

## Climatepalooza Pt. 2

*Featuring:*

**Niel Fletcher**, ESG Researcher, MSCI

**Andrew Young**, ESG Researcher, MSCI

Mike Disabato:

What's up everyone? And welcome to the weekly edition of ESG Now, where we cover how the environment, our society, and corporate governance affects and are affected by our economy. I'm your host, Mike Disabato, and this is part two of our Climatepalooza episode. Last week, we took you through three carbon reduction plans made by some of the most pollutive sectors in our economies. And this week we are going to examine two sectors that aren't that directly pollutive, but control enough of the economy to be considered on the same plane as the oil and gas majors, for example, when it comes to indirect emissions. So thanks as always for joining us, stay tuned.

Mike Disabato:

We are all more or less interconnected by certain industries, whether we'd like it or not. The movements that their constituents make shape our world and their ambition in cutting carbon sets our current epoch either for failure or hopefully success. Which means we must understand what they plan to do in this regard and why.

Mike Disabato:

Last week we spoke about the carbon reduction plans of companies in three of these sectors: energy, utilities and materials. Their plans focused on changing, relatively visible polluted practices, fossil fuel, procurement and distribution, burnt coal and oil to generate electricity and the carbon emissions from the making of essential materials like cement.

Mike Disabato:

This week, we focus on two industries that carry much of the way our society is changing and how it gets the funds to change banking and technology. And I think it's best to start with banking today, an ancient industry that holds the strings for how and what prospers.

Mike Disabato:

My colleague, Nigel Fletcher alongside another of my colleagues [inaudible 00:01:43] recently authored a report on one of the most difficult to assess facets in the banking industry: the environmental risks in bank's loan books. A bank's loan book is basically the main artery of its emissions. So to continue with our Climatepalooza episode, where we provide you with a roadmap of how to think about carbon reduction plans, I called up Nigel and asked him to first take me through the carbon emissions of the banking industry as a setup to discuss the environmental complexity of a bank's loan book.

Nigel Fletcher:

Similar to other sectors, banks will have their Scope One and Scope Two emissions from their operations. But then in terms of kind of the indirect emissions, if you're looking at the Scope Three emissions, they will have the most important category for them is category 15, which is the so-called finance emissions. And this will make up the large majority of the bank's total emissions. So they're sort of important to understand. And I think at this stage, I guess we know that it's kind of difficult for banks to be able to calculate those finance emissions. So to date, most banks, they still do not report finance emissions. So several have committed to do so and some have taken initial steps to disclose finance emissions. But to date, the number of banks disclosing finance emissions is kind of small.

Mike Disabato:

So this brings us right back to a common theme that we had last week, the lack of disclosure for many companies on the important types of Scope Three emissions. I looked at the major banks out there and the only ones that report their Scope Three emissions, any Scope Three emissions, not just category 15, are BMO and the infamous Deutsche Bank. That's it. That bank you're thinking of in your mind, nothing, they're reporting nothing on Scope Three and no bank that I know of provide the entirety of their loan in equity portfolio Scope Three emissions. Those category 15 emissions that Nigel just talked about, and that represents about 70% of their total emissions. Now it should be said that there is no guidance on the best way to do that.

Mike Disabato:

So to report on your category 15 and Scope Three emissions as a bank is a significant task, but there are banks coming out with Net Zero 2050 targets that include a target for reducing category 15 emissions. So let's get into hypothetical mode right now. What would the banks have to do in order to make those targets more than just big talking?

Nigel Fletcher:

I guess the starting point would be say like what we see. So in terms of what we see, we see banks maybe setting targets for specific portfolios. Like they may be saying, we want to reduce the absolute financed emissions from, I don't know, our shipping portfolio or our transport portfolio by X percent by this year.

Nigel Fletcher:

Or they maybe doing targets that are sort of intensity based targets. So they'll say, I don't know, whatever the economic output is for that sector that they're lending to, they'll say that they want to sort of reduce that by, I don't know, 20 or 30% or something like that. And that would be kind of the target that they had for then that part of the portfolio. But I guess in terms of sort of the end game, the end game, I guess, would be that the banks would be reporting the finance emissions for their whole portfolio, including their equity investments and having a target to reduce that.

