Carbon Tracker Initiative

Missed Pitch

Many leading asset managers' investment practices deviate from climate positioning

Analyst Note

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About Carbon Tracker

The Carbon Tracker Initiative is a team of financial specialists making climate risk real in today's capital markets. Our research to date on unburnable carbon and stranded assets has started a new debate on how to align the financial system in the transition to a low carbon economy.

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1 Key Findings

- **To meet asset owner demand for Paris-aligned portfolios, asset managers have sought to label investment vehicles as climate-compatible.** However, regulators are beginning to crack down on practices considered “greenwashing”.

- **Where portfolios contain constituents that are clearly not aligned with Paris, asset managers may be exposing themselves to regulatory and reputational risk.** We find over 160 funds which are named for their sustainability/climate credentials yet hold a combined $4.5bn of investments in 15 oil and gas companies that are not assessed to be aligned with Paris goals.

- **Being a signatory of the Net Zero Asset Managers Initiative (NZAM) is a signal to the market that managers will invest in line with a 1.5°C pathway.** For this to be credible, investee companies should be climate-aligned.

- **Yet, we find many of the largest NZAM members are heavily invested in unaligned oil and gas companies.** We analyse the shareholdings of 25 NZAM members into 15 such companies, and find:
  - Some, like Blackrock, Fidelity, and the Capital Group have significant holdings in almost all companies and increased their positions in 2022.
  - Others, like DWS, Abrdn, and Schroders carry more limited exposures, which were stable throughout 2022.

- **The acceleration of the energy transition potentially increases the transition risk exposure of such investments.** While increases in holdings are likely the result of high commodity prices in 2022 investors must be aware of the advancing demand substitution risks from new technologies.

- **Passive investment products account for some of these increases,** raising questions about the compatibility of index products with Paris Agreement goals.

- **While managers may argue that an active ownership approach can be used to ensure companies achieve 1.5°C alignment, voting data suggests that managers tend not to support 1.5°C-aligned resolutions.**
  - Regulators are cracking down on voting practices which could be perceived as contradictory to stated policies on climate.
  - Asset owners should clearly express their voting preferences to their chosen managers and monitor them regularly.

2 Executive Summary

As awareness of the climate crisis increasingly permeates the investment community, more and more investors are seeking to ensure that their capital is not being used in ways which could contribute to further global temperature rise. This includes those acting from a universal owner perspective in addition to ethical/impact investors. As such, asset owners are increasingly wishing their portfolios to be aligned with the goals of the Paris Agreement. However, investment decisions are often outsourced to asset managers, who, seeking to capture demand for climate-aligned investments, may or may not act in line with their clients' wishes.

Asset managers who promote climate credentials not reflected in investment practices carry reputational risks

In recent years, several initiatives have sprung up to coordinate different financial actors to achieve the goal of net zero emissions by 2050; the Net Zero Asset Managers Initiative (NZAM), is one such example, which sets various targets for its signatories to work towards in order to decarbonise their portfolios.

Most importantly, NZAM membership signals to the market that the asset manager intends to take climate considerations seriously

Asset managers who fail to uphold their climate commitments face risks on two fronts. First, managers are under increasing scrutiny from regulators, who have begun to crack down on what can be perceived as contradictions between fund managers' stated positions on climate and their investment practices. Furthermore, firms risk jeopardising the level of assets under their management by alienating those clients seeking climate-aligned investments, who could move to another, more aligned manager. A study by pwc found that 39% have rejected or stopped investing with an asset manager due to "shortcomings" in the manager's ESG investment practices.[1] Moreover, investors who are not concerned with climate issues may be put off by investments that are overly-exposed to energy transition-related risks including, e.g., demand substitution risks.

Funds marketed as "green" can have large investments in unaligned oil and gas companies

As demand from investors for sustainable investment products has grown, asset managers have stepped up to provide fund products which they market as "green", "ESG", "sustainable", "transition" or "low-carbon". However, our analysis finds 164 funds which are advertised under these monikers which contain large investments in fossil fuel companies (Table 1). Firms would do well to consider the potential ramifications of promoting products in such a way. If asset owners feel they have been misled, then there is a risk of capital flight to more aligned managers.

[1] pwc (2022), *Asset and Wealth Management Revolution 2022*

TABLE 1: FUND ADVERTISING SUMMARY

Fund Name Contains	No. of Funds	MV of Fossil Positions ($m)	Passive Funds (%)	Supplied by NZAM Members (%)
"ESG"	110	3,758	74	98
"Sustainable"	26	79	8	77
"Climate"	11	372	55	100
"Carbon"	10	69	50	100
"Transition"	7	309	14	100
Total	164	4,587	-	-

Sources: Factset, CTI analysis
Notes: Market value of positions as of 31/12/2022; positions across 15 companies in universe; total position in oil and gas may be materially larger

Regulators are cracking down on contradictions between managers' climate positions and investment practices

Beyond the potential reputational damage these practices could impart on asset managers, they may also present a source of regulatory risk. Regulators are increasingly cracking down on what could be perceived as misleading advertising practices in the fund management industry. The European Securities and Markets Authority,[2] the European Commission[3], the UK's Financial Conduct Authority,[4] and the US Securities and Exchange Commission[5] have all begun to investigate managers whose investments do not reflect their publicised climate policies. Indeed, BNY Mellon and Goldman Sachs have both been recently fined by SEC for failing to adequately adhere to the companies' own ESG policies in their investment decision-making. [6]

And yet asset managers still hold significant positions in unaligned fossil companies

In this note, we analyse the investments of 90 asset managers who are among the top shareholders in 15 of the world's largest listed oil and gas companies[7] to ascertain which managers could potentially be viewed as investing in line with 1.5˚C.

None of these 15 oil and gas companies analysed here have implemented climate plans we view as 1.5˚C-aligned (which include planning for production declines, setting absolute emissions reduction targets and adequately disclosing climate risks).[8] As such, it is difficult to see how portfolios with significant investments in unaligned oil and gas companies can themselves be considered 1.5˚C-aligned. We find that many asset managers, including 25 members of NZAM, carry substantial exposure to these 15 oil and gas companies. Some, like Blackrock, Fidelity, and Capital Group, hold

[2] ESMA (2022), *ESMA launches a consultation on guidelines for the use of ESG or sustainability-related terms in funds' names*
[3] European Commission (2021), *What is the EU Taxonomy Article 8 delegated act and how will it work in practice?*
[4] Financial Conduct Authority (20/03/2023), *Dear CEO Letter: ESG Benchmarks Review*
[5] LinkLaters (2022), *ESG spotlight moves to investment advisers and registered funds under SEC proposals*
[6] SEC (23/05/2022), *SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations;* SEC (22/11/2022), *SEC Charges Goldman Sachs Asset Management for Failing to Follow its Policies and Procedures Involving ESG Investments*
[7] Company universe consists of bp, ConocoPhillips, Chevron, Devon, Equinor, Eni, ExxonMobil, EQT, EOG Resources, Occidental, Pioneer, Repsol, Shell, Suncor and TotalEnergies
[8] See Carbon Tacker (2022), *Paris Maligned* and Carbon Tracker (2022), *Managing Peak Oil*; Carbon Tracker (2022), *Absolute Impact 2022*; Carbon Tracker (2022), *Still Flying Blind*

significant positions in almost all of the 15 companies analysed, and they expanded their holdings throughout 2022 (Table 2).

Interestingly, not all NZAM members behave in the same way. While one might expect to see similar approaches among members towards investing in the oil and gas sector, there are, in fact, material differences between managers: DWS, LGIM, and Schroders have much less exposure, and held their positions relatively stable throughout 2022.

TABLE 2: TOP 35 ASSET MANAGERS BY VALUE OF AGGREGATED OIL & GAS POSITIONS

Rank	Asset Manager	HQ	No. Investee Companies (/15)	NZAM Member?	Average Position Size (%OS)		Market Value of O&G Positions ($bn)		AUM ($bn)	O&G Positions % of AUM
					2021	2022	2021	2022		
1	Vanguard	US	15	No	6.3	6.2	80	125	7,200	1.7
2	BlackRock	US	15	Yes	6.0	6.6	72	116	8,940	1.3
3	State Street	US	15	Yes	3.6	3.7	53	80	3,410	2.3
4	Capital Group	US	11	Yes	3.4	4.0	32	45	2,200	2.0
5	Berkshire Hathaway	US	4	No	0.4	6.0	5	43	299	14.3
6	Fidelity	US	15	Yes	1.3	1.8	13	31	3,900	0.8
7	Geode Capital Management	US	15	No	1.1	1.2	15	24	713	3.3
8	JPMorgan Chase	US	15	Yes	1.0	1.1	13	22	4,000	0.5
9	Bank of America	US	9	No	1.0	1.0	11	17	1,400	1.2
10	Morgan Stanley	US	15	No	0.7	0.7	10	17	1,300	1.3
11	Northern Trust	US	15	Yes	0.7	0.7	11	17	1,000	1.7
12	T. Rowe Price Group	US	14	Yes	0.8	0.8	8	15	1,280	1.2
13	UBS	Switzerland	15	Yes	0.7	0.7	9	14	1,064	1.3
14	Wellington Management	US	15	No	0.8	0.9	9	14	1,200	1.1
15	BNY Mellon	US	15	No	0.6	0.6	9	13	1,840	0.7
16	Amundi	France	6	Yes	0.7	1.0	9	12	2,040	0.6
17	Invesco	US	15	Yes	0.8	0.7	8	12	1,410	0.9
18	Dimensional	US	15	No	0.6	0.7	6	12	653	1.8
19	Legal & General	UK	15	Yes	0.5	0.5	6	12	1,400	0.8
20	Dodge & Cox	US	7	No	2.7	2.3	8	11	323	3.5
21	Franklin Resources	US	15	Yes	0.7	0.7	8	11	1,500	0.7
22	Charles Schwab	US	14	No	0.4	0.5	6	10	755	1.4
23	Ameriprise	US	15	No	0.4	0.5	6	10	956	1.1
24	TIAA	US	14	No	0.5	0.6	6	10	1,210	0.8
25	Royal Bank of Canada	Canada	14	No	0.6	0.6	6	8	1,000	0.8
26	Sun Life Financial	Canada	11	No	0.7	0.8	5	8	1,330	0.6
27	GQC Partners	US	7	No	0.8	0.9	3	8	88	8.6
28	DWS	Germany	15	Yes	0.3	0.3	5	7	878	0.8
29	Goldman Sachs	US	15	No	0.3	0.4	3	6	2,500	0.3
30	abrdn	UK	14	Yes	0.3	0.3	4	5	458	1.2
31	Wells Fargo	US	12	No	0.3	0.3	3	5	1,880	0.3
32	Schroders	UK	14	Yes	0.3	0.4	3	5	898	0.6
33	BPCE	France	15	No	0.3	0.3	4	5	1,710	0.1
34	Equitable	US	15	No	0.2	0.3	3	5	908	0.1
35	Orix	Japan	15	No	0.3	0.4	3	4	400	0.1

Source: Factset; CTI analysis; NZAM; figures for AUM sourced from company websites, annual reports, ADV filings and 13F filings. Notes: positions in 15 companies only; total positions in oil and gas may be materially higher. Berkshire Hathaway's AUM figure is its total portfolio value; Wells Fargo's AUM figures are total group assets; Goldman Sachs' AUM figure is Assets Under Supervision. Converted from reported currencies at closing current/USD price on 31/12/2022. Managers ordered by value of aggregate position at 31/12/2022.

