

# Transition Investing

## SALONE SRI

ESMA Guidelines on fund naming rules with a focus on “Transition”-related terms

November 2024

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# Agenda

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**ESMA  
Guidelines for  
funds with  
transition-  
related terms**

**2**

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**Options to  
measure  
company-level  
transition**

# ESMA Guidelines for funds with transition-related terms

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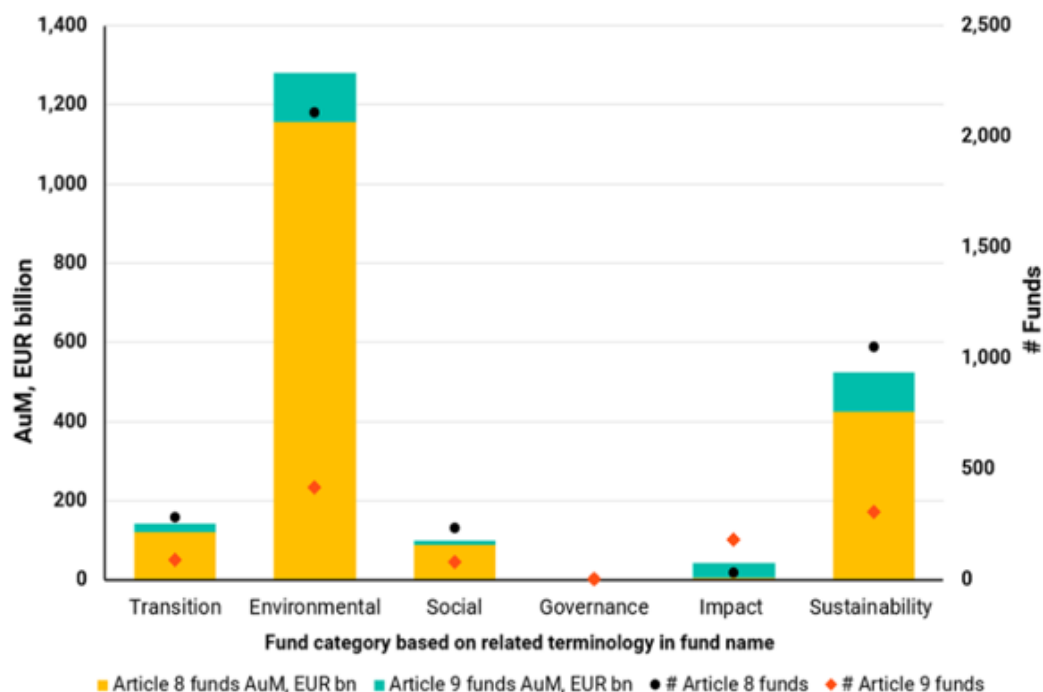
# ESMA Guidance on Funds' Names imposes specific requirements for funds with transition-related names

|  | Transition-related terms  | Social- or governance related terms              | Environmental-related terms                  | Impact-related terms | Sustainability-related terms     |
|--|---|--|--|----------------------|----------------------------------|
|  | i.e. Transition, improve, progress, evolution, transformation, net zero | i.e. Governance, controversies, social, equality | i.e. Environmental, green, climate, ESG, SRI | i.e. Impact          | i.e. Sustainability, Sustainable |
| <b>CTB exclusions</b><br>(controversial weapons, tobacco, UNGC, OECD)  | ✓   | ✓  | ✓  | ✓                    | ✓                                |
| <b>PAB exclusions</b><br>(thermal coal, fossil fuel, electricity generation)   |   |  | ✓  | ✓                    | ✓                                |
| At least 80% of investments should meet the environmental and social characteristics or sustainable investment objective                               | ✓   | ✓  | ✓  | ✓                    | ✓                                |
| <b>Demonstrate that investments are on a clear and measurable path to social or environmental transition</b>   | ✓   |  |  |                      |                                  |
| Ensure investments are made with the intention of generating positive and measurable social and environmental <b>impact</b> alongside financial return |   |  |  | ✓                    |                                  |
| Commit to invest meaningfully in <b>SFDR Article 2(17)</b> sustainable investments   |   |  |  |                      | ✓                                |

