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Investment viewpoint

Swiss climate scores

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Switzerland and its financial market are committed to transitioning to net-zero greenhouse gas emissions by 2050. This is needed to honour its obligations under the Paris Agreement of holding the increase in the global temperature to well below 2°C and pursuing efforts to limit it to 1.5°C.

The Swiss Climate Scores establish best-practice transparency on the Paris-alignment of financial investments to foster investment decisions which contribute to reaching the climate goals. These scores contain indicators reflecting the current situation of invested companies in financial portfolio as well as forward-looking metrics associated with these companies.

The Swiss Climate Scores aim to increase climate transparency for end investors and ensure all financial market participants use consistent and comparable data to assess the net zero objectives.

1. Switzerland is committed to fulfil the 2015 Paris Agreement requirements

Current science indicates that global warming beyond 1.5°C has potentially catastrophic impacts on the natural world and human society. Published in 2015, the Paris Agreement sets long-term goals to guide all nations to substantially reduce global greenhouse gas emissions to limit the global temperature increase in this century to 2°C while pursuing efforts to limit the increase even further to 1.5 degrees.[1]

On 6 October 2017, Switzerland ratified the Paris Agreement and thus committed to a greenhouse gas (GHG) emissions reduction target of 50% by 2030 in comparison with 1990 levels, with partial counting of its emissions reductions abroad. In addition, the country also declared an indicative total reduction target of 70 to 85% by 2050 compared with 1990 levels, also with partial counting of emission reductions abroad.[2] Besides, the Federal Council urges to align on net zero target by 2050, which means that by 2050, global emissions of greenhouse gases may not exceed the amount that can be absorbed by natural and technical sinks.

2. Switzerland ranks among the world leaders in terms of climate finance

To meet the Paris Agreement objectives and transition to a low carbon economy, Switzerland has relied both on climate tests and on key international initiatives over the last few years. This way, Switzerland ensures that its financial market participants use state-of-the-art climate metrics and tools. Two major Swiss initiatives are worth to be noted.

Since 2017, the Federal Office for the Environment (FOEN) in close collaboration with the State Secretariat for International Finance (SIF) runs regular Paris Agreement Capital Transition Assessments (PACTA) climate tests that help monitor the progress of the entire financial markets' climate goal alignment. Based on the 2022 PACTA update, it appears that Swiss financial institutions are mostly misaligned in high-carbon technologies with mixed results for alignment in low-carbon technologies.

1 https://www.un.org/en/climatechange/paris-agreement.
2 https://www.bafu.admin.ch/bafu/en/home/topics/climate/info-specialists/climate--international-affairs/the-paris-agreement.html.

3. The Swiss Climate Scores push forward the multiple existing Swiss initiatives

In 2020, the Federal Council set the goal that Switzerland should be leading in sustainable finance. To do so, the Federal Council adopted on 17 November 2021 various measures to increase greater transparency on climate metrics related to financial flows[3] and recommended that:

- Financial market participants should use "comparable and meaningful" climate indicators to help create transparency in all financial products and client portfolios through consistent metrics. That could be done through implied temperature rise indicators (ITR), that would "provide clients with a straightforward understanding of how financial products can be classified in terms of their impact on the climate".[4]
- Financial market participants should join net-zero international alliances to set industry standards shared by global players across the world.

In an important next step going beyond these disclosures, the Federal Council launched Swiss Climate Scores for climate transparency in financial investments on 29th June 2022. The Swiss Climate Scores (SCS) establish best-practice transparency on the Paris-alignment of financial investments to foster investment decisions that contribute to reaching the climate goals. At the moment, their use is on a voluntary base, for the time being, and is intended to make investment decisions more efficient, providing investors awareness of the climate impact of their investments as well as the benefit from economic opportunities in the transition to net zero.

Based on this first definition, SCS are based on six scores that can be defined into two categories:

- Actual situation scores: they reflect the current situation of global companies in the financial product or portfolio,
- Future situation scores: they show where these companies are currently positioned in relation to global climate goals.

