Responses to the consultation on infrastructure components to expand the scope of the Net Zero Investment Framework

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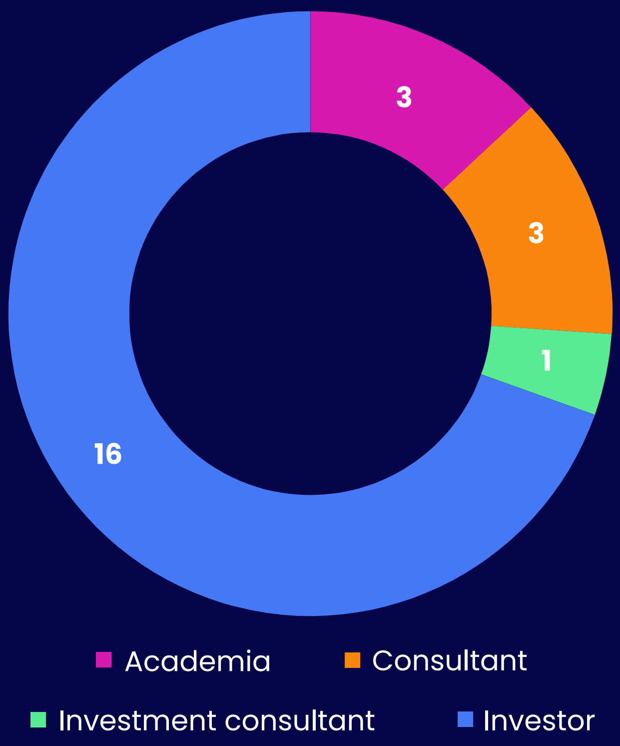
Contents

Introduction

In July 2022, IIGCC published a consultation document to develop the components for infrastructure assets to complement and expand the scope of assets covered by the Net Zero Investment Framework (the Framework). During the four-week consultation period, we received twenty-three written responses, sixteen of which came from investors.

We are extremely grateful to all those who contributed to the consultation and we would also like to thank AIGCC and IGCC for their support. This document summarises the responses and feedback given to the consultation questions.

