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## A Net Zero Assessment of the Japanese Market

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- According to the net zero scenario alignment assessment conducted by the firm, 17% of the Japanese companies subject to the assessment were assessed to be aligned to the net zero scenario in 2023 (9% in 2022). While the most difficult-to-meet net zero assessment criteria are set to mid-term targets, the number of Japanese companies that set intermediate targets in line with the net zero scenario has doubled in 2023 from 2022.
- Our climate engagement target companies have seen a significant improvement in their average CDP temperature rating over the past year compared to other companies.
- In our analysis of the excess returns on stock prices of corporate groups by assessment level of alignment with the net zero scenario, the companies that were aligned to the net zero scenario showed a positive trend compared to the starting point of the analysis (April 2019). On the other hand, companies that are not aligned to net zero show zero or negative trends.

### Financial Markets Aim to Achieve Net Zero

The Glasgow Finance Alliance for Net Zero (GFANZ), launched in April 2021, is now in its third year. GFANZ is a coalition of the willing financial institutions that aim to achieve a net zero society before 2050, and more than 550 institutions from 50 countries have currently agreed to it<sup>1</sup> and have expressed their commitment to net zero.

GFANZ has organizations for each type of financial business, which are currently

forming eight sector associations, mainly including the Net Zero Asset Owner Alliance (NZAOA), Net Zero Asset Managers initiative (NZAM), Net Zero Banking Alliance (NZBA), and Net Zero Insurance Alliance (NZIA)<sup>2</sup>. Within each alliances, signatory institutions are required to set net zero targets, reports the progress of the target achievement, and promotes the industry-wide efforts to achieve net zero.

As the only asset management company in Asia when NZAM was established in December 2020, Asset Management One has

<sup>1</sup> GFANZ Member Website <https://www.gfanzero.com/membership/> (2023-9-20)

<sup>2</sup> Same as above

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<sup>3</sup>participated in and signed on to NZAM as a member of the Advisory Committee at the time. In September 2021, the firm set and disclosed a target to align 53% of our assets under management to net zero as an intermediate target toward 2030.<sup>4</sup>

## Asset Management One Net Zero Assessment

In order to define the intermediate targets required as a signatory institution to NZAM and measure progress, each company shall establish a method for assessing the alignment of assets to the net zero scenario and measure the level of achievement of the net zero target by the method specified by each company. Our net zero assessment method was based on the Net Zero Investment Framework (hereinafter referred to as "NZIF")<sup>5</sup> of the Paris Aligned Investors Initiative<sup>6</sup>.

The NZIF defines sectors with high greenhouse gas emissions as high-impact sectors and other sectors as low-impact sectors, and assesses them using six assessment criteria (Figure 1, Items A through F).

The targets of our Japanese company net zero assessment are the constituents of the passive funds we manage, and are the index constituents that account for 95% of each index's Financed Emissions. The number of

Japanese companies subject to net zero assessment (stock names) was 548 in 2022 and 547 in 2023<sup>7</sup>.

Figure 1. Items for Assessing Net Zero Alignment of the NZIF

Assessment item	Definition
A. Ambition	A long-term commitment to achieve global net zero by 2050
B. Targets	Short- and mid-term targets that include Scopes 1 and 2 as well as important Scope 3 as reduction targets
C. Emissions performance	Carbon intensity track record that is aligned to achieve net zero by 2050
D. Disclosure	Disclosure of emissions, including Scopes 1 and 2 as well as material Scope 3
E. Decarbonization strategy	A quantitative plan that includes initiatives to achieve GHG reduction targets and increase green revenues
F. Alignment of capital allocation	A clear track record of consistent capital expenditures available toward achieving net zero by 2050

(Source: Created by Asset Management One based on the NZIF)

<sup>3</sup> The members of the Advisory Committee served a one-year term since the establishment.

<sup>4</sup> Our news release: [https://www.am-one.co.jp/pdf/news/259/210910\\_AMOne\\_newsrelease.pdf](https://www.am-one.co.jp/pdf/news/259/210910_AMOne_newsrelease.pdf)

<sup>5</sup> For a detailed NZIF guide, refer to the NET ZERO INVESTMENT FRAMEWORK 1.5°C IMPLEMENTATION GUIDE (IIGCC), March 2021.

