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TRANSCRIPT

How Much Goes into a Net-Zero Commitment?

Featuring:

***Diana Tidd**, Head of Index and Chief Responsibility Officer*
***Veronique Menou**, Head of Corporate Responsibility*
***Joseph Gagliardi**, Head Of Corporate Services*

Adam Bass (00:03):
This is MSCI Perspectives, your source for insights for global investors, and access to research and expertise from across the investment industry. I'm your host Adam Bass and today is April 22nd, 2021. Today, a bonus episode for earth day. You may have seen in the news recently that MSCI has committed to reaching net zero carbon emissions before the year 2040. Net zero is a hot topic these days and commitments from companies to reach that milestone, well, they've ranged from Netflix's hyperaggressive goal of 2022, that's next year, to the less optimistic goals of 2050 and even beyond for some. There are also many companies that haven't decided when, or even if they can reach net zero. While others, they're at a loss about how to get started. As for MSCI.

Diana Tidd (01:00):
We feel that it's vital that we not only talk the talk, but walk the walk. And so that means when we look at what we put out to market and what we suggest as best approaches to the market, that we ourselves look at those and adopt those as well. So, we want our corporate responsibility strategy to support our position as a solution's provider in this space.

Adam Bass (01:24):
That's Diana Tidd, MSCI's head of index and chief responsibility officer. On today's special release, we're going to speak with Diana and other key decision makers about MSCI path to net zero as sort of a live case study. We'll explain some of the many things to consider when picking a target date, and some of the challenges that may arise along the way. We'll also reveal how indexes themselves can serve as a tool to track global net zero progress.

Diana Tidd (01:56):
Our concern was how do we get people comfortable with this type of commitment, which is not an everyday type of commitment? It's a long-term commitment. It's how often are we

making commitments out from 2021 to 2040. And putting it down to the world and saying, "We commit to this, we will achieve this."

Adam Bass (02:18):

But before we get to all that, let's start with a simple question. What is net zero and why is it important?

Veronique Menou (02:26):

I think this net zero concept, it means that you are capturing through your reduction, or reduction initiative, or through using difference offset mechanism. As a firm or as an investor you are removing as much emissions as you emit from the atmosphere. So, in total your carbon footprint is at zero. In a way, it's quite a simple concept.

Adam Bass (02:56):

That's Veronique Menou, MSCI head of corporate responsibility.

Veronique Menou (03:00):

Few months back, a few governments like the EU have made commitments to be net zero. Then it was followed by a few coalition of investors also developing different frameworks and committing to be net zero. And then a few companies also making some commitment to be net zero, or carbon neutral, or carbon negative. It's a global action now. And with the COP 26 coming up.

Adam Bass (03:36):

COP 26 you may remember is the 26th United Nations Climate Change Conference. The Paris Agreement, that's what came out of COP 21.

Veronique Menou (03:45):

COP 26 coming up, the U.S. getting back into the Paris Agreements. You don't have that many places in the world where you can hide and not be transparent on your carbon emissions. So, I think there is an increasing pressure from governments to really impose greater transparency on companies to disclose their carbon footprint. We've seen recently in several countries, the TCFD Report becoming mandatory for the state listed companies.

Adam Bass (04:26):

In fact, as Vero and team were working on MSCI's commitment, the business reality became abundantly clear when.

Veronique Menou (04:34):

We received a request from one of our clients, asking us to put our commitment to net zero into a contract. I think this pressure is going to only increase in the world we are in.

Adam Bass (04:51):

Why are governments and companies so concerned with adopting net zero policies? Well, according to the latest research, we must as a global community, reach a net zero economy by 2050, if we are to align with the 1.5 degree warming scenario outlined in the Paris Agreement.

Veronique Menou (05:11):

So, this is really the hot stop, 2050. But it says no later than, so should we go with 2040, 2035, 2030? So, that's kind of the first thing we're trying to figure out.

Adam Bass (05:26):

But it's more than a timing issue. Net zero might be simple to understand as a concept, but it's not so simple to enact. For instance, how do you measure your carbon impact?

Veronique Menou (05:40):

As you probably know, as a company, you have different types of emissions. You have your direct emissions, you have indirect emissions. So, the direct emission at scope 1, the indirect emissions coming from the electricity use is scope 2. And you have all of the other indirect emissions. The emissions from your suppliers upstream and the emissions from your product downstream. So, if we want to commit to being net zero, should we just commit to be net zero on our direct emissions, so scope 1? Or should we also include scope 2, or should we also include scope 3? And obviously, especially if you look into scope 3 data, that's where it becomes challenging because there are many unknowns in this space. And in particular in the supply chain, typically.

Diana Tidd (06:31):

The processes reviewing and proposing the commitment really got to thinking about how tangibly will you start to make these changes.

Joe Gagliardi (06:40):

There's going to be costs no matter what. There's going to be a cost if you don't do anything, because then you're going to lose credibility with clients and with shareholders. You're not going to be able to acquire investment, you're not going to be able to acquire clients.

