Cushon Decarbonisation Transition Plan

cushon

Goal: We target an 80% reduction in scope 1 & 2 carbon footprint by 2030 compared to the 2022 baseline

We define the baseline as the carbon footprint of underlying funds' benchmarks thereby measuring the emission performance of the Cushon Sustainable Investment Strategy against the broader economy. In the following, we explain the pathway to achieving this target.

Targets

Emission Metrics

Setting a decarbonisation target requires measuring the portfolio's carbon emissions. The most commonly used portfolio emission metrics are:

- Total carbon emissions represent the absolute financed emissions of a portfolio measured in tCO2e. Emissions are attributed based on an equity ownership approach, i.e., if a portfolio owns x% of a company, then it finances x% of the company's total greenhouse gas emissions. (The equity ownership approach is generalised to non-equity holdings by attributing emissions across the total capital structure of the invested company.) Total carbon emissions represent a portfolio's emissions in absolute terms. To compare emissions between different portfolios so-called "intensity based metrics" which normalise the total carbon emissions are used:

- Carbon footprint (aka EVIC intensity) are the total carbon emissions divided by the portfolio value. It represents the financed emissions per unit of investment in a portfolio. The carbon footprint is the recommended metric by DWP and most commonly used by UK master trusts.

- Carbon intensity (aka revenue intensity) are the total carbon emissions divided by the weighted average portfolio revenue. It represents the financed emissions per unit of revenue.

- Weighted average carbon intensity (WACI) represents the emissions per unit of revenue weighted by the value of each company in the portfolio. Note that, contrary to the carbon footprint and carbon intensity, WACI does not use the equity ownership approach.

Key

tCO2e – tonnes carbon dioxide emissions

Scope 1 emissions – direct greenhouse emissions that occur from sources that are controlled or owned by an organisation (offices, facilities or cars)

Scope 2 emissions – indirect greenhouse emissions associated with the purchase of electricity, steam, heat, or cooling (for said offices, facilities or cars)

Transition pathway – framework or plan for thinking about how we will transition to a lower carbon world and economy

In line with the broader industry we set a decarbonisation target for the carbon footprint of our portfolio. However, it should be noted that:

- the equity ownership approach links financed emissions to valuations of the underlying companies. Consequently, the carbon footprint can change both due to decarbonisation of the underlying companies and due to changes in their valuations.

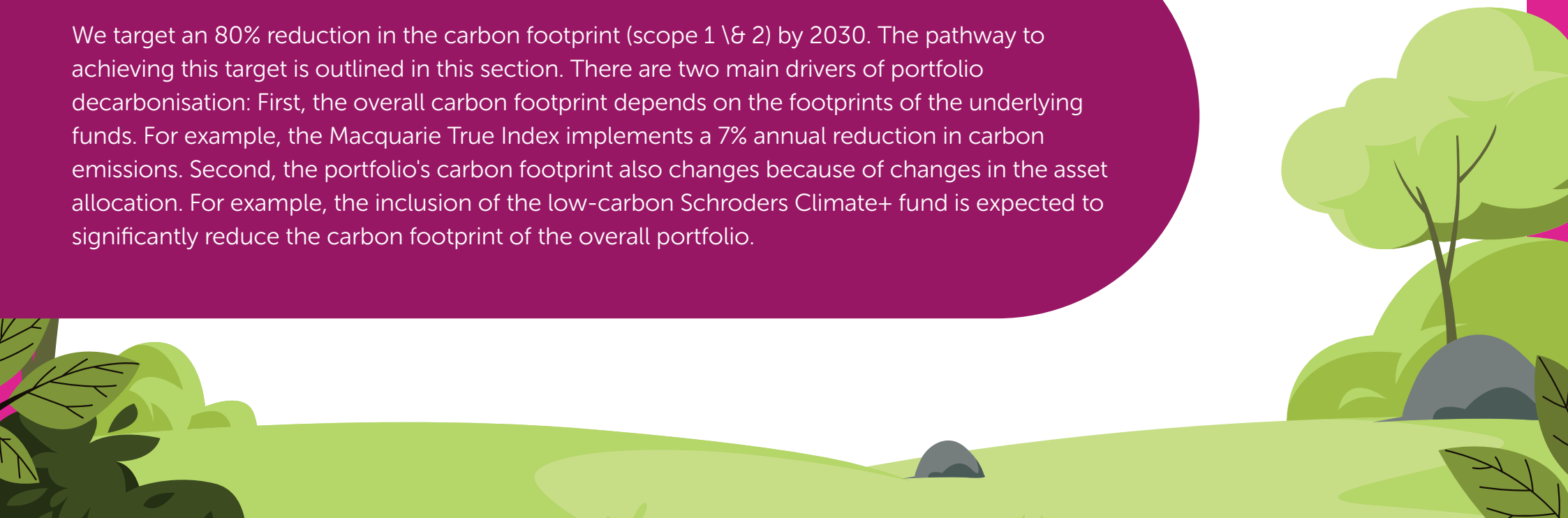
- the carbon footprint does not capture the emission efficiency of companies, i.e., the emissions per unit of output. The carbon intensity accounts for a form of emission efficiency by normalising the total carbon emissions by revenue.

