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# NET INVESTMENT FRAMEWORK ZERO 1.5°C

6<sup>th</sup> August 2020

IIGCC Webinar

# IIGCC

The Institutional Investors  
Group on Climate Change

The Paris Aligned  
Investment Initiative  
is supported by:



Environment Agency  
Pension Fund



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## Welcome

**Stephanie Pfeifer**, CEO, IIGCC

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## Introduction

**Lucian Peppelenbos**, Senior Responsible Investment and Governance Specialist, APG Asset Management; Co-Chair, PAII

**Adam Matthews**, Director of Ethics and Engagement, Church of England Pensions Board; Co-Chair, PAII

**David Adkins**, Head of Investment Strategy, Lloyds Banking Group – Pensions Investment and Funding Team; Steering Group, PAII

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## The Net Zero Investment Framework

**Daisy Streatfeild**, Investor Practices Programme Director, IIGCC

**Craig Mackenzie**, Head of Strategic Asset Allocation, Aberdeen Standard Investments  
Co-Lead, Strategic Asset Allocation Working Group, PAII

**Inger Huus-Pedersen**, Chief Portfolio Manager, PKA  
Co-Lead, Sovereign Bonds Working Group, PAII

**Murray Birt**, Senior ESG Strategist, DWS  
Co-Lead, Real Estate Working Group, PAII

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## Phase II of PAII

**Daisy Streatfeild**, Investor Practices Programme Director, IIGCC

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## Q&A

**All speakers**

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## Concluding remarks

**Adam Matthews**, Director of Ethics and Engagement, Church of England Pension Board; Co-Chair, PAII

**Stephanie Pfeifer**, CEO, IIGCC

- IIGCC is the European membership body for investor collaboration on climate change.
- An investor-led network of more than **250 asset owners and asset managers** from 15 countries, together we represent over €33 Trillion in assets.
- IIGCC works to support and help define the public policies, investment practices and corporate behaviours that address the long-term risks and opportunities associated with climate change.



Many of our members are based in Europe

# Paris Aligned Investment Initiative



## Co-Chairs

- **Lucian Peppelenbos**, Senior Responsible Investment and Governance Specialist, APG Asset Management
- **Adam Matthews**, Director of Ethics and Engagement, Church of England Pensions Board

## Steering Group

- **Dewi Dylander**, Deputy Director, ESG, PKA
- **David Adkins**, Head of Investment Strategy, Lloyds Banking Group Pensions Trustee Limited
- **Michael Marshall**, Director of Responsible Investment & Engagement, LGPS Central
- **Christina Olivecrona**, Senior Sustainability Analyst, AP2
- **Faith Ward**, Chief Responsible Investment Officer, Brunel Pension Partnership
- **Peter Smith**, Investment Manager, TPT Retirement Solutions

## Working Group Co-Leads

### Strategic Asset Allocation

- **Craig Mackenzie**, Head of Strategic Asset Allocation, Aberdeen Standard Investments
- **Bart Kuijpers**, Head of Fiduciary Investments, BMO Global Asset Management

### Sovereign Bonds

- **Inger Huus-Pedersen**, Chief Portfolio Manager, PKA
- **Lupin Rahman**, Head of EM Sovereign Credit, PIMCO

### Listed Equity & Corporate Fixed Income

- **Kaisie Rayner**, Senior Manager, Responsible Investment & Fund Development, Scottish Widows, part of Lloyds Banking Group
- **Francis Condon**, Executive Director, Sustainable Investment Research, UBS Asset Management

### Real Estate

- **Murray Birt**, Senior ESG Strategist, DWS
- **Faith Ward**, Chief Responsible Investment Officer, Brunel Pension Partnership

The Paris Aligned Investment Initiative is supported by:



Expert input and peer review:



# The Paris Aligned Investment Initiative

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