Asset manager shareholders are expected by regulators and clients to vote in line with climate commitments

Holding outsized positions - the largest managers hold anywhere from 1% to 12% of outstanding shares - in oil and gas companies means that asset managers have enormous influence when it comes to voting at company AGMs. While some managers see a role for 'active stewardship' (i.e., the most compelling way to effect change on climate is to hold shares in carbon-intensive companies and vote to change their climate behaviour) in reality, many asset managers vote against even relatively mild climate-orientated shareholder proposals.

While, of course, not all resolutions will warrant support, regulators and clients may take issue with firms who consistently vote against proposals aimed at improving companies' transition strategies or greenhouse gas emissions: the SEC has recently announced an investigation into "sustainable" funds which vote against ESG-focussed shareholder resolutions.[9] Climate-concerned clients, meanwhile, will ensure that their manager is aware of their preferences when it comes to voting season, and scrutinise their voting intentions, policies, and histories.

Passive investment products may lead clients to unwittingly invest in oil and gas

Passive investment funds have exploded in popularity over the past decade, and many managers have a substantial number of passive product offerings. However, index funds may have unforeseen consequences for clients, who may not be aware of the exposure they generate to unaligned oil and gas companies.

In 2022, the spike in oil prices caused by the Russian invasion of Ukraine lead to a broad rise in oil and gas company share prices, which would have resulted in them carrying a greater weight in market capitalisation or price-weighted indices, and a greater exposure as a result. While 2022's market conditions were likely an anomaly, the consequent rise in passive investors' exposure should raise serious questions about the fundamental compatibility of indexed investment products with ambitions for 1.5°C -aligned portfolios. If investors, asset managers, and exchanges wish for there to be 1.5°C-aligned passive products on the market, then they will need to be benchmarked off new, 1.5°C-aligned, indices.

Asset managers' fossil exposures are a proxy for the exposure to reputational and regulatory risk

In summary, asset managers must reflect upon the risks posed to their business activities by holding, and deepening, large positions in fossil fuel companies, summarised as:

- **Risk of loss of assets under management** through not delivering on asset owners' wishes on climate, or by failing to recognise the risks posed to investee companies by the accelerating energy transition.
- **Litigation from financial regulators** who consider asset managers investing contrary to advertised position on climate to be acting contrary to the legitimate expectations of their clients.

AMs should be careful to ensure that climate-related commitments and advertising are consistently reflected within investment decision-making. Those who get this right, and act in the long-term interests of investors, are likely to be well placed for the future.

[9] Securities and Exchange Commission (2022), *2022 Examination Priorities*

3 Introduction

2023 will see the eighth anniversary of the adoption of the Paris Agreement, which saw 195 countries commit to constraining global temperature warming to "well below 2°C", and to strive for 1.5°C. Across the world, governments have been (and continue to be) instituting policies to ensure that national goals for emissions reductions are achieved.

Achieving Paris goals requires an acceleration of the shift to a cleaner, renewable energy system

To have any chance at achieving the 1.5°C goal, global CO_2 emissions need to fall rapidly, reaching net zero by around 2050. This will require a complete overhaul of the global energy system with huge implications for the oil and gas industry. The IEA states that demand for both oil and gas needs to fall by c.25% by 2030 and by c.75% by 2050.[10]

Fortunately, the rollout of renewables – and consequent substitution of fossil demand – has already commenced and is advancing rapidly in the transport and electricity sectors.[11] Not only are renewables cleaner and cheaper[12] than their fossil counterparts, but they are also a means to achieve greater energy security and independence - issues which have been central to energy policy considerations since the Russian invasion of Ukraine last year.

Yet oil and gas companies have so far been slow to adapt to these challenges. While we have seen a pronounced increase in firms' rhetoric around climate and the energy transition over the past few years, the reality is that almost none are taking the actions required to be aligned with a rapid transition towards a low-carbon 1.5°C future (see Section 4).

Investors wield considerable influence in the fossil energy system…

Underlying the fossil energy system is a network of financiers and investors, asset owners among them. Rather than investing directly in companies, asset owners – organisations such as pension funds, foundations, sovereign wealth funds, and insurers which represent long-term capital investors – often use asset managers to invest capital on their behalf. The asset management industry has ballooned in size in recent years. The top 20 asset managers now control over $59.5tn in assets under management (AUM).[13] Concurrently, asset managers have become some of the largest investors in the world's listed companies – including, as this note will show, oil and gas producers who are not assessed to be 1.5°C-aligned.

… and are growing increasingly concerned about the role of their capital in the climate crisis

Climate concerns amongst the investment community are growing and, in response, initiatives have sprung up with the aim of coordinating efforts by financial actors to help curb greenhouse gas emissions. These initiatives usually stipulate that their members work towards the goal of achieving 'net zero' emissions by 2050, a milestone which is essential, but necessarily sufficient, for limiting global temperature warming to 1.5°C. While working towards net zero by 2050 is certainly laudable, the ultimate temperature warming outcome achieved will depend on the trajectory that emissions take on the way to reaching net zero. Slower reduction pathways could exhaust the global

[10] Carbon Tracker (2023), *On Track for Paris?*
[11] IEA (2022), *Renewable Electricity*
[12] IRENA (2021), *Majority of New Renewables Undercut Cheapest Fossil Fuel on Cost*
[13] Thinking Ahead Institute (2022), *The World's Largest 500 Asset Managers*

carbon budget before net zero is even achieved, leading to a temperature rise in excess of 1.5°C (or a 'temperature overshoot') by mid-century.[14]

To address heightening climate concerns among the financial community, the United Nations (UN) has overseen the development of several investor-orientated net zero programmes. These include the Race to Net Zero, the Finance Initiative, and the Principles for Responsible Investment, as well as the High Level Expert Group, to scrutinise the net zero commitments of non-state entities. The Race to Net Zero works with the Glasgow Financial Alliance for Net Zero (GFANZ), which has spearheaded seven initiatives aimed at different segments of the financial system, including insurance, banking, and, of relevance here, asset owners (Box 1: Asset Owner Climate InitiativesBox 1) and asset managers.

Box 1: Asset Owner Climate Initiatives

Among the climate initiatives that target asset owners are the UN's Net-Zero Asset Owner Alliance (NZAOA) and the Institutional Investors Group on Climate Change (IIGCC) initiative for Paris Aligned Asset Owners (PAAO), both founded in 2019.

The NZAOA currently has 84 members, with a combined AUM of $11tn. **Signatories have committed to decarbonising their investment portfolios at a sufficient pace to reach net zero emissions across their portfolios by 2050.**[15] The group has also publicised their position on the oil and gas sector specifically, in which it calls on investors to "align portfolio allocation and de-risking activities with climate ambitions" and specifically calls for no new direct infrastructure financing for new upstream oil and gas fields, among other positions.[16] The PAAO has 57 signatories representing over $3.3tn of AUM, with members also working toward a goal of net zero GHG emissions across their investments by 2050.[17]

We note that there is a shortcoming in these initiatives that we hope will be addressed in the future: both the NZAOA and the PAAO cite that members should achieve net zero "consistent with"[18] or "in line with"[19] the goal of limiting warming to 1.5°C, but neither appears to set targets for when alignment with this temperature outcome should be achieved. This could potentially undermine the initiatives' effectiveness: alignment with a credible 1.5°C pathway needs to be realised urgently to minimise the chance of temperature overshoot. Indeed, it's hard to see how a portfolio including oil and gas companies could credibly be considered 1.5°C-aligned by either asset owners or regulators, unless those investee companies are themselves 1.5°C-aligned.

While the methodology underlying the PAAO and NZAOA net zero targets may not be perfect, **the success and broad uptake of the two initiatives demonstrates the intent that exists in the asset owner community to act on climate**. Asset owners will increasingly seek to align their portfolios with 1.5°C, and asset managers will need to adapt accordingly: the PAAO has issued specific guidance for its members on ensuring that their asset managers are heeding owners' climate mandates.[20]

[14] See Carbon Tracker (2022), *Absolute Impact 2022* for more details.
[15] UN (2023), *UN-convened Net-Zero Asset Owner Alliance*
[16] UN (2023), *Position on the Oil and Gas Sector*
[17] IIGCC (2022), *Paris Aligned Asset Owners initiative First Progress Report*
[18] UN (2023), *UN-convened Net-Zero Asset Owner Alliance*
[19] IIGCC (2022), *Paris Aligned Asset Owners initiative First Progress Report* p.3
[20] IIGCC (2022), *Paris Aligned Asset Owners initiative First Progress Report* p.56

Even climate-unconcerned asset owners should be wary of transition risk

One common refrain heard from the financial community when discussing climate action is that it is not the job of investors to decide what is and isn't required action for companies to tackle global emissions. Or, as Blackrock's Larry Fink puts it, asset managers should not be expected to act as "environmental police."[21] Instead, it is governments who should set the pace for the energy transition and dictate the actions the fossil industry should make. But leaving aside questions about responsibility for climate action, the reality is that **the policy response to climate, coupled with the demand substitution effects of new technologies, are mainstream financial risks** and they must be treated as such, rather than dismissed as being some ancillary "ESG" concern.

Carbon Tracker has long argued that demand for fossil products will fall in the medium term; as peak *demand* for oil and gas becomes closer, market consensus on the value of future cash flows from these companies could change rapidly, impacting share prices and asset owners' returns. As such, it is the asset managers' duty to consider these influences on energy demand when evaluating fossil companies as potential investments.

Indeed, among the 15 oil and gas companies considered here, we have demonstrated that each has a significant portfolio of potential production assets which are unlikely to be financially viable in a low-carbon/fast-transition future.[22] If sanctioned, then expected revenues from these projects may not materialise; invested asset owners with longer-term investment horizons, like pension funds and institutional investors, could be particularly vulnerable to transition-induced value erosion.

Asset managers must recognise clients' concerns and deliver credibly 1.5°C-aligned products

Ultimately, managers who are seen to be acting contrary to their advertised positions on climate are potentially jeopardising their own business model and risking the level of assets under their management - asset owners may choose to move their capital to an alternative manager more aligned with their own investment principles.