- the metrics are a point-in-time snapshot of the emission intensity of a portfolio. They do not in themselves provide any insight into the decarbonisation pathways of the portfolio or the underlying companies. A credible decarbonisation pathway has to account for companies' ability to achieve future emission reductions.

It is therefore important to not rely on a single metric to analyse and compare portfolios' emission performance.

Cushon's Decarbonisation Pathway

We target an 80% reduction in the carbon footprint (scope 1 \& 2) by 2030. The pathway to achieving this target is outlined in this section. There are two main drivers of portfolio decarbonisation: First, the overall carbon footprint depends on the footprints of the underlying funds. For example, the Macquarie True Index implements a 7% annual reduction in carbon emissions. Second, the portfolio's carbon footprint also changes because of changes in the asset allocation. For example, the inclusion of the low-carbon Schroders Climate+ fund is expected to significantly reduce the carbon footprint of the overall portfolio.



Portfolio and Real-World Decarbonisation

It is important to note that our priority is decarbonisation of the real economy rather than simply reducing financed emissions of the portfolio. Cushon believes that in some circumstances exclusion can be the best way of achieving real-world change and in others supporting real-world transition is appropriate. The Schroders Climate+ fund illustrates that emission reductions and real-world decarbonisation can also be aligned. However, we do not shy away from investing in today's high emitting companies if they have credible decarbonisation plans to align themselves with net zero. For example, the Lombard Odier Target Net Zero fund contributes almost 20% to the overall carbon footprint but constitutes only 5% of the portfolio. It is however expected to materially drive real-world decarbonisation by investing in companies developing low-carbon technologies in high-emitting sectors.

This is why a nuanced approach to measuring portfolio decarbonisation is necessary. The tension between lowering the portfolio's carbon footprint and investing in the most material decarbonisation in the real economy can be reconciled by means of granular sectoral targets. Beyond the portfolio and fund-level decarbonisation pathways covered in this document, we intend to disclose detailed sector targets covering our investments in the near future.

Ingham Greenhouses, Bury St Edmunds

Low Carbon Farming

✓ **Europe's largest sustainably powered hydroponic greenhouse**

✓ **The greenhouses are a world first in capturing waste heat from the nearby Fornham water treatment works, and by way of ground source heat pumps, injecting the previously wasted heat into the greenhouses – reducing CO2 emissions by 75%**

✓ **10 times less water used than field farming**

✓ **100,000 peppers grown every day, 400 new jobs, size of 20 football pitches**

Click here to see their website and here to watch a short video for more information.

