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# Climate Risk Integration and Credible Corporate Climate Transition Plans: Perspectives from Planet Tracker and ELFA members

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## Executive Summary

- The ELFA Climate & Net-Zero Member Workshop, convened on October 18, 2023, brought together 30 participants from 20 different investment firms, offering a platform to delve into critical aspects of climate risk integration and credible corporate climate transition plans within the leveraged finance sector. Notably, Planet Tracker, a non-profit sustainable finance think tank, shared insights on the enduring significance of climate considerations for credit managers. The workshop stimulated robust discussions on evaluating climate change risks at firm, portfolio, and investment levels, revealing diverse approaches to industry initiatives and unveiling challenges in aligning global net-zero ambitions.
- Out of the 20 investment firms, five organisations mentioned that they have made public net-zero commitments and belong to the Net Zero Asset Managers Initiative (NZAMI). This commitment underscored a growing momentum towards climate action, with participants sharing the proportion of assets under management (AUM) subject to decarbonisation targets.
- Workshop participants also discussed several practical challenges in aligning net-zero ambitions globally, especially following reports of the changing sentiment relating to ESG and climate ambitions in certain US states.
- At the portfolio level, attendees shared which external partners they use to collect and measure GHG emissions, and we found that climate change risk assessments are not yet common among credit managers. However, some participants believed that frameworks put forward by the Transition Pathway Initiative (TPI) and the International Sustainability Standards Board (ISSB) will accelerate the adoption of climate change risk frameworks across managers.
- Finally, existing climate transition frameworks were discussed that are available to investors to help assess a portfolio company's climate transition plan. A climate transition plan is a strategic planning instrument that helps companies align their various climate actions. It should contain time-bound and, where possible, verified science-based targets that align with the latest climate science. In this report, we highlight Planet Tracker's and CDP's work in this area. For example, CDP's data highlights a discrepancy between the number of disclosed targets and transition plans in general. Even though portfolio companies demonstrate that they have science-based targets, the data suggests that this is not always supported by a credible climate transition plan outlining how they will achieve them.
- In essence, the ELFA Member Workshop offered a panoramic view of the current state of climate considerations within leveraged finance, celebrating achievements while pinpointing challenges. The discussions underscored the crucial role of credible transition plans and signalled a collective industry commitment to navigate the evolving landscape of climate-related finance, transparency, and collaborative action.


## Introduction

As part of our continued efforts to support the growth of ESG investing in leveraged finance markets and as a follow-up from our inaugural 2021 climate workshop, in October ELFA held a Climate & Net-Zero Member Workshop for ELFA members. The Member Workshop hosted 30 attendees, representing 20 different investment firms. ELFA also invited Planet Tracker, a non-profit sustainable finance think tank, to present their work and explain why climate topics should continue to matter to credit managers.

Following Planet Tracker's presentation and audience Q&A, participants continued the conversation and discussed the steps their firms are taking to assess climate change risks at the firm, portfolio, and investment levels. Participants also shared additional challenges their firms face when tackling climate-related topics in the leveraged finance market, particularly concerning data collection and analysis.

## Firm-level Initiatives

Following Planet Tracker's insightful presentation, the ELFA Climate & Net-Zero Workshop continued with attendees providing an overview of their current position on net-zero ambitions and to what extent they integrate climate change risk into their investment portfolios. We discussed drivers for joining industry-level climate initiatives, the various climate frameworks that are in place, the setting of decarbonisation targets, and the practical challenges credit managers face in developing and delivering their climate ambitions. One such challenge is the changing sentiment in the US on net-zero ambitions.

### Net Zero Asset Managers Initiative

Out of the 20 investment firms, five organisations mentioned that they have made public net-zero commitments and belong to the Net Zero Asset Managers Initiative (NZAMI),[1] an international group of asset managers committed to supporting the goal of net-zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit global warming to 1.5 degrees Celsius. A couple of firms also shared an ambition to join the initiative in the future and detailed other carbon disclosures set at the firm and fund levels.

These investment firms discussed their experience of joining such initiatives and their impact on their portfolio management. The drivers of publicly pledging net-zero come from a combination of end-investors' evolving needs and investment firms' own climate ambitions. "The NZAMI provides for a flexible approach and a practical solution", according to a credit manager.

The discussion then moved on to firm-level decarbonisation targets. Workshop participants shared what proportion of their assets under management (AUM) are subject to a decarbonisation target, which varied between 35% and 83% of their total AUM. Typically and understandably, the more challenging asset classes were excluded from these initial public commitments.

An ELFA member asked how to implement such commitments for private credit investments and how to influence such borrowers as lenders. Another member, who has joined the NZAMI, responded to this question and highlighted a report from the Institutional Investors Group on Climate Change (IIGC) and the PRI from 2016.[2] The report presents a framework that LPs and GPs can use in due diligence and when engaging with their fund and portfolio company investments.

