managers, service providers) that climate change is an important issue for them. • Signal to companies that they expect them to effectively manage the risks and opportunities presented by the low-carbon transition. • Signal to policy makers that climate change is an important issue for institutional investors.
Investment analysis and decision-making	The data and information provided by the Transition Pathway Initiative could be used to help: • Understand whether companies are managing the transition to a low-carbon economy and if they are setting emissions reductions targets. • Compare a company's performance with its industry peers. • Identify leading companies as examples of best practice. • Identify companies setting emissions reductions targets aligned with the Paris Agreement. • Identify companies that may not be effectively preparing for the low-carbon transition. • Identify companies that need to provide additional disclosure about their climate risk/transition strategies. • Identify companies that are not taking their responsibilities to assist with the transition to a low-carbon economy seriously.
Asset manager engagement	Asset owners (or asset managers that outsource investment management) could encourage their asset managers to publicly support TPI and to promote TPI to their client base. They could also ask these asset managers to: • Use TPI data and information in their reporting (e.g. to report on their portfolio characteristics, to report on their engagement activities). • Use TPI data in their risk management processes (e.g. to help assess the exposure of their portfolios to transition-related risks and opportunities). • Make companies aware of TPI and the Management Quality and Carbon Performance indicators that are being used by TPI.
Company engagement	See detailed company engagement section below.
Voting	TPI is working with a number of proxy voting agencies to develop guidance on how information on companies' management processes and performance could be used to inform (but not direct) voting activities.
Public policy engagement	Investors could use the data and information provided by TPI to highlight weaknesses in corporate practices and disclosures, and to encourage governments and standard-setting bodies to take action to strengthen these practices and disclosures. Investors could also use TPI to highlight the need for government policies to be supportive and enabling of the transition to a low-carbon economy,

	in particular to ensure that policy aligns with 2-degree temperature limit goals.
Reporting and Accountability	Beyond direct client and beneficiary reporting (see above), the data and information provided by TPI may also help investors to meet other reporting requirements, such Stewardship Codes and the PRI's Reporting and Assessment Framework. The TPI indicators and framework align with the draft recommendations from the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD)[1]

[1] See further: https://www.fsb-tcfd.org/

4. FOCUS ON COMPANY ENGAGEMENT

Many investors regularly engage with companies on environmental, social and governance (ESG) issues to gather information (e.g. on management practices, on performance) that can be used to inform investment views, and to influence or change corporate practices or behaviours on the issue in question. While different investors will inevitably ask different questions in their engagement, the data and information provided by TPI allows investors to ask questions about companies' management of the greenhouse gas emissions associated with their business, and about their planned or expected future carbon performance.

The following questions are possible ways that TPI could be used to support company level engagement by investors.

Ahead of meeting with or speaking with a company you should be familiar with the company's overall position (Level 0-4), how the company's overall position compares to its sector peers and the questions where the company was assessed as Yes, and those where it was assessed as No.

Suggested Engagement Questions: Transition Pathway Evaluation

- Are you satisfied with your position in the Transition Pathway Initiative?
    - Do you think that your position relative to your sector peers is an accurate reflection of your approach?
- Has your position in the Transition Pathway Initiative been discussed at board or senior management level?
    - If yes, what were the outcomes of these discussions
- Will you be taking action to improve your position?
    - If yes, what actions will you be taking?
    - If no, why not?

Suggested Engagement Questions: Management Quality Assessment

- Do you intend to develop a climate change policy?
- Do you intend to set greenhouse gas emission reduction targets?
- Do you intend to publish information on your Scope 1 and Scope 2 greenhouse gas emissions?
- Do you intend to publish information on your Scope 3 greenhouse gas emissions?
- Do you intend to nominate a board member or board committee with explicit responsibility for your climate change policy?
- Do you intend to have your greenhouse gas emissions data verified?

- Do you support domestic and international efforts that seek to limit the global temperature rise to well below 2 degrees?
- Can you provide information on the business costs – for example, capital investments, costs of carbon permits – associated with climate change?
- Do you intend to incorporate environmental, social and governance issues into your executive remuneration?

Suggested Engagement Questions: General Strategy and Approach

- What have been the key challenges you are encountering relating to the transition to a low-carbon economy? How are you addressing them?
- How do you expect your approach to managing your greenhouse gas emissions and the low-carbon transition to change over time?
- Who is responsible for overseeing these strategies?
- What resources have you allocated for the development and implementation of these strategies?

APPENDIX 1: COMPANY ASSESSMENT TEMPLATE

Company Name:		
TPI Level:		
No.	**Question**	**TPI Assessment (Yes/No)**
Level 0: Unaware of (or not Acknowledging) Climate Change as a Business Issue		
1	Does the company acknowledge climate change as a significant issue for the business?	
Level 1: Acknowledging Climate Change as a Business Issue		
2	Does the company explicitly recognise climate change as a significant issue for the business?	
3	Does the company have a policy (or equivalent) commitment to action on climate change?	
Level 2: Building Capacity		
4	Has the company set energy efficiency or relative or absolute greenhouse gas emission reduction targets?	
5	Has the company published information on its Scope 1 and 2 greenhouse gas emissions?	
Level 3: Integrated into Operational Decision-making		
6	Has the company nominated a board member or board committee with explicit responsibility for oversight of the climate change policy?	
7	Has the company set quantitative relative or absolute targets for reducing its operational (Scope 1 and 2) greenhouse gas emissions?	
8	Does the company report on Scope 3 emissions?	
9	Has the company had its operational (Scope 1 and 2) greenhouse gas emissions data verified?	
10	Does the company support domestic and international efforts to mitigate climate change?	
Level 4: Strategic Assessment		
11	Has the company reduced its operational (Scope 1 and 2) greenhouse gas emissions over the past 3 years?	
12	Does the company provide information on the business costs – for example, capital investments, costs of carbon permits – associated with climate change?	
13	Has the company set long-term relative or absolute targets for reducing its operational (Scope 1 and 2) greenhouse gas emissions?	
14	Has the company incorporated environmental, social and governance issues into executive remuneration?	