Investor Expectations for Shipping Transition to Net Zero Emissions

Asset Manager & Asset Owner Task Force
ABOUT THE ASSET MANAGER & ASSET OWNER TASK FORCE

The Sustainable Markets Initiative (SMI) was formed at the invitation of His Royal Highness the Prince of Wales, at the World Economic Forum (WEF) Annual Meeting 2020, with the goal of creating a coalition of parties who share his view that progress towards a sustainable future must be accelerated. The Asset Manager & Asset Owner Task Force is a sub-group of the SMI formed of a group of CEO-level executives from a number of the world’s largest asset manager and asset owners. It brings together senior leaders to develop and enable solutions to help accelerate the transition to sustainable markets and support the rapid decarbonisation required across the real economy using the two most powerful levers at their disposal: capital already invested in companies and fresh capital investments directed at climate mitigation and adaptation projects.

Members of the Task Force include:

- AP2
- Bank of America Merrill Lynch Asset Management
- BlackRock
- Brookfield Asset Management
- CalPERS
- CalSTRS
- Capital Group
- CDPQ
- Fidelity International
- Gulf Capital
- HSBC Asset Management
- JPMorgan Asset Management
- Kuwait Investment Authority
- Legal & General Investment Management
- Macquarie
- Morgan Stanley
- National Employment Savings Trust
- New Zealand Superannuation Fund
- Ninety One
- PensionDanmark
- The People’s Pension
- PIMCO
- PKA
- Rockefeller Capital Management
- Schroders
- TIAA/Nuveen
- Vanguard
- Washington State Investment Board
- Wells Fargo Asset Management

This document is the product of the Stewardship & Engagement Working Group of the SMI Asset Manager and Asset Owner Task Force.

Chaired by Rockefeller Capital Management

With contributions from:

- BlackRock
- CalSTRS
- Capital Group
- Fidelity International
- HSBC Asset Management
- JPMorgan Asset Management
- Kuwait Investment Authority
- Legal & General Investment Management
- State Street
- TIAA/Nuveen
- Vanguard
I. INTRODUCTION

As long-term investors, we recognize the threat of climate change to our investments and view fulfillment of the Paris Agreement’s goal to hold global average temperature rise to “well below 2°C” as an imperative. Shipping is a carbon intensive sector that delivers roughly 80% of global trade. The International Maritime Organization (IMO) estimates the shipping sector currently comprises 2.89% of global emissions. Yet as other industries decrease their emissions more quickly than shipping, which is growing in trade volume, shipping’s share of global emissions is expected to rise to as much as 10% by 2050. The relatively long lifecycle of ships makes it particularly incumbent on industry participants to start acting now to align with global efforts toward that decarbonization. Significant investments are needed in developing low carbon fuels, ships powered by low carbon fuels, and land-based port infrastructure required to support this transition. The failure to adequately prepare for the energy transition presents notable environmental, physical and transition risks to companies and investors. Amongst many, one of these is the risk of stranded assets arising from the failure to convert fleets and infrastructure.

We acknowledge the carbon reduction targets the IMO has set for the sector. However, recognizing the scale and urgency of the action needed, we ask shipping companies to raise their ambition by striving for net zero emissions by 2050. In the spirit of partnership and collaboration, we have developed the following investor expectations which we hope will help companies and investors better manage climate-related risks and proactively position themselves for a low carbon economy.

As active stewards of capital, we regard stewardship as integral to our investment process. While each of our firms may take different approaches to stewardship, we agree on the principles laid forth herein, and we will independently incorporate them into our research and engagement efforts – in accordance with each firm’s unique approach to stewardship. Many of our expectations below seek enhanced disclosures which would enable us to quantify and measure progress within our investment universe. When making active investment decisions in shipping companies and interconnected industries, we will, wherever possible, seek to review and consider company performance against these points alongside other fundamental factors in our research and analysis. Those of us that actively engage companies individually, will, where possible and within the context of our broader engagement strategy, encourage company progress in the areas specified below.

Oversight of company performance in these areas is vital to our fiduciary responsibility. We believe the actions articulated herein will help firms create long-term shareholder value for our clients and are critical for a sustainable future.