# Impact of ESMA Guidelines on EU Funds

- Over 30% (4,790) of over 14,000 article 8 and 9 funds (EUR 2 trillion) have names that appear relevant to the naming rules
- Many, but not all, have at least some relevant exclusions in place

Environmental- and sustainability-related terms account for the bulk of Article 8 and 9 fund names



Number of unique SFDR Article 8 and 9 funds with identifiable keywords related to ESMA guidance classification: 4,790. Data as of May 20, 2024. Source: MSCI ESG Research

## Exclusions status quo of Article 8 and 9 funds

| Article 8 funds                            |            |               |        |        |                |
|--|------------|---------------|--------|--------|----------------|
|  | Transition | Environmental | Social | Impact | Sustainability |
| Applies norms-based screening (UNGC, OECD) | 86%        | 84%           | 74%    | 84%    | 90%            |
| Excludes controversial weapons             | 90%        | 90%           | 85%    | 84%    | 92%            |
| Excludes tobacco                           | 86%        | 76%           | 80%    | 72%    | 82%            |
| Excludes thermal coal                      | 83%        | 80%           | 81%    | 66%    | 80%            |
| Excludes fossil fuel                       | 84%        | 75%           | 72%    | 63%    | 80%            |

| Article 9 funds                            |            |               |        |        |                |
|--|------------|---------------|--------|--------|----------------|
|  | Transition | Environmental | Social | Impact | Sustainability |
| Applies norms-based screening (UNGC, OECD) | 91%        | 88%           | 75%    | 83%    | 90%            |
| Excludes controversial weapons             | 93%        | 89%           | 84%    | 79%    | 90%            |
| Excludes tobacco                           | 89%        | 79%           | 74%    | 71%    | 82%            |
| Excludes thermal coal                      | 86%        | 77%           | 68%    | 60%    | 74%            |
| Excludes fossil fuel                       | 77%        | 66%           | 49%    | 49%    | 68%            |