Mike Disabato:

Okay, so what part of their portfolio would banks likely reduce if they started to look at their Scope Three emissions? Well, Nigel and his coauthor Yaku looked at what the makeup of the bank loans are by region and sector at the moment. And they saw that for all the regions out there, an average of about 25% of bank loans, a quarter of bank loans, are to industries that have a high exposure to issues related to climate change, natural capital, pollution and waste. And these are, as you would expect, the

energy utilities and material companies, the ones we talked about last week. The remaining 75% are less risky industries. 10% of that gets the medium category, but the rest are in the greener side of risk. So does this mean that if banks wanted to aggressively lower their emissions from category 15, that they would just have to cut their loans to these highly pollutive industries.

Nigel Fletcher:

I guess that they kind of have to work with their customers to understand how their customers are sort of their customers pathway in terms of transitioning to a low carbon economy and that's kind of what the banks need to understand in order to kind of manage their own risk. So it's not a case of saying or stop lending. I mean, there's obviously in terms of banks have put out statements in terms of, I don't know, let's say like the Arctic Sands where they've stopped lending or they've reduced going to reduce exposure to like coal, powered plants and things like that. So, there is instances like that but I don't think generally, but then it's also a case of working, I guess, with the corporates to understand what their pathway in terms of the transition is to the lower carbon economy.

Mike Disabato:

So it sounds like Nigel kind of loses steam there, but it's a useful point. Banks have a lot of power when it comes to dictating the term of the loans that they provide businesses and people. It's prevailing thought one that is currently being pushed by stakeholders and regulators, I promise you this, is that there are industries that are going to be more at risk due to a low carbon transition than banks might find themselves requiring a more granular data set on what sort of carbon and risks certain loans might entail. Or they may take a more business friendly tech and offer more financing to projects that are considered "green".

Nigel Fletcher:

And that may be through what they're doing in terms of underwriting green bonds, what they're doing in terms of sustainable finance product development and if what they're doing in terms of offering consulting or advisory services, to be able to take advantage of these opportunities as the space matures and from our analysis of the snapshot that we did sort of banks in Europe, Singapore, and Canada, they appeared to be the most active currently in capturing green finance opportunities while banks in like Saudi Arabia, Bahrain, Kuwait, Russia, Poland, they currently lag the sample of banks that we looked at in their involvement in green finance.

Nigel Fletcher:

But I wonder, I guess there's also another important point to mention there is that there can be significant differences amongst banks within the country. So if you take the U.S. for example, we have a large, I don't, let's say drained in terms of scoring for sort of environmental finance opportunities. And the reason for that is that the lowest scoring banks, they tend to be the regional banks in the U.S. and they're not yet active in terms of positioning themselves for those sustainable finance opportunities. And I think just more globally, one of the takeaways was also that many banks have not yet sort of entered that space.

Mike Disabato:

So there's some opportunity there, okay. To bring everything back to how you should look at a bank's carbon reduction plan, there seems to be two prevailing themes here. The first is one that's already tried and true and one we talked a lot about last week, and it's not only a commitment to cut Scope

Three emissions, but for banks, a disclosure of what their Scope Three emissions are, especially for category 15. Another interesting facet of these plans though, is the financing of the green economy through bank loans. If the banking industry decides to do that while moving away from financing, the more pollutive industries they currently provide loans to. Those industries we talked about last week, the utilities, the materials, the energy sector and companies, then maybe those industries will see a massive secondhand shift in how they can operate. And that might change how our economy can operate.

Mike Disabato:

Let's keep with that thought because the next and last industry on this Climatepalooza is the tech industry. It's similar to banks in that the tech industry, isn't a large direct emitter. Technology companies offer services or software products that sit on hardware and their Scope One and Two operational emissions. Aren't all that high. They've got buildings, they've got data centers, they've got packaging issues for companies like Amazon, but that's it when it comes to operational emissions. But like banks, technology companies have large Scope Three emissions due to the influence and exposure that they have to pollutive industries. And so we think you should know how to assess their carbon reduction plans. And to help me with this, I called my colleague, Andrew Young, who covers the tech industry for us. And he wanted to focus on two companies, well, really one massive tech company, and then a contrasting point with another massive tech company. And his star of the show, as it almost has to be with tech, was Google. And he first took me through Google's carbon reduction plan as a proxy for the industry as a whole.

Andrew Young:

Yeah, maybe representative of the sector, even broader sections of the economy because the target, the Google's climate target is ambitious. We'll say that it's ambitious, but it's also limited in Scope. So it's, it's both of these things at the same time, Google's pledge only includes Scope One and Two. So it's direct emissions coming from its operations, it's data centers, its offices. And so that means it leaves out according to its own calculations, 93% of its footprint.

