



— Investing for a  
world of change

# Targeting effectiveness

Asset owners weigh risks and  
opportunities of investing for  
an inclusive energy transition

Planetary Pulse

November 2023

# Are asset owners moving from decarbonising their portfolios to reducing emissions?



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# Introduction

Asset owners were never going to have a single, all-encompassing approach to the risks and opportunities presented by climate change. When allocators of capital, the top 100 of which manage almost US\$26 trillion<sup>1</sup>, started implementing strategies in alignment with the 2015 Paris Agreement, it became imperative they learn about all aspects of the energy transition.

By itself, decarbonising portfolios is little more than cosmetic. Many asset owners, recognising the importance of real-world impact, are initiating investment strategies designed to generate risk-adjusted returns from the energy transition.

This evolution has led to a developing range of tools, targets and objectives, while asset owners have been updating net zero frameworks to focus on meaningful impact.

Ninety One's research, conducted independently by FT Longitude, surveyed 300 asset owners and consultants across eight sub-industries. Making up the respondents were 125 in Denmark, Germany, the Netherlands, Switzerland, and the UK; 80 in the US and Canada; 60 in Australia, Hong Kong and Singapore; and 35 in Botswana, Namibia and South Africa.

The research investigates asset-owners' strategies and investment through the lens of real-world impact, in terms of the targets they set, the frameworks in which they operate, and the practices they implement. The findings show that asset owners are deploying a broad spectrum of approaches. These range from setting targets for entire portfolios to investing in the efforts of high emitters committed to achieving their own transition pathways.

Among the findings was a particular surprise. The research shows that climate-related investment practices seem to have decreased, year-on-year. This response comes in a year, 2023, when July was the hottest month on record globally. On July 31, the daily sea surface temperatures value rose to a record high<sup>2</sup>.

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1. [Thinking Ahead Institute](#).

2. [Copernicus Climate Change Service](#).



## About the research

This report reveals the findings from new primary research into real-world impact and transition finance. It is based on a survey of 300 senior professionals at asset owners and advisors around the world, including pension funds, insurers, endowments, foundations, central banks, sovereign wealth funds and consultants. The research was carried out in September 2023.

**We would like to extend our thanks to the following experts for their time and insights:**

- Hortense Bioy, Global Director of Sustainability Research, Morningstar
- Andrew Coburn, CEO, Resilience
- Xolisa Dhlamini, Head of Sustainability Operations and Impact and Investment Committee Member, Sanlam Umbrella Fund
- Daan Spaargaren, Responsible Investment Strategist, PME Pensioenfonds
- Michael Wilkins, Executive Director and Professor of Practice, Centre for Climate Finance & Investment, Imperial College Business School



# 1 Climate-focused targets: moving to a granular approach

Our research shows that, for nearly all asset classes, climate-related strategies are here to stay. Almost half of asset owners (48%) have between one-quarter and half of their assets under management (AUM) invested in portfolios with climate-related instructions or objectives, up from 40% in 2022. This rises to 75% for endowment funds, which typically invest for designated purposes.

A significant number of respondents say their infrastructure (45%), private equity (50%), private debt (44%), corporate debt (41%) and listed equities (36%) asset classes are within the scope of their climate-related objectives. Sovereign debt is the only asset class that falls below this, at 17%.

## Emissions reduction is still the main target type

The climate-related targets and metrics that asset owners are using remain broadly the same as in 2022. Emissions-reduction targets were the most used in 2022, and this is still the case in 2023. Nearly half (49%) of asset owners have an emissions-reduction target in place for their fund, while 43% - rising to 54% in Asia-Pacific (APAC) - use Climate Value-at-Risk (VaR). In North America, the second-most-used target type is portfolio coverage/asset-level alignment (40%) and, in Europe, it is implied temperature rise (44%).

Nearly two-thirds of asset owners (61%, rising to 67% in North America) use the same climate-related target type for all asset classes and funds. Using the same type of target allows organisations to minimise risk, increase resource efficiency and build expertise while retaining control over outcomes, according to respondents.

Having a clear net-zero transition plan in place at company level allows all functions to “row in the same direction,” according to a US-based sustainability leader for a large insurance provider.

