INTRODUCING THE TRANSITION PATHWAY INITIATIVE
SUPPORTING THE TRANSITION TO A LOW-CARBON ECONOMY
Under the 2015 Paris Agreement\(^1\), countries have committed to limiting increases in global average temperature to less than 2°C above pre-industrial levels, and to pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels. In November 2016, the Paris Agreement entered into force and, to date, over 160 countries have now made pledges – Nationally Determined Contributions (NDCs) – explaining how they intend to contribute to the Paris Agreement targets.

Policy action on climate change at a national and international level is a source of investment risk and opportunity. The transition to a low-carbon economy may affect company cash flows and profits. It may result in ‘stranded assets’, where the value of certain assets is significantly reduced because they are rendered obsolete or non-performing from a financial perspective.

Energy intensive sectors, the fossil fuel-based industries and high greenhouse gas emitting sectors are particularly exposed to this risk.

Delivering emissions reductions of the magnitude envisaged by the Paris Agreement will require considerable capital investment, by the public and the private sector. Many institutional investors already have long track records of addressing the impacts that climate change may have on their portfolios. They have adopted climate change policies to guide their investment decision-making, they have invested in low carbon strategies, they have made important contributions to strengthening corporate practice and reporting on climate change, and they have encouraged governments to adopt policy measures that accelerate the transition to a low-carbon economy.

\(^1\) [http://unfccc.int/paris_agreement/items/9485.php](http://unfccc.int/paris_agreement/items/9485.php)
Despite these efforts, to date it has not been clear to investors what the transition to a low-carbon economy looks like for individual companies as well as for sectors. This means that investors face important practical questions such as:

- How can investors know if company strategies sufficiently address the very real climate risks that are embedded in business models?

- How can investors know whether companies are positioning themselves appropriately for a low carbon economy and to meet the goals of the Paris Agreement?

- How can investors demonstrate – to beneficiaries, to clients, to stakeholders – that their interventions are making a meaningful contribution to the goals of the Paris Agreement?

- How can investors demonstrate – to beneficiaries, to clients, to stakeholders – that they are effectively managing the risks and the opportunities presented by the transition to a low-carbon economy?
“As a long-term investor USS wants to be able to assess how companies are managing climate change and the risk it poses to their business. The TPI provides a tool for us to do this and as a result will allow us to make better informed investment decisions improving financial returns for our members and beneficiaries.”

Elizabeth Fernando, Head of Equities at USS
The TPI aims to evaluate what the transition to a low carbon economy looks like for companies in high-impact sectors starting with oil and gas, mining, electricity generation, cement, iron and steel and autos. This enables asset owners and other stakeholders to make informed judgements about how companies with the biggest impact on climate change are adapting their business models to prepare for the transition to a low carbon economy.

TPI involves asset owners working together with the Grantham Research Institute on Climate Change and the Environment at the London School of Economics and Political Science (LSE), supported by data from FTSE Russell, to:

- Evaluate the quality of companies’ management of the greenhouse gas emissions associated with their business (‘Management Quality’).
- Evaluate how companies’ planned or expected future carbon performance compares to international targets and national pledges made as part of the Paris Agreement2 (‘Carbon Performance’).
- Report this information publicly through a free online tool hosted by the Grantham Research Institute on Climate Change and the Environment at the London School of Economics and Political Science (LSE).3

TPI encourages investors to use the indicators and the online tool, as they see fit, to inform their investment research, decision-making, company engagement and in time their proxy voting.

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2 http://unfccc.int/paris_agreement/items/9485.php
3 http://www.transitionpathwayinitiative.org
The Transition Pathway Initiative is an asset owner-led initiative. As of Summer 2017, thirteen asset owners and five asset managers with over £2 trillion under management had come together.

TPI is partnering with the Grantham Research Institute on Climate Change and the Environment at the London School of Economics and Political Science (LSE) and FTSE Russell.

TPI is also supported by:
In relation to the evaluation of Management Quality, companies are annually assessed as follows against 14 indicators:

**FIGURE 1: MANAGEMENT QUALITY ASSESSMENT**

- **LEVEL 0**
  - Company does not recognise climate change as a significant issue for the business

- **LEVEL 1**
  - Company explicitly recognises climate change as a significant issue for the business
  - Company has a policy (or equivalent) commitment to action on climate change

- **LEVEL 2**
  - Company has set energy efficiency or relative or absolute GHG emission reduction targets
  - Company has published info on its Scope 1 & 2 GHG emissions