Workshop participants then discussed how asset managers align their net-zero ambitions globally. Are certain regions not becoming increasingly apprehensive of ESG and climate ambitions, and how do these asset managers deal with such sentiments? A participant responded to this and mentioned, for example, the changing sentiment in certain US states. "There is certainly a bifurcation and divergence within the US on net-zero ambitions", according to this investment manager. "However, there is also a regulatory obligation for investment firms in certain other regions, for example, in the EU, to meet evolving ESG and climate standards, and our firm will need to respond and adapt to these."

## Climate risk integration in investment portfolios

### GHG emissions and climate change risk frameworks

Our discussion moved on to the carbon footprinting of investment portfolios. GHG emissions are one quantifiable measure of a company's environmental impact. Once measured, a company can then target GHG emissions reduction in, for example, its most carbon-intensive areas and operations, thereby reducing both its footprint and costs.

Workshop participants shared which external partners they use to collect and measure GHG emissions in their investment portfolios. Various vendors exist, but coverage varies between asset classes. High-yield bonds typically receive the highest coverage from external data vendors, with broadly syndicated leveraged loans coming next, and private credit being the least covered across data vendors. Specialist data vendors have recently come online with a specific private credit focus, which is helpful for this market segment.

More data vendors are also increasingly using ELFA's ESG Fact Sheets to collect ESG data, including GHG emissions data, from portfolio companies, which is helping to improve data coverage across leveraged credit markets. Workshop participants mentioned that they and data vendors have also started to track the percentage of their underlying borrowers in their portfolios with net-zero ambitions.

[1] https://www.netzeroassetmanagers.org/

[2] "A Guide on Climate Change for Private Equity Investors", IIGCC and PRI, 2016: https://www.unpri.org/download?ac=274. The IIGCC is a forum for collaboration on climate solutions for investors.

Climate change risk assessments are not yet common among credit managers. However, participants believed that frameworks put forward by the Transition Pathway Initiative (TPI)[3] and the International Sustainability Standards Board (ISSB) will accelerate the adoption of climate change risk frameworks across managers.

### Climate transition plans

Various frameworks are available to investors to help them assess a portfolio company's climate transition plan. A credible climate transition plan is aligned to 1.5°C and has rigorous targets. Firms should set near-term science-based targets to halve emissions by 2030 and a net-zero long-term target by 2050 at the latest.

We will look here at (i) how Planet Tracker approaches this assessment, and (ii) the CDP climate questionnaire. According to CDP, a climate transition plan is a time-bound action plan that clearly outlines how an organisation will achieve its strategy to pivot its existing assets, operations and entire business model towards a trajectory that aligns with the latest and most ambitious climate science recommendations, i.e., halving greenhouse gas (GHG) emissions by 2030 and reaching net-zero by 2050 at the latest, thereby limiting global warming to 1.5°C. Environmental disclosure alone is not enough – it needs to lead to accountability and transformation; hence the relevance of climate transition plans as part of a business's strategy.

Along its sustainability journey, an organisation will typically set emissions reduction targets, commit to monitoring its progress on climate, and reduce its exposure to climate-related risks. A climate transition plan is a strategic planning instrument that helps organisations align their various climate actions.

## Planet Tracker

### Greenwashing risk

Planet Tracker highlighted at the workshop how they identify and target potential greenwashing by companies. They explained that 'greenwashing' can arise when companies have science-based targets approved and disclose that they are aligned with 1.5 degrees Celsius; however, having a target does not necessarily mean a company has a plan and a credible strategy that will enable the company to reach set targets by 2030 and 2050 respectively.

### Methodology

Planet Tracker's approach to assessing companies' climate transition roadmaps builds on frameworks such as the CDP Climate Transition Plan, McKinsey Sustainability's Solving the Net-Zero Equation, MSCI's Climate and Net-Zero Solutions, PRI's Pathways to Net-Zero and the TCFD's Recommendations.[4] Planet Tracker's methodology contains four major components:

1. **Climate alignment:** to verify alignment, it assesses the sources of GHG emissions data, determines the trend in emissions based on the last three years, and if this trend is aligned with science-based targets.
2. **Policy and governance:** it quantifies stakeholder engagement (for example, with suppliers, customers and policymakers), reviews the oversight responsibility of set targets and 'skin in the game' of management.
3. **Risk analysis:** it reviews transition and physical risks disclosure and estimates and assesses risk management's response and investment.
4. **Strategy assessment:** reviews any mitigation initiatives to close the gap between extrapolated trends and science-based targets

Examples of Planet Tracker's Climate Transition Assessment include Nestle, Procter & Gamble, Unilever and Walmart among others. The financial think tank also includes with each report institutional engagement sheets such as Nestle's Engagement Sheet, P&G's Engagement Sheet, Unilever's Engagement Sheet, and Walmart's Engagement Sheet.