<sup>6</sup> An initiative established in May 2019 within the Institutional Investors Group on Climate Change (IIGCC).

<sup>7</sup> These numbers of companies are the numbers of companies subject to assessment for stock names only. In addition, our company also targets unlisted bond issuing companies.

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In the actual assessment, the satisfaction of each criterion is assessed based on the analysis of external ESG data vendors and analysts, referring to the aforementioned NZIF. The external ESG data used for the assessment were CDP Temperature Rating (hereinafter referred to as "CDP Temperature Rating") data and ISS ESG data. Some companies that were not covered by the vendors were assessed by our own analysts.

The assessment results were classified into five levels, (1) to (5), of alignment assessment to the NZIF net zero scenario

according to the status of satisfaction of the assessment item criteria (Figure 2 below). Of these, companies classified as "(1) Achieving Net zero," "(2) Aligned to a net zero pathway," or "(3) Aligning toward a net zero pathway" are determined as net zero companies. In addition, the number of assessment items differs between high-impact and low-impact sectors, and in low-impact sectors, no company is classified as "(4) Committed to net zero" (see Figure 3 on the next page for the assessment flow).

Figure 2. Five Levels of Net Zero Scenario Alignment of the NZIF

Net zero assessment	Definition
① Achieving Net zero	Companies that have achieved or are close to achieving net zero for the current emissions intensity, and have investment plans and business models that are expected to achieve their targets
② Aligned to a net zero pathway	Assessment items A to F satisfied (BCD satisfied in low-impact companies) Appropriate performance in line with the targets set for assessment item C achieved over the long term
③ Aligning toward a net zero pathway	Assessment items B, D, and E satisfied
④ Committed to net zero	Companies that meet assessment item A by setting a clear long-term target of achieving net zero by 2050
⑤ Not aligned	All companies not fallen under one of the above

(Source: Created by Asset Management One based on the NZIF)

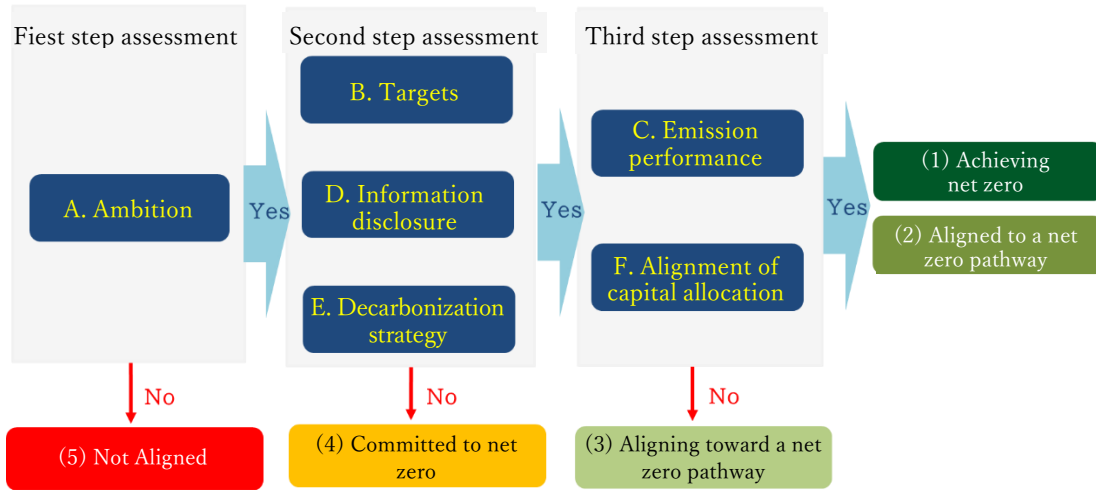
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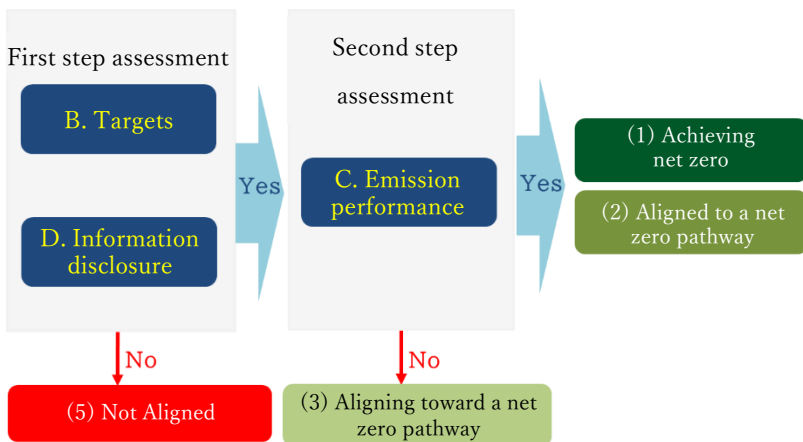
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Figure 3. Our Net Zero Assessment Flow (High-impact and Low-impact Sectors)