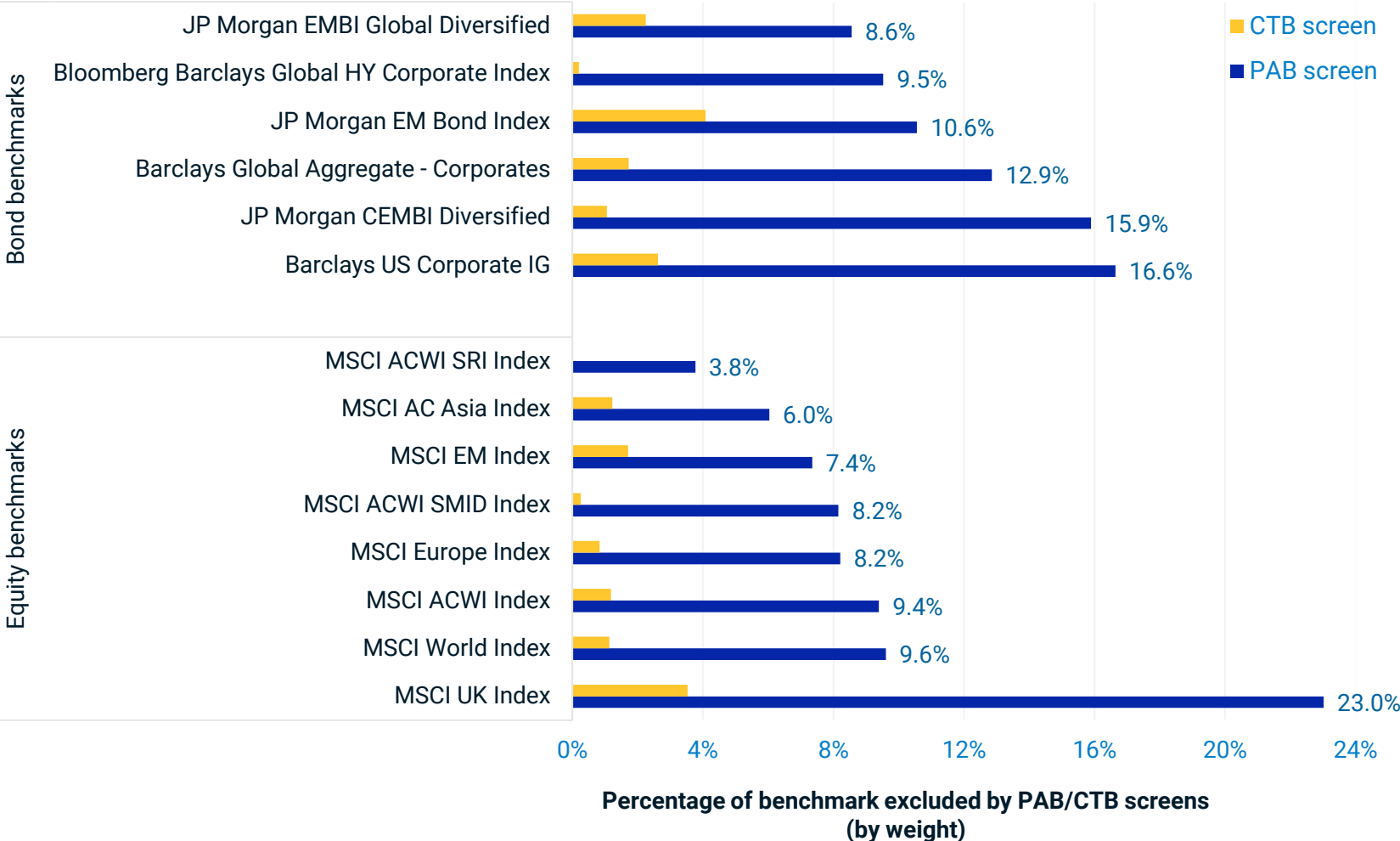
Number of unique SFDR Article 8 and 9 funds with identifiable keywords related to ESMA guidance: 4,790. Data as of May 20, 2024. Source: MSCI ESG Research

# Investable universe with PAB and CTB screens

**Portfolio construction implications**

**Smaller universe of eligible investments for bonds than equities**

**Regional differences in PAB exclusions**



Source: MSCI ESG Research LLC. Data as of July 31, 2024. PAB stands for Paris-Aligned Benchmarks and CTB stands for Climate Transition Benchmarks.

# How have the ESMA fund naming rules impacted your firm?

- Developing **new products** to specifically address the fund labels defined in ESMA's final report
- **Renaming** fund to meet criteria in ESMA's final report
- **Applying exclusions** to existing funds in order to retain fund names
- Its too early to say the impact on our funds / firm

MSCI client workshop results\*

5%

27%

41%

27%

Out of total 37 responses  
Rounded numbers



Source: MSCI ESG Research LLC  
\*MSCI Client Workshop: EU Regulation, October 2024.

# What social or environmental themes are your biggest priority for transition-related funds?

- Net zero by 2050
- Climate mitigation or other decarbonization transition
- Biodiversity-related
- Other environmental
- Social-related

MSCI client workshop results\*

32.5%

65%

2.5%

0%

0%

*Out of total 40 responses  
Rounded numbers*



# Options to measure company-level transition

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# A “clear and measurable path”: tracking fund progress over time

For some transition fund goals, the priority today is measuring the *fund's* baseline performance to track *fund* progress over time...

...but this may lead to “paper” portfolio transition without real world progress.

Measuring **company-level progress** within portfolios may better align with ESMA's requirement to demonstrate that “**investments are on a clear and measurable path to social or environmental transition**”.

# Options to measure company-level transition

## External frameworks

### **Net Zero Investment Framework (NZIF), e.g.**

- companies achieving net zero or aligned to net zero pathways
- companies not aligned to net zero in high emitting sectors

### **EU Taxonomy, e.g.**

- companies with low percentage of aligned turnover but moderate to high level of aligned capex
- Companies with no/low percentage of aligned turnover but high percentage of eligible turnover

### **Sustainable Development Goals (SDG)**

- companies demonstrating alignment with the goals

Other...