## CDP

### Climate questionnaire

CDP is a not-for-profit charity that runs a global disclosure system for investors, companies and states to manage their environmental impacts. CPD has a climate questionnaire that corporates can complete, which contains 21 KPIs that align with a credible climate transition plan.

In February 2023, the CDP published a report[5] providing an overview of the current state of climate transition plan information disclosed through CDP's 2022 climate change questionnaire. The data analysed in this report spans over 18,600 organisations in 13 industries and across 135 countries. While the report is not an assessment

[3] https://www.transitionpathwayinitiative.org/
[4] A full description of the framework can be found here: https://planet-tracker.org/net-zero-transition-plan-assessment-template-for-investors-in-consumer-goods-companies/
[5] "Are companies developing credible climate transition plans?", CDP, February 2023: Climate_transition_plan_report_2022_(10).pdf (cdp.net)

of an organisation's climate transition towards a 1.5°C-aligned world – it is an evaluation of whether an organisation's disclosure is sufficient and credible.

13% of the organisations reporting through CDP have many elements of a credible climate transition plan; however, only 0.4% disclosed sufficient detail to all key indicators. This demonstrates that most organisations have a long way to go to improve transition-relevant disclosures in their CDP climate change response.

### Methodology

According to the CDP, generally, the trend of disclosure and implementation of a credible climate transition plan follows a journey which is initiated by the identification of risks and opportunities, the establishment of governance structures to guide the progress of the transition, strategising through robust scenario analysis, implementation of a plan by setting science-based targets (SBTs) and establishment of resources (financial and otherwise) to achieve set targets.

This journey is consistent with the data assessed in the CDP report as more than a third of the disclosing organisations met the disclosure criteria for the risks and opportunities element of a credible climate transition plan – this was followed closely by the governance element (24%) and the policy engagement element (19%). In contrast, financial planning, targets, and strategy to achieve net zero were the poorest performing elements of a credible climate transition plan with 3%, 4% and 7% of organisations meeting the disclosure criteria in these respective elements.

#### Third-party verification of targets

According to CDP, "a robust emissions inventory with third-party verification is the bedrock of the transition journey and the foundation of setting science-based targets which underpin a credible climate transition plan".

A climate transition plan should contain time-bound and, where possible, verified SBTs that align with the latest climate science.

CDP assessed disclosed targets and investigated three key indicators: (1) absolute targets, (2) intensity targets, and (3) net-zero targets. Although organisations may disclose their ambitious emissions reduction targets via other means, CDP views the SBTi as the gold standard for setting credible SBTs. According to CDP, the SBTi follows an independent, rigorous, verified and science-aligned process aimed at driving ambitious climate action in the industry.

CDP's data highlights a discrepancy between the number of disclosed targets and transition plans in general. Even though organisations demonstrate that they have science-based targets, the data suggests this is not always supported by a credible climate transition plan outlining how they will achieve them.

## Conclusion

In conclusion, the ELFA Climate & Net-Zero Member Workshop provided a comprehensive insight into the current landscape of climate risk integration and credible corporate climate transition plans within the European leveraged finance market. With representatives from 20 investment firms, the workshop facilitated discussions on various aspects, including net-zero commitments, decarbonisation targets, and challenges in aligning global net-zero ambitions. The participation of five organisations in the NZAMI showcased a growing commitment to mitigating climate change. However, the workshop also revealed practical challenges, especially regarding data collection and analysis, and highlighted the evolving sentiment on ESG and climate ambitions in certain US states.

At the portfolio level, the discussion emphasised the need for credit managers to adopt climate change risk assessments, with a recognition that frameworks from organisations like the TPI and the ISSB could drive their adoption. The workshop delved into the significance of climate transition plans, exploring frameworks from Planet Tracker and CDP. Planet Tracker's approach focused on comprehensive assessments, including climate alignment, policy and governance, risk analysis, and strategy assessment. CDP's climate questionnaire, encompassing 21 KPIs, revealed that while 13% of organisations demonstrated elements of a credible climate transition plan, only 0.4% disclosed sufficient detail across all key indicators.

The importance of third-party verification for setting science-based targets was underscored, with CDP emphasising the need for a robust emissions inventory. Despite organisations disclosing science-based targets, the data exposed a gap between the number of disclosed targets and the presence of credible climate transition plans. In essence, the workshop highlighted both progress and challenges in integrating climate considerations into leveraged finance, emphasising the critical role of credible transition plans and the ongoing need for collaboration, transparency, and data standardisation within the industry.

[6] "Are companies developing credible climate transition plans?", CDP, February 2023: Climate_transition_plan_report_2022_(10).pdf (cdp.net), page 19

## About ELFA:

ELFA is a professional trade association comprised of European leveraged finance investors from over 60 institutional fixed income managers, including investment advisors, insurance companies, and pension funds. ELFA seeks to support the growth and resilience of the leveraged finance market while acting as the voice of its investor community by promoting transparency and facilitating engagement among European leveraged finance market participants. For more information please visit ELFA's website: www.elfainvestors.com.

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