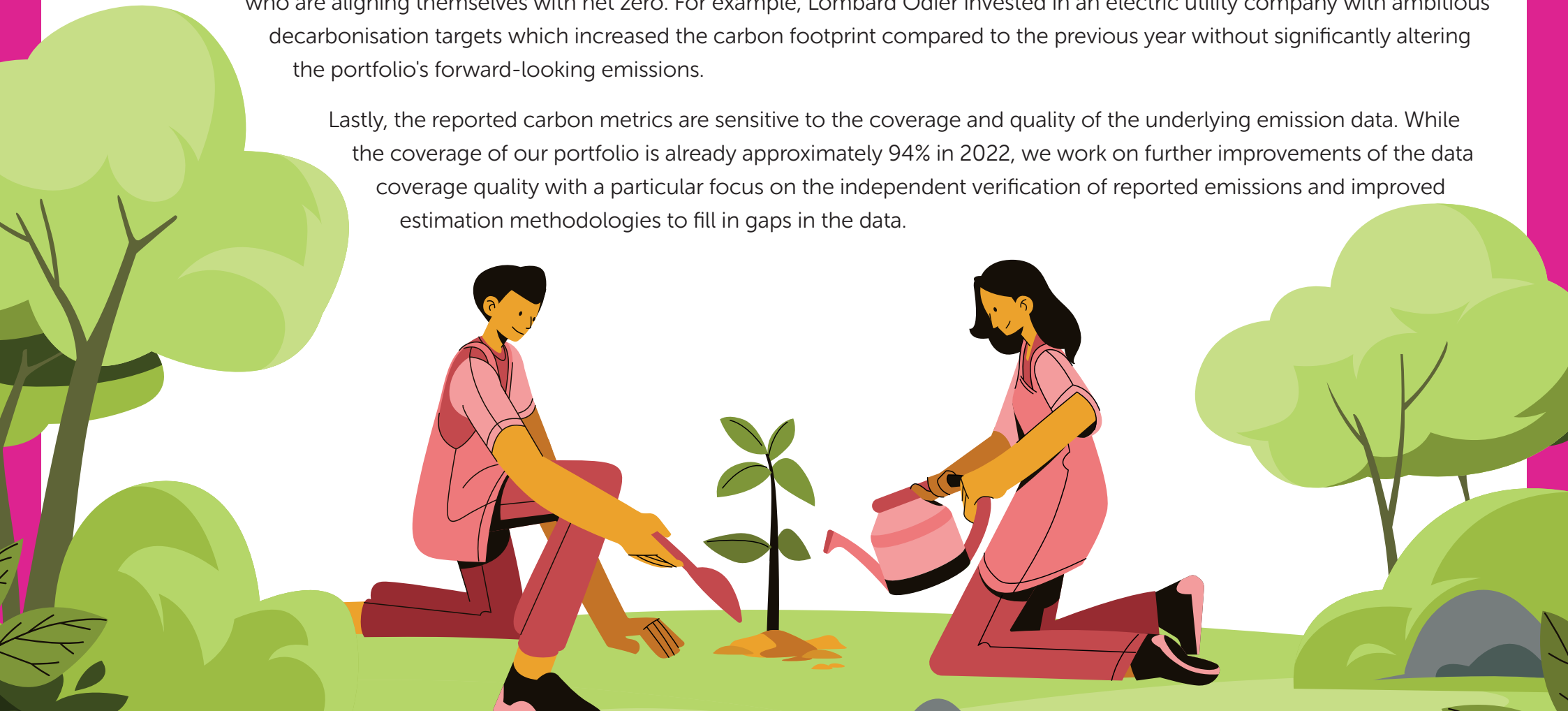
Portfolio Emission Volatility

While the design of the Cushon Sustainable Investment Strategy can credibly deliver the targeted decarbonisation by 2030, short-term volatility in the emission metrics is expected.

On the one hand, the equity ownership approach means that company valuations affect the portfolio's emission intensity. For example, although the emissions of the Macquarie True Index decreased by more than 7% between 2021 and 2022, its carbon footprint increased because of the decline in valuations.

On the other, the most material real-world decarbonisation can often be achieved by investing in the high-emitting companies who are aligning themselves with net zero. For example, Lombard Odier invested in an electric utility company with ambitious decarbonisation targets which increased the carbon footprint compared to the previous year without significantly altering the portfolio's forward-looking emissions.