High-impact Sectors



Low-impact Sectors



(Source: Created by Asset Management One)

## Net Zero Alignment Assessment Results

The results of our alignment assessment with the net zero scenario for Japanese companies in 2023 and 2022 are shown in Figure 4. In 2023, 17% of the 547 companies subject to the assessment were assessed as net zero, doubling the percentage compared to 9% in 2022. Japanese companies have

made some progress in aligning to the net zero scenario over the past year.

In 2023, among the companies assessed to be conforming to the net zero scenario, 46 companies fell under “(2) Aligned to a net zero pathway,” and 46 companies fell under “(3) Aligning toward a net zero pathway.” Since the number of companies assessed as (5) Not aligned has decreased compared to the previous year, we can see that more companies have taken measures to align with

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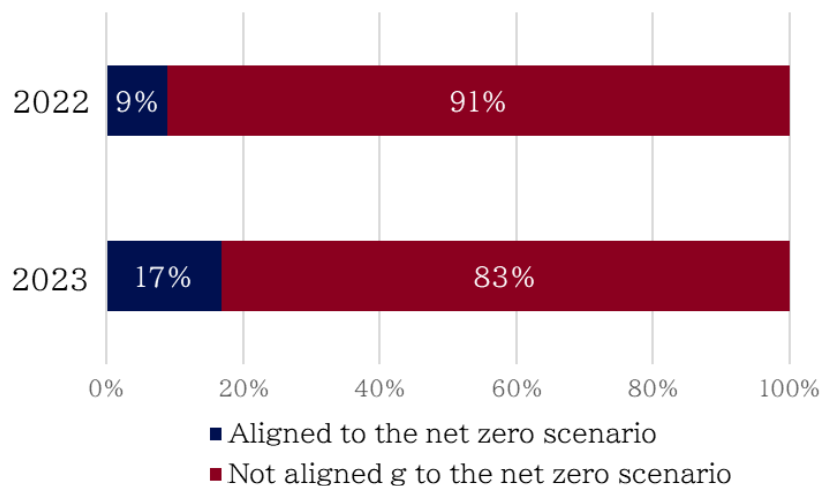
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the net zero scenario in the past year (see Figure 5 on the next page).

Figure 6 (next page) shows the results of each assessment item. Among the assessment items for net zero alignment assessment in 2022, the lowest percentage of “Yes” was “Targets,” but in 2023, companies with approximately twice the number of companies compared to the previous year answered “Yes.” We can see that more companies have made progress in setting intermediate targets in a way that is consistent with achieving net zero by 2050. On the other hand, there has been no significant progress in expressing ambition and disclosing decarbonization strategies (see Figure 6 on the next page). This indicates that

there was no increase in the number of companies expressing new ambitions or announcing a roadmap for decarbonization strategies in high-impact sectors. The assessment of decarbonization strategies requires information disclosure on the prospects for technological innovation, the capital investment required to achieve ambitions and targets, and the reduction measures in the supply chain. Progress in these disclosures will be an important factor for companies to increase the likelihood of achieving their future targets and to increase the appeal of the net zero strategies to investors.