“We have a global strategy on ESG integration that sets out what we do or don’t invest in and how we engage with investors. The strategy very directly incorporates our climate plan and our decarbonisation targets for our portfolio, which are steered by our net-zero commitments and our membership of the Net Zero Asset Owner Alliance [NZAOA],” they say.

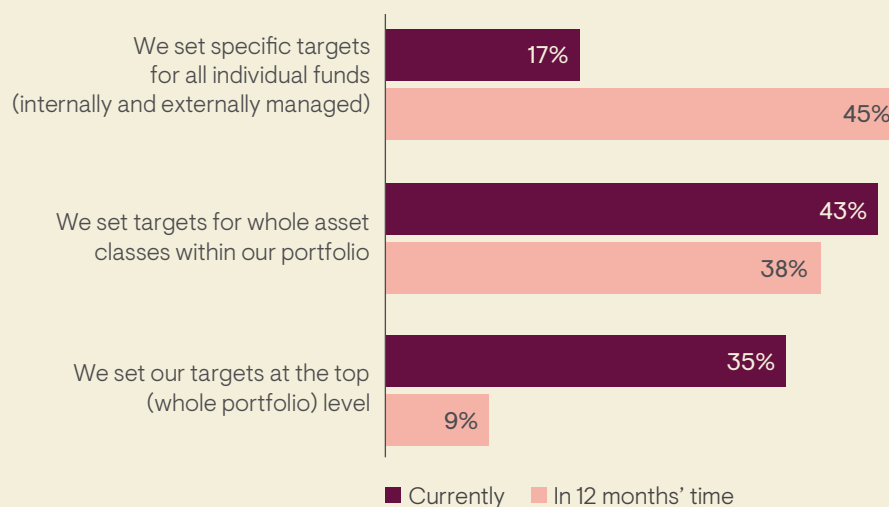
## Fund-level climate targets

Although asset owners focus on the same **type** of target, they expect to adopt a more granular approach when it comes to the **level** of the structure to which the target is applied.

Our research shows that, over the next 12 months, many asset owners expect to pivot from top-level targeting towards fund-specific targets.

Currently, 43% set targets for whole asset classes within their portfolio, and 35% set targets at the top (whole portfolio) level. However, 45% say they plan to set specific targets for all individual funds within the next 12 months. This applies to both internally and externally managed funds.

### Over the next 12 months, many expect to pivot from top-level to fund-specific targets



This more granular approach recognises that setting targets at whole portfolio level is no longer adequate. This also allows asset owners to acknowledge that the pace of decarbonisation will vary between asset classes, regions and sectors.

Daan Spaargaren, Responsible Investment Strategist at Dutch pension fund PME, explains that his institution has set an overall goal of reaching net-zero emissions by 2050<sup>3</sup>. “That is the technical aim overall, but we divide that into goals for specific asset classes, from equities and bonds to PE and real estate,” he says. “Because all these asset classes have different characteristics, different measurement systems, and different instruments to steer in order to achieve impact.”

3. [PME Climate Plan](#).

## 2 Scepticism and the adoption of proprietary frameworks

Although a target-setting framework is key, the link between framework adoption and impact is unclear. While the majority (57%) of asset owners believe that using established climate-related target-setting frameworks has a real impact on emissions levels, these frameworks may constitute a roadblock. A notable minority of asset owners (34%) state that using established frameworks actively prevents investments from making a real-world impact. Moreover, 44% think their frameworks fail to support real-world impact in emerging markets.

### A clear divide on impact

The view that established frameworks are preventing real-world impact could be leading to a wider adoption of proprietary target-setting frameworks. Overall, almost half of asset owners (48%) use fully or largely proprietary frameworks that are developed in-house or with the help of a consultancy for setting climate-related investment targets.

Those who believe in the effectiveness of established frameworks are more likely to follow the Science-Based Targets initiative (SBTi) framework to the letter than use a custom/proprietary framework.

Spaargaren highlights PME's need for flexibility in choice of framework: "We are looking into SBTi because the framework is ambitious and it's setting the baseline on how and when companies should comply with the Paris Agreement pathway," he says. "In addition, we use the Partnership for Carbon Accounting Financials (PCAF) methods for measuring our carbon emissions. And we also comply with TCFD guidelines for our annual reporting."