## Internally developed methodologies

**Use a variety of metrics** to implement transition strategy and measure improvement overtime, e.g.

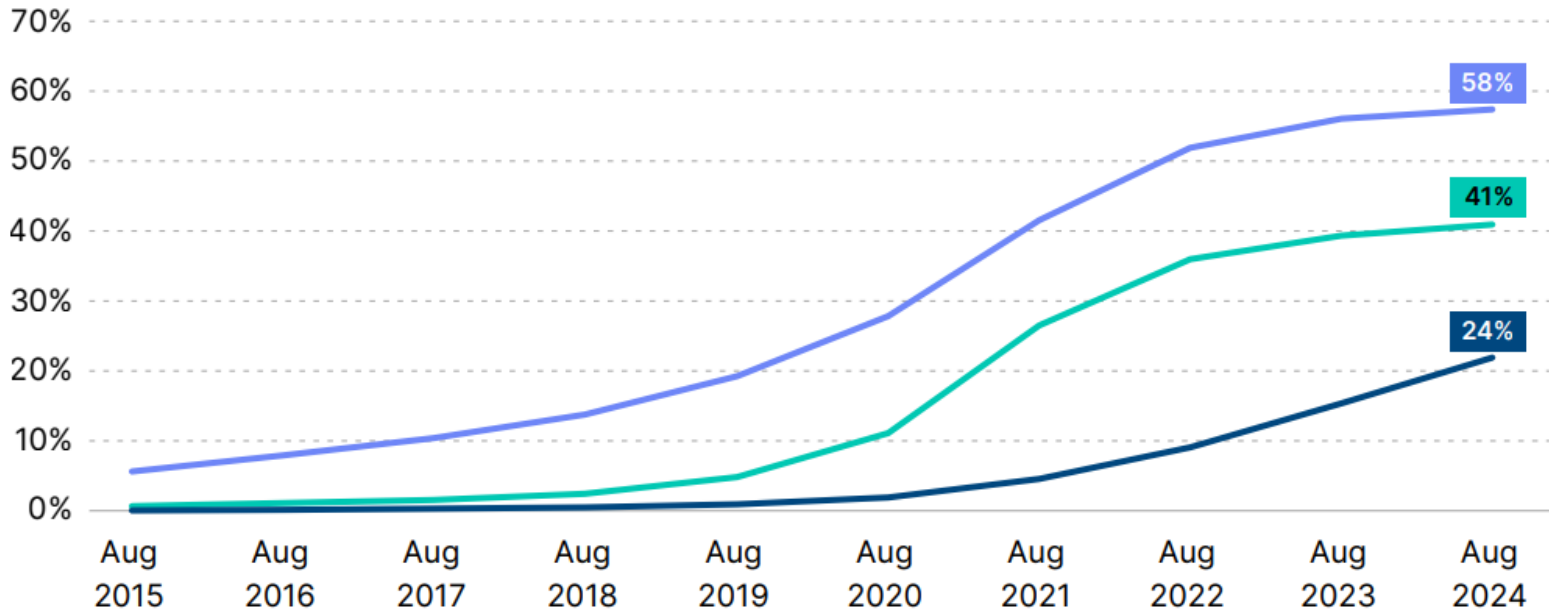
- companies with credible **transition plans** and year-over-year decarbonization results
- companies meeting Paris Aligned Benchmark criteria

**Use a unique metric** to measure transition progress overtime, e.g.

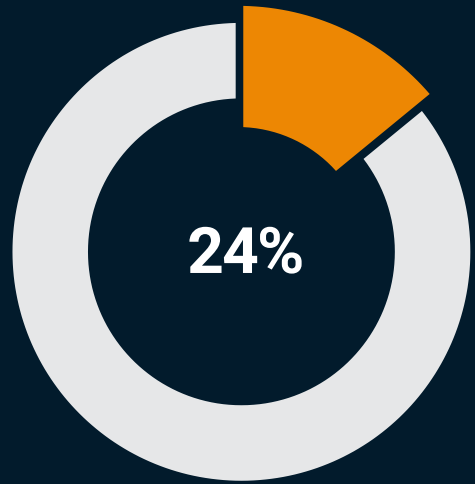
- Irrespective of company commitment or intent, track change over time and allocate capital to companies successful at demonstrating progress for the single metric (such as workforce diversity, water consumption, or Principle Adverse Indicators)