Indeed, the industry appears to have started to react to this demand from asset owners. Managers are now offering a range of "ESG" funds, which often promote their green or "low carbon" credentials. However, these funds can often still contain significant exposure to unaligned, carbon-intensive companies (Section 2.1). Moreover, fund managers are increasingly publicising their own climate policies and commitments to climate initiatives, such as the Net Zero Asset Managers Initiative. These public commitments can be viewed as signals to the markets and investors that managers intend to take climate action seriously. Those investing in ways that could be seen as contrary to their commitments could face rebuke from clients.

Regulators are increasingly cracking down on "greenwashing" in the fund management industry

Policymakers seeking to deliver on national climate/net zero commitments are looking to financial regulators to ensure that financial systems are more sustainable. Acting on these mandates, regulators are beginning to crack down on perceived climate contradictions between asset managers' marketing materials and investment practices, exposing fund managers to potential sanctions. Examples include the European Securities and Markets Authority,[23] the European

[21] Environmental Finance (15/02/2023) *Asset managers not 'environmental police', says BlackRock's Fink*
[22] See Carbon Tracker (2022), *Managing Peak Oil* for full details.
[23] ESMA (2022), *ESMA launches a consultation on guidelines for the use of ESG or sustainability-related terms in funds' names*

Commission,[24] the UK's Financial Conduct Authority,[25] and the US Securities and Exchange Commission[26], which have all started to crack down on what is perceived as greenwashing within in the fund management industry.

Asset managers with large investments in unaligned fossil companies face rebuke by both clients and regulators

We submit that asset managers would do well to be more cognisant of the risks associated with holding, and deepening, large positions in fossil fuel companies, summarising these as:

- **Risk of loss of assets under management** through not delivering on asset owners' wishes on climate, or by failing to recognise the risks posed to investee companies by the accelerating energy transition.
- **Litigation from financial regulators** who consider asset managers investing contrary to the advertised position on climate to be acting contrary to the legitimate expectations of their clients.

To investigate which managers may be most exposed to these risks, we have analysed the investment practices of the top 20 shareholders in each of 15 of the world's largest listed oil and gas companies. To wit, we will explore the following questions:

- Which asset managers have been increasing holdings in oil and gas companies?
- Are these investments compatible with clients' wishes and expectations on climate?
- Could these investments be perceived by regulators as contrary to asset managers' public positioning on climate?
- Irrespective of climate and sustainability concerns, do these practices increase risk to asset owners/beneficiaries?
- Are current passive investing practices to blame?
- Is there a role for active stewardship in these scenarios?

While we recognise the significant contribution of the bond market to financing the fossil fuel industry, this is not the focus of this report. However, given the size of their AUM, we would hypothesise that many of the asset managers in this report are likely also to be among the companies' largest bondholders.

[24] European Commission (2021), *What is the EU Taxonomy Article 8 delegated act and how will it work in practice?*
[25] Financial Conduct Authority (20/03/2023), *Dear CEO Letter: ESG Benchmarks Review*
[26] LinkLaters (2022), *ESG spotlight moves to investment advisers and registered funds under SEC proposals*

4 Asset Managers' Positioning on Climate

If asset managers wish to be seen as acting on climate, then they cannot credibly be facilitating actions in the real economy which will contribute to the exceedance of a Paris-aligned carbon budget and increase overall global temperature rise. For oil and gas companies, there are several metrics by which climate alignment can be assessed.

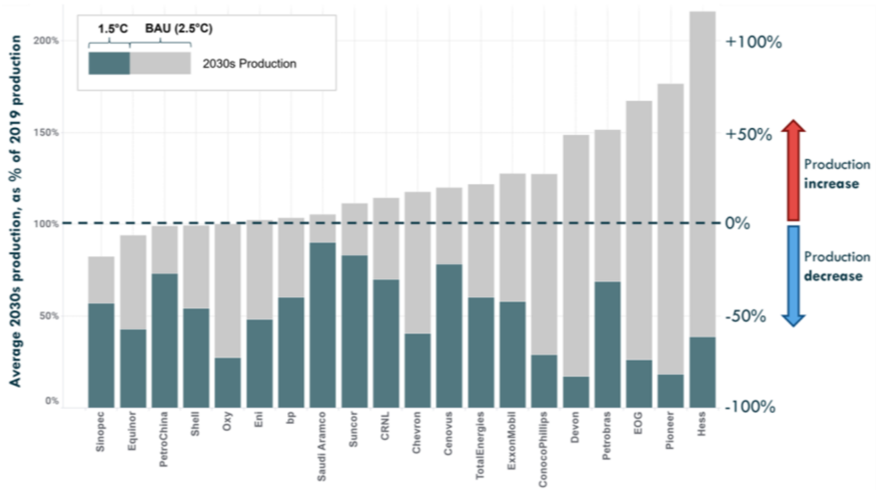
Assessing the Climate Alignment of Oil and Gas Companies

Through several series of reports, Carbon Tracker has explored the different requirements necessary for an oil and gas producer to be considered Paris-aligned. These include:

1. **Capital allocation and production plans** which should align with the demand requirements of low carbon scenarios[27]
2. **Emissions reduction targets** which should cover the full suite of a companies' emissions across all products and be set on an absolute basis and be accompanied by a credible plan for delivery against these targets[28]
3. **Executive remuneration policies** which should not incentivise executives to chase hydrocarbon volume growth[29]
4. **Climate risk disclosures** which should ensure companies are using adequately reporting risks to investors in financial statements[30]

For upstream oil and gas companies, 1.5˚C alignment will require an overhaul of their traditional business models; for many, hydrocarbon production would need to fall significantly (Figure 1).

FIGURE 1: 1.5˚C/FAST TRANSITION ALIGNMENT REQUIRES PLANNING FOR PRODUCTION FALLS



Source: Rystad Energy, CTI Analysis
Note: Adapted from Paris Maligned (CTI, 2023), Company universe differs from those analysed here and instead includes the 20 largest companies by market cap inlcluded in the E&P and Integrated segments of the S&P Global Oil Index as of 22/08/2022.

[27] Carbon Tacker (2022), Paris Maligned [https://carbontracker.org/reports/paris-maligned/] and Carbon Tracker (2022), Managing Peak Oil [https://carbontracker.org/reports/managing-peak-oil/]
[28] Carbon Tracker (2022), Absolute Impact 2022 https://carbontracker.org/reports/absolute-impact-2022/]
[29] Carbon Tracker (2022), Crude Intentions https://carbontracker.org/reports/crude-intentions/]
[30] Carbon Tracker (2022), Still Flying Blind [https://carbontracker.org/reports/still-flying-blind-the-absence-of-climate-risk-in-financial-reporting/]

None of the 15 companies analysed herein meets these requirements for Paris-alignment. This begs the question - can those who continue to invest in unaligned companies consider themselves climate aligned? Indeed, it is hard to see how **asset owners seeking credibly 1.5˚C-aligned portfolios can own financial interests in companies that are not themselves 1.5˚C-aligned.**

4.1 Fund Advertising Practices

The asset management industry is competitive, with many managers competing to attract AUM. In a market in which asset owners have a huge range of funds to choose from - there are over 2000 listed ETFs and 7000 mutual funds in the US alone – fund marketing is a relatively easy way to differentiate one product from another. Given the increasing prevalence of climate concerns amongst asset owners, it is no surprise that asset managers use labels such as “sustainability” to draw in climate-committed investors. As a strategy, it appears to work: growth in “ESG-orientated” AUM is anticipated to outpace the broader market,[31] and funds that are labelled as “high sustainability” have been demonstrated to attract significant capital inflows.[32] The question is - do “sustainable” funds actually imply sustainable investments?

Asset managers are pushing “green” funds with large investments in unaligned O&G companies

Our analysis finds that products sold by asset managers using various monikers like “green”, “ESG” or “sustainable” can have sizeable positions in oil and gas companies (Table 3). Furthermore, asset owners may believe that by investing in “green” funds they are reducing their exposure to transition risk by doing so, only to find that these products have large positions in companies whose assets may deliver lower-than-expected returns in a rapid transition future.

TABLE 3: FUND ADVERTISING SUMMARY

Fund Name Contains	No. of Funds	MV of Fossil Positions ($m)	Passive Funds (%)	Supplied by NZAM Members (%)
"ESG"	110	3,758	74	98
"Sustainable"	26	79	8	77
"Climate"	11	372	55	100
"Carbon"	10	69	50	100
"Transition"	7	309	14	100
Total	164	4,587	-	-

Sources: Factset, CTI analysis
Notes: Market value of positions as at 31/12/2022; positions across 15 oil and gas companies in universe; total position in oil and gas may be materially larger.

Among the worst offenders of the funds analysed is NZAM member BlackRock’s “ACS Climate Transition World Equity Fund”, which held over $219m worth of shares in 10 of the 15 companies we studied (bp, Chevron, ConocoPhillips, Devon, EOG, ExxonMobil, Occidental, Pioneer, Repsol, and TotalEnergies) at the end of 2022. BlackRock states that investors can expect the fund to provide exposure to companies listed in the MSCI World Index which “…are well-positioned to maximise the opportunities and minimise the potential risks associated with a transition to a low carbon economy”[33], but we have found that none of the 10 oil and gas companies in which the fund holds

[31] Pwc (2022), Asset and Wealth Management Revolution 2022
[32] Hartzmark, S. M., and Sussman, A., B., (2019), ‘Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows’. ECGI Finance Working Paper N. 565/2018
[33] BlackRock (2023), ACS Climate Transition World Equity Fund Factsheet

shares have Paris-aligned businesses, and each risks sanctioning assets which could become stranded asset risk in a fast-transition scenario.

Managers promoting "green" funds with exposure to fossil fuel companies risk alienating clients

These sorts of naming practices are exactly those which could be seen to be misleading to clients, as these funds are likely to attract capital from climate-concerned investors only to have their capital invested in fossil-intensive companies. **For asset managers, this carries a reputational risk – misleading asset owners could lead to capital flight toward 'genuinely' sustainable alternatives, jeopardising access to liquidity**. A recent study of institutional investors by pwc found that 39% have rejected or stopped investing with an asset manager because of "shortcomings" in their ESG investment strategies, and 50% would consider changing their asset manager for this reason.[34]

Table 4 exhibits several funds which are among the worst offenders in our sample, in that they have significant investments in these unaligned companies despite being advertised as 'climate' or 'ESG' funds. BlackRock's iShares V Plc – MSCI World Energy Sector ESG UCITS ETF, for example, had 35% of the fund invested in our sample of 15 companies at YE2022.