Organisation



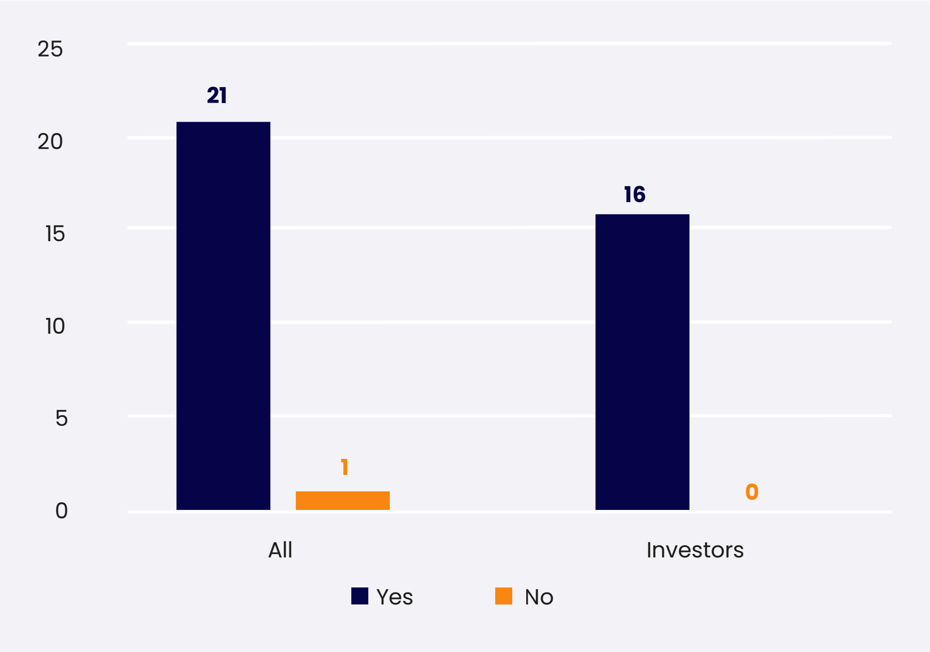
Key results

- Viewed overall, the responses are highly supportive of the approach taken in the consultation document
- The intention to include infrastructure into the Framework was welcomed by almost all and has been flagged a priority by specialised investors
- Most respondents agreed with all the proposals laid out in the consultation document
- At the same time as agreeing with the broad approach taken, the consultation was helpful in highlighting problematic areas where additional work or clarifications would be beneficial. The main areas that were focused on concerned:
  - The challenges of adopting the proposed approach in emerging markets
  - The definition of the alignment criteria
  - Requests to review some of the targets and timelines
  - Similarly to Private Equity, a request for specific guidance for Funds of Funds

Below is a summary of the feedback provided by respondents to the consultation. We discuss the issues raised by the responses, relating it both to the intention of the consultation document and also to how the components for infrastructure would marry with the established Net Zero Investment Framework. We have made it clear where clarifications or amendments to the components are proposed in response to the feedback.

NZIF outlines a best practice methodology for investors to include infrastructure assets into their net zero targets. IIGCC encourages investor signatories to initiatives such as NZAM and PAAO to adopt the guidance and methodology as best practice, but investors are ultimately accountable for disclosing against their targets and being transparent as part of their net zero commitments. It is a foundational principle of how IIGCC and its members work together that the choice to adopt guidance, best practice tools or tactics prepared by IIGCC is always at the ultimate discretion of individual signatories based on their own decision making. The aim is to provide a framework that can be used by asset owners and asset managers, all of whom will have differing mandates and starting points from which they make their own decisions. In that context, the Framework should be used on an 'implement or explain' basis to take account of differing contexts, strategies and aims and the fact that jurisdiction, regulation and best practice will determine the approach that can be taken by a particular signatory.

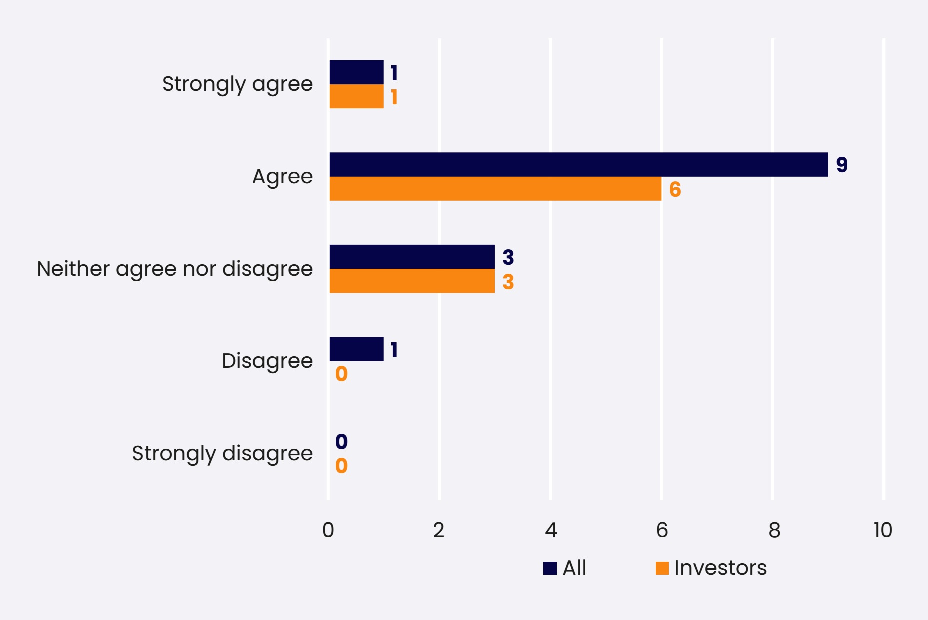
Q1 Do you agree with the broad approach proposed in the consultation document?



The feedback provided was highly supportive of the broad approach taken in the consultation document. Throughout the responses to the questions posed, disagreements represented a minority of respondents, providing comfort that the approach enjoys broad support.