# Listed companies with climate targets by target type

41% of companies have set a target that aspires to reduce emissions to net-zero (though not necessarily in line with climate science), up about four percentage points over the same period. Overall, 58% of listed companies have published a climate commitment, up about four percentage points from a year ago.







- Percent of companies with climate targets for 2024 and beyond
- Percent of companies with self-declared net-zero targets, including SBTi-approved net-zero targets
- Percent of companies with science-based targets

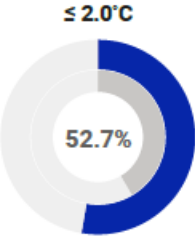
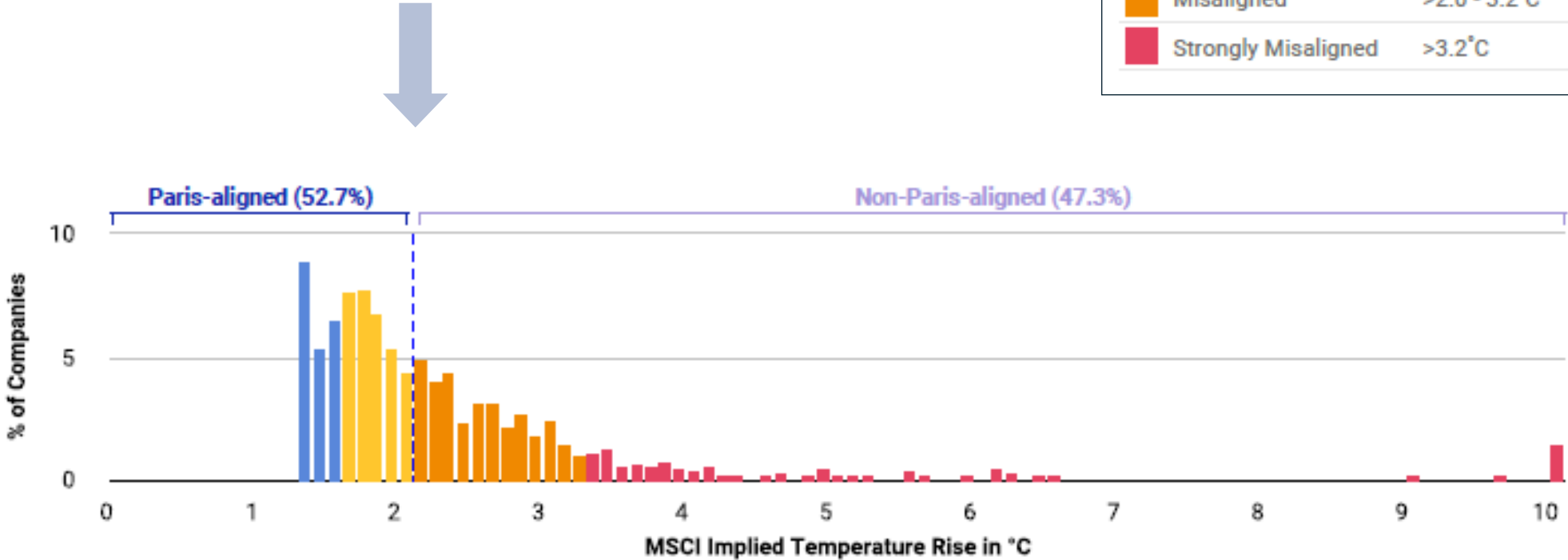