Adam Bass (06:58):

That's.

Joe Gagliardi (06:59):

I'm Joe Gagliardi, I'm the global head of corporate services at MSCI. I'm also a member of the Corporate Responsibility Committee. Many corporates have started with what they really most directly control. What do they do to heat the buildings, to run generators for emergency power, things like that. The first thing you have to do is you have to measure. There're certainly well-established mechanisms to measure some of your greenhouse gas emissions. We know, for example, the actual electric consumption we have in various offices so, that's very easy to measure. The consumption most companies are really good at that now. Our travel agencies are for example, able to provide us very accurate emission estimates based on the actual flights our employees take.

Joe Gagliardi (07:53):

We have revisited and revised the sustainability criteria we consider when we're looking at buildings to locate our offices. It's a checklist that considers the green certification of the building. Is it lead certified, for example? Is the building or the utility provider offer renewable energy? If they do, is it a 100% renewable sourced or is simply a portion of it coming from renewables? What about the building's accessibility to public transportation? Is it easy for employees to bike to, does it provide bike parking and showers, for example? If employees are driving, what kind of parking does it provide? Does it provide charging stations for electric vehicles?

Adam Bass (08:39):

As we said, the devil's in the details and those details, they affect every employee who works at a firm with a commitment to net zero.

Joe Gagliardi (08:49):

There's clearly going to be a lot of ownership that has to be exhibited by every employee. So, if we revise travel policies to really emphasize and require employees to make the most climate responsible decision that will have an impact to them. First and foremost we're going to ask employees in the future, is this travel really necessary? What is the business critical objective that you're trying to achieve by traveling? Then the question is how are you going to travel? Are you going to take two or three individual trips to see two or three different clients? Are you going to try to bundle that all into one trip? And then if you are going to take that trip, if there's a viable train or other high-speed option available, can you take that instead of getting on an airplane? So, we all must change our behaviors to select the most carbon responsible way to travel, to step up with how we engage with our supply chain.

Adam Bass (09:57):

Okay. That's the second time we've heard the supply chain mentioned in his many minutes, why is that?

Joe Gagliardi (10:03):

Ultimately engagement with the supply chain is critical to understand those scope 3.

Adam Bass (10:10):

Ah, yes. Scope 3 emissions, the ghost in the shell. The elusive, hard to measure, but definitely real up and downstream impact of producing goods and services. Say you have an office, and say that office has a kitchen, and say in that kitchen, you have paper plates. Great you might think, I don't have to do the dishes. Or actually better yet say you have ceramic plates. So, yes, you do have to wash them, but they're better for the earth, right? Well, there is a carbon cost associated, even with those plates. One that could vary greatly, depending on who produces them, where the materials are sourced, how far and by what method they're shipped? And you get the idea it's complicated is what I'm saying.

Joe Gagliardi (10:59):

So, we've made a lot of progress in those scope 1 and scope 2. At this point, 90% of our employees are located in buildings that are certified. We've made significant progress in switching to renewable energy. At this point, 70% of our purchase electricity comes from a renewable source. All of our data centers, they run 100% on renewable energy. The most controllable part of this, we've made a lot of progress, suppliers scope 3 that will take some more time and much more engagement with our supply chain for example.

Diana Tidd (11:37):

For us we felt like it was really important to look first in the mirror at ourselves and say, "What are the direct emissions that we can control? And then how do we make changes to those at the same time, we'll definitely be engaging the suppliers."

Joe Gagliardi (11:53):

One example is we have a supplier code of conduct. We've had one for several years now. We're looking at modifying that to be very specific about needing our suppliers to represent, to disclose, to manage, to measure their carbon impact.

Adam Bass (12:15):

So, understanding your scope 1 and scope 2 emissions, I get that. Getting a handle on where you are as a first step, changing what you can, make sense too. But engaging with vendors, group projects always make things much more complicated. And it's not just your vendor, your vendor has vendors, and they have vendors, and they have vendors, and so on and so on. The rabbit hole here gets very deep. And that brings us to these things called carbon offsets. Credits that companies can buy to offset the carbon they produce. You might ask, "Oh, that's great. If I know what my carbon impact is, why go through all this trouble and potentially disrupt business when I can just buy an indulgence, basically."

Veronique Menou (13:04):

You have now a variety of pledges from 2025 to 2050. And if you look at those like you have like certain companies at 2025. But to be honest, I think most of those companies what they're going to do is just buy offsets. This is definitely something we should not do. And this is one of the key risks here. And actually there's been lots of bad press these days on this because, the simplest way would be, fine I have my carbon emissions, I don't need to do anything. I would just buy offsets and I'm done. And this doesn't make any sense from a climate standpoint. But I think obviously from a reputational standpoint, it would definitely be the really bad. It's important to do also when you consider this commitment is to develop a comprehensive strategy to reduce your carbon footprint.