4. The six Swiss Climate Scores foster investment decisions in order to reach ambitious climate goals

4.1. The Greenhouse gas emissions score

The GHG emissions attributed to a company can be generated directly by their owned or controlled assets (Scope 1), from the generation of their purchased energy (Scope 2), and from elsewhere in their up or downstream activities (upstream or downstream Scope 3). Most of the time, GHG emission accounting would focus only on scopes 1 and 2, since these two scopes are easy to assess and required by regulatory disclosures. However, as stated by the Portfolio Alignment Team (PAT) report from the TCFD,[5] published in 2020, "a robust and accurate portfolio warming metric should capture all global emissions. Scope 3 inclusion is required to capture emissions emitted by companies indirectly, such as those by consumers in the use phase of products".

As such, the Greenhouse gas emissions score relies on all sources of GHG emissions from invested companies, integrating scopes 1 to 3 GHG emissions.

The GHG score is twofold, as it provides two metrics:

- Portfolio carbon intensity (as compared to the intensity of the portfolio benchmark) calculated as the GHG emissions of the fund (in CO_2e) divided by the revenues associated by the invested companies (in CHF M).
- Portfolio carbon footprint (as compared to the footprint of the portfolio benchmark) calculated as the GHG emissions of the fund (in CO_2e) divided by invested assets (in CHF M).

As quoted by the TCFD PAT report, LOIM internal methodology already integrates scopes 3 emissions in its ITR tool that assesses the alignment of invested companies.

4.2. Exposure to fossil fuel activities score

There is overwhelming scientific consensus of the need to phase-out coal and stop financing new fossil fuel projects. In its last report on climate change, the Intergovernmental Panel on Climate Change (IPCC) states that "in modelled pathways that limit warming to 1.5°C (>50%) with no or limited overshoot, the global use of coal, oil and gas in 2050 is projected to decline with median values of about 95%, 60% and 45% respectively, compared to 2019".[6]

Thus, monitoring the exposure of companies to fossil fuels is critical to assess their sensitivity to climate policies and their alignment towards innovative and technological strategies. The Exposure to fossil fuel activities score enables investors to have a metric related to potentially stranded assets.

The Exposure to fossil fuel activities score requires the share of investments into:

- Companies with activities in coal; and
- Companies with activities in other fossil fuel.

3 https://www.efd.admin.ch/efd/en/home/the-fdf/nsb-news_list.msg-id-85925.html.
4 https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-85925.html.
5 https://www.tcfdhub.org/wp-content/uploads/2020/10/PAT-Report-20201109-Final.pdf.
6 https://www.ipcc.ch/report/ar6/wg3/downloads/report/IPCC_AR6_WGIII_FullReport.pdf.

Through its exclusion policy, last updated in September 2022 and publicly available,[7] LOIM entities are prohibited from making investments in companies deriving more than 10% of their revenues from thermal coal extraction, coal power generation, tar sands, shale oil and gas as well as artic oil and gas exploration. This threshold captures main exposures to fossil fuel activities and may be reassessed, depending on clients' needs and market insights on fossil fuel risks.

4.3. Verified commitments to net-zero score

An increasing number of companies commits voluntarily to transition to net-zero and set interim targets. The effectiveness of such commitments depends on whether interim targets are credible, science-based, and transparent. As an example, many companies are now pledging to reach net zero. However, most of them only meet net zero objectives partially, because their pledge only concerns scope 1 (excluding scopes 2 and 3) net zero or because they only rely on offsetting policies and do not decarbonise their business at all.

Thus, relying on robust, consistent and market-approved data is key to assess companies' commitments to reach net zero. One of the main reliable sources used by the market is called the Science-based targets initiative (SBTi). When a company reports under the SBTi framework, it commits to reach net-zero CO_2 emissions at the global level by 2050 and net-zero greenhouse gas (GHG) emissions in 2050 or later. The specificity of SBTi targets is that this organisation reviews estimates of the remaining emissions budget, top-down mitigation scenarios as well as sectoral studies to determine 1.5ºC-aligned pathways at the global and sectoral level. This approach is thus sector-specific and relies on forward data, based on political decisions aiming at curbing GHG emissions: "SBTi emissions corridors presume that transformative political steps will be taken to rapidly reduce global emissions."

The Verified commitments to net-zero score requires:

- The share of companies in portfolio with verified commitments to net-zero and credible interim targets.