That said, the responses also provided many helpful suggestions on ways in which specific elements of the document could be enhanced. We detail these in the responses to individual questions below.

Q2 Do you agree with the proposed definition of infrastructure assets and types of investments to be included in scope?



Q3 If not, what amendments to this definition do you propose? Please explain how these would ensure an approach that is consistent with the PAII criteria to ensure impact, rigour, and practicality.

Most respondents agreed or strongly agreed with the definition proposed in the consultation document, with only one respondent disagreeing.

In the detailed responses, some requested greater clarifications while one respondent proposed an alternative definition based on The Infrastructure Company Classification Standard (TICCS) definition of infrastructure.

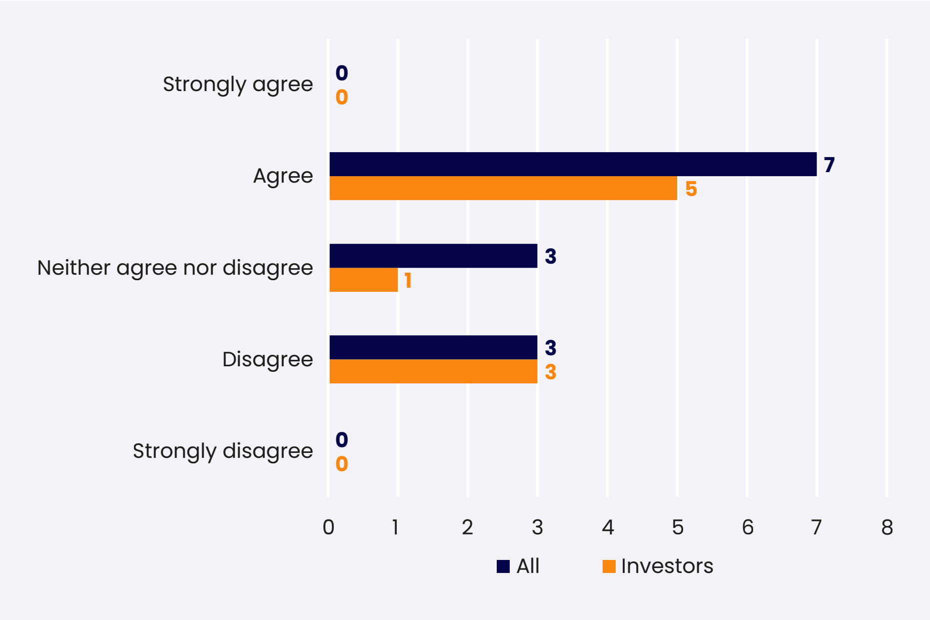
The definition of infrastructure used in the consultation document is deliberately broad. It is not intended to be exclusionary and alternative definitions can be adopted by investors using the Framework, providing they meet two criteria that are important for defining the scope for infrastructure within the Framework.

- First, the definition should be broad enough to ensure that infrastructure assets are included in scope for an investor's net zero commitment[1]
- Second, the definition should provide a clear boundary relative to other asset classes such that investors can select the appropriate approach to assess the alignment of assets within their portfolios.

We suggest adopting these same criteria when assessing related questions, for instance concerning the best approach to take with project finance.

