

Q&A with Wellington Community Fund's (WCF) Investment Adviser, Forsyth Barr

This Q&A accompanies WCF and Forsyth Barr's Combined Commitment on Climate Change.

Introduction

In 2021 Wellington Community Fund (WCF), along with a majority of the Community Trusts of Aotearoa New Zealand, signed a Funders Commitment on Climate Action. This recognises the important role community funders play in building better outcomes for our environment and communities. Linn Araboglos, Chief Executive of the WCF, has been heavily involved in driving the implementation of the initiative as leader of the Climate Action Working Group.

Part of one of the seven commitments (Commitment 6: Decarbonise our investments and operations) seeks to proactively address the risks and opportunities of the transition to a low carbon society in investment strategies. Over the last few years, the Forsyth Barr and WCF teams have explored what this really means for the investment portfolio. This led us to produce the 'Combined Commitment' which ties our organisations together in a partnership that commits us both to support the portfolio to be aligned with net zero emissions by 2050 or sooner. In summary, this commits us to:

1. Keeping the weighted average carbon intensity and financed emissions of the portfolio low;
2. Intentionally increase investment in solutions for climate change that also meet WCF's investment objectives;
3. Work in partnership with industry peers and portfolio companies to drive credible decarbonisation strategies.

The full Combined Commitment can be viewed [here](#)

We talked to Katie Beith, Forsyth Barr's Head of ESG, to get the background on what this really means for WCF's investment portfolio.

Getting started

When we first started looking into what it means for WCF to decarbonise its investments, we quickly realised that we needed to understand the starting point before we could recommend any actions. For us, the investment requirements stipulated in the Statement of Investment Policy and Objectives (SIPO) were our first port of call. WCF's long term objectives are to:

1. Preserve the real (inflation adjusted) value of capital of the Fund in perpetuity;
2. Ensure a sustainable and fairly stable level of spending over time;
3. Maintain equity between present and future generations.

And specifically, to achieve a return after fees of CPI + 3.5% p.a. over rolling 15-year periods. These investment objectives must be achieved within the constraints of WCF's Responsible Investment Policy while also reflecting the organisational needs in terms of annual grants and operational expenditures. And finally, the WCF has relatively high liquidity requirements which means the portfolio is predominantly invested in liquid listed securities.

These requirements are non-negotiable and therefore, everything we do in relation to decarbonising the portfolio must be constructed around meeting these investment objectives.

Initial 'climate screen'

The second piece of context setting we did was an initial 'climate screen' of the portfolio to assess the baseline. For information, the WCF portfolio contains a mix of (predominantly) directly held securities and a few external funds which help to build out diversification of the portfolio. For this exercise, we focused on directly held listed equities – the securities within our control.

For the NZ direct stocks held, we used Forsyth Barr's proprietary C&ESG ratings of NZX companies to assess the good and bad carbon performers in NZ. And for the international stocks held, we used Sustainalytics, one of our ESG service providers, to look at the carbon risk profile of portfolio companies.

Alongside this initial 'climate screen', Forsyth Barr has been working towards assessing how well companies in our model portfolios are preparing for the transition to a low carbon economy. Understanding both physical and transition risk posed to companies from climate change is core. But equally just as important is to understand a company's emissions profile and how it may also be contributing to climate change. This assessment is very much in its early days and is reliant on what companies publicly report. With climate disclosures now regulated in NZ and with many countries poised to follow suit, we look forward to greater transparency around what companies are doing to manage and mitigate climate change risks and opportunities. This improved disclosure will help us in our long term assessments of investments. This ongoing project is a core part of the commitments in the Combined Commitment.

Our broad conclusion regarding the 'climate screen' and assessment of how the companies in the WCF portfolio are preparing for the transition to a low carbon economy is that the companies are at **different stages in their journeys and have varying levels of disclosure**. Publicly stated climate aspirations are also very mixed. All companies assessed have a long way to go. Our conclusion was that, as investors, the best way we can support the transition to low carbon economy is to let companies know that we expect them to transition, that we support these efforts, and we will be monitoring progress. **This highlights the importance of an engagement strategy.**

Portfolio carbon measures

The WCF portfolio already has exclusions in place for the extraction, refinement or sale of fossil fuels. This exclusion means that, as a starting point, a large portion of the carbon-intensive companies are not investable. This has positive benefits for the overall carbon profile of the portfolio.

One of the measures that investors have started using to assess the carbon profile of a portfolio is to assess the 'weighted average carbon intensity' (WACI) of a portfolio. Another is the 'financed emissions' of a portfolio.

WACI: The level of carbon emissions a portfolio generates per dollar of revenue from the underlying portfolio companies. Revenue is used in the denominator to normalise emissions.

Financed emissions: Represent the total greenhouse gas emissions associated with all the companies or activities financed by the portfolio, without accounting for the individual carbon intensity. Enterprise value including cash (EVIC) (the sum or market capitalisation plus total debt) is used as the denominator.

$$\text{Weighted average carbon intensity} = \sum \left(\frac{\text{current value of investment}}{\text{current portfolio value}} \right) \times \left(\frac{\text{issuer's Scope 1 and Scope 2 GHG emissions}}{\text{issuer's revenue}} \right)$$

$$\text{Financed emissions} = \sum \left(\frac{\text{current value of investment}}{\text{enterprise value including cash}} \right) \times \text{Scope 1 and Scope 2 GHG emissions}$$

There are pros and cons with using each of the metrics – neither are perfect and, at times, can move in opposite directions.

WACI provides insight into a company's carbon efficiency per dollar of revenue earned and is a useful metric for comparing companies within sectors.

Listed equities only.