Figure 4. Net Zero Alignment Assessment Results



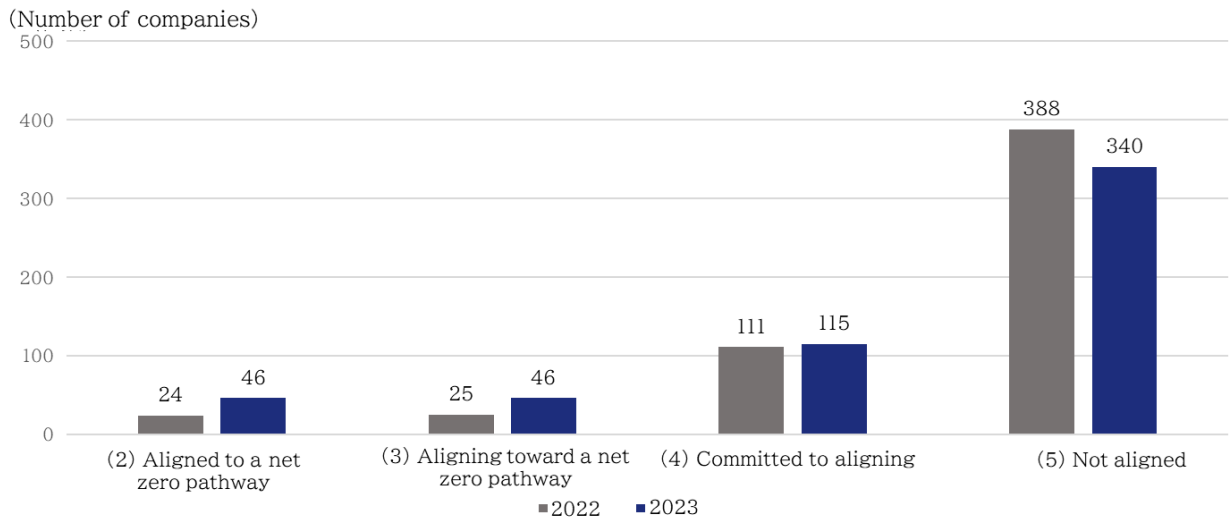
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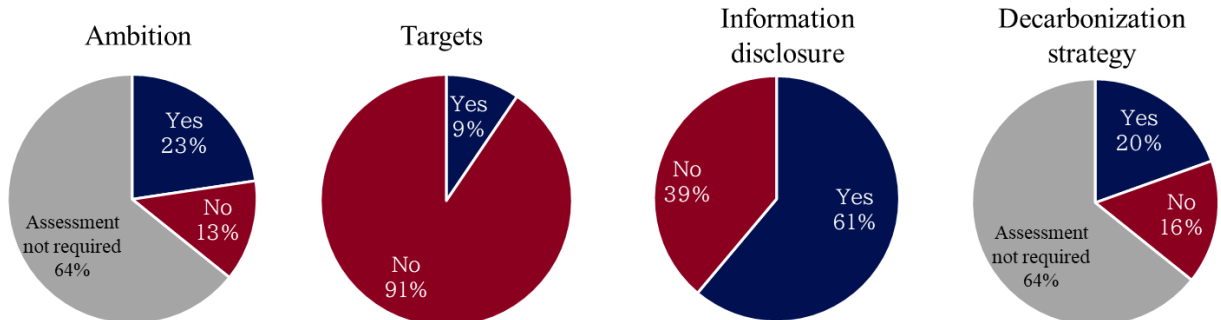
Figure 5. Net Zero Alignment Assessment Results—Number of Companies by Alignment Level



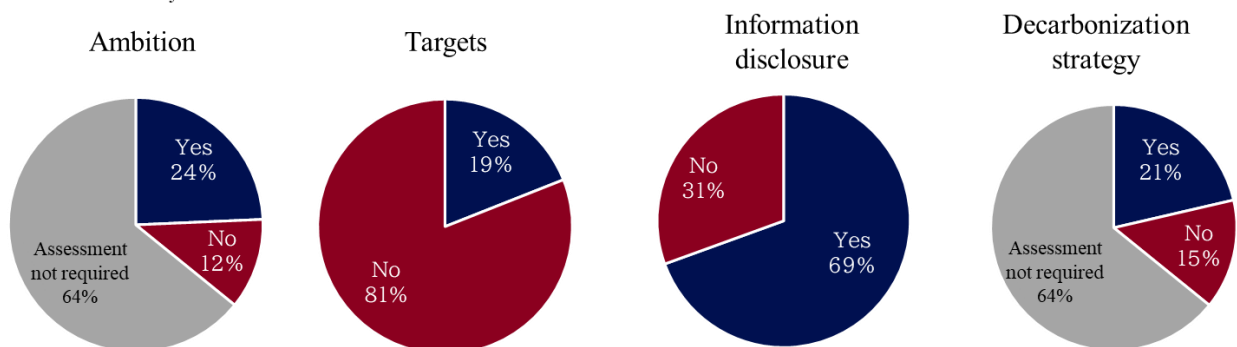
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Figure 6. Net Zero Alignment Assessment—Results by Item