TABLE 4: WORST OFFENDERS – "GREEN" FUNDS

Fund Name	Provider	Investments in O&G companies (% of fund)	YoY Change in Fund O&G Investments (pp)	Fund Type
iShares V Plc - MSCI World Energy Sector ESG UCITS ETF	BlackRock	35	+35	Passive
SSGA SPDR ETFs Europe I Plc - S&P US Div Aristocrats ESG UCITS	State Street	13	+6	Passive
BlackRock CIF - iShares UK Equity ESG Index Fund UK	BlackRock	13	+13	Passive
BlackRock Solutions Fds. ICAV - Coutts UK ESG Insights Eq. Fd.	BlackRock	12	+12	Active
Invesco FTSE All Share ESG Climate UCITS ETF	Invesco	10	+5	Passive
PassIM Structured Funds plc - Nordnet Index Fund EM ESG	JP Morgan	9	+2	Passive
JPMorgan ETFs (IE) ICAV - Europe Res. Enh. In. Eq. (ESG)	JP Morgan	7	+4	Passive
FlexShares STOXX US ESG Select Index Fund	Northern Trust	6	+4	Passive
Invesco S&P International Developed ESG Index ETF	Invesco	4	+4	Passive

Sources: Factset, CTI analysis
Notes: % of fund invested in 15 companies studied as at 31/12/2022. positions across 15 companies in universe; total position in oil and gas may be materially larger

Beyond reputational damage, asset managers are exposing themselves to regulatory risk

As noted in the introduction, these advertising practices, which could be considered misleading, are now exposing asset managers to regulatory risk, as overseers are beginning to crack down on managers making unrealistic claims around funds' sustainability credentials.[35] The European Securities and Markets Authority,[36] the European Commission,[37] the UK's Financial Conduct Authority,[38] and the US Securities and Exchange Commission[39] have all started to crack down on what is perceived as false advertising within the fund management industry. Regulatory risk is not

[34] Pwc (2022), Asset and Wealth Management Revolution 2022
[35] FT (14/06/2022), ESG's legal showdown: 'There's nothing to suggest DWS is a one off'
[36] ESMA (2022), ESMA launches a consultation on guidelines for the use of ESG or sustainability-related terms in funds' names
[37] European Commission (2021), What is the EU Taxonomy Article 8 delegated act and how will it work in practice?
[38] Financial Conduct Authority (20/03/2023), Dear CEO Letter: ESG Benchmarks Review
[39] LinkLaters (2022), ESG spotlight moves to investment advisers and registered funds under SEC proposals

limited to advertising practices: managers are also now facing scrutiny over contradictory proxy voting behaviour (Box 2).

The SEC recently fined BNY Mellon's asset management arm $1.4m for misstatements about the ESG credentials of some of its mutual funds, setting a precedent that they "*…will hold investment advisers accountable when they do not accurately describe their incorporation of ESG factors into their investment selection process.*"[40] The Commission subsequently charged Goldman Sachs Asset Management for failing to adequately follow its own policies on ESG when selecting securities for two of its mutual funds.[41]

In response, financial institutions are beginning to recognise these regulatory hazards. HSBC, for example, added "regulatory environment risk" around potential greenwashing sanctions to its list of external risk factors in its 2022 annual report.[42] The threat of sanctions applies to the firms as a whole, but individuals could also be seen as culpable – German asset manager DWS saw its CEO resign in 2022 after its offices were raided by police on suspicion of prospectus fraud after they were accused of greenwashing in their product offerings.[43,44]

4.2 Climate Initiatives

Alongside starting to recognise the changing tide of asset owners' climate-oriented investment preferences - as evidenced by the plethora of green funds now being offered on the market - the fund management community have also started to promote their green credentials by publicising their individual climate policies and through membership of different net zero initiatives.

One such initiative is the Net Zero Asset Managers Initiative (NZAM), a sub-group of GFANZ. Established in late 2020, the alliance has 301 signatories covering $59tn of AUM – including some of the biggest names in the industry – where **members commit to aligning all AUM with net zero emissions by 2050.**[45]

The NZAM members' commitments include:[46]

i. Setting interim targets for the proportion of AUM to be aligned with a 50% reduction in CO_2 by 2030 by the IPCC's 1.5°C pathway;
ii. Taking into account their portfolio's scopes 1 and 2 emissions and, "to the extent possible", scope 3;
iii. Prioritising real economy emissions reductions within investee companies, and;
iv. Implementing a stewardship and engagement strategy that is consistent with the ambition for all AUM to achieve net zero emissions by 2050 or sooner.

[40] SEC (23/05/2022), *SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations*
[41] SEC (22/11/2022), *SEC Charges Goldman Sachs Asset Management for Failing to Follow its Policies and Procedures Involving ESG Investments*
[42] HSBC (2022) *Annual Report and Accounts* p.137
[43] FT (20/06/2022), *Asset managers told to clean up greenwashing and net zero claims*
[44] FT (03/06/2022), *Greenwashing is tempting for CEOs who tell stories*
[45] NZAMI (2023), *The Net Zero Asset Managers Initiative*
[46] NZAMI (2023, *Commitments*

The NZAM is clearly a positive step and should have a real impact. However, as with the asset owner initiatives, the primary limitation is that setting targets to cover only a (chosen) proportion of AUM allows, in theory, fund managers to exclude oil and gas investments from the proportion of assets which are covered by targets, which could undermine the achievement of emissions reductions.

Similarly, the NZAM's treatment of scope 3 emissions, or end-use, emissions could be strengthened: curbing scope 3 emissions are crucially important when it comes to heavy polluters like oil and gas companies, as c. 85% of their emissions fall under the category of scope 3.[47] Action to reduce these emissions is urgently needed: of the 15 companies analysed herein, eight do not include scope 3 emissions in their net zero targets, while just four have interim targets before 2050 that include scope 3 emissions on an absolute basis.[48]

NZAM membership can be considered a statement of support for 1.5°C

Given the current gaps in the NZAM targets' methodology, which we hope will be tightened over time, asset managers could rightly say that there is no strict contradiction between the initiative's rules – which appear to allow for the holding and expansion of positions in unaligned oil and gas companies – and their investment practices.

However, notwithstanding these facts, NZAM membership can be thought of as **a signal to asset owners that the asset manager intends to take their climate commitments seriously.** In theory, it should be able to act as a bell weather for climate-concerned asset owners to determine who they can depend on to manage their capital in a manner aligned with their own investment principles. For this reason, it is important to identify those NZAM members who could be considered to be flouting their public commitments by continuing to invest in oil and gas companies that are not aligned with a 1.5°C pathway.

[47] Equinor (2020), *Sustainability Report* p.22

[48] ConocoPhillips, EQT, EOG Resources, Devon, Pioneer, Suncor and ExxonMobil do not include scope 3 emissions in their net-zero by 2050 targets. See Carbon Tracker (2022), *Absolute Impact 2022* for details.

5 Asset Managers' Oil and Gas Investments

Russia's invasion of Ukraine reverberated through energy markets in 2022, sending oil and gas prices soaring in the early part of the year. For oil and gas companies, this contributed to windfall profits, which, combined with promises of bumper dividend payments, made these companies attractive investment opportunities. It is perhaps therefore unsurprising, that certain asset managers expanded their shareholdings substantially throughout the year.

Yet asset managers investing in companies at odds with marketing materials, publicly stated climate commitments, and, increasingly, clients' wishes, could be considered negligent by regulators and ultimate beneficiaries.

Commodity prices normalised down to their pre-Ukraine levels in the latter part of 2022, making it unlikely that oil companies earn similarly supernormal profits in FY2023. Between this step down in financial performance and companies' likely minimal progress on transition adaption, asset managers who doubled down on oil and gas last year are both exposing their investment decisions to challenges by climate-committed clients, and their clients to transition-induced value erosion.

Oil and Gas Company and Asset Manager Universe

To structure our analysis, and derive a manageable universe, **we focus on 15 of the world's largest list oil and gas companies.**[49] To identify the asset managers of interest, we looked at the 20 largest shareholders (by % of outstanding shares held) of each of these 15 companies, as of 31/12/2022. Combined, **this created a universe of 90 asset managers**, including some of the world's largest managers and 25 members of the NZAM. When considering the investments of these 90 managers across these 15 investee companies, we include all positions irrespective of size.

We find that asset managers have built sizeable positions in the oil and gas sector, with many of the top asset manager shareholders investing in the majority of the 15 companies covered (Table 5). Among these largest 35, 15 are members of the NZAM. Unsurprisingly, the 'big three' fund managers (Vanguard, BlackRock, and State Street) hold the largest positions, but some other smaller firms have outsized investments in the industry: Dodge and Cox, for example, has 3% of its AUM invested in just five oil and gas companies.

[49]Company universe consists of bp, ConocoPhillips, Chevron, Devon, Equinor, Eni, ExxonMobil, EQT, EOG Resources, Occidental, Pioneer, Repsol, Shell, Suncor and TotalEnergies. The sample of companies is the same as those covered in our *Absolute Impact 2022* report, which itself was based off the largest listed companies by 2019 production volumes.

TABLE 5: TOP 35 ASSET MANAGERS BY VALUE OF AGGREGATED OIL & GAS POSITIONS

Rank	Asset Manager	HQ	No. Investee Companies (/15)	NZAM Member?	Average Position Size (%OS)		Market Value of O&G Positions ($bn)		AUM ($bn)	O&G Positions % of AUM
					2021	2022	2021	2022		
1	Vanguard	US	15	No	6.3	6.2	80	125	7,200	1.7
2	BlackRock	US	15	Yes	6.0	6.6	72	116	8,940	1.3
3	State Street	US	15	Yes	3.6	3.7	53	80	3,410	2.3
4	Capital Group	US	11	Yes	3.4	4.0	32	45	2,200	2.0
5	Berkshire Hathaway	US	4	No	0.4	6.0	5	43	299	14.3
6	Fidelity	US	15	Yes	1.3	1.8	13	31	3,900	0.8
7	Geode Capital Management	US	15	No	1.1	1.2	15	24	713	3.3
8	JPMorgan Chase	US	15	Yes	1.0	1.1	13	22	4,000	0.5
9	Bank of America	US	9	No	1.0	1.0	11	17	1,400	1.2
10	Morgan Stanley	US	15	No	0.7	0.7	10	17	1,300	1.3
11	Northern Trust	US	15	Yes	0.7	0.7	11	17	1,000	1.7
12	T. Rowe Price Group	US	14	Yes	0.8	0.8	8	15	1,280	1.2
13	UBS	Switzerland	15	Yes	0.7	0.7	9	14	1,064	1.3
14	Wellington Management	US	15	No	0.8	0.9	9	14	1,200	1.1
15	BNY Mellon	US	15	No	0.6	0.6	9	13	1,840	0.7
16	Amundi	France	6	Yes	0.7	1.0	9	12	2,040	0.6
17	Invesco	US	15	Yes	0.8	0.7	8	12	1,410	0.9
18	Dimensional	US	15	No	0.6	0.7	6	12	653	1.8
19	Legal & General	UK	15	Yes	0.5	0.5	6	12	1,400	0.8
20	Dodge & Cox	US	7	No	2.7	2.3	8	11	323	3.5
21	Franklin Resources	US	15	Yes	0.7	0.7	8	11	1,500	0.7
22	Charles Schwab	US	14	No	0.4	0.5	6	10	755	1.4
23	Ameriprise	US	15	No	0.4	0.5	6	10	956	1.1
24	TIAA	US	14	No	0.5	0.6	6	10	1,210	0.8
25	Royal Bank of Canada	Canada	14	No	0.6	0.6	6	8	1,000	0.8
26	Sun Life Financial	Canada	11	No	0.7	0.8	5	8	1,330	0.6
27	GQC Partners	US	7	No	0.8	0.9	3	8	88	8.6
28	DWS	Germany	15	Yes	0.3	0.3	5	7	878	0.8
29	Goldman Sachs	US	15	No	0.3	0.4	3	6	2,500	0.3
30	abrdn	UK	14	Yes	0.3	0.3	4	5	458	1.2
31	Wells Fargo	US	12	No	0.3	0.3	3	5	1,880	0.3
32	Schroders	UK	14	Yes	0.3	0.4	3	5	898	0.6
33	BPCE	France	15	No	0.3	0.3	4	5	1,710	0.1
34	Equitable	US	15	No	0.2	0.3	3	5	908	0.1
35	Orix	Japan	15	No	0.3	0.4	3	4	400	0.1