1 Green infrastructure is not in scope for this guidance

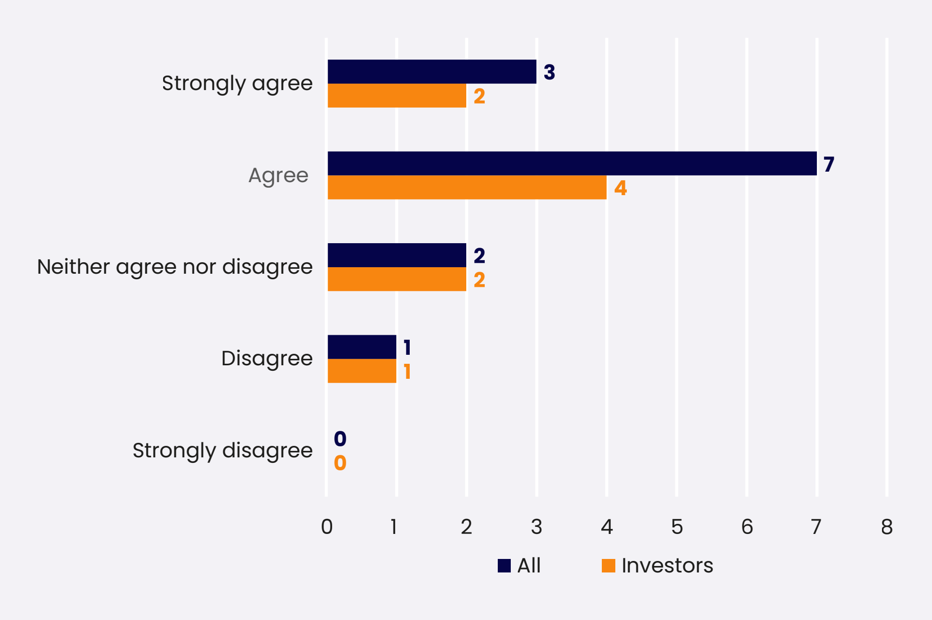
Q4 Are the proposed alignment criteria and additional recommendations relevant to assessing and ensuring alignment of infrastructure assets to a net zero pathway, and measuring progress towards alignment?



Q5 If not, please describe the amendments or additions to the proposals that you recommend?

Responses are included on the next page below Q6.

Q6 Do you agree that the existing performance of an asset should be considered as sufficient to be categorised as 'aligning' if its current and forecast performance is below the intensity of the net zero pathway relevant for that asset, and it continues to perform in line with this over time?



We bucket together the responses to these questions because they both relate to alignment and because feedback to Q6 was typically adjoined to Q4 and Q5.

Respondents were supportive of the proposed alignment criteria and recommendations to measure progress and ensure alignment of infrastructure assets to a net zero pathway. They also supported the specific question on whether the existing performance of an asset was sufficient to categorise an asset's aligning status, providing certain conditions for its targeted pathway were met.

The main themes in the feedback focused on the following:

Emerging markets (EM)

- Respondents were concerned that the proposed approach would be challenging to adopt given a lack of clarity over pathways / trajectories and that, as a result, specific guidance should be provided for EM infrastructure

We note the specific challenges for infrastructure investors in emerging markets, with non-existent or inadequate data common and insufficient precision over the required pathways, limiting the scope to apply a science-based approach. It is recognised that without the availability of these key inputs, net zero targeting investors will be forced to adopt a 'best endeavours' approach until the data become available, while at the same time using engagement to fill as many gaps as possible.

Individual criteria

- Some felt that the definition of the third criteria could usefully be clarified to set out what was expected, particularly in terms of meeting the emissions pathway target
- Some questioned the usefulness of emissions forecasts
- Some sought to maximise the convergence of definitions with those for asset classes already in the Framework, e.g. for the second criteria and for the definition of medium-term targets
- Finally, some requested explicit clarification of the timing of the engagement target for carbon-based energy and transport assets

In response to the feedback, we propose that the wording of the third criteria be amended to make clear the different expectations for aligning and aligned assets with net zero pathways. An aligned asset would need to see emissions decline consistent with targets set to converge an asset with a net zero pathway, whereas compiling and disclosing emissions and targets would be sufficient to establish an asset as aligning. We recognise that the achievement of this criterion is sufficiently demanding that, on its own, it merits the achievement of aligning status. We propose to add a footnote to this effect to the document.

Although a number of assumptions are needed to generate a forecast of emissions, being explicit about those assumptions has the strong merit of highlighting some of the areas on which an investor should engage, both specific to the asset and relating to broader government policy.

In terms of the timing of the target for 100% of carbon-based energy and transport assets to be the subject of engagement, or management interventions, the typically smaller number of investments held in an infrastructure portfolio, compared with liquid assets as well as the urgent need for transformation of energy systems, explains why this is an immediate requirement for investors with net zero targets.

