Breckinridge CAPITAL ADVISORS

Breckinridge Marks One Year as Signatory To Net Zero Asset Managers Initiative

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Key Takeaways

- Business and economic risks accompany climate change and a carbon-neutral economic transition.
- Corporate bond investors evaluate the reliability of future cash flows, based on evolving risks and opportunities.
- The Net Zero Asset Managers initiative is facilitating new frameworks to analyze company progress in transitioning away from carbon.

Real business and economic risks are associated with climate change and transitioning to a carbon-neutral economic future. The UN Intergovernmental Panel on Climate Change Sixth Assessment Report, *Impacts, Adaptations and Vulnerabilities*, released in 2022 states the risks clearly.

In September 2022, we reemphasized our views on climate risk and the value of an active approach to net zero investing in "*There Is Nothing Passive Net Zero in Fixed Income*." We wrote, "Breckinridge believes there is a solid investment case for long-term investors to transition portfolio holdings to net zero greenhouse gas (GHG) emissions by 2050, consistent with global ambitions to limit global warming to 1.5 degrees Celsius above pre-industrial levels."

Our conviction about material climate risks is consistent with our decision more than a decade ago to systematically integrate environmental, social and governance (ESG) analysis into our investment process. As with most ESG risks, we believe that climate and transition risks are not adequately assessed or priced into many investments and, that these financially material risks will increase over time.

As a corporate bond investor, Breckinridge is responsible for evaluating the reliability of future cash flows, which requires us to focus on the evolving risks and opportunities associated with a carbon-neutral economy. In our discussions with corporate and municipal bond issuers, we are often impressed by the growing understanding of the need to manage, mitigate, and adapt to climate risk.

In December 2021, we signed the Net Zero Asset Managers Initiative (NZAMi), an international group of asset managers committed to supporting the goal of net zero (GHG) emissions by 2050 or sooner. Today, nearly 300 asset managers with more than $66 trillion in assets under management have joined us as NZAM signatories.

We believe the NZAMi is facilitating the addition of important new frameworks for the analysis of a company's progress in transitioning from carbon. NZAMi signatories are developing investment approaches independently that recognize the financial materiality of climate risk and an associated economic transition, including efforts to benchmark the progress of security issuers toward their own net zero goals.

In the year since signing NZAMi, we developed our own bottom-up corporate issuer and alignment assessment and an engagement program to support our NZAMi commitments. Our NZAMi investment case is defined by the Breckinridge investment team and integrated within a net zero investment framework that is focused on financial materiality.

Corporate Climate Transition Risk Framework

Our Corporate Climate Transition Risk Framework serves as the foundation for our net zero assessments. Our analysts created the framework leveraging the guidance found in the *Implementation Guide* published by the Institutional Investors Group on Climate Change (IIGCC). Employing the process, our security analysts can assess exposure to climate risks, track emissions reductions, evaluate the climate related goals of a company and their strategies to achieve the goals, and the quality of a company's climate governance approach.

NZAMi also asks asset managers to assess strategies and feasibility of emissions reductions initiatives, capital expenditures, research and development alignment, and to conduct an engagement process with issuers to gain further insights onto their net zero progress. Our assessments are summarized in company-level net zero categorizations that indicate progress along net zero pathway (Figure 1).

FIGURE 1: COMPANY LEVEL NET ZERO CATEGORIZATIONS

Source: The categories were defined in the IIGCC Net Zero Investment Framework Implementation Guide.

Companies can achieve net zero through a combination of reducing their GHG emissions and neutralizing any remaining GHG emissions by removing an equivalent amount from the atmosphere through the purchase of carbon credits.

Net Zero Targets

We set three targets:

Portfolio Coverage Target: We commit to attaining a minimum of 90 precent (by market value) of all corporate fixed income assets under management in the achieving, aligned, or aligning categories by 2030. Our analysts will measure progress using our Corporate Transition Risk Framework.

Portfolio Decarbonization Target: We seek to reduce fair share emissions intensity in net zero aligned portfolios, as requested by clients, by 50 percent by 2030 from our 2019 baseline. The target is inclusive of operational emissions (Scope 1 and 2) at the portfolio level, calculated in line with *Partnership for Carbon Accounting Financials* (PCAF) emissions accounting standards. We expect to outline a separate scope 3 target over time as data availability and consistency improves.

Engagement Threshold Target: We believe forward-looking investing demands a strong sense of stewardship, engagement, and collaboration. We will engage with at least 70 percent of financed emissions annually starting in 2023, increasing to 90 percent by 2030.

Net Zero Customization Capabilities

We can customize portfolios to align with our NZAMi commitment, consistent with our broader investment approach. To learn more, please contact a member of our consultant relations team.

Our Operational Emissions

Beyond our investment approach, each business unit within the firm is working to understand the NZAMi commitment and its business implications for their teams. Governance of the commitment is top down, formed by the firm's senior leadership team and supported by the Board of Directors.

While there are no set targets in the NZAMi for operational emissions, it's expected that firms take this into consideration in their overall goals. In 2021, we set a goal for more meaningful and accurate measurement of our own emissions, making incremental moves in that direction. For example, a new managed travel program includes the ability to track emissions more accurately using data directly from airlines, and estimated emissions from hotel stays and rental cars.

The program was officially activated in January 2022, just as business travel was increasing post COVID restrictions. We plan to report on our progress in our 2022 Corporate Social Responsibility report.

The Commitment Is Growing, So Too Is the Urgency

For many years, resistance from investors to examining climate risk was based on the lack of consistent disclosure and proper frameworks. The NZAM helps to overcome this by setting clear targets and facilitating the development of new frameworks for assessing a company's progress in reducing emissions and transitioning from carbon.

While we take a cautious view of issuers' net zero aspirations—and may consider selling corporate bond holdings with materially weak or lagging climate transition performance over time—we are encouraged to see the growing understanding of the net zero movement.

We also are keenly aware of the finite time available to investors to get ahead of the risks posed by GHG emissions and advancing climate change, as well as to identify opportunities to invest in and advance the efforts of companies that are pursuing net zero operations.

The net zero movement provides a well-defined path for issuers, investors, and asset owners to follow and at Breckinridge, we look forward to working diligently and collaboratively with all towards achieving its goals.