Mike Disabato:

Okay, 93%. That's a lot of percent, but still the word ambitious was used in there, I think. So before we get to the contrasting company, I wondered what that ambitious part of Google plan was. And Andrew was nice enough to oblige.

Andrew Young:

They want to run on renewable energy all of the time. So up until now they've been a responsible company in that they've offset their emissions, their operational emissions through purchasing offsets. Now they want to run on renewable energy all of the time, which means also where they have locations, data centers, or offices that do not have access to renewable energy, they will have to install that capacity and run that capacity.

Mike Disabato:

That's an important point when considering climate plans, because if Google is to do that, it would mean that would be setting up renewable energy systems and communities that might not otherwise have the funds to do so. And maybe hypothetically that access energy could be sold off to a local utility to make the entire system greener in that area. You know, companies, helping companies still

the lack of Scope Three emissions being included in the plan should be noted. And what would a Scope Three included plan look like for Google? Well, I'm glad you asked.

Andrew Young:

It would need to address the emission in its supply chain. So this is things what we call capital goods. So this is, you know, all the equipment that goes into their data centers, all the equipment that are used in its offices and the footprint derived from that equipment. So that means Google would have to work with those suppliers as well to mitigate that footprint. So, Google buys thousands, millions of semiconductor, of chips to put in computers and in its starter centers. It will have to work with those chip manufacturers to reduce their footprint. And so therefore encouraging a broader sector of the economy to reduce their emissions in line with the company's own ambitious operational emissions.

Mike Disabato:

Now, the reason Google is getting a bit of a side eye in this episode is because there are a number of tech companies that have included Scope Three emissions in their carbon reduction plans: Salesforce, Microsoft VMware, Accenture the big consulting firm have all committed to Net Zero emissions across all Scopes, but you might be thinking well, Google is bigger than all those companies. Maybe it's just too complex. Well, its main competitor Amazon also included Scope Three in its emissions reduction plan.

Andrew Young:

So Amazon is a technology company, but also a company with a large physical for print in terms of it's the logistics of its eCommerce business. This company has committed to Net Zero by 2040 and set intermediary targets on the way there. So for the operations like to use renewable energies by 2025 across all of the operations, also to have a 100,000 electric vehicles on the roads by 2030, also to reduce the emissions coming from their shipments. So reduce their emissions from their planes, reduce their emissions from the ships, going around the world, etcetera. And then also upgrading their buildings, upgrading their data centers to use the most energy efficient technologies and that means working with supplies as well.

Mike Disabato:

So, okay. Why is Scope Three inclusion so important here? Well, as we've spoken about on this episode, on last week's episode, to focus on Scope Three is also to focus on the economy as a whole. It's a focus on how a company wields their power, both over their suppliers and oddly especially for technology companies, their customers. So if a company says we're going to cut our missions across all Scopes, it means they will have to work with both their suppliers and their customers to lower their collective carbon footprint. Kind of like how I said, hypothetically, Google might be introducing renewable energy systems with the Scope One and Scope Two plans. There's these offset effects that might be setting up recycling programs for their hardware as Apple has done or trying to introduce more electric vehicles in their delivery fleets as Amazon is trying to do. And Andrew noted, it also means those massive hardware companies that make semiconductors and casings for cellphones and computers will also have to green their systems. Now what the point of these two episodes, these Climatepalooza as we put on?

Mike Disabato:

Well, more carbon reduction plans are going to be coming out and different factors are going and to be affecting those plans. And we hope with these two episodes, you've got a bit of an understanding of how to think through those desires by companies to lower their collective carbon footprint. Because as the world moves to shift away from pollutive industries, you will have to assess whether or not the plans we are putting forward are actually useful or just smoke screens.

Mike Disabato:

And that's it for the week. I wanted to thank Nigel and Andrew for joining me to discuss the news with a ESG twist. I wanted to thank you so much, especially if you listen to part one and part two of this Climatepalooza episode, I hope it was at least enjoyable to listen to if not useful.

Mike Disabato:

Don't forget to rate and review us as always. That helps us get a little bit higher in the podcast lists and subscribe wherever you get your podcast. Of course, that's also helpful. Thanks again and talk to you next week.