Finally, we acknowledge the benefits of standardised definitions for timescales within the Framework wherever possible. However, the nature of Infrastructure as an asset class is sufficiently different from other asset classes that this needs to be reflected in the definition of its criteria. Other aspects of managing net zero commitments for Infrastructure assets that are also pertinent to other asset classes – for example the potential need for the use of offsets – will be handled in future guidance for the Framework overall.

Categorisation of aligning versus aligned assets

- Some respondents requested that there be a clearer distinction between these aligning and aligned assets
- One respondent proposed that 'aligning' be defined purely on the basis of the first two criteria, with a primary focus on forecast performance
- Another respondent argued that a full inventory of all material scope 3 emissions should be completed within 2-3 years for an asset to be considered aligning

We recognise the importance of clear definitions for the alignment of assets to ensure that investors have a clear template for evaluation as well as a set of areas to target for improvement. We also recognise the wide range of circumstances faced by investors in infrastructure and have sought to establish a balance between these different demands by allowing two different routes for an asset to be aligning.

As discussed above, the compilation and disclosure of scope 1, 2 and 3 emissions and the establishment of a target are judged to be sufficient on their own to establish aligning status for an asset. This can be thought of as being a similar requirement to establishing forecasts given that without the current data, forecasts would be near impossible to produce or of limited value. By contrast, simply committing to establish an inventory of scope 3 emissions does not equate to an asset being aligning.

Whilst being definitive on the definition of aligning and aligned status, the approach adopted in the Framework allows investors flexibility to set out their own approach for assessing the progression of an asset from aligning to aligned providing that these are explained and consistently put into practice.

EU taxonomy

- Some suggested using alternatives to the taxonomy, perhaps based on proxy sectors for climate solutions
- Others looked for a clearer definition of the use of the taxonomy in the broader context of the Framework

We recommend the EU taxonomy as being a widely understood and used measure suitable for defining investments in climate solutions for many investors. However, as set out in the consultation document (Box 1 - page 11), it is not the only approach recognised as being valid. "Other science-based taxonomies or criteria for robustly identifying assets or activities that represent the climate solutions required to achieve net zero emissions by 2050 or sooner" may also be used. We recognise that the EU taxonomy will not be appropriate in all circumstances: it is designed to be a benchmark for the evaluation of climate solutions investments rather than a mandatory tool.

Greenfield

- Some requested greater clarity on allocations for developments in low impact sectors
- Others argued that there should be clear boundaries on the definition of an aligning asset (the step to becoming operational should not change its status)

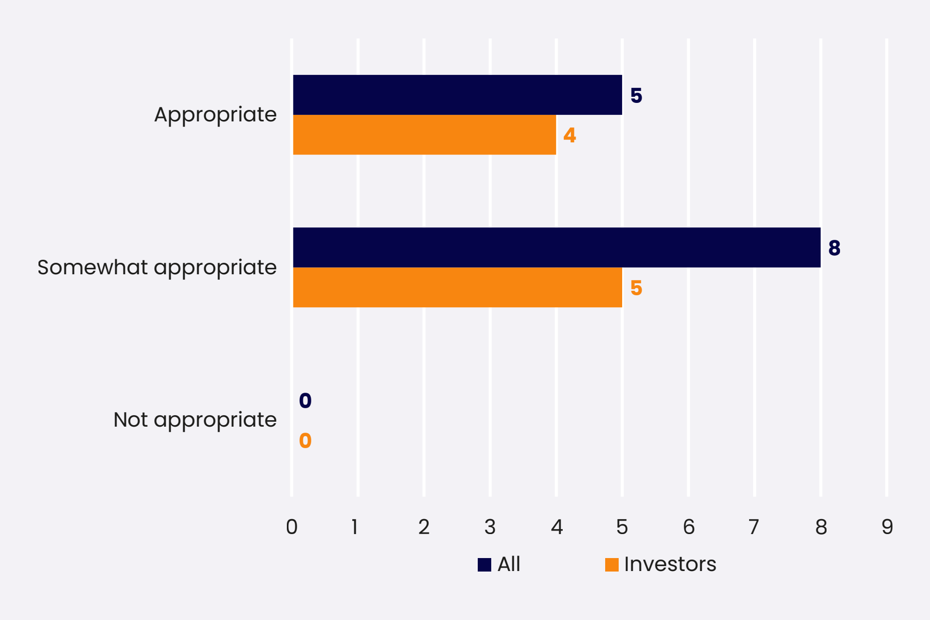
We note that the most advanced status a greenfield site can reach is aligning. Beyond meeting the required criteria for a greenfield asset to be aligning, an investor would need to ensure that scope 1, 2 and 3 emissions data are compiled and disclosed as well as a target set. Although this is a distinct requirement, the first criteria for greenfield assets to be aligning requires a plan for the lifecycle of the asset to be consistent with net zero. Providing the asset follows the expected trajectory for emissions in the plan, the correct disclosures and establishment of a target should be consistent with aligning status being maintained in operation. **We have added a footnote to the document to this effect.**