Source: Factset; CTI analysis; NZAM; figures for AUM sourced from company websites, annual reports, ADV filings and 13F filings. Notes: positions in 15 companies only; total positions in oil and gas may be materially higher. Berkshire Hathaway's AUM figure is its total portfolio value; Wells Fargo's AUM figures are total group assets; Goldman Sachs' AUM figure is Assets Under Supervision. Converted from reported currencies at closing current/USD price on 31/12/2022. Managers ordered by value of aggregate position at 31/12/2022.

5.1 Investments by NZAM Members

In our universe of 90 asset managers, 25 are members of NZAM. Here, we analyse the holdings of the top 15 of these, ranked by the value of their aggregate positions in the 15 companies in the universe (Figure 6).

Asset owners likely see NZAM membership to mean managers' investments are climate-aligned

Asset managers who sign up to NZAM are in effect signalling to asset owners that they intend to take climate considerations and net zero goals seriously. In response, clients of NZAM signatories could reasonably expect that investments made on their behalf are aligned with 1.5°C. Otherwise, the credibility of both the asset managers and the NZAM itself could be jeopardised.

Asset managers must be clear to themselves on the signals that their membership sends to clients. We note that in late 2022 Vanguard made a widely publicised withdrawal from NZAM.[50] This could seem like a blow to the initiative, but Vanguard's exit in some ways may have added to its credibility: Vanguard may never seriously have expected to achieve the goals to which it committed through its membership and its decision allows climate-committed asset owners to vote with their feet and move their capital to another NZAM-aligned asset manager. That being said, we would not encourage withdrawals from the initiative, but rather for signatories to work towards its targets, and for those to be strengthened over time. Where issues could arise is when those managers who are members cannot be trusted by their clients or are found by regulators to be behaving contrary to their public commitments.

Yet some NZAM members are heavily invested in oil and gas…

Figure 2 shows the wide range in oil and gas shareholdings that exist across the NZAM asset managers. Some, like Blackrock, State Street, Capital Group and Fidelity, hold significant positions in almost all of the 15 companies analysed. At the end of 2022, Capital Group's $46bn investments in oil and gas companies accounted for 1.6% of its total AUM – it will be interesting to see whether those assets are covered by the firm's portfolio alignment targets once they are disclosed.[51] Others, like Amundi, own shares in only about half of the companies studied. The average size of NZAM members' stakes is 1.5% of outstanding shares, but holdings in individual companies can be significantly higher – BlackRock, for example, owns 12.4% of EQT.

Investment practices differed across the 25 NZAM members analysed. Some, like, abrdn, DWS, and Schroders, hold much smaller positions. These lesser invested managers are largely located in Europe, while the bigger positions are held by their (often much larger in AUM terms) North American counterparts.

[50]Vanguard (2022), *An update on Vanguard's engagement with the Net Zero Asset Managers initiative (NZAM);* see, e.g. Reuters (07/12/2022), Vanguard quits net zero climate effort, citing need for independence, Financial News London (08/11/2022) Vanguard exit from $66tn net-zero coalition could trigger 'domino effect', ESG expert warns

[51] Net Zero Asset Managers Initiative (2023), *Capital Group* [accessed 17/03/2023]

… and added to their positions in 2022

The asset managers with large shareholdings across multiple companies tended also to be the ones who increased their stakes throughout the year (Figure 3). Blackrock, Fidelity, and Capital Group's net exposure to these companies all increased in 2022, while other managers (like Northern Trust, Legal & General, DWS, and abrdn, and Schroders) kept their exposure relatively stable.

EQT proved a popular choice for those expanding their oil holdings, with Amundi, Franklin Templeton, Fidelity, Invesco, State Street, and Capital Group all buying up shares throughout 2022. In terms of Paris alignment, EQT remains a laggard in its peer group. While the company has an absolute emissions reduction target, it does not include scope 3 emissions. Interestingly, BlackRock appeared to take an opposing view of EQT's potential future performance, selling off its holdings throughout the year.

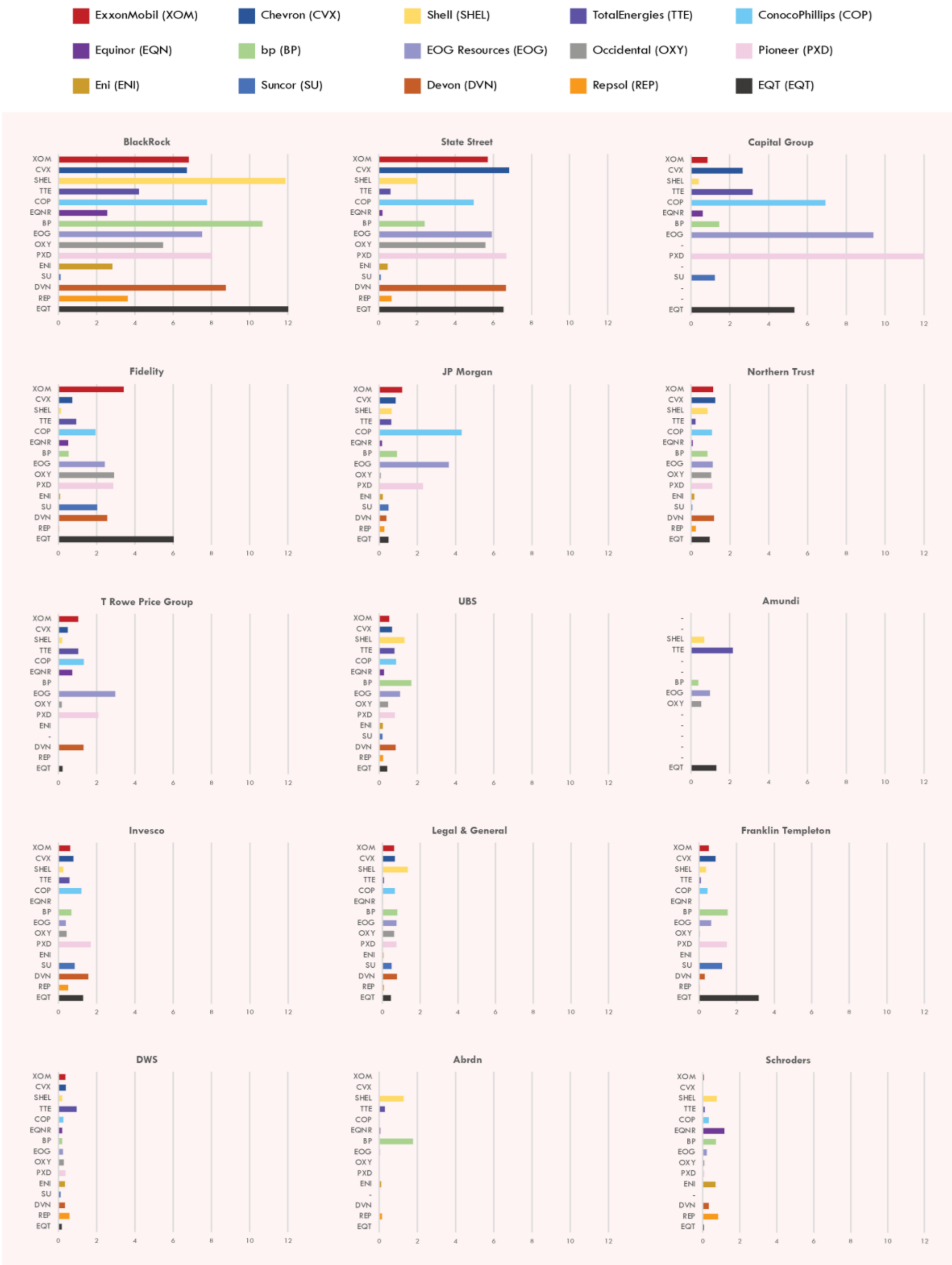
Alignment of NZAM members varies; climate-concerned asset owners can vote with their capital

Across the cohort studied, we find that not all asset managers share similar investment patterns. In theory, since they are all NZAM members and working towards shared targets, one might expect to see a similar sort of investment strategy being deployed vis-á-vis oil and gas companies, e.g., a shift away from the least climate-aligned companies or greater inflows to those which are considered more transition-proof, or even a general shift away from the sector. But we find that certain asset managers, like Blackrock, Capital Group, Fidelity, and T Rowe Price Group have been growing their already substantial investments in the sector.

Asset owners concerned about the climate impacts of their investments could resolve to seek out managers with reduced exposure to unaligned companies. If NZAM membership is considered a draw, then managers who generally refrained from deepening their positions, like Northern Trust, Legal & General, DWS, abrdn, and Schroders could be viewed as having upheld the principles of the initiative throughout 2022, at least moreso than some of their peers. In fact, Aviva recently announced that it has divested almost all of it is exposure to fossil fuel companies, which is a clear sign of its commitment to achieving its NZAM targets.[52] For those asset managers that are pursuing an an engagement strategy ahead of a divestment one, the way they use their votes is critically important - see Box2 for further discussion on this.

