MSCI ESG Research LLC

Breaking Down Net-Zero Climate Targets

A Guide for Issuers

ESG Issuer Relations

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Contents

The Role of Corporates in Achieving Net Zero

Net-zero commitments by constituents of the MSCI ACWI Index[1] made up 15% of all decarbonization targets set in 2020, up from 8% in 2019.[2] So what does a net-zero target really entail?

Achieving net zero means balancing greenhouse gas (GHG) emissions released into the atmosphere from Scope 1, 2 and 3 sources with the amount removed.[3] For many companies, this will require minimizing emissions throughout their value chains and compensating for any unavoidable emissions with carbon removal or offsets. Based on current projections, the world needs to achieve a "net-zero" state no later than 2050 if we hope to stay within a 1.5°C-degree warming scenario[4] as set out in the Paris Agreement. With 80% of listed companies[5] on track to exceed a 2°C scenario according to an MSCI analysis,[6] it is clear that much work still needs to be done.

This guide breaks down the components behind net-zero target-setting for companies. Given the heterogeneity of target parameters, they can prove difficult to compare, even among issuers in the same industry. To address this difficulty, the MSCI Target Scorecard offers a consistent framework across three dimensions – comprehensiveness, ambition and feasibility – and defines an emissions reduction trajectory that would see a company achieve net zero.[7]

Dimension #1: Comprehensiveness

Does the Target Cover the Majority of a Company's Emissions?

A company's net-zero target should cover all, or at least most, of its total emissions across all scopes. If this is not possible, a company should focus on emissions hotspots within its carbon footprint to make the most meaningful reductions. The reference value against which emissions reductions will be tracked over time is known as base year emissions. Comprehensive calculation of a company's Scope 1, 2 and 3 base year emissions indicates wider coverage of its carbon footprint and enables more thorough target-setting.

[1] The MSCI ACWI Index is a global equity index consisting of securities from developed and emerging-market countries.

[2] As of January 2021. Watanabe, K. and Panagiotopoulos, A. "Breaking Down Corporate Net-Zero Climate Targets." May 2021.

[3] IPCC. "SPECIAL REPORT: GLOBAL WARMING OF 1.5 ºC." 2018.

[4] Compared to pre-industrial temperatures.

[5] Constituents of the MSCI ACWI Investable Markets Index, as of November 30, 2020.

[6] MSCI.com. "Climate Reality Bites: Actually, We will Not Always Have Paris." December 2020.

[7] Target scorecards will be released in phases for companies that are constituents of MSCI indexes.

Key Challenges for Target Comprehensiveness

In some sectors, a misalignment exists between the emissions hotspots within company value chains and the scopes covered by net-zero targets. For example – of MSCI ACWI constituents as of May 2021 – 87% of the energy sector's GHG emissions originate in Scope 3, but only 18% of the sector's targets address these Scope 3 emissions. The difference is even starker in the financials sector, where 99% of emissions are associated with Scope 3 but only 16% of targets cover this scope.[8] This misalignment may be driven in part by the challenges that companies face in calculating Scope 3 emissions, which requires more granular data and complex assumptions than are required for determining Scope 1 and 2 emissions.

Dimension #2: Ambition

How Much and How Quickly Does a Target Aim to Reduce Emissions?

The timeline for emissions reduction requires a balance between ambition and feasibility. Setting a net-zero target must take shifting dynamics into account. For example, it may be unfeasible for a company to drastically cut emissions in the short- to medium-term due to the lack of low- or zero-carbon alternatives in their business operations or value chain. Therefore, a company may set interim targets, where annual reductions are initially of a lower percentage than the absolute reduction needed to achieve net zero. To compensate for this slower start, ambition (i.e., annual emissions reductions) would need to ratchet up over time.

Key Challenges for Target Ambition

Although a net-zero pledge is a step in the right direction, companies should look to establish stepping stones along the way to kickstart strategy development and ensure they have a plan in place to meet their commitment. Interim targets can serve as a rallying point for a company's internal stakeholders and create early impetus for the operational changes needed to meet medium- and long-term targets. They also provide tangible benchmarks of a company's progress to investors and other stakeholders.

[8] Sectors defined according to the General Industry Classification (GICS®, the global industry classification standard jointly developed by MSCI and Standard & Poor's). Data determined from constituents of the MSCI ACWI Index as of January 5, 2021. Scope 3 emissions were estimated using the MSCI Scope 3 Carbon Emissions Estimation Methodology, which is aligned with the GHG protocol. For more detailed information on the estimation methodology, please see: Hadjikyriakou, P., Bokern, D. and Klug, A. 2020. "Scope 3 Carbon Emissions Estimation Methodology." MSCI ESG Research LLC.

Dimension #3: Feasibility

How Feasible is a Given Target?

Companies will need to devote resources to plan and implement a decarbonization strategy, in many cases going beyond existing emissions reduction initiatives. Still, a company's operating environment will present various constraints or opportunities to decarbonization efforts. Balancing these factors with emissions reduction ambitions and timelines will ultimately determine how feasible a company's targets are and the likelihood of meeting these targets, whether within direct operations (Scope 1 and 2) or throughout the value chain (Scope 3).