Lastly, the reported carbon metrics are sensitive to the coverage and quality of the underlying emission data. While the coverage of our portfolio is already approximately 94% in 2022, we work on further improvements of the data coverage quality with a particular focus on the independent verification of reported emissions and improved estimation methodologies to fill in gaps in the data.



Pathways of Underlying Fund

The pathway is informed by the design of the underlying funds which can be broadly grouped into three categories:

Passive tilts

The Macquarie True Index targets an ongoing annual emission reduction of at least 7%. The carbon emissions of the index are calculated by weighting the emissions of the underlying companies in the index by their index weight. In particular, no equity ownership approach is used. The ongoing decarbonisation of the index can be achieved by means of either the underlying companies decarbonising or further tilts away from high-emitting companies. This means that the index could become less diversified if the pace of decarbonisation of the underlying companies is too slow. We closely monitor the index composition, its emission distribution and its level of diversification compared to a market-capitalisation weighted benchmark.

The LGIM Future World GBP Corporate Bond Index tilts to companies with a higher LGIM Issuer ESG score and achieves an immediate emission reduction of 50% compared to the benchmark. While no explicit annual reduction target is implemented in the index, the tilting is expected to favour companies with lower emissions and better transition plans to achieve ongoing reductions.

Impact

The Schroders Climate+ is designed as a net negative carbon portfolio, i.e., the sum of negative and avoided emissions exceeds the fund's total carbon emissions. Note that carbon credits generated by negative or avoided emissions only offset the fund's total carbon emissions if they are retired within the fund. If they are sold by the fund, the offsets will be claimed by their buyers and thus cannot be counted towards the fund's carbon footprint. However, because of its focus on climate change mitigation and adaptation the funds' carbon footprint gross of any avoided or negative emissions is small.

The Wellington Global Impact Bond Fund is expected to achieve a 50% carbon footprint reduction by 2030 compared to 2019. Because of its focus on social and climate impact, the fund's carbon footprint is already extremely low and unlikely to be a material concern for our overall target.

Transition

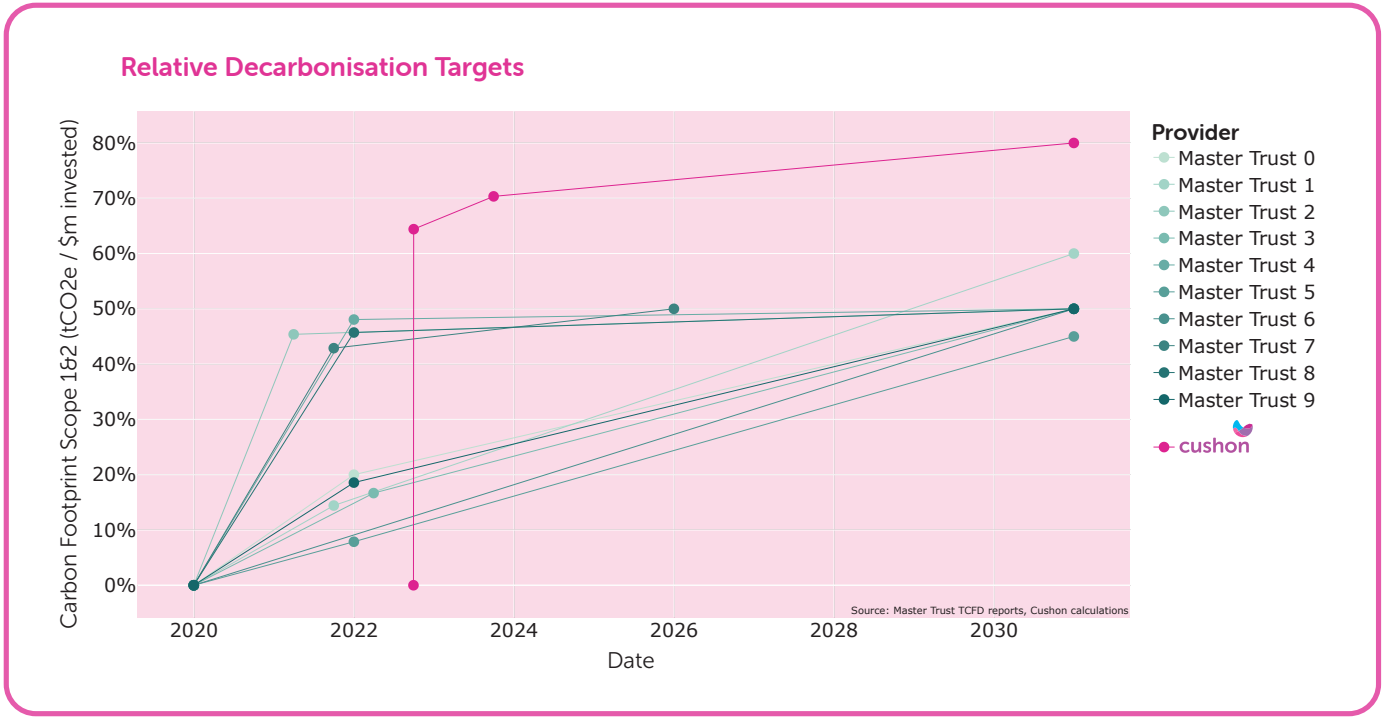
The Lombard Odier Target Net Zero Fund is focussed on driving real-world decarbonisation by investing in the companies with credible plans to align with net zero. It targets a 50% carbon footprint reduction by 2030 compared to 2019. The fund is a material driver of our overall footprint and expected to be particularly volatile because of its investment objective. It is currently the only fund that includes scope 3 in its decarbonisation target.