[52] Environmental Finance (14/03/2023), Aviva completes divestment of £2.5bn in fossil fuel companies

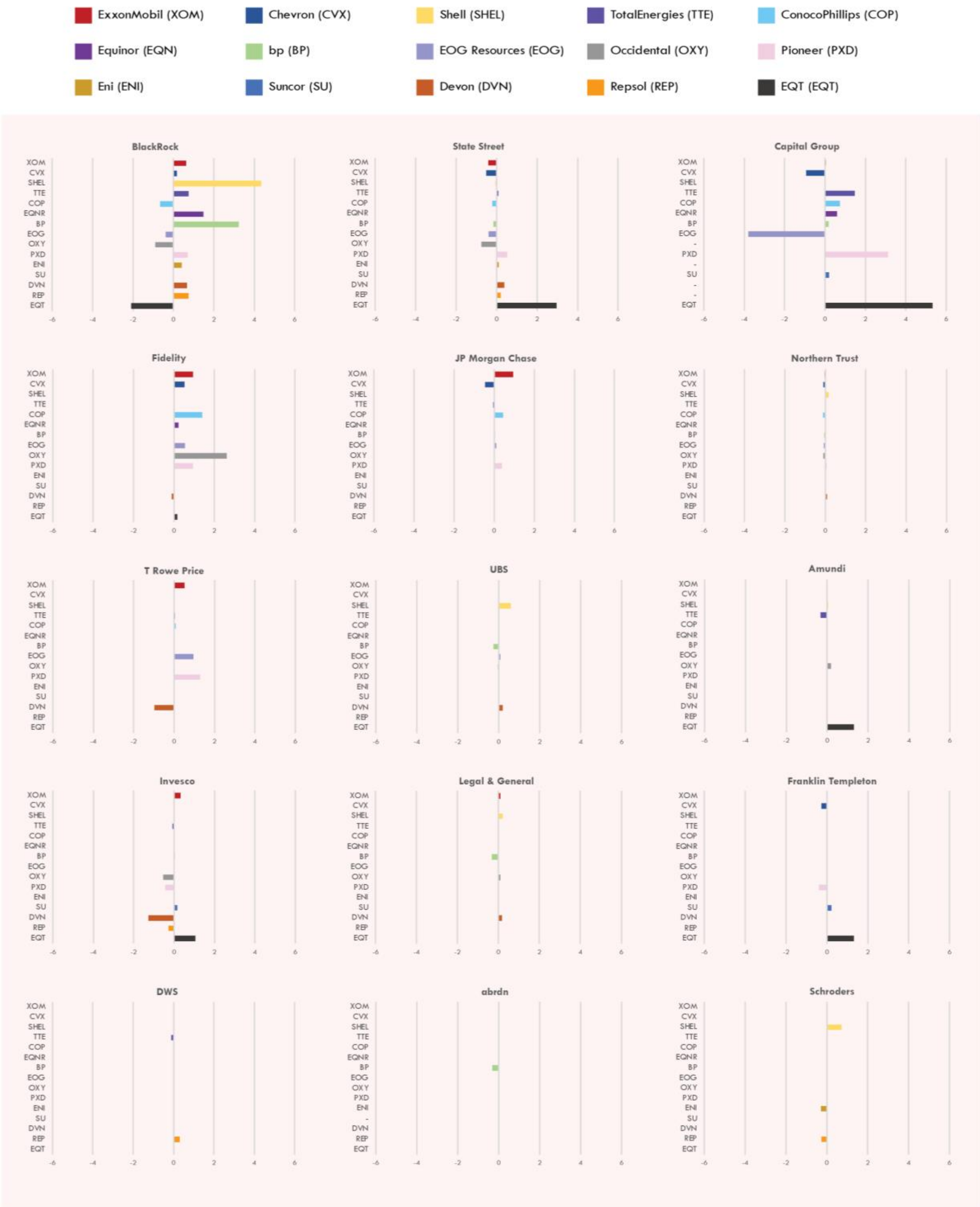
FIGURE 2: TOP 15 NZAM MEMBERS – OIL & GAS HOLDINGS AT END OF 2022 (% OF OUTSTANDING SHARES HELD)



Source: Factset, NZAM, CTI analysis.

Notes: Top 15 NZAM members by AUM. Holdings as at 31/12/2022. Companies ordered by market cap as of 31/12/2022. XOM = ExxonMobil; CVX = Chevron; SHEL = Shell; TTE = TotalEnergies; COP = ConocoPhillips; EQNR = Equinor; BP = bp; EOG = EOG Resources; OXY = Occidental; PXD = Pioneer; ENI = Eni; SU = Suncor; DVN = Devon; REP = Repsol; EQT = EQT

FIGURE 3: TOP 15 NZAM MEMBERS - CHANGES IN OIL & GAS HOLDINGS IN 2022 (PERCENTAGE POINT CHANGE IN OUTSTANDING SHARES)



Source: Factset, NZAM, CTI analysis

Notes: Top 15 NZAM members by AUM .Holdings as at 31/12/2022. Companies ordered by market cap as of 31/12/2022. XOM = ExxonMobil; CVX = Chevron; SHEL = Shell; TTE = TotalEnergies; COP = ConocoPhillips; EQNR = Equinor; BP = bp; EOG = EOG Resources; OXY = Occidental; PXD = Pioneer; ENI = Eni; SU = Suncor; DVN = Devon; REP = Repsol; EQT = EQT.

Box 2: Asset Managers' Proxy Voting Practices

Being among the largest shareholders in the world's largest listed oil and gas companies means that asset managers have enormous influence when it comes to proxy voting season. Some fund managers see their role as 'active stewards', which is to say that the preferred way for investors to tackle climate concerns is to hold shares and exert influence over a company's energy transition strategy and environmental impact is by voting at general meetings.

Asset managers who vote contrary to advertised positions on climate could face rebuke from regulators

Managers who elect to take an 'active management' approach to their shareholdings should be aware that deficiencies in climate-related proxy voting policies are now a source of regulatory risk, as regulators are increasingly scrutinising what could be viewed as contradictory voting practices. The SEC, for example, is investigating "sustainable" funds which vote against ESG-focused shareholder proposals.[53]

In 2022, NZAM signatory BlackRock announced that it would vote against most climate-related shareholder proposals, saying that many resolutions that were being put forward were too "prescriptive or constraining on companies".[54] Granted, it's likely that not all ESG-orientated proposals warranted support, but BlackRock cited the setting of absolute scope 3 emissions targets as an example of those resolutions with which it is concerned. It is notable, however, that of BlackRock's 14 investee companies, four have absolute scope 3 emissions targets, and each of these four posted outsized financial performance in 2022.[55] For example, Eni – in which Blackrock held a 2.8% stake at YE2022 – has the most ambitious absolute reduction targets of its peers, 35% by 2030,[56] and yet posted decade-high returns in 2022.

Emissions reductions targets set on an absolute basis with interim targets are the bare minimum that investors should expect from oil and gas companies who claim to be Paris-aligned. While asset owners may not support every climate proposal filed, it is important to push managers to support proposals around emissions targets, as well as investment allocation, remuneration policies, and climate disclosures if they wish to maintain their holdings while achieving portfolio alignment with 1.5°C. Indeed, amid growing scrutiny from regulators, asset managers need to act to preserve the perceived integrity of their own investment practices.

Deferring to management on transition resolutions could inhibit companies from acting on climate

Managers' proxy voting decisions are particularly decisive for companies which have historically been reluctant to take adaptive action to the energy transition (an issue which is notably pronounced in the US). Indeed, it has been shown that fund managers have incentives to be "excessively deferential—relative to what would best serve the interests of their own beneficial investors—toward the preferences and positions of the managers of portfolio companies".[57] Management's incentives may be misaligned with shareholders when it comes to transition strategies, as executives can be enticed by short-term returns to expand production, despite the long-term requirements to adopt low-carbon business strategies.[58]

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[53] Securities and Exchange Commission (2022), 2022 Examination Priorities
[54] Blackrock (2022), 2022 climate-related shareholder proposals more prescriptive than 2021
[55] Eni, TotalEnergies, Repsol, and bp have absolute emission targets (see Carbon Tracker (2022), Absolute Impact 2022).
[56] See Carbon Tracker (2022), Absolute Impact 2022 for a full discussion of Eni's emissions targets.
[57] Bebchuk, L., and Hirst, S., (2019) Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy Columbia Law Review, Vol. 119, pp. 2029-2146
[58] See Carbon Tracker, (2022) Crude Intentions for a full discussion of management incentives and their influence on transition strategies,

5.2 Investments by non-NZAM Members

Out of our cohort of 90 asset managers, 65 have not yet signed up to the NZAM. While many have set their own net zero emissions targets, it appears that they do not prevent investing in unaligned oil and gas companies. We find that fund managers have continued to invest their clients' capital in companies whose assets are exposed to transition risk.

While these managers may be less at risk of regulatory kickback, they may be exposing asset owners to significant energy transition risk

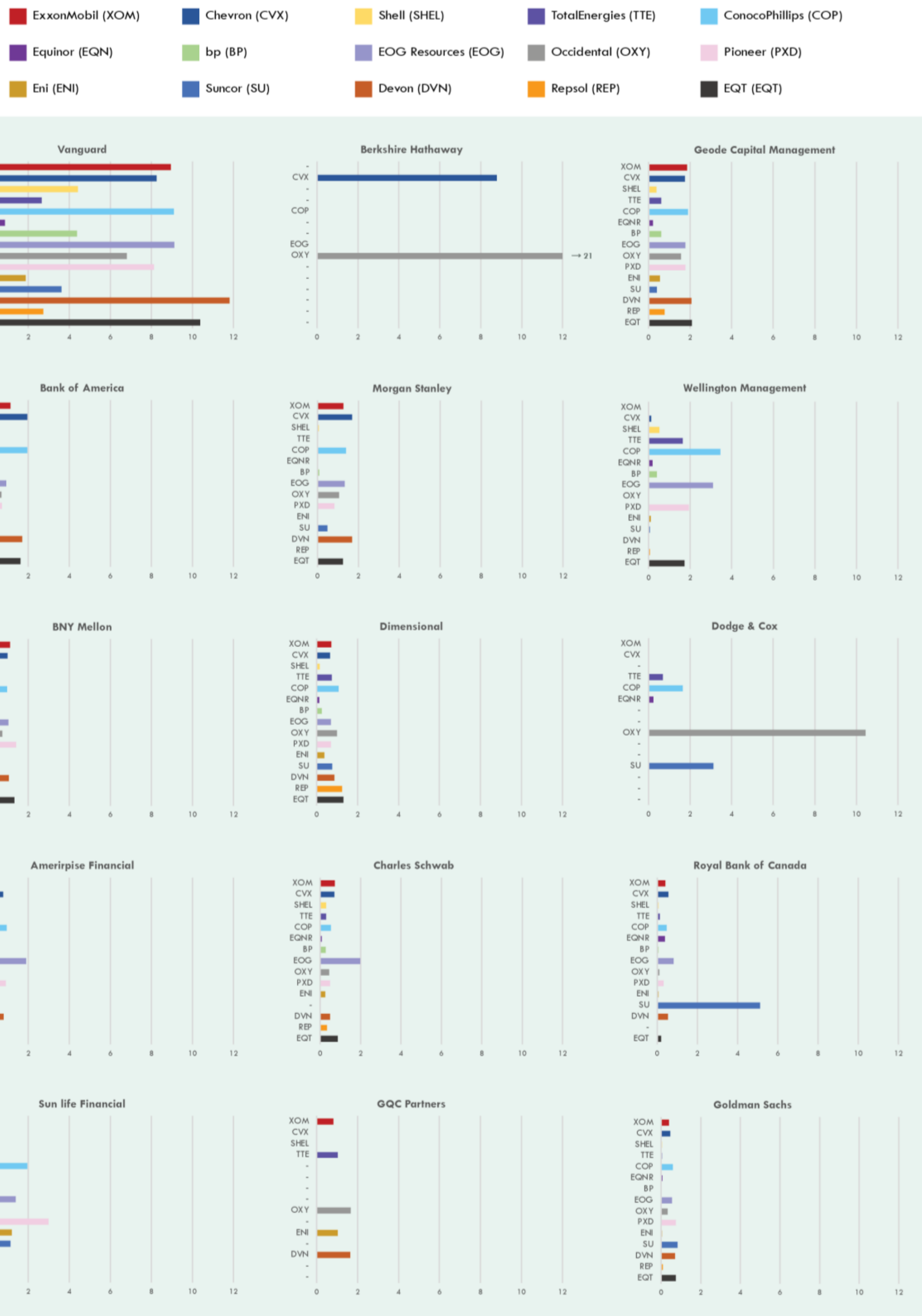
Share price volatility may lead to returns in the near term, and some clients may be prepared to accept that risk/reward profile. However, once there is market consensus that we have reached a downward trend in terms of fossil demand there could be sharp and significant fall in in share prices: asset owners who are concerned about the future value of their investments will likely consider these investment dynamics when selecting a capital manager.