Key Challenges for Target Feasibility

In the transition to a net-zero economy, companies will have to evaluate the contribution of their products and services to a warming planet and potentially shift their business models. Where emissions reductions are still unfeasible despite such a shift, companies may have to incorporate carbon removal or offsets into planning. The reliance on unguaranteed biological approaches, e.g., offsets that may be impermanent, or technologies with uncertain commercial viability may leave a question mark on a company's decarbonization strategy.

Call to Action: Set and Publicize Net-Zero Targets

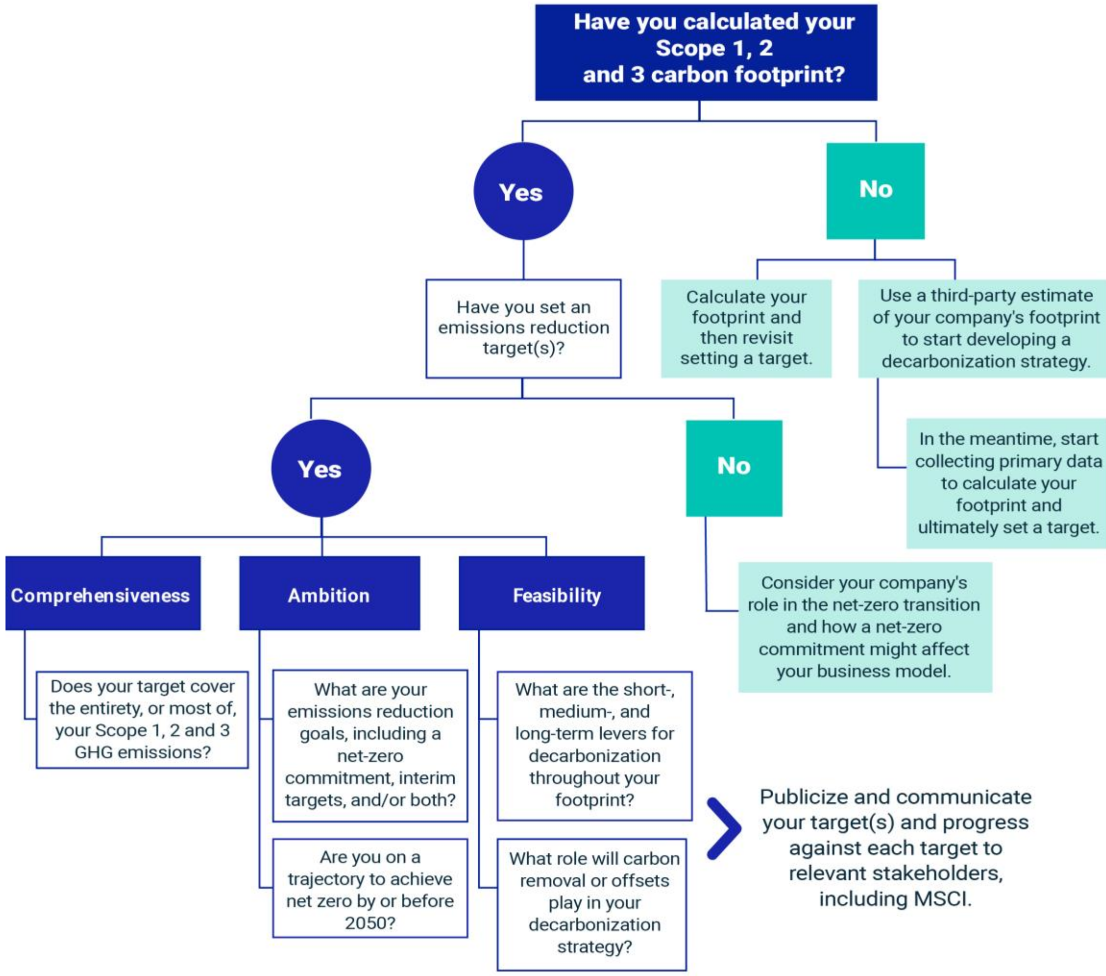
MSCI's Target Scorecard simplifies comparability of target comprehensiveness, ambition and feasibility for all stakeholders. The ability to make meaningful comparisons between companies' targets is essential for issuers who wish to compare their target(s) against their peers' or investors assessing the trajectory of their portfolio footprint.

We call on companies to play an active role in this initiative. Scorecards will be developed based on public information already collected regularly by our analysts, and companies will also have the chance to submit emissions and target-setting data directly on our Issuer Communications Portal. We encourage companies who have not yet set net-zero or interim targets to use this guide as a starting point to consider their role in the net-zero transition.

The complete framework on breaking down net-zero climate targets can be found here.[9]

[9] Watanabe, K. and Panagiotopoulos, A. "Breaking Down Corporate Net-Zero Climate Targets." May 2021.

Steps to Setting a Net-Zero Target



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