The MSCI ESG Research podcast is provided by MSCI Incs Subsidiary, MSCI ESG Research LLC, a registered investment advisor under the Investment Advisers Act of 1940. And this recording and data mentioned here in is not been submitted to and, or received approval from the United States Securities and Exchange Commission or any other regulatory body. The analysis discussion should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. The information contained in this recording is not for reproduction in whole or in part without prior written permission from MSCI ESG Research. None of the discussion or analysis put forth in this recording constitutes an offer to buy or sell or a promotional recommendation of any security, financial instrument or product or trading strategy. Further, none of the information is intended to constitute investment advice or recommendation to make, or refrain from making, any kind of an investment decision and may not be relied on as such. The information provided here is as is and the user of the information assumes the entire risk of any use it may make or permit to be made of the information. Thank you.

## About MSCI

MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 50 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process. To learn more, please visit [www.msci.com](http://www.msci.com).

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the "Information") is the property of MSCI Inc. or its subsidiaries (collectively, "MSCI"), or MSCI's licensors, direct or indirect suppliers or any third party involved in making or compiling any Information (collectively, with MSCI, the "Information Providers") and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or disseminated in whole or in part without prior written permission from MSCI.

The Information may not be used to create derivative works or to verify or correct other data or information. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software, or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other MSCI data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not by applicable law be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or willful default of itself, its servants, agents or sub-contractors.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

It is not possible to invest directly in an index. Exposure to an asset class or trading strategy or other category represented by an index is only available through third party investable instruments (if any) based on that index. MSCI does not issue, sponsor, endorse, market, offer, review or otherwise express any opinion regarding any fund, ETF, derivative or other security, investment, financial product or trading strategy that is based on, linked to or seeks to provide an investment return related to the performance of any MSCI index (collectively, "Index Linked Investments"). MSCI makes no assurance that any Index Linked Investments will accurately track index performance or provide positive investment returns. MSCI Inc. is not an investment adviser or fiduciary and MSCI makes no representation regarding the advisability of investing in any Index Linked Investments.

Index returns do not represent the results of actual trading of investible assets/securities. MSCI maintains and calculates indexes, but does not manage actual assets. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the index or Index Linked Investments. The imposition of these fees and charges would cause the performance of an Index Linked Investment to be different than the MSCI index performance.

The Information may contain back tested data. Back-tested performance is not actual performance, but is hypothetical. There are frequently material differences between back tested performance results and actual results subsequently achieved by any investment strategy.

Constituents of MSCI equity indexes are listed companies, which are included in or excluded from the indexes according to the application of the relevant index methodologies. Accordingly, constituents in MSCI equity indexes may include MSCI Inc., clients of MSCI or suppliers to MSCI. Inclusion of a security within an MSCI index is not a recommendation by MSCI to buy, sell, or hold such security, nor is it considered to be investment advice.

Data and information produced by various affiliates of MSCI Inc., including MSCI ESG Research LLC and Barra LLC, may be used in calculating certain MSCI indexes. More information can be found in the relevant index methodologies on [www.msci.com](http://www.msci.com).

MSCI receives compensation in connection with licensing its indexes to third parties. MSCI Inc.'s revenue includes fees based on assets in Index Linked Investments. Information can be found in MSCI Inc.'s company filings on the Investor Relations section of [www.msci.com](http://www.msci.com).

MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Except with respect to any applicable products or services from MSCI ESG Research, neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI's products or services are not intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Issuers mentioned or included in any MSCI ESG Research materials may include MSCI Inc., clients of MSCI or suppliers to MSCI, and may also purchase research or other products or services from MSCI ESG Research. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body.

Any use of or access to products, services or information of MSCI requires a license from MSCI. MSCI, Barra, RiskMetrics, IPD and other MSCI brands and product names are the trademarks, service marks, or registered trademarks of MSCI or its subsidiaries in the United States and other jurisdictions. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and Standard & Poor's. "Global Industry Classification Standard (GICS)" is a service mark of MSCI and Standard & Poor's.

MIFID2/MIFIR notice: MSCI ESG Research LLC does not distribute or act as an intermediary for financial instruments or structured deposits, nor does it deal on its own account, provide execution services for others or manage client accounts. No MSCI ESG Research product or service supports, promotes or is intended to support or promote any such activity. MSCI ESG Research is an independent provider of ESG data, reports and ratings based on published methodologies and available to clients on a subscription basis. We do not provide custom or one-off ratings or recommendations of securities or other financial instruments upon request.

Privacy notice: For information about how MSCI ESG Research LLC collects and uses personal data concerning officers and directors, please refer to our Privacy Notice at <https://www.msci.com/privacy-pledge>.