The Ninetyone Global Return Credit fund focusses on transition pathways to identify in each sector the companies with best-in-class transition plans to align with a net zero pathway.

Peer Group Comparison

Relative Decarbonisation Targets

Most UK master trusts target a 50% reduction in scope 1 \& 2 carbon footprint by 2030 compared to a 2019 baseline. Progress since 2019 has been varied. Four master trusts have achieved reductions of more than 40% while most other providers' reductions are less than 20%. The reductions observed to date are relatively straightforward to achieve because of the high concentration of scope 1 \& 2 emissions in a few sectors. Small tilts from the highest emitting sectors can achieve large relative reductions. It will be interesting to monitor the scope 1 \& 2 performance over the coming years and master trusts' ability to reduce their overall emission intensity including scope 3.



The graph is based on underlying data that was correct at April 2023

Absolute Decarbonisation Targets

Relative reductions are highly dependent on the chosen baseline. We note that, contrary to our approach of setting a target relative to the broader economy, most master trusts define the baseline as the carbon footprint of their own portfolio in 2019. It is therefore important to benchmark emission intensities in absolute terms. Translating relative decarbonisation targets into targeted absolute carbon footprints can provide an important insight into the actual sustainability of the different portfolios. However, as noted above, carbon footprints are inherently volatile because of mark-to-market movements, data sources, and coverage and are therefore unlikely to be exactly comparable between master trusts.

Conclusion

We believe that the climate crisis requires urgent action. Setting long-term decarbonisation or net zero targets without a detailed pathway and immediate action is an inadequate response to this challenge. One action that can be taken today is to significantly reduce portfolio emissions in the short term. We are therefore targeting an 80% reduction by 2030. Our transition plan demonstrates that an 80% reduction is relatively straightforward in that diversification losses are modest.

In the near future, we intend to refine our target setting approach further. First, our focus on real-world decarbonisation necessitates a granular approach to target setting accounting for the differences in emission intensities across sectors and industries to identify the most effective ways to drive emission abatements. Second, financing climate solutions is a key priority of the Cushon Sustainable Investment Strategy and we intend to set out detailed targets on the share of climate change mitigating revenues across our portfolio. Third, with increasing quality of emission reporting and estimation we intend to include scope 3 emissions in our targets as soon as practically feasible.

Finally, there is no Paris Aligned pathway that does not rely on significant quantities of carbon sequestration. Cushon therefore believes that it is crucial to stimulate the production of high quality carbon credits via investment in carbon sequestration via both natural capital and technology driven sequestration. This is achieved via our private markets portfolio.