II. EXPECTATIONS OF SHIPPING COMPANIES

1. **Governance:** Implement a strong governance framework which clearly articulates the board’s accountability and oversight of climate change risk and transition opportunities. This should include:
   a. **Board oversight,** including a climate-competent board, with the appropriate mix of skills and experience to oversee the climate transition strategy, and explicit responsibility for oversight of this matter either by a specific board member, committee, or the full board.
   b. **Incorporation of climate risks and opportunities into company strategy** and alignment between spending on public policy advocacy and the achievement of the Paris Agreement.

2. **Strategy/Action:** Consistent with the goals of the Paris Agreement and with the Net Zero commitments made by investors and shipping customers, we expect companies to:
a. **Strive to achieve Net Zero emissions in Scope 1 and Scope 2 by 2050.** To accomplish this companies should develop robust transition strategies and programs, and set short-, medium-, and long-term targets for reaching GHG emissions reductions. Actions that could help achieve this ambition may include such steps as investing individually and through strategic partnerships in the research and development of zero emission fuels and value chain entities needed to bring them to market at scale; in the interim, adopting lower emissions fuels such as LNG and biofuels as well as using shore power connections; purchasing zero emission ready ships starting today; and participating in “green corridors” that may enable faster commercialization of green fuels.

b. **Put in place a capital allocation strategy that contributes to the development, commercialization, use, and scaling of green shipping technologies with substantially lower carbon emissions.** We recognize that the transition will require significant investments beyond fuels and ships themselves, which will include land-based infrastructure to support the adoption of green technologies at scale and the alignment of supply chain aspects such as transport and bunkering of green fuels.

c. **Identify and implement technical design and operational efficiency improvements across operations that will reduce GHG emissions,** while recognizing that these alone will not be sufficient to reach Net Zero emissions goals. These measures may include things such as, but not limited to, Green Supply Chain Management (GSCM), hull cleaning to reduce drag, vessel trim optimization, speed and routing optimization, and the installation of solar/wind auxiliary power for accommodation services.

d. **Proactively collaborate with government entities and private sector entities across the value chain that aim to increase ambitions for GHG reductions in the shipping sector through policy advocacy that is consistent with the goals of the Paris Agreement.**

3. **Disclosure in mainstream financial filings or sustainability reporting of the following:**

   a. **Task Force for Climate Related Financial Disclosures (TCFD) aligned disclosures of governance, strategy, risk management, metrics and targets used to assess and manage climate related risks and opportunities.** This should include disclosure of board oversight and all Strategy/Action points mentioned in Section 2 above (transition strategies, plans, targets, capital allocation implications, operational efficiency improvements and collaboration) and a discussion of various climate-related scenarios considered, among which at least a 2°C Celsius or lower scenario (or other as per the most current TCFD recommendations).

   i. **Fuel use:** (1) Total energy consumed, (2) percentage fuel use by fuel type, (3) percentage renewable, (4) NOx and SOx emissions levels.

   ii. **Climate alignment of fleet:** We ask for disclosure of absolute CO₂ emissions and carbon intensity and decarbonization trajectory of the entire fleet using the metrics and methodology outlined by the Poseidon Principles including Annual Efficiency Ratio (AER), which utilizes data already submitted by companies to the IMO Data Collection System (DCS).

   b. **Participation and support for policy, finance, or other third-party initiatives to support green shipping technologies,** including via contributions to IMO Funds, support for the development of carbon pricing mechanisms, etc.

   c. **Policy advocacy:** Generally and specifically as it relates to climate-linked outcomes.

**III. EXPECTATIONS OF OTHER PLAYERS**

The collective efforts of numerous interconnected players across the public, and private, sectors and value chain are essential to set shipping on a sustainable trajectory. In the context of the global transition to a more sustainable future, climate friendly changes within other sectors will similarly
position them to achieve long-term success and deliver shareholder value. As consumers become increasingly aware of the carbon footprint of their merchandise from production to point of sale, the staggering emissions increases projected to come from the global transport of goods will receive increasing scrutiny. Companies transporting their goods to consumers around the world will find themselves meaningfully disadvantaged if this is ignored. In recognition of this, we hold the following expectations of additional entities:

- **Ports:** Given the importance of ports in providing the infrastructure needed to enable many aspects of the transition, we will look for:
  - Preparedness of infrastructure to enable the use of alternative fuels at scale, including the development of “green corridors”.
  - Disclosure of data needed to evaluate performance on aspects related to emissions including:
    - Enforcement of IMO/MARPOL limits for emissions of SOx and NOx.
    - Having an emissions policy aligned with IPCC, IMO or EU (best) in place and third-party monitoring.
    - Installation of renewable energy power at ports, if available in the region.
    - Lower fees, or other incentives, offered to ships with good emissions ratings.
    - Implementation of Green Supply Chain Management (GSCM) practices.
    - Skills, and systems, available to support green port technologies.
    - Any air pollution fines received.

- **Customers of shipping (auto, consumer goods, energy):** To prepare for an increasing sensitivity to carbon footprints, we believe it is increasingly important to monitor and disclose Scope 3 emissions data. Doing so will help identify products where increased customer sensitivity to carbon emissions will translate to willingness to pay for lower emission transportation. We therefore encourage companies that utilize shipping to transport their goods to make efforts to begin disclosing Scope 3 emissions data.

Additional industries including banks, insurers, energy companies, third party verifiers and others are affected by this transition and play important roles in accelerating progress and positioning themselves for long-term success. The financing of investments needed to transition our economy to a sustainable future spans multiple sectors. Numerous frameworks, including the Poseidon Principles and many others, have emerged to guide investments toward long-term sustainability. We will articulate our expectations for banking and several other sectors separately.

Finally, governments will play a critical role in creating policy that incentivizes the transition, bringing together various stakeholders and creating markets through their own investments. Under the umbrella of the Sustainable Markets Initiative, we will encourage governments of both developed, and developing, countries to embrace the following:

- Increase commitments to policy measures that will incentivize the transition to Net Zero shipping (e.g. carbon tax on emissions, investments in R&D related to green shipping technologies, municipal investments in infrastructure to support the green transition).
- Use their voice within international organizations such as the IMO to accelerate GHG reduction ambitions to achieve Net Zero emissions by 2050.
- Foster coordination between various actors across the value chain whose investments are needed to transition to zero emission fuels.
- Evaluate opportunities for government procurement of low carbon fuels, and other related services and infrastructure, to kick-start the transition to zero emission shipping.
IV. CONCLUSION

We are all long-term investors acting in the interests of the beneficial owners whose capital we manage. Despite our various viewpoints and investment approaches, we believe these expectations for shipping industry players are important to the sustainability of the industry. They are based on rigorous industry efforts to examine decarbonization in the sector and build on existing guidelines and frameworks such as Climate Action 100+ and the Poseidon Principles, amongst others. We believe that our own efforts to reference these expectations in our investments and our engagements—along with efforts of other asset owners and asset managers to do the same—will have the effect of accelerating the transition to a Net Zero future by 2050. These asks are meant to serve as an example of best practice—they are not intended to be overly prescriptive, and are certainly not exhaustive. Rather, they are designed to accelerate actions that—if taken—will lead to faster decarbonization of a critical industry with a growing carbon footprint.

‘The Intergovernmental Panel on Climate Change advises that unless there are immediate, rapid and large-scale reductions in greenhouse gas emissions, limiting warming to close to 1.5°C or even 2°C will be beyond reach. We need to identify what actions we can take right now to get on track while still planning the systemic changes needed for visions for the future of shipping. Inevitably individuals, companies and governments will be moving at different speeds—but we all need to go as fast as we can, to take action now. So, this initiative is vitally important as a further indication of commitment to decarbonize a sector so critical to society.’

- Matthieu de Tugny
President of Marine and Offshore
Bureau Veritas
REFERENCES

Climate Action 100+: The Three Asks
Climate Action 100+: Benchmark and Disclosure Indicators
UN PRI Investor Expectations for Aviation Industry
Poseidon Principles
Zero Emission Mission
UNEP Fi Turning the Tide: a toolkit for investors in financing a sustainable ocean economy
SASB Maritime Transportation Standard

Sustainable Blue Economy Principles for Banks, Insurers and Investors: developed by the European Commission, WWF, the World Resources Institute (WRI) and the European Investment Bank (EIB)