## The need for greater standardisation

Interestingly, many asset owners feel that stricter mandatory targets are still needed to achieve real impact. Although several asset owners are using proprietary or consultant-developed frameworks, 43% say that there is too much discretion permitted in the selection of climate-related targets and 44% say the same about the metrics that underpin them.

“There are so many different methodologies that are allowed within these frameworks that they can produce different orders of magnitude, depending on which framework and calculation methods you go down,” says Andrew Coburn, CEO of Risilience, a consultancy specialising in climate-analytics technology.

The implied frustration here suggests that asset owners may be open to a more prescriptive approach to facilitate real-world impact.

Hortense Bioy, Global Director of Sustainability Research at Morningstar, a provider of investment data, research and analytics, agrees that standardisation is required. “There is still no consensus on what companies should report on and methodologies. The lack of consistency in disclosure makes it hard to compare and analyse data across companies,” she explains. “One key metric that is still being debated is Scope 3 emissions, which are notoriously difficult to calculate. Regulators around the world are still debating whether or when to mandate Scope 3 disclosure. We think the sooner the better even if the data is imperfect.”

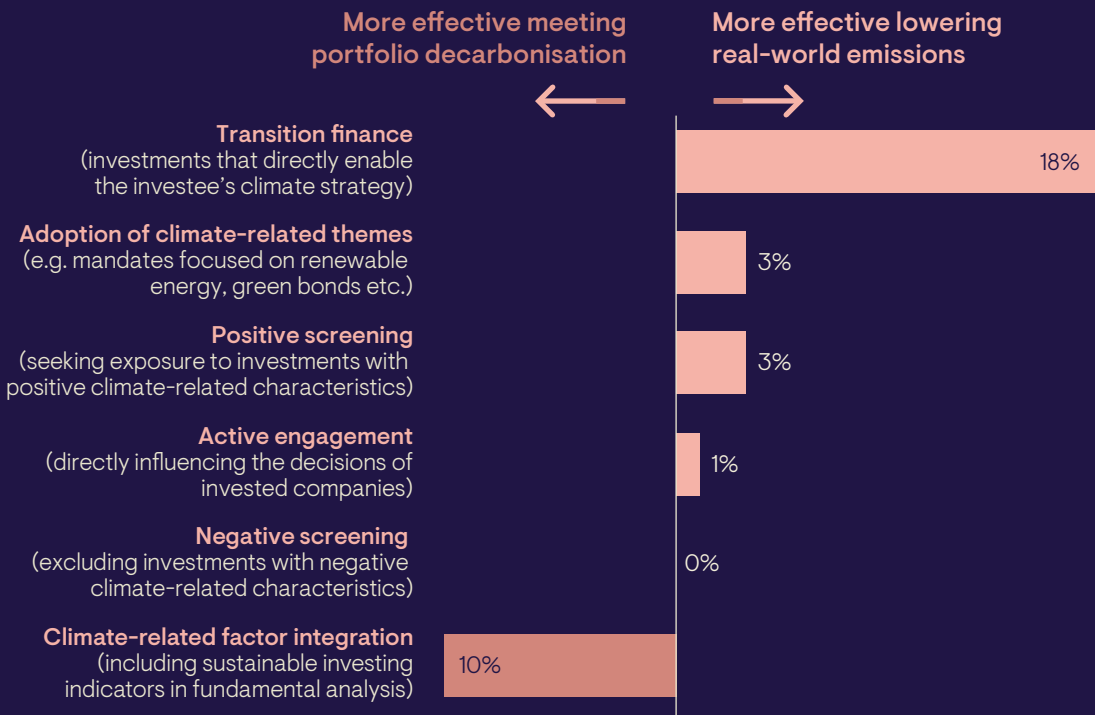
As Bioy explains, a standardised framework would need to incorporate forward-looking metrics that give a full picture of an investment’s future impact. Notably, this would help asset owners support a just transition in emerging markets, a highly challenging task.

“Many financial institutions are having to grapple with the concept of a just transition, and the social and economic impacts of investing in climate-aligned assets. So, how it impacts labour, social mobility, equality, migration and health, and all these other issues, which can be a side-effect or second-order impact of climate investing,” says Michael Wilkins, Executive Director and Professor of Practice, Centre for Climate Finance & Investment, at Imperial College Business School.

