A five-step guide to reducing emissions in portfolio (and achieve net-zero

How-to guide | December 15th, 2021

Since the Paris Agreement, governments, scientists, and organisations have introduced an increasing number of measures to reduce emissions. The most common approach is defined in three words: "Net-zero by [2020-2050]"

This is easier said than done. We developed the following 5-step approach to help FIs get started.

Step 1. Set a baseline GHG emissions footprint

You can only manage what you measure. Therefore, the first step is to determine the total amount of GHG emissions in portfolio. Where no direct (physical) GHG emission company data is available, a footprint can be established by modelling based on portfolio data. Read more about how we do this here.

By using this method, an FI can estimate GHG emissions in portfolio in terms of Scope 1, 2 and 3. Furthermore, they can use this overview to identify GHG hotspots in their portfolio. This allows for a first understanding of what they are up against – and where action is most effective.

Step 2. Develop a GHG abatement strategy and target (net-zero)

The second step is to develop a GHG abatement strategy and set clear targets. FIs can identify the highest emitting assets in portfolio and thus prioritize engagement on emission reduction.

Furthermore, an FI can also prioritize engagement based on the most harmful types of GHG emissions. For example, by targeting methane emissions first, which is more potent and short-lived than CO_2.

Generally, advocating for emission reduction rather than divestment can have a bigger impact. Although divesting makes a quick dent in a portfolio's footprint, divestment can open the door for investors with less ambitious (or no) reduction intentions to pick up the financing gap.

As a final step, the remaining portfolio emissions need to be neutralized through compensation measures. FIs can do this collaborating with partners to identify carbon offsetting projects and/or buying carbon credits. Such

Figure 1. Quantification of the baseline Scope 1, 2 and 3 emissions of a portfolio of investments

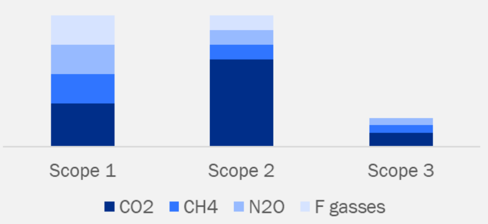
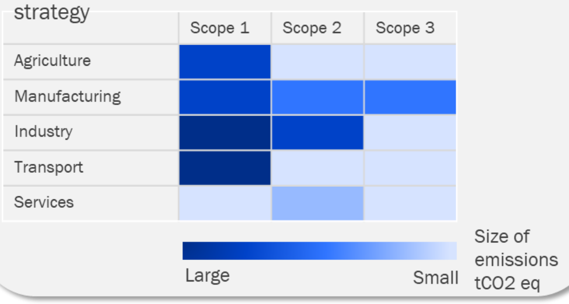


Figure 2. Identification of GHG hotspots for abatement strategy



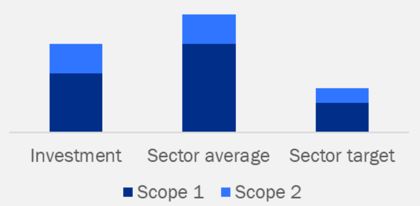
compensations measures should come as a last resort, and we encourage FIs to reduce emissions in portfolio to the extent that it is possible.

Step 3. Integrate the strategy across the organisation

As a third step, it is important to communicate on targets as part of an organization-wide climate strategy. FIs will need to align their investment decisions with a new strategy, for example by screening new investments based on their GHG footprint. In doing this, sector averages can be used to determine if the investment is sensible. Furthermore, sector averages can serve as a point of reference for a client's potential climate performance. In this case, FIs can ensure climate targets are set during deal structuring and are included in legal documents.

Integrating a climate strategy across the organization is a challenging endeavour: it requires strong leadership and communication on priorities and objectives. There are important choices to be made at this point, the most obvious being alignment of financial targets with climate targets. On top of this, for development portfolios, there is the need to reconcile climate action with addressing development needs (here). We will not attempt to standardize an approach for making such choices, as it is there is no 'one-size fits all' solution. What is clear however is that the stakes are high and the time to act is now.

Figure 3. Integrating net-zero targets in investment decision making

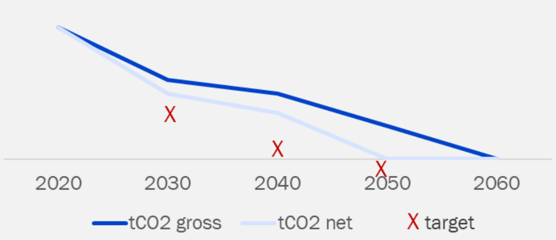


Step 4. Track progress over time and adjust actions

As a fourth step, FIs can set a timeframe for tracking progress and analyse if their abatement activities have met annual targets. If they did not meet targets, FIs can adjust investment activities and/or follow up with their investees on additional reduction opportunities.

Again, this is does not come without challenges. It can be difficult to engage with portfolio companies, particularly in developing countries, where companies might lack the skills and local support. Beyond providing finance, FIs can look into providing technical support. Furthermore, FIs can be proactive and work with other stakeholders and advocate for regulatory action. Finally, transitioning to a carbon neutral economy is an enormous task and it requires an industry-wide effort. FIs can and should make use of shared learnings and experiences to accelerate this effort.

Figure 4. Tracking and communicating progress over time



Step 5. Be accountable to stakeholders

As a final step, FIs can make their climate footprint, targets, and strategy public. This is for several reasons. First, disclosure and reporting alignment at an international level provides a more reliable overview of the world's annual GHG emissions, facilitating collective climate action. But more importantly, accountability to stakeholders does not end with a climate pledge

- it warrants disclosure and transparency on your climate journey.

Ideally, the organizational knowledge sharing process is as inclusive as possible, meaning that results are communicated in a way that is understandable by all stakeholders, rather than only GHG disclosure specialists. This means stakeholders are informed and can engage with the organization and challenge it. On top of that, employees can make a link between their contribution and the progress of the organization's climate strategy, leading to increased engagement.

If you are interested in what steps you can take to put your climate commitment into action, you can reach out to sabine.dankbaar@stewardredqueen.com (in Amsterdam), jeanmarc.hoffman@stewardredqueen.com (in Luxembourg) , pauline.brunner@stewardredqueen.com (in Singapore).