Share of listed companies that have set **science-based climate targets**

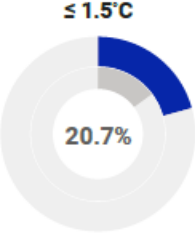
# MSCI ITR to identify listed companies aligned to the Paris Agreement



| Implied Temperature Rise Categories   |                | % of companies in category |
|---|----------------|----------------------------|
|  1.5°C Aligned       | <= 1.5°C       | 20.7%                      |
|  2°C Aligned         | > 1.5°C - 2 °C | 32.0%                      |
|  Misaligned          | >2.0 - 3.2°C   | 33.8%                      |
|  Strongly Misaligned | >3.2°C         | 13.5%                      |



52.7% of companies within the portfolio (vs. 41.6% for the benchmark) align with the goal of limiting temperature increase to below 2°C.



20.7% of companies within the portfolio (vs. 14.9% for the benchmark) align with the goal of limiting temperature increase to below 1.5°C.



Source: MSCI ESG Research, data as of May 31, 2024

# Net Zero Investment Framework

- Net Zero Investment Framework (“NZIF”) provides a globally recognized framework to **evaluate companies transition to net zero**.
- The framework is based on **six criteria** ranging from carbon emissions disclosure, to aligned capital expenditure.
- Investors can assess **companies/funds alignment** by classifying a group of companies into one of the **five alignment categories**.

| Asset alignment criteria        |   |          | Criteria for lower impact companies |          |           |             |
|---------------------------------|---|----------|-------------------------------------|----------|-----------|-------------|
| Criteria                        | Descriptions  | Net-zero | Aligned                             | Aligning | Committed | Not aligned |
| Net-zero criteria               | Achieving the emissions intensity required by the 2050 pathway and an investment plan that will maintain it.  |          |                                     |          |           |             |
| 1. Ambition                     | A <b>long-term 2050</b> goal consistent with achieving global <b>net-zero</b>   |          |                                     |          |           |             |
| 2. Targets                      | Short- and medium-term emissions <b>reduction targets</b> (Scope 1, 2 material Scope 3)   |          |                                     |          |           |             |
| 3. Emissions performance        | Current <b>emissions intensity</b> (Scope 1, 2 material Scope 3) performance relative to targets  |          |                                     |          |           |             |
| 4. Disclosure                   | <b>Disclosure</b> of Scope 1, 2 material Scope 3 emissions  |          |                                     |          |           |             |
| 5. Decarbonization strategy     | A quantified <b>plan setting</b> out the measures that will be deployed to deliver GHG targets, proportions of revenues that are green and where relevant increases in green revenues |          |                                     |          |           |             |
| 6. Capital allocation alignment | A clear demonstration that the <b>capital expenditures</b> of the company are consistent with achieving net-zero emissions by 2050  |          |                                     |          |           |             |

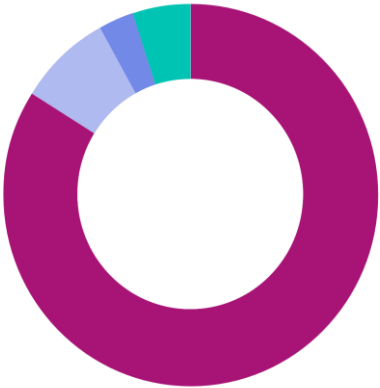


Source: IIGCC, MSCI ESG Research. Note: Companies in low-impact sectors were required to meet Criteria 2, 3 and 4, highlighted in a red rectangle, to be assessed as aligned.

# Assessing alignment based on the Net-Zero Investment Framework

MSCI ESG Research has categorized each of the world’s listed companies according to the NZIF maturity scale. Applying the voluntary framework to the world’s listed companies offers one indication of their alignment with a science-based net-zero emissions trajectory.