2022 Results by Net Zero Assessment Item



2023 Results by Net Zero Assessment Item



(Source: Created by Asset Management One)

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## Net Zero Engagement

We are engaged in measures that each company should take to meet the net zero scenario. In terms of engagement, it is important to analyze the status of technology development in various sectors and the steps that each company should take toward the transition to net zero, and to encourage the implementation of steady measures and disclosure of information toward net zero.

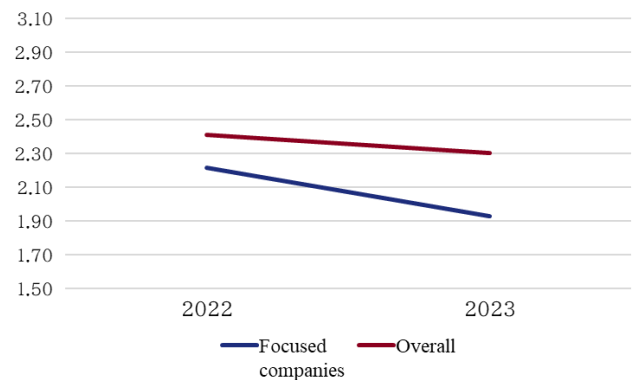
One of them is the setting and disclosure of mid-term targets that aligned to the net zero scenario. We use the CDP Temperature Rating<sup>8</sup> as the main criterion against our targets. As mentioned above, regarding the assessment items for setting intermediate targets, there are few companies that have completed setting targets that meet the criteria (CDP Temperature Rating of 1.5°C) (see Figure 6 on the previous page). Our company seeks to set intermediate targets in engagement that meet the CDP Temperature Rating of 1.5°C, which is a target assessment based on scientific evidence.

For the CDP Temperature Rating, we compared the average rating of our 62 climate change engagement-focused companies<sup>9</sup> with the average rating of all companies (548 companies subject to net zero assessment in 2021) in 2022 and 2023. As a result, we found

that the group of engagement-focused companies had a greater (lower) improvement in CDP Temperature Rating (Figure 7).

Of course, these are not the engagement effects by our firm alone, but it suggests the importance of communication from investors to companies about setting intermediate targets aimed at achieving net zero.

Figure 7. Changes in CDP Temperature Rating



(Source: Created by Asset Management One based on CDP Temperature Rating)

Data of CDP Temperature Rating from July 2022 and July 2023 was used. This assessment is based on an analysis of the past performance over a certain period of time and is not a guarantee of future performance.

<sup>8</sup> The CDP Temperature Rating is one of the climate change survey assessment information provided by CDP, and assesses the level of alignment of each company’s carbon emission reduction target to net zero based on the methodology of Science Based Targets. If the CDP Temperature Rating is 1.5°C, the company’s disclosed carbon emission reduction target is considered to be aligned with net zero. The highest CDP Temperature Rating is 3.2°C.

<sup>9</sup> Considering the time it takes for engagement effects to materialize, the survey targets 62 climate change engagement-focused companies in FY 2020.