Figure 4 breaks down the oil and gas positions of the 15 non-NZAM asset managers with the largest shareholdings across the 15 oil and gas companies studied. While large positions are, to some extent, to be expected given the amount of capital that these asset managers control, it is nonetheless striking to see company ownership consolidated in the hands of so few stakeholders. Vanguard yields the most influence across the sample. The firm is a shareholder in all 15 companies, with a combined $116bn worth of investments. The size of its holdings ranges from 2.6% of Equinor to 12.5% of EQT, with an average stake of 7.1%. By comparison, Geode Holdings, our third largest non-NZAM manager by the value of their aggregate positions ($23bn), owns an average 1.2% stake in the 15 companies.

Surprisingly, there is little difference in investment practices across NZAM and non-NZAM members

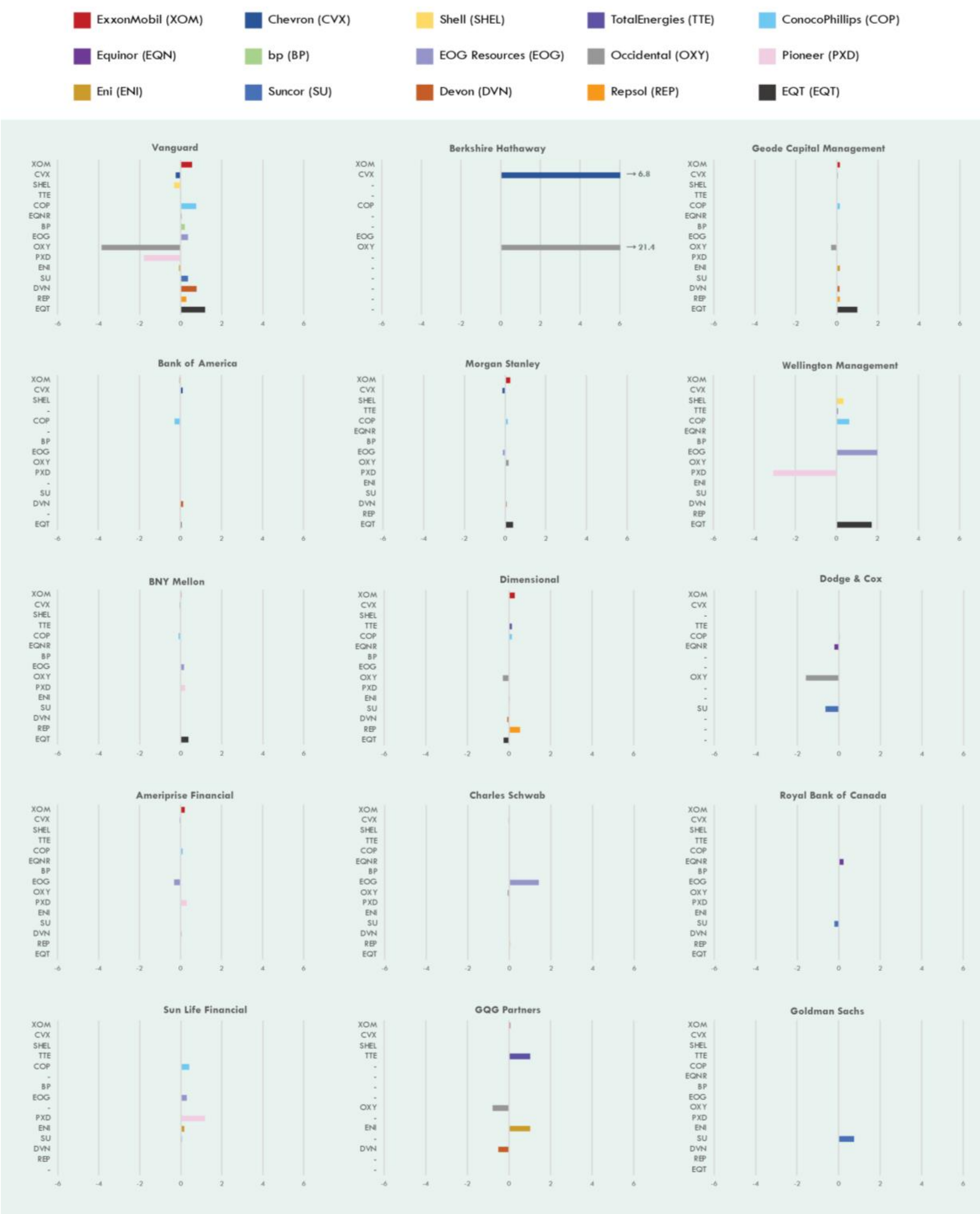
Interestingly, we find that NZAM members and non-members had similar increases in their oil and gas investments. For the largest asset managers (by the value of their positions in the 15 companies studied), NZAM members (Figure 3) actually increased their shareholdings more than non-members (Figure 5). Why that might be the case is beyond the scope of this note – though it may be partly caused by certain managers offering a large amount of passive investing products (Box 3) - but it does suggest that those NZAM members who have been doubling down on oil and gas (like BlackRock , Capital Group and Fidelity) may face even more thorough scrutiny from regulators and clients for their investment decisions, given that managers with ostensibly weaker climate commitments are refraining from expanding their investments into these companies.

FIGURE 4: TOP 15 NON-NZAM MEMBERS – OIL & GAS HOLDINGS (% OF OUTSTANDING SHARES HELD)



Notes: Top 15 non-NZAM members by the value of their aggregate positions in all 15 companies. Holdings as at 31/12/2022. Companies ordered by market cap as of 31/12/2022. XOM = ExxonMobil; CVX = Chevron; SHEL = Shell; TTE = TotalEnergies; COP = ConocoPhillips; EQNR = Equinor; BP = bp; EOG = EOG Resources; OXY = Occidental; PXD = Pioneer; ENI = Eni; SU = Suncor; DVN = Devon; REP = Repsol; EQT = EQT

FIGURE 5: TOP 15 NON-NZAM MEMBERS - CHANGES IN OIL & GAS HOLDINGS IN 2022 (PERCENTAGE POINT CHANGE IN OUTSTANDING SHARES)



Notes: Top 15 non-NZAM members by the value of their aggregate positions in all 15 companies. Holdings as at 31/12/2022. Companies ordered by market cap as of 31/12/2022. XOM = ExxonMobil; CVX = Chevron; SHEL = Shell; TTE = TotalEnergies; COP = ConocoPhillips; EQNR = Equinor; BP = bp; EOG = EOG Resources; OXY = Occidental; PXD = Pioneer; ENI = Eni; SU = Suncor; DVN = Devon; REP = Repsol; EQT = EQT.

Box 3: Passive investing could lead to unforeseen fossil exposure

Passive, or index funds have rapidly grown in popularity over the past decade, and some of the increases in shareholdings found in our analysis can likely be attributed to purchases made via such products. These funds, which involve investing to mirror the return of a specified benchmark index, like the S&P 500, are particularly popular among retail investors due to their lower administrative burdens and management fees.

However, retail investors may not be fully aware of the exposure to heavily carbon-emitting companies that investing in passive funds will generate.

Passive products could amplify asset owners' exposure to transition risk

The pitfalls of passive investing in relation to climate alignment and transition risk exposure were amplified over the last year. Over the period studied, there was a broad rise in company share prices, which would have resulted in their carrying greater weight in any market capitalisation or price-weighted indices, leading to greater exposure for passive investors.

The question this then begs is: are passive investors effectively being set up for a fall? Passively managed funds effectively do not have an exit option as they cannot sell shares if a company is underperforming, which has led Vanguard's ex-CEO F.W. McNabb to describe passive investors as "permanent shareholders".[59] Therefore, without a deliberate effort to discriminate on some basis between indexed companies, this would imply that passive investors are particularly exposed to transition-induced value erosion. It also amplifies the power they have when it comes to voting season (Box 1).

From an alignment perspective, it also calls into question whether asset managers who predominantly offer passive products (like BlackRock or Amundi) can ever credibly be expected to meet alignment or net zero targets, or indeed their commitments made under initiatives like NZAM without appropriate, 1.5°C-aligned benchmarks. Asset managers with, for example, 'exclusion policies' (or pledges to exclude certain polluting sectors, like coal producers, from their portfolios), largely admit that these policies do not apply to their passively managed funds.[60] This therefore raises questions around the fundamental compatibility of traditional index funds with climate-orientated investment goals. Investors who want to ensure the alignment of their portfolios may wish to invest more actively. Additionally, regulators should be cognisant of the role that passive funds have in exposing investors to carbon intensive investments.