Listed companies by NZIF maturity scale category



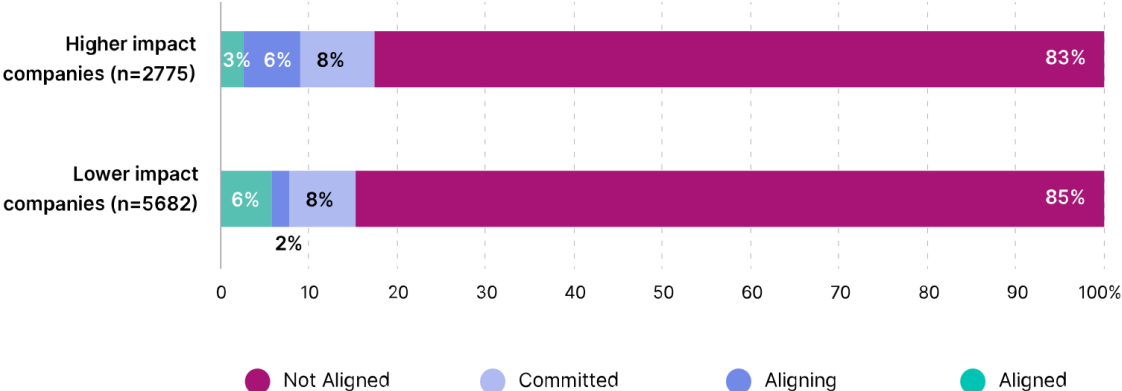
● Not Aligned 84%   
 ● Aligning 3%  
● Committed 8%   
 ● Aligned 5%

NZIF alignment of the 100 largest listed companies by markets

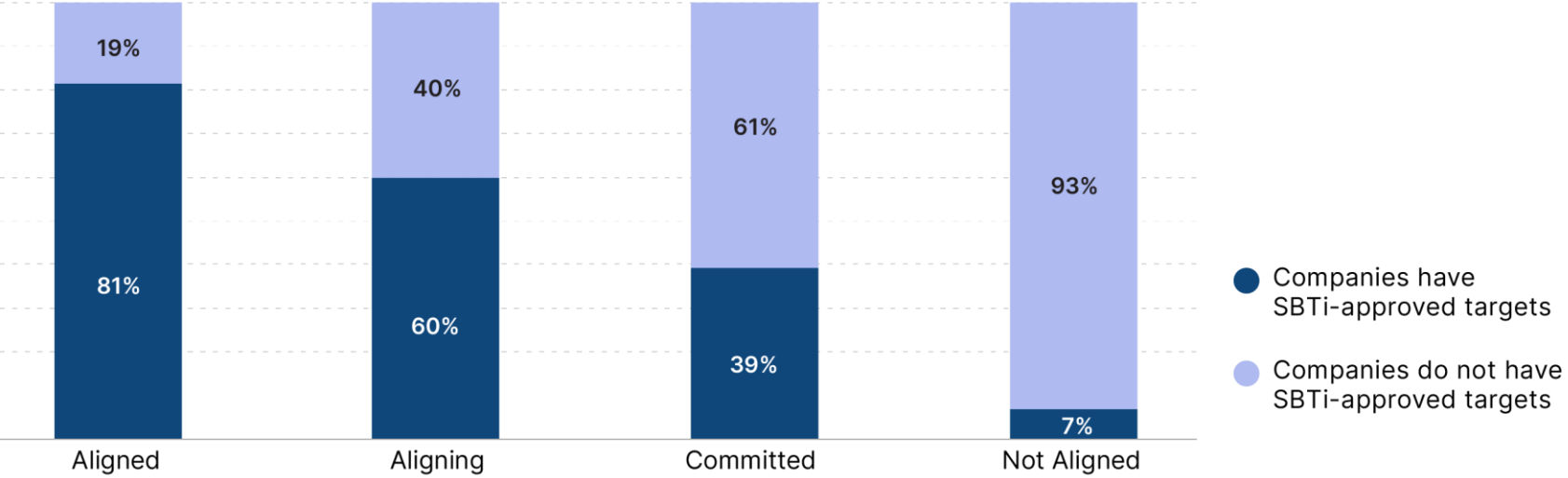


● Not Aligned 43%   
 ● Aligning 12%  
● Committed 30%   
 ● Aligned 15%

NZIF alignment of listed companies by impact category



# Share of listed companies that have set science-based climate targets by NZIF maturity-scale category



**NZIF categories correlate strongly** with listed companies' setting of **science-based decarbonization targets**, as of June 24, 2024.