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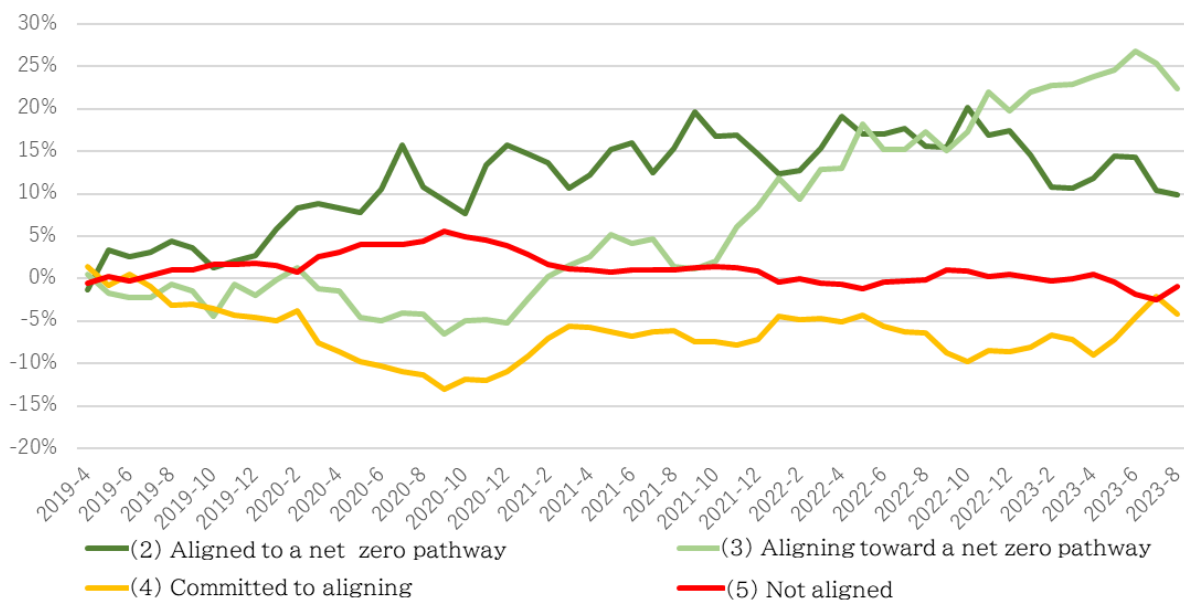
## Net Zero and Stock Price Performance

Lastly, we analyzed the trends in excess returns on stock prices by corporate group based on our net zero scenario alignment level<sup>10</sup> (Figure 8).

Since the start of the analysis in April 2019, the excess returns on stock prices for companies that are "(2) Aligned to a net zero pathway" has continued to show positive

results. In addition, companies that were assessed as "(3) Aligning toward a net zero pathway" continued to record positive results from the starting point, and showed the highest excess returns recently (22.3% as of August 2023). On the other hand, companies that were assessed as not aligned with the net zero scenario ("(4) Committed to aligning" and "(5) Not aligned") showed that their excess returns tended to be negative or close to 0 percent.

Chart 8. Excess Returns on Stock Prices by Net Zero Assessment Result



Analysis conditions: The companies targeted for analysis were 427 companies that were classified as companies emitting 95% of the Financial Emissions in the TOPIX. Excess returns are calculated as excess returns (relative to the simple average returns of all analyzed companies) of the simple average portfolio for each assessment result. The return analysis period is from April 2019 to August 2023. The Barra model is used for the excess return analysis. This analysis is based on an analysis of the past performance over a certain period of time and is not a guarantee of future performance.

(Source: Created by Asset Management One based on the Barra model)

<sup>10</sup> Since our company's net zero assessment started for the first time in July 2022, before that, we analyzed excess returns from April 2019 based on the same assessment assumption. In July 2023, the second assessment was applied to the group classification.

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## Summary

In recent years, efforts to tackle climate change have become a huge cost burden for companies and society, and conversely, it has become an opportunity for growth. In recent years, there has been a growing trend in Japan to demand action from companies to curb climate change, such as the movement on carbon pricing and the government's announcement of investment in climate change measures. Therefore, it is not surprising that the investment behavior of investors reflects companies' climate change measures and their actual results. Looking at

the results of net zero and stock price performance analyzed above, this trend is becoming more pronounced. In addition, it was found that Japanese companies are making progress in aligning to the net zero scenario in this net zero assessment that can be very positively assessed.

As an asset management company that invests widely in the Japanese market, our company will continue to focus on net zero engagement and investment strategy development in order to bring the Japanese market as a whole to net zero.

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### Author profile

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Since 2022, as Sustainable Investment Officer at Asset Management One, Minako oversees ESG integration and sustainable investment across the assets that the firm manages. Before joining the firm, Minako worked at Nomura Asset Management and MSCI ESG Research for 15 years in total as an ESG professional.

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