To assess the credibility of the trajectory of its portfolio, LOIM analyses each commitment taken by the issuers depending on three in-house scores, internally calculated:

1. The SBTi target of the issuer that assesses the maturity of the issuer regarding climate neutrality and net zero;
2. The ESG score of the issuer that assesses the consistency and the reliability of the issuer; and
3. The strategy and governance score, based on an internal methodology relying, among other, on the issuer's public roadmap to achieve net zero targets, the issuance of green bonds, the existence of an internal carbon price and the C-level responsibility on climate issues.

4.4. Management to net-zero score

Financial institutions can contribute to the transition to net-zero, by aligning their investment strategy with a consistent 1.5°C decarbonisation pathway.

As a consequence, the Net Zero Asset Managers initiative (NZAMi) was created in order to provide institutional investors with clear commitments from asset managers aiming at decarbonizing their investments. The NZAMi requires asset managers to set concrete objectives and regularly update them. Thus, when joining the initiative, an asset manager commits to:

- "Set an interim target for the proportion of assets to be managed in line with the attainment of net-zero emissions by 2050 or sooner; and
- Review [its] interim target at least every five years, with a view to ratcheting up the proportion of AUM covered until 100% of assets are included".

The Management to net-zero score asks the following questions:

- Does the investment strategy include a goal to reduce the GHG emissions of its underlying investments through concrete short (1-3 years) or mid-term (5 years) targets?
  - If yes, then provide the percentage of average annual reduction path (incl./excl. relevant Scope 3).
- Is the portfolio part of a third-party verified commitment to net-zero by the financial institution, including credible interim targets?

LOIM joined the NZAMi on 29 March 2021 and published its initial target disclosure was published on 1 May 2022, committing to 70% of total assets under management to be managed in line with net-zero targets, representing USD 49 billion at this date. This target comprises scope 1, 2 and relevant scope 3 emissions and the methodology is built on the SBTi for financial institutions.

[7] https://am.lombardodier.com/files/live/sites/am/files/Documents/AssetManagement/RegulatoryDisclosures/2022/Policy_LOIM_Exclusion_15.09.2022.pdf.

4.5. Credible climate stewardship score

The Federal Council is deeply committed to accelerate the climate transition through dialogue and engagement. As such, financial institutions are urged to contribute to the transition to net-zero by engaging with invested companies on third-party verified, science-based net-zero aligned transition plans until 2050.

The Credible climate stewardship score asks the following questions:

- Are companies in the portfolio subject to credible stewardship on climate transition?
  - If yes, then provide the share of companies currently under active climate engagement.
    - If yes, then provide the share of climate votes supported.
      - If yes, then provide the link of climate stewardship strategy and report.
- Is the financial institution a member of a climate engagement initiative?
  - If yes, then provide the name of this initiative.

Through its engagement activities, LOIM seeks to encourage companies to align their business models with sustainable transition pathways. We focus on those sectors where GHG emissions are harder-to-abate or in sensitive sectors and industries relative to climate transition and natural capital protection. We address the need to decarbonize business models via the Oxford Martin Principles. We use the strategic framework provided by the Oxford Martin Principles for Climate Conscious Investors[8] to engage companies on their commitment to climate transition with the goal of net-zero alignment. This ranges from governance of climate transition to appropriate target setting and reportable outcomes. Our engagement with companies through this framework is articulated alongside the following three questions:

- Does the company have a commitment to transition to net-zero emissions?
- Does the company have a profitable net-zero business model under net-zero?
- Has the company set quantitative medium-term targets that will be reported against?

4.6. Global warming alignment score

This score only addresses to data providers, that are required to:

- Be guided by the goal to achieve net-zero emissions by 2050, consistent with the 1.5°C warming limit of the Paris Agreement and in line with the latest IPCC findings.
- Comply with the technical considerations of the TCFD 2021 PAT report “Measuring Portfolio Alignment – technical considerations.
- Permit the Swiss government to disclose aggregate implied temperature scores based on your methodology on the following indices, to compare them with other providers: SMI, MSCI World, MSCI World Materials, MSCI World Industrials, MSCI World Utilities, MSCI World Real Estate.

5. Conclusion

Over the next few years, the Federal Councill will regularly review these scores and, if need be, adapt them to the latest international findings in order to ensure that these scores represent best practice in terms of climate transparency.

8 https://www.oxfordmartin.ox.ac.uk/downloads/briefings/Principles_For_Climate_Conscious_Investment_Feb2018.pdf.

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