

Introduction



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For those unfamiliar with the origins of net-zero investing, it is essentially a response to global warming. Geological records show that the Earth's climate is always changing and that it changes very slowly. The average global surface temperature had fallen approximately 0.8°C in a fairly steady trend that started about 5,000 years ago and ended about 200 years ago. And then suddenly, the trend reversed. During the last 200 years, the 30-year average global surface temperature has risen by more than 1°C.

Strong scientific evidence shows that the global warming of the last two centuries has resulted from an increase in atmospheric greenhouse gases (GHGs) caused by an increase in the industrialized production of goods and services to meet the demands of a growing global population with rising standards of living.

What are the implications of global warming for investors? Although it is impossible to answer this question with any precision, it is clear that global warming is a risk. Economic infrastructure around the world has been designed and built with the assumption of a stable climate. The more the climate moves away from historical baselines, the less likely economies will function at peak productivity and efficiency. Similar to other major global events, climate change will likely bring economic opportunities for some companies, but in aggregate, the opportunities are unlikely to offset the risks.

Many investors have begun to regularly assess the risks and opportunities of climate change. At a micro level, they are evaluating how climate change might impair a company's physical assets or affect its productivity, profitability, and cash flows. At a macro level, investors are considering how governments' efforts to mitigate and adapt to climate change through regulation, spending, taxes, and incentives might affect consumer demand and industry profitability.

A smaller but significant portion of investors has gone beyond risk assessment, asking how they might help mitigate the root cause of global warming. It was this question that gave birth to net-zero investing.

Net-zero investing is still in its infancy. The Institutional Investors Group on Climate Change published the first guidance on net-zero investing in 2020. Much has changed since then. Experience has yielded important insights, and practices continue to evolve.

Net-zero investing generally involves investing in projects and plans, engaging with investees, and supporting public policies to simultaneously earn a return

on invested capital and help bring about a future global state where the net increase in GHG emissions from human activities is zero.

Risk management, portfolio alignment, and real-world decarbonization are important aspects of net-zero investing. Risk management focuses on the physical risks of climate change and the transition risks that may arise from efforts to mitigate or adapt to climate change. Portfolio alignment focuses on constructing a portfolio of assets that, in aggregate, aligns with a specified decarbonization pathway that leads to net zero. Real-world decarbonization focuses on deploying capital to finance specific projects, technologies, and initiatives and on persuading issuers and policymakers to take steps that are conducive to achieving net zero.

Although all net-zero investors share a common goal to contribute to global net zero, they put different amounts of emphasis on risk management, portfolio alignment, and real-world decarbonization. Furthermore, they pursue their different goals in different ways, on different timelines, and within different regulatory and cultural contexts. For these reasons, a variety of approaches and practices are followed under the moniker “net-zero investing.” Climate benchmarks, climate bonds, value at risk, scenario analysis, system-level investing, stewardship, and blended finance are but a few of the many threads in the evolving conversation about how the financial sector can play a role in the reduction of global net GHG emissions.

Against this backdrop, we are pleased to present this net-zero guide—a compilation of ideas about net-zero investing from thought leaders in academia and industry. As the global association of investment professionals, with nearly 200,000 charterholders across 160 markets, it is our privilege to convene experts and practitioners to help advance both theory and practice.