# 3 Greater awareness of the trade-offs

Our research suggests there is a disconnect between decarbonisation intentions and outcomes. The majority of asset owners (55%) who implement climate-related factor integration as an investment tool say it contributes more to portfolio decarbonisation than to reducing emissions in the real world (45%). A difference of 10%. Transition finance displays an inversion of this pattern – 34% say it makes a significant contribution to portfolio decarbonisation, compared to 52% who say it is lowering real-world emissions. A difference of 18%.

Transition finance is clearly recognised for its real-world credentials over and above meeting portfolio decarbonisation targets



The fact that developed countries have dominated the discourse on climate change may have contributed to this disconnect, explains Xolisa Dhlamini, Head of Sustainability Operations and Impact at Sanlam, a multinational financial services group headquartered in South Africa. There is a very narrow focus in the climate discourse because, quite often, the discourse is focused on solutions that speak to mitigation. Whereas [systemic] adaptation and transition are not yet getting enough financial support because of the skewed focus on mitigation opportunities,” he says. “It’s frustrating for us, as we’re operating in emerging markets, which are impacted significantly by climate change.”

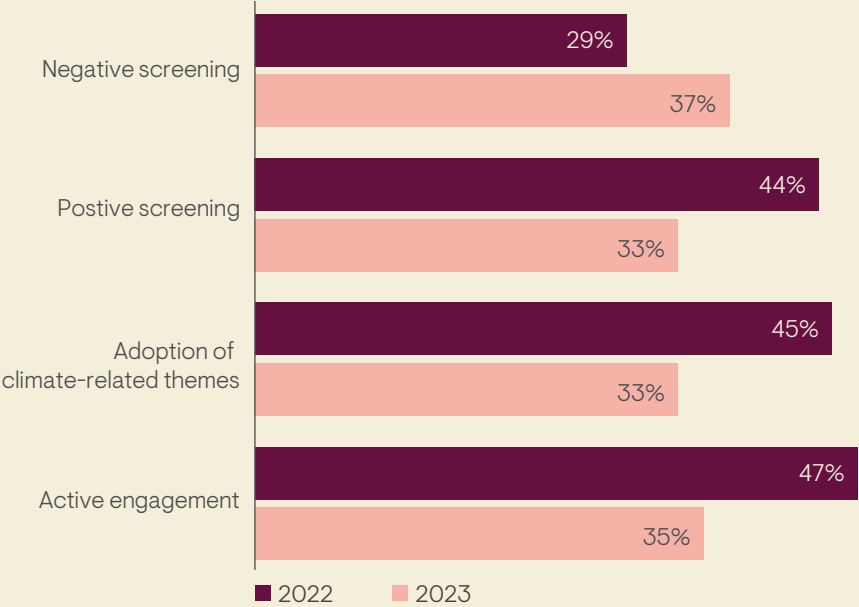
## Conflicting priorities

Surprisingly, the study shows that climate-related investment practices seem to have decreased, year-on-year, across the board. Despite asset owners viewing positive screening as the practice with the strongest impact in lowering real-world emissions, just 33% are using it in 2023, down from 44% in 2022. There are also fewer owners using active engagement (35%, down from 47%) and the adoption of climate-related themes (33%, down from 45%), both of which most asset owners say make a high contribution to lowering real-world emissions. Negative screening is the only practice on the rise (37%, up from 29%).

The decrease in certain practices is even more apparent in North America, where 2022’s top choices have plummeted: factor integration and positive screening, both cited by 52% in 2022, are now used by only 25% and 45%, respectively, while those adopting climate-related themes have decreased from 48% to 33%.

The US-based sustainability leader points to “the whole rhetoric playing out around ESG” in their country. “It’s hitting a lot of asset owners and more directly around pension funds. Certain states aren’t so fond of this concept of ESG, and there’s actually some impact that state legislators or attorneys general can have over how state funds are invested.”