We also note the higher bar for high impact sectors in terms of the disclosures that investors are required to make, but do not consider that further clarifications for investments in low impact infrastructure sectors are required.

In addition to the above feedback, there were also requests for more information on decarbonisation approaches as well as on guidance on minimum standards regarding scope 3 screening and target setting. Respondents raised questions concerning the ranking of transition risk

In response, we note that its preferred approach is to avoid being overly prescriptive over the ranking of risk given the wide range of circumstances that investors might face.

Q7 Do you consider the proposed targets appropriate for asset owners and asset managers?



Q8 If not, please describe any amendments or clarifications you would recommend and describe how these ensure targets are science-based, support achieving impact in the real economy, and are practical for a range of asset owners and managers to use.

In response to Q7, every respondent agreed that the proposed targets for asset owners and asset managers were at least somewhat appropriate. Similarly, to the answers given to other questions, there were requests for guidance on how to phase in scope 3 emissions, what approach should be taken to benchmarking embodied emissions and on how concentrated portfolio risk should be handled.

The primary emphasis in respondents' comments focused on:

Timeline

- Some respondents favoured extending the portfolio coverage target from five to ten years
- By contrast, others argued that 100% of assets should be net zero or aligned by 2030

We note the different views on the timeline for achieving portfolio coverage targets. The objectives seek to balance the challenging starting point for some infrastructure assets, along with the pressing need for progress in this sector to facilitate emissions reductions elsewhere. This inevitably leads to sources of tension. We observe that portfolio coverage is expected to be progressive. Moreover, the requirement for assets to be net zero or aligned by 2040 creates a natural constraint on earlier targets. As a result, it is judged that the proposals strike a good balance between these different interests, whilst we also note the dependence on progress by governments for investors' targets to be achievable.

Prioritisation

- Some suggested that there should be increased focus on assets in carbon-intensive sectors or where infrastructure served as a facilitator for emission reductions by other economic agents or alternatively where investors have over 20% ownership or a board seat. Others sought clarification concerning the status of the portfolio reference targets.

We agree that it is important to prioritise carbon-intensive assets and note that this is already factored into the components for infrastructure in engagement requirements for investors. It is considered that additional criteria for ranking of assets within a portfolio would be likely to create greater complexity for investors and hence, consistent with the above discussion on overall timing, we do not favour additional prioritisation.

Concerning the portfolio reference targets, although of secondary importance for infrastructure specialists, these are included for consistency with other asset classes as they allow managers with a range of asset classes under management to incorporate infrastructure into broader emissions reduction commitments. For infrastructure specialists, they are optional and we propose to make this secondary status clear in the document.

Feasibility

- Some questioned the feasibility of forecasting internal rate of return (IRR) and argued that alignment actions were intimately connected to asset selection, portfolio construction and risk management. Others requested guidance on best practice for benchmarking full lifecycle emissions.

We note that forecasting IRR is a common business practice and that investors should seek to integrate climate scenarios into their business evaluation to meet their net zero commitments. In many asset classes, it is helpful to consider the investment process as a whole when considering the requirements of the net zero commitment and agree that this is also the case for infrastructure assets.