Financed emissions provide an important absolute view of emissions 'owned' by different investors. However, apportioning based on the percentage of EVIC owned is still imperfect since changes may be driven by volatility affecting the market values of company equity and debt. *Listed equities and bonds only.*

Given neither of these metrics are perfect, it is important to track them both. And given they can be volatile when the market is volatile, it is also important to track absolute emissions for each portfolio holding and how they are changing over time.

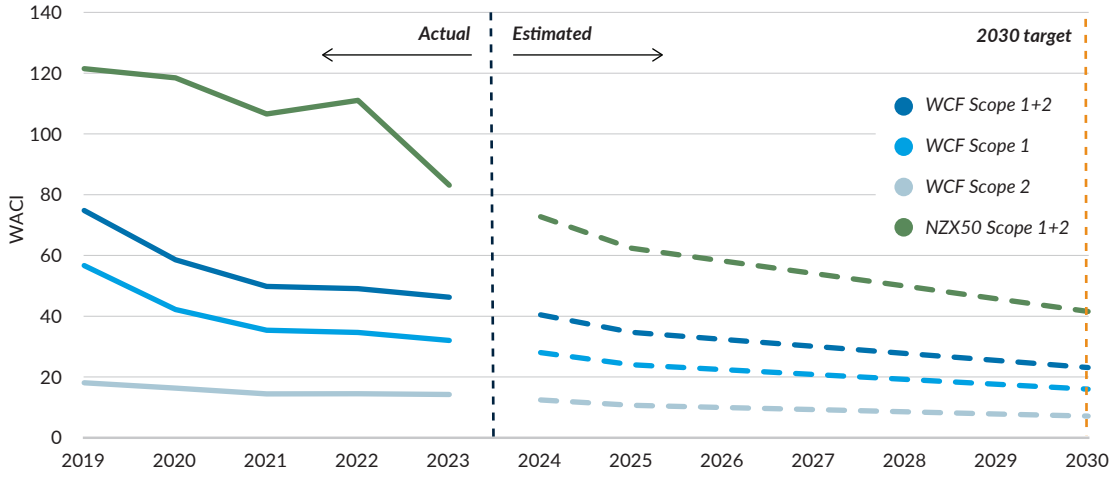
It should also be noted that changing a portfolio to have a low WACI or low financed emissions does not actually remove carbon from the atmosphere. It does, however, send a signal that, as investors, you are not willing to allocate capital to companies that are not transitioning to a lower carbon economy.

For WCF's direct portfolio, the WACI and financed emissions were already very low when compared to the NZX50, ASX200, and MSCI ACWI indices. This was key in the decision to not put interim targets in the Combined Commitment. Our general view was that **the portfolio had minimal exposure to carbon intense companies and, therefore, our efforts should be spent on encouraging portfolio holdings to reduce their absolute emissions.**

WEIGHTED AVERAGE CARBON INTENSITY



PATH TO HALVE WACI BY 2030...



Data limitations

Our analysis to date has focused on the scope 1 and 2 emissions of portfolio companies only, given the many challenges with scope 3 data. We acknowledge and accept these limitations.

This does not mean we ignore scope 3 emissions. On the contrary. We view companies with high scope 3 emissions as a signal of climate transition risk. Reporting is improving in this area – but there is little commonality in how companies are identifying and reporting their scope 3 emissions. Through engagement with companies, Forsyth Barr is encouraging companies to publicly disclose and start measuring their material scope 3 emissions. For NZ companies, the new climate disclosure standards should drive a vast improvement in comparability and consistency of scope 3 emissions reporting.

We also accept that there are gaps in carbon data across the market. In our current analytics on portfolios, if a company does not report their scope

1 and 2 data, they are excluded from our analysis. This creates a significant limitation to our assessment. Positively, data coverage is trending upwards quite quickly. On the downside, our backward-looking trend assessments incorrectly assume the portfolio holdings have remained the same over the last five years.

We acknowledge that achieving a net zero investment portfolio is an ongoing process that requires regular monitoring, evaluation, and adjustments to align with evolving scientific, regulatory, and market developments. We accept the methodologies we are currently using to assess and define the carbon profile of a portfolio will evolve as our knowledge, insights, and capabilities deepen. The drives us to **be cautious in how we use the carbon analytics described**. In our view, carbon data as it currently sits, should not be used to make investment decisions in isolation, but should be considered as an input which enables us to better understand climate risks and opportunities.

Solutions for climate change

The discussion so far has focussed on reducing climate risk from the portfolio. There is another lens, arguably more important to think about, in terms of driving investment in solutions for climate change.

While there are a significant number of publicly listed investment options working on promising solutions for managing and mitigating the effects of climate change, we recognise that many of the investment options are often private. Therefore, it is important that there is space in the asset allocation to allow for investment in private assets, with the appropriate guardrails in place, whilst not forgetting WCF's liquidity requirements.

This opens up options for **intentionally increasing investment in companies, products, or securities that provide climate change solutions.**

In summary...

It is a great privilege to work with WCF on this urgent agenda. Developing the Combined Commitment puts us both on the same page and commits us to look to the future and do what we can from an investment perspective to manage and mitigate the effects of climate change. We absolutely recognise that our work to date is by no means perfect or complete. But we cannot let perfection get in the way of action. Achieving a net zero investment portfolio is a long term and ongoing process that requires regular monitoring, evaluation, and adjustment to align with evolving scientific, regulatory, and market developments. It is not directly within our control but we can influence action.

We also recognise that the path towards achieving our goals will not be linear, and we may not see clear and obvious progress each year. However, we commit to making meaningful progress over longer multi-year timeframes, learning and improving as we go.