**Fewer report using climate-related themes, positive screening and active engagement**



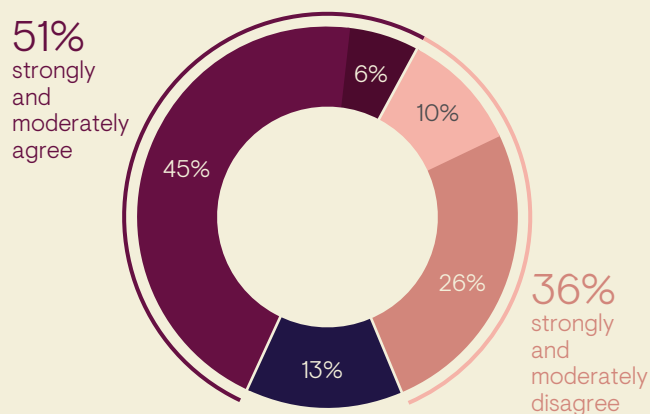
## Climate targets are perceived to weigh on returns

The focus on emissions profiles, rather than real-world impact, may be related to the perception of a trade-off between climate-focused practice implementation and actual financial returns. Over half of asset owners (54%) are worried about achieving emissions-reduction targets while delivering the best possible returns. This is despite a reported appetite for high-risk/high-return investments: more than half (51%) state that their fund is seeking to invest in high emitters with innovative or ambitious decarbonisation plans.

“Asset owners need to maintain balanced and diversified portfolios, while managing risk, including climate-related risks,” Bioy explains. As the world transitions to a low-carbon economy, asset owners should know exactly how the companies they invest in plan to adapt their business models, their operations and their products and services. “Companies should have credible transition plans with science-based targets, and if they don’t, then asset owners need to engage and put pressure on them to disclose one. Transition plans are becoming mandatory in some countries, like in the UK,” she says.

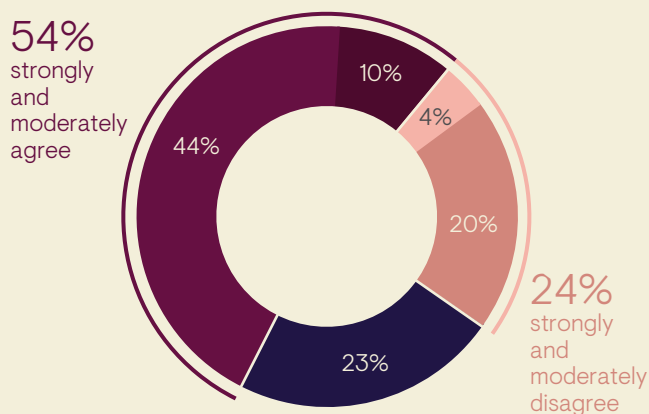
### Asset owners are looking to invest in high emitters with strong plans but appear worried about related returns

Our fund is seeking to invest in high emitters with innovative or ambitious decarbonisation plans



■ Strongly disagree    ■ Moderately disagree  
■ Moderately agree    ■ Strongly agree  
■ Neither agree nor disagree

In future, we expect it to be increasingly difficult to achieve emissions-reduction targets while delivering the best possible returns



Research by Imperial College has found that return expectations for clean and renewable energy investments were on a par with or even better than traditional investment asset classes, including fossil fuels. “In many cases, the returns are more stable, which is a trait that many investors value. So, it’s not just the absolute return, but also the lack of volatility, which can actually be a huge benefit to asset owners,” Imperial College’s Wilkins says.

## The transition finance opportunity

Although transition finance is the climate-related investment practice least cited by survey respondents, there is evidence to suggest that interest is high and the outlook for the investment strategy is strong.

Asset owners are aware of their role in helping companies in hard-to-abate sectors transition to sustainable business models and practices. More than half (51%) agree that financial institutions have a responsibility to help fund the decarbonisation of high emitters.

“When you look at the economic activity that has generated environmental damage, the private sector should clearly be contributing to addressing the risks brought by climate change,” says Xolisa Dhlamini. “Asset owners need to drive that through investments, whether it’s for mitigation, adaptation or transition — whatever the case may be, they have a part to play.”

Two in five respondents (40%) report that their fund currently owns or manages transition finance investments, with around one-third saying they will likely be making transition finance investments within the next 12 months (35%) and the next three years (30%). Only 3% state that they have no interest in transition finance investments. Existing transition finance allocations are mostly applied to actively managed private debt (38%).