81% of companies classified as "aligned" (the most mature NZIF category) have an SBTi-approved target (or have committed to set one).



# What approach is more suitable for you in measuring transition?

- Comprehensive framework
- Internally developed screens

## MSCI client workshop results\*

58%

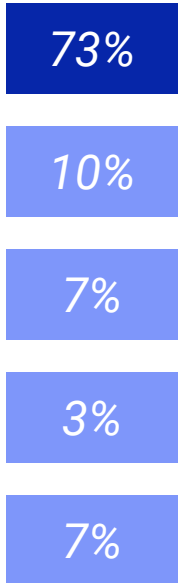
42%

*Out of total 26 responses  
Rounded numbers*

# What is the minimum criteria you might consider “credible” for a clear and measurable path to environmental transition?

- SBTi
- Any decarbonization plan
- PAB exclusions
- Top 50% in carbon intensity per GICS industry
- Sustainable business activity involvement (MSCI Environmental Impact and/or EU Taxonomy alignment)

MSCI client workshop results\*



Out of total 30 responses  
Rounded numbers



Source: MSCI ESG Research LLC  
\*MSCI Client Workshop: EU Regulation, October 2024.

# Other MSCI Transition resources

MSCI  MSCI ESG RESEARCH LLC

## The Climate Transition Is Increasingly About Opportunity

The cost competitiveness of green technologies adds to reasons for investors to act

May 2023

LU0426578240

## Managing Climate-Transition Risk in Credit Portfolios

Jan 31, 2022



- A portfolio's climate-transition risk, a major element of overall climate-change risk, is associated with the portfolio's emission footprint.
- We investigate two approaches to reduce credit portfolios' exposure to climate-transition risk: using either a decarbonization target as a constraint or a weighting scheme based on the securities' climate profiles.
- Tractability, turnover and trading cost related to each method are crucial factors that may impact the performance of a portfolio and can help in deciding the approach to managing climate-transition risk.

MSCI  RESEARCH INSIGHT

## Financing the Climate Transition

Investment rationale and implementation approaches

June 2024



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## What Can Capex Reveal About Emissions Reductions?

5 mins read August 29, 2024 | Shitiz Chaudhary

### Key findings

- Measuring progress toward climate targets by only examining emissions trends during interim years may provide an incomplete picture due to the long-term nature of these goals.
- Companies with climate targets have tended to direct more capital expenditure (capex) to activities designed to mitigate climate change or for renewable-energy generation than companies without targets, especially within utilities.
- Investors assessing the transition readiness of portfolio companies through capex data should consider sectoral and regional variations to more effectively apply investment and engagement strategies.



## Olive Is the New Black: The Rise of Transition Funds

6 mins read September 12, 2024 | Rumi Mahmood, Xinxin Wang, Shuang Guo

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RESEARCH INSIGHTS  
MSCI ESG RESEARCH LLC

## Tools to Track Transition

A fixed income study of sixteen firms in four sectors

Michael Ridley, Anett Husi, Meghna Mehta

June 2024

# MSCI Contacts Italy

- [michela.rota@msci.com](mailto:michela.rota@msci.com)
- [xiaoou.ye@msci.com](mailto:xiaoou.ye@msci.com)
- [Ilaria.digiamberardino@msci.com](mailto:Ilaria.digiamberardino@msci.com)

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| United States +1 888 588 4567 * | South Africa + 27 21 673 0103    | China + 86 21 61326611        |
| Canada + 1 416 687 6270         | Germany + 49 69 133 859 00       | Hong Kong + 852 2844 9333     |
| Brazil + 55 11 4040 7830        | Switzerland + 41 22 817 9777     | India + 91 22 6784 9160       |
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|                                 | Italy + 39 02 5849 0415          | South Korea +82 70 4769 4231  |
|                                 | France + 33 17 6769 810          | Singapore +65 67011177        |
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