Paris-aligned index funds require Paris-aligned benchmarks

Passive products based on conventional indices, even those which are supposedly geared towards 'sustainable' investing, cannot be considered aligned if they purchase shares in unaligned oil and gas companies. If asset managers, regulators, and index providers believe that there should be credibly Paris-aligned products on the market, then they need to be based off Paris-aligned indices. Oil and gas companies could be excluded from benchmarks writ large, but a likely more practical solution would be to create an index which includes companies only on the basis that they meet credible, Paris-aligned metrics. Carbon Tracker has proposed metrics to gauge the alignment of oil and gas companies in areas including production sanctioning decisions, capex allocation, emissions targets, and remuneration policies[61], which could serve as criteria for inclusion.

Lastly, regulators may also need address timeframes over which fund performances are benchmarked. Currently, fund performance is assessed over the relatively short term (c. 3 years). But given the medium-to-long term risks arising from transition induced value erosion, a more appropriate timeframe could be between 15-25 years.

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[59] Bebchuk, L., and Hirst, S., (2019) Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy Columbia Law Review, Vol. 119, p.2047
[60] Reclaim Finance (2022), Asset Manager Climate Scorecard 2022
[61] See for examples: Paris Maligned (2023), Crude Intentions (2022), Absolute Impact (2022).

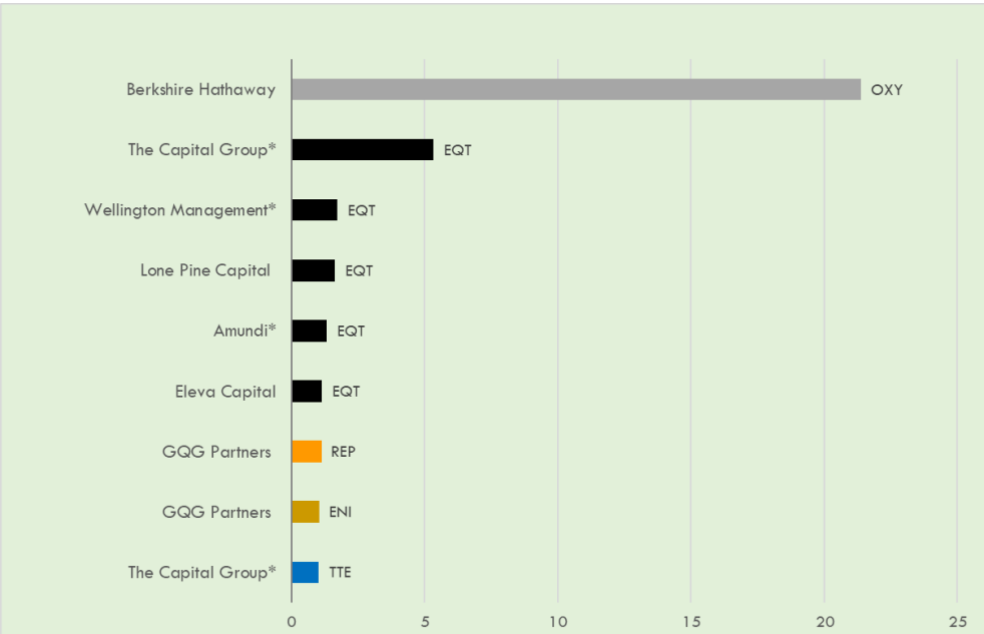
Elevated commodity prices attracted new entrants to the sector…

We find some asset managers have entered into (sometimes large) new positions in companies where they had none before (Figure 6). For example, Capital Group - despite being an NZAM member - bought 5.3% and 0.6% stakes in EQT and Equinor, respectively. Capital Group weren't alone in buying into EQT: Wellington Management, Lone Pine Capital and SAS Rue la Boetie all took up positions during the year.

At the same time, Warren Buffet's Berkshire Hathaway took on a huge, widely publicised,[62] 21% stake in Occidental, worth over $12bn. The move is a bet on American oil production, and Buffet has also said he believes oil prices will remain elevated into the future.[63] However, we have found that Occidental is among the least Paris-aligned of the oil majors, with over 75% of its business-as-usual unsanctioned project capex falling outside what is required in a 1.7-2.5°C warming scenario. To be aligned with 1.5°C, Oxy's production would need to fall by c.75% by the 2030s.[64] We have also found Occidental's emissions reduction plans to be far from credible: the company excludes equity-owned assets from its intensity-only net zero targets, and its plans to reduce emissions rely unduly on Direct Air Capture (DAC) technology, which has yet to be proven to work at scale.[65]

Given that the company has not indicated that it intends to adhere to these Paris requirements, Berkshire Hathaway's huge investment in Occidental will likely give pause to any climate-committed asset owners who are seeking a manager.

FIGURE 6: NEW ENTRANTS (% OUTSTANDING SHARES HELD AT 31/12/2022)



*Sources: Factset, NZAM, CTI Analysis. Notes: * denotes NZAM membership. TTE = TotalEnergies; OXY = Occidental; ENI = Eni; REP = Repsol; EQT = EQT*

[62] See e.g. Reuters, Bloomberg, CNBC, and Business Insider
[63] Bloomberg, 19/08/2022
[64] Carbon Tracker (2022), Paris Maligned p.9
[65] See Carbon Tracker (2022), Absolute Impact 2022 for more details

6 Recommendations for Stakeholders

For asset owners:

- Don't be fooled by fund names: seemingly "sustainable" funds can have sizeable positions in companies which are not themselves Paris-aligned.
- Challenge asset managers to explain how holding investments in oil and gas companies which are not Paris-aligned is in keeping with their stated sustainability goals.
- If your asset manager is a major shareholder in such companies, scrutinise their voting record/intentions, particularly if you have a mandate from beneficiaries to act on climate.
- Consider moving funds to a different, more aligned, asset manager if your current manager's investment practices are concerning.
- Investors in passive funds may wish to consider the underlying indices off which funds are benchmarked.

For asset managers:

- Investing in unaligned oil and gas companies may be perceived by regulators as a failure to adhere to stated policies on climate, exposing the firm to threats of sanctions.
- Recognise that climate-concerned investors, particularly retail, may be alienated by oil and gas investments and AUM may therefore be at risk.
- Ensure that voting practices are consistent with public climate commitments.
- Consider whether the performance of passively managed funds be benchmarked off a longer time horizon, e.g. 15-25 years.
- Consider whether to push index providers for new indices to be developed which do not include unaligned companies. Index providers should consider which metrics for climate alignment should be used when deciding which companies to include within an index?

For policymakers/regulators:

- Consider whether advertising standards need to be tightened to combat potentially misleading marketing practices.
- Continue to monitor the behaviour of asset managers and whether they are acting in line with stated positions on climate and in their clients' best interests.

Appendix 1

TOP 25 NZAM MEMBERS BY BY VALUE OF AGGREGATE OIL & GAS POSITIONS

Rank	Asset Manager	HQ	No. Investee Companies (/15)	Average Position Size (%OS)		Market Value of O&G Positions ($bn)		AUM ($bn)	O&G Positions (% of AUM)
				2021	2022	2021	2022		
1	BlackRock	US	15	6.0	6.6	72	116	8,940	1.3
2	State Street	US	15	3.6	3.7	53	80	3,410	2.3
3	Capital Group	US	11	3.4	4.0	32	45	2,200	2.0
4	Fidelity	US	15	1.3	1.8	13	31	3,900	0.8
5	JP Morgan Chase	US	15	1.0	1.1	13	22	4,000	0.5
6	Northern Trust	US	15	0.7	0.7	11	17	1,000	1.7
7	T. Rowe Price	US	14	0.8	0.8	8	15	1,280	1.2
8	UBS	Switzerland	15	0.7	0.7	9	14	1,064	1.3
9	Amundi	France	6	0.7	1.0	9	12	2,040	0.6
10	Invesco	US	15	0.8	0.7	8	12	1,410	0.9
11	Legal & General	UK	15	0.5	0.5	6	12	1,400	0.8
12	Franklin Templeton	US	15	0.7	0.7	8	11	1,500	0.7
13	DWS	Germany	15	0.3	0.3	5	7	878	0.8
14	abrdn	UK	14	0.3	0.3	4	5	458	1.2
15	Schroders	UK	14	0.3	0.4	3	5	898	0.6
16	BNP Paribas	France	15	0.2	0.2	3	4	536	0.7
17	Lazard	Bermuda/US	13	0.2	0.2	2	2	216	1.1
18	Aviva	UK	15	0.1	0.1	1	2	429	0.5
19	M&G	UK	11	0.1	0.1	1	1	494	0.2
20	Sanders Capital LLC	UK	1	2.3	2.5	0.8	1	61	1.8
21	Storebrand	Norway	11	0.1	0.1	0.5	0.8	103	0.8
22	Ruffer Investment Company	UK	6	0.2	0.1	0.9	0.8	32	2.4
23	Baillie Gifford	UK	6	0.1	0.1	0.7	0.6	272	0.2
24	Banco Santander	Spain	9	0.1	0.1	0.4	0.5	429	0.1
25	Cardano	UK	3	0.2	0.1	0.2	0.2	55	0.3

Source: Factset; CTI analysis; NZAM; figures for AUM sourced from company websites, annual reports, ADV filings and 13F filings. Notes: positions in 15 companies only, total positions in oil and gas may be materially higher. Converted from reported currencies at closing current/USD price on 31/12/2022. Managers ordered by value of aggregate position at 31/12/2022.

Appendix 2 - Methodology

Ownership Data

We extracted time series data on company ownership – for each of the 15 companies studied - from FactSet, which categorises shareholders as 'Institutions' and 'Mutual Funds/ETFs', a subset of institutions. For each shareholder position, we obtained the following data:

FactSet Datapoint	Comment
Institution / Fund Name	-
Parent Company Name	-
Market Value of Positions	As at 31/12/2021 and 31/12/2022
% of Outstanding Shares Owned	As at 31/12/2021 and 31/12/2022 Calculated as the sum of all institutional or fund held positions divided by the number of shares outstanding
% of Portfolio Invested	As at 31/12/2021 and 31/12/2022 Calculated for individual funds as the Market Value of the position divided by the total market value of the portfolio
Holder Style	Includes GARP, Index, Growth, Yield, Value, Aggressive Growth, and Deep Value.

Methodology:

To derive the full position of each asset manager in each company, we aggregated Factset's data on each institutional shareholders according to each institution's parent company. For example, JP Morgan's holdings were aggregated from JPMorgan Investment Management, Inc.; JPMorgan Asset Management (Canada) Inc.; JPMorgan Asset Management (Taiwan) Ltd., among others.

The sample of 90 asset managers was created by analysing the top 20 shareholders in each of the 15 companies analysed, by percentage of outstanding shares owned as at 31/12/2022. From this sample, the positions of each asset manager across all 15 companies were included in our analysis, irrespective of whether the position was among the top 20 or not.

To determine whether a fund is passively or actively managed, we used Factset 'Holder Style' categorisations. Where Holder Style = Index, the fund was considered passive, and active otherwise.

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