Transition finance can be a strong instrument for investors looking to achieve real-world impact, according to the 52% who say the practice’s contribution to lowering emissions is high or very high. On top of this, 60% of consultants say they advise clients to make allocations to transition finance, even where this could increase portfolio carbon intensity.

The outlook for transition finance is especially strong in emerging markets and developing countries, which are expected to account for the bulk of emissions growth in the coming decades<sup>4</sup>. While private financing for emerging economies is currently limited because of risk aversion and disincentives to invest in hard-to-abate sectors (which make up a larger share of those economies), 57% of respondents agree that emerging-market transition finance will grow rapidly over the next three years.

In fact, half of respondents (51%) say that emerging-market transition finance is a major commercial opportunity for asset owners. However, concerns about future returns mirror those in developed markets. More than half (52%) also appear concerned about the risk/return profiles available in the universe of emerging-market transition finance assets.

Hortense Bioy says that there is a need for greater innovation to help developing countries access sustainable finance, such as blended finance: “In a public-private partnership, the government will take on the higher-risk tranches of an investment, and that will allow private investors such as asset owners to come in and thus scale the capital that is needed.”

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4. [www.iea.org](http://www.iea.org).





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## How can asset owners achieve real-world impact and financial returns?

**When asked how their organisation can achieve the greatest positive, real impact on climate while also achieving return objectives, asset owners gave the following responses:**

### Long-term planning and flexibility

Many organisations emphasised the importance of both long-term planning and flexible time horizons to balance climate impact and return objectives. Transition finance investments won't bring only environmental benefits, they will also improve the earnings value of a business, but investors need to consider the longer time horizon required for these investments, says Resilience's Andrew Coburn. "Modern financial rules discount 30-year returns at a much heavier rate than potentially they should. So, some tolerance around the time horizons of the returns is probably an important part of the thinking," he notes.

### Data-driven decision making

'Robust data' was frequently mentioned as critical to supporting decisions that align with climate goals and returns. Morningstar's Bioy underscores the importance of forward-looking metrics. "To complete the narrative and assess the full impact of an investment, asset owners need more forward-looking information from companies and governments. This will give asset owners the confidence they need to finance the transition," she says.

## Collaboration and partnerships

Collaboration with investee companies, experts and teams is seen as essential to achieving climate and financial objectives. Engaging with companies directly to create a credible transition plan with science-based targets, for example, will help asset owners manage risks and returns. PME has successfully engaged with high-emitting companies in its portfolio, Spaargaren says. “We’re seeing a credible change at these electricity and utilities companies, which now have a coal phase-out plan and are investing in renewables to make solar and wind a bigger part of their energy mix,” he says.

## Cost-effective, risk/return approaches

Organisations frequently stress the need for cost-effective solutions and maintaining profitability while pursuing climate initiatives. “We think that there shouldn’t be a trade-off between sustainability and returns, they should go hand in hand,” says Spaargaren. “Our policy owners are going to need that money 20 years from now or whenever they need it,” echoes the US-based sustainability leader. “It’s important to make sure that we understand what the returns and risks look like in managing our portfolio.”

## The need for financial innovation

For asset owners to create a diverse and balanced portfolio, they require new, widely accessible targeted products. “A lot of the pension funds fall below the segregated mandate threshold to structure portfolios tailored for their sustainability objectives and trustees of large asset owners don’t necessarily have an opportunity to sit down and conjure up a product, so they’re quite reliant on what the market offers,” Dhlamini stresses. “We haven’t seen sufficient products that allow institutional and retail asset owners of different sizes to be crowded into financing climate-related initiatives. The fund-management industry needs to innovate in such a way that it addresses all asset owners’ needs.”

# Conclusion

Asset owners have the capital and influence to invest for both impact and return. This research shows there is material recognition among asset owners of certain opportunities and risks presented by transition finance. It also shows there is meaningful divergence of how asset owners view the effectiveness of established net-zero frameworks and their ability to support decarbonisation in the real economy.

A majority of asset owners are asking for greater standardisation and significantly more guidance regarding their approach to investing for an inclusive energy transition. Innovation in financial products, notably in emerging markets, can help direct capital towards investments that promise both opportunities and impact.



## Important information

FT Longitude research paid for by Ninety One.

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