



We'll Always Have Paris: How Institutional Exposures to Carbon Emissions Have Evolved Since 2015

Noticeable decarbonization happened since 2019. Our decomposition reveals the sources.

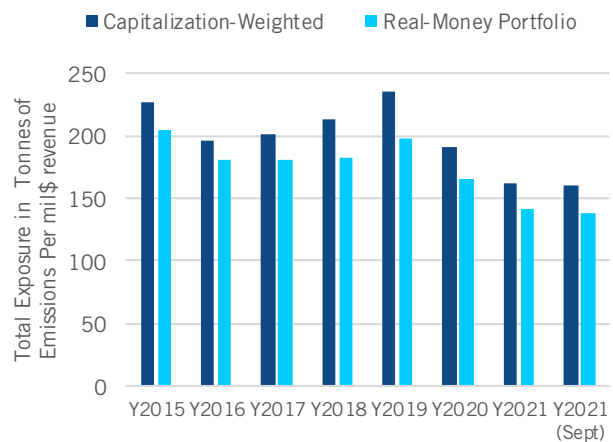
The 2015 Paris Agreement marked a milestone in that all nations agreed to work together to tackle climate change with the goal of limiting global warming to well below 2 degrees Celsius and adapt to its effects. Responding to this changing landscape and taxonomy in climate change, investors are increasingly paying attention to the carbon exposure of their portfolios, and are joining forces to decarbonize through active engagement, reallocation and/or divestment as we transition to a low carbon economy. Fast track to 2021, almost six years later, we ask: where are we standing now? Have the institutional investor portfolios achieved lower carbon exposures?

In this analysis, we seek to understand to what degree real-money investors (unlevered institutional portfolios such as mutual funds, pensions, and insurance) as a group have decarbonized their portfolios and to characterize the drivers and nature of any such decarbonization. We develop a coherent framework to measure decarbonization within portfolios and decompose these changes in carbon exposure into distinct components mapping to company behavior, investor behavior, and relative price effects. We then apply this framework to a large and high quality proprietary dataset of institutional investor portfolios from State Street's custodial information to understand the evolution of institutional decarbonization in recent years.

We have a few notable findings regarding to institutional investors' carbon exposures in the equity market. First, we find there is a noticeable decarbonization trend globally since 2019 from both active holdings (excess positions over benchmark) and total holdings (the actual positions taken by investors) perspectives, measured through both carbon emissions and carbon intensity metrics. Second, our decomposition analysis reveals that the reduction in investor exposure to carbon on an overall basis has been primarily driven by repricing of assets as well as decarbonization by the underlying companies, while the reduction of active carbon exposure has been driven by reallocations. Regionally, we find European assets lead the US, EM and the rest of the world with steady reduction in carbon exposure since 2015, while investors have only begun to reduce carbon exposure with US assets since 2019.

For more on this topic, see our 2021 working paper on Insights: **"We'll Always Have Paris: How Institutional Exposures to Carbon Emissions Have Evolved Since 2015"** by Alexander Cheema-Fox, George Serafeim and Hui (Stacie) Wang

Global Total Exposure Based on Carbon Intensity




Source: State Street Associates, S&P Trucost, MSCI

State Street Associates

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