- **LEVEL 3**
  - Company has nominated a board member or board committee with explicit responsibility for oversight of the climate change policy
  - Company has set quantitative targets for reducing Scope 1 & 2 GHG emissions (relative or absolute)
  - Company reports on its Scope 3 GHG emissions
  - Company has had its Scope 1 & 2 GHG emissions data verified

- **LEVEL 4**
  - Company has reduced its Scope 1 & 2 GHG emissions over the past 3 years
  - Company provides information on the business costs associated with climate change
  - Company has set long-term quantitative targets (>5 years) for reducing its GHG emissions
  - Company has incorporated ESG issues into executive remuneration

- **LEVEL 5**
  - Company has set long-term quantitative targets (>5 years) for reducing its Scope 1 & 2 GHG emissions
  - Company has incorporated ESG issues into executive remuneration

- **LEVEL 6**
  - Company has reduced its Scope 1 & 2 GHG emissions over the past 3 years
  - Company provides information on the business costs associated with climate change
  - Company has set long-term quantitative targets (>5 years) for reducing its GHG emissions
  - Company has incorporated ESG issues into executive remuneration

- **LEVEL 7**
  - Company has reduced its Scope 1 & 2 GHG emissions over the past 3 years
  - Company provides information on the business costs associated with climate change
  - Company has set long-term quantitative targets (>5 years) for reducing its GHG emissions
  - Company has incorporated ESG issues into executive remuneration

- **LEVEL 8**
  - Company has reduced its Scope 1 & 2 GHG emissions over the past 3 years
  - Company provides information on the business costs associated with climate change
  - Company has set long-term quantitative targets (>5 years) for reducing its GHG emissions
  - Company has incorporated ESG issues into executive remuneration

- **LEVEL 9**
  - Company has reduced its Scope 1 & 2 GHG emissions over the past 3 years
  - Company provides information on the business costs associated with climate change
  - Company has set long-term quantitative targets (>5 years) for reducing its GHG emissions
  - Company has incorporated ESG issues into executive remuneration

- **LEVEL 10**
  - Company has reduced its Scope 1 & 2 GHG emissions over the past 3 years
  - Company provides information on the business costs associated with climate change
  - Company has set long-term quantitative targets (>5 years) for reducing its GHG emissions
  - Company has incorporated ESG issues into executive remuneration
“I applaud the new Transition Pathway Initiative and its founding members. It represents yet another potentially powerful way of aligning real-world global investments with the real-world urgency of meeting the goals, aims and aspiration of the Paris Climate Change Agreement.”

Patricia Espinosa, Executive Secretary of the UN climate convention (UNFCCC)
In relation to the evaluation of Carbon Performance, companies are assessed both against the globally-agreed 2 degrees temperature increase target, and against national pledges for emissions reductions made at, or subsequent to, the Paris Agreement.

These Carbon Performance assessments are conducted on a sector-by-sector basis, taking account of the relative amount of decarbonisation that will be required from different sectors to limit temperature increases. This enables investors to evaluate how companies are aligning their business models with the emission reduction targets being set by national governments, illustrated in the figure opposite. These assessments are based on the International Energy Agency (IEA) Energy Technologies Report.

**Company A’s current carbon intensity and future targets are not aligned with the Paris pledges or 2 degrees.**

**Company B’s current carbon intensity is aligned with the Paris pledges or 2 degrees, but its future target is only aligned with the Paris pledges.**

**Company C’s current carbon intensity and future targets are aligned with 2 degrees.**
HOW CAN IT BE USED?

Investors can use the Transition Pathway Initiative in a number of different ways. For example, they might use it to help inform their:

- **Investment processes**, for example by strengthening the emphasis on how climate change and transition risk affects their investment principles and strategy and providing questions that can be asked in investment manager review meetings.

- **Investment decision-making**, for example as an assessment of companies’ exposure to low-carbon transition risks and opportunities and as an assessment of companies’ quality of management and performance.

- **Engagement activities**, for example through setting and monitoring engagement goals for their internal teams or for external service providers and through monitoring company actions.

- **Proxy voting decisions**, for example by informing how you integrate climate into your voting decision-making and those of your managers.

Investors can also encourage other investors to use the online tool, thereby promoting greater consistency about the types of disclosure required from companies relating to low-carbon transition.
“The launch of the TPI highlights the growing momentum among asset owners to consider the economic implications of the transition towards a low-carbon economy into their stewardship and investment processes. FTSE Russell has long been a pioneer in ESG and sustainable investing and we are delighted to have been chosen by the TPI as the data and analytics partner for this exciting initiative.”

Mark Makepeace, CEO of FTSE Russell
CONTACT
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CO-CHAIRS
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