Veronique Menou (14:06):

And the first step in this strategy is to look at how internally through your own action, you can reduce as much emissions or as many men as possible. So, that's really the first objective. Then in a second step there will be unavoidable emissions. I think we all know that there will be some inevitable emissions again, because for our employee commute, for electricity use, even business travel. I think it's very difficult to think about a world in 10 years time where people all work virtually and don't meet each other in-person.

Joe Gagliardi (14:50):

There's a of things that are kind of outside of our control, but as those become more widely available we'll have the ability to reduce those emissions. But until then, there are going to be unavoidable emissions. So, offsets can help you bridge that gap. As far as true carbon offsets, those typically refer to projects that for example, maybe introduce carbon sequestering. So, a classic example is planning trees. We want to support those, I think, and those are appropriate sometimes to offset what is unavoidable, but the risk is that over time demand for those offsets is going to rise because every one is out there saying they need to either get to net zero or get to a place where they're in some cases removing more carbon than they even put out.

Joe Gagliardi (15:54):

So, the price for these offsets over time as the demand rises, the price we think is also going to rise. There are estimates out there from the World Bank and other sources that what cost you 10 or $20 today could cost you a 100, 200, $300 at some point in the future, per metric ton to remove kind of the impact of a metric ton of CO2. So, the cost to remove our carbon impact over time could be much more than the effort it would take and the cost it would take to simply eliminate it at the source.

Adam Bass (16:27):

So, while some use of offsets might be unavoidable and even necessary, at least in the near term, the key to a global net zero economy is global action. Or as Diana put it.

Diana Tidd (16:40):

We all have a role to play in achieving net zero and avoiding a climate disaster. Our stakeholders care about our commitment to lowering our carbon footprint and also committing to net zero. And as various groups start to engage other groups to drive their action as well. It creates this virtuous circle of commitments to net zero, and then we all help ourselves achieve it. And it's also an essential that the investment community has a gauge of the progress. And so for MSCI, one important aspect, we thought how we can help is not only putting out for example, ESG ratings, and warming potential, and other metrics that are available to the investment community.

Diana Tidd (17:26):

But also to look at ACWI and ACWI IMI and saying, "Okay, at the current rate, what's the warming potential of ACWI and how long would it take us to achieve the goals we're all seeking?" So 1.5 degrees. And if we all engage with those companies or act as corporates ourselves, then ACWI can actually move to be net zero sooner by the action we'll universally take. And so we're now committed to reporting on the progress of ACWI in terms of warming potential and essentially net zero. So, that the investment community has a gauge of how we're all progressing on our path.

Adam Bass (18:08):

And that's what's meant by the phrase greening of ACWI.

Diana Tidd (18:11):

That's what's meant by greening of ACWI, exactly. As we all engage in the company underneath to take it onto themselves, and take on the feedback from their stakeholders to commit to net zero themselves and lower their carbon footprints ACWI itself essentially becomes green, one company at a time.

Adam Bass (18:30):

Right now, looking at that exact measure, the world is not on track to achieve its 1.5 degree goal, not even close. Instead we're on track to hit a staggering 3.5 degrees celsius of warming by the end of the century, is there any hope, can we make it? And as Diana said, avert a climate disaster?

Veronique Menou (18:54):

The other day, I was actually listening to a panel on a net zero and there was a poll. The question was, what is the proportion of companies that have committed to net zero that are actually going to meet their target? And like the majority of respondents. And so it's like between 25 and 50% will meet that target. So, I think the majority of people think that yes, companies have commitment, but most of them won't meet their commitment. So, we decided to go for 2040 to make sure we commit, we're going to be committed to report on progress regularly over time. So, I think that's definitely key. The transparency aspect is very key. We are on the same boat together. There some uncertainty, there some challenges and we should do that altogether. So, we going to share lessons learned with you, we want to be transparent with you on the progresses that we make. We really want to communicate and share so that we can all collaborate and achieve that goal all together.

Adam Bass (20:07):

Last year as the world and even this podcast focused almost exclusively on the pandemic. Many of those we spoke to noted there were lessons that we could take with us as we tackled climate change. That was the crisis standing off to the side, waving its arms and shouting, "Hey, I'm still here." These lessons include cooperation, sustained focus and perseverance in the face of setbacks. Let's hope we learn them and that they stick. We'll continue to follow the story on Perspectives as it evolves. 1.5 degrees of warming might be our global end goal when it comes to climate change.

Adam Bass (20:47):

But as we've heard over the course of this episode, net zero and net zero commitments, especially, those are only the starting points. That's all for this week. Our thanks to Diana, Vero and Joe, and to all of you for listening. Next week with lockdown lifting, economies restarting and stimulus flowing, questions about inflation continue to come up as well. We'll look at the impact on equities and fixed income. Until then, I'm your host, Adam Bass. And this is MSCI Perspectives. Stay safe, everyone.

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