In terms of best practice for assessing full lifecycle emissions and consistency with net zero pathways, we anticipate that over time it will be possible to credibly benchmark embedded emissions related to steel and concrete with a 1.5° scenario. It will be important for infrastructure investors to incorporate this into their assessment of the value chain. An explanatory footnote to this effect will be added to the document, whilst future IIGCC work will seek to promote best practice.

Specific guidance for asset owners

- Some respondents requested additional guidance on best practice for asset owners in ensuring their asset manager providers are taking the necessary steps to align infrastructure investments

Asset owners play a key role in the net zero ecosystem. In the context of the guidance for infrastructure, some asset owners may have direct investments, but for those who do not, asset owners should evaluate the reports of the asset managers they mandate to run funds for them, assessing whether guidance is being applied.

Where asset managers are not complying with the approach proposed, asset owners can usefully consider whether the rationale is consistent with the way in which other asset managers are operating. They can then work with their asset managers to identify how best practice can be advanced and hurdles towards the achievement of net zero overcome.

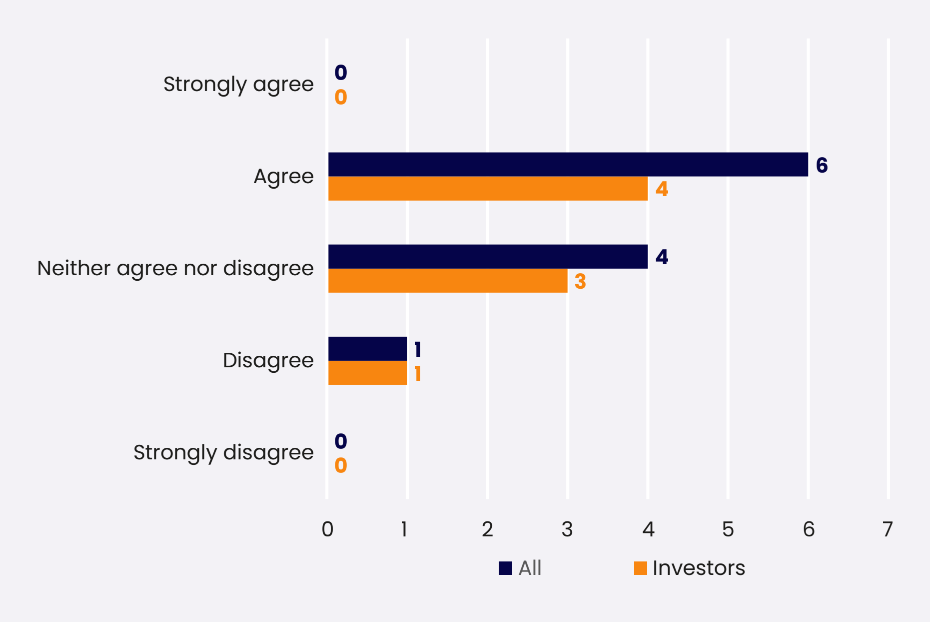
EU taxonomy

- Some respondents requested clarity on the relationship between targets for investment in climate solutions and infrastructure investment,
- Some asked whether an asset must have a formal taxonomy assessment
- Others asked whether "enabling activities" and "transitional activities" as defined in the taxonomy qualify as climate solutions

As set out in the consultation document (Box 1 – page 11), investments in climate solutions "should be based on the EU Taxonomy mitigation criteria and other science-based taxonomies or criteria for robustly identifying assets or activities that represent the climate solutions required to achieve net zero emissions by 2050 or sooner."

We note that gauging whether or not an asset meets the DNSH (do no significant harm) criterion may be hard to conclude without technical advice and will explore the possibility of establishing an annex to assist in assessing eligibility at a sector level.

Q9 Do you agree with the approach for Fund of Funds?



Q10 If not, how do you propose ensuring managers in fund of fund structures set net zero goals?

Viewed overall, respondents were supportive of the proposed approach for Fund of Funds. To the extent that respondents raised concerns, they tended to focus on the investable universe being reduced too severely, while there were requests for greater clarity in some areas.

Targets

- Some suggested that the target for investments in Fund of Funds was too prescriptive. Others recommended a more flexible approach than the proposed target, to aim to only invest with firms or fund managers with portfolio coverage targets by 2030 at the latest. One proposed alternative was to allow asset owners and asset managers to report on the proportion of investments invested in committed net zero firms, to recognise the reduced level of influence of Fund of Fund managers.
- Some suggested a grace period for new asset managers / firms might be appropriate given the significant and costly data collection and reporting demands.

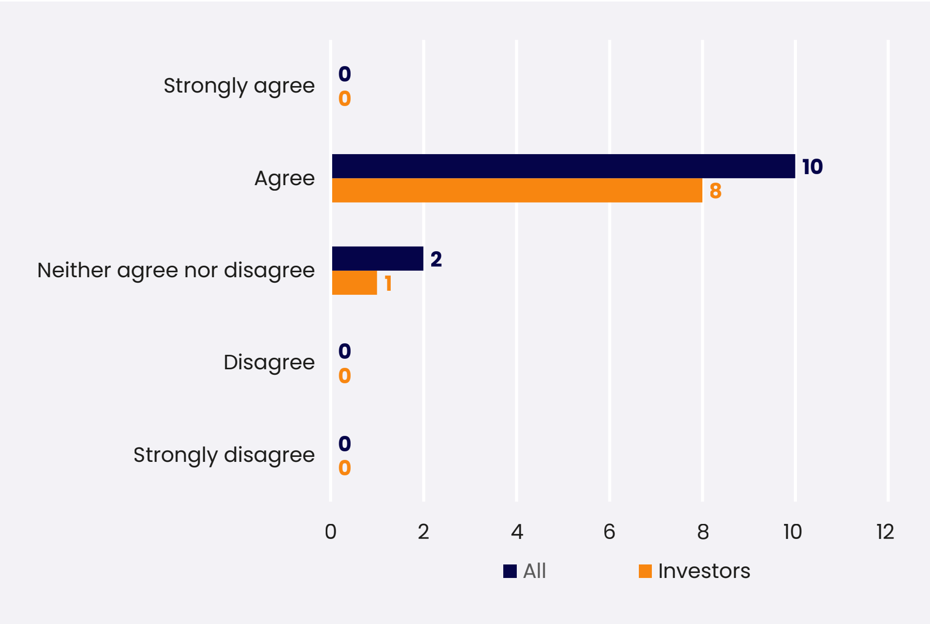
We note the feedback, but emphasise that the requirement for Fund of Funds is that they invest in managers which have committed to net zero, rather than in managers which have already achieved a net zero target. By 2030, it is expected that this will leave a broad investable universe, but we stand ready to re-evaluate the requirement at a later date if necessary.

Requested clarifications

- Some asked for guidance on whether the proposed target was for new or all investments
- Others requested guidance on the assessment of Fund of Funds themselves, particularly given the risk of double counting of underlying investments.

In response to the request for guidance, we emphasise that the targets relate to all assets. Managers should respond to the guidance on an 'implement or explain' basis.

Q11 Do you agree that the recommended actions for asset managers and asset owners capture the key activities that should be undertaken to manage climate risk/opportunity, increase net zero alignment of portfolio companies and funds/ portfolios, and to achieve net zero targets?



Respondents again provided clear support for the recommended actions as they related to the key activities to be adopted by asset owners and asset managers to manage climate risk and opportunity. The primary requests made were for clarifications. The prime examples of clarifications requested were as follows:

- Over what period are actions mandatory?
- What definition of green infrastructure should be used when assessing the target to increase exposure?
- Separately, some argued in favour of incorporating other environmental targets (i.e., biodiversity, water use, and sustainable transport) as well as engaging companies to invest in R&D for climate-related innovation, GHG abatement technologies for their respective sectors and value chains.

We are grateful for the requests for clarification and note that, where not otherwise stated, actions should be completed as soon as practicable. The encouragement for asset owners to increase exposure to green infrastructure is not a specific target and might be usefully considered at the same time as defining the entity's target for climate solutions.

Finally, we welcome the increasing relevance of biodiversity and water use targets to investors. From the perspective of an investor's net zero commitments, these are clearly relevant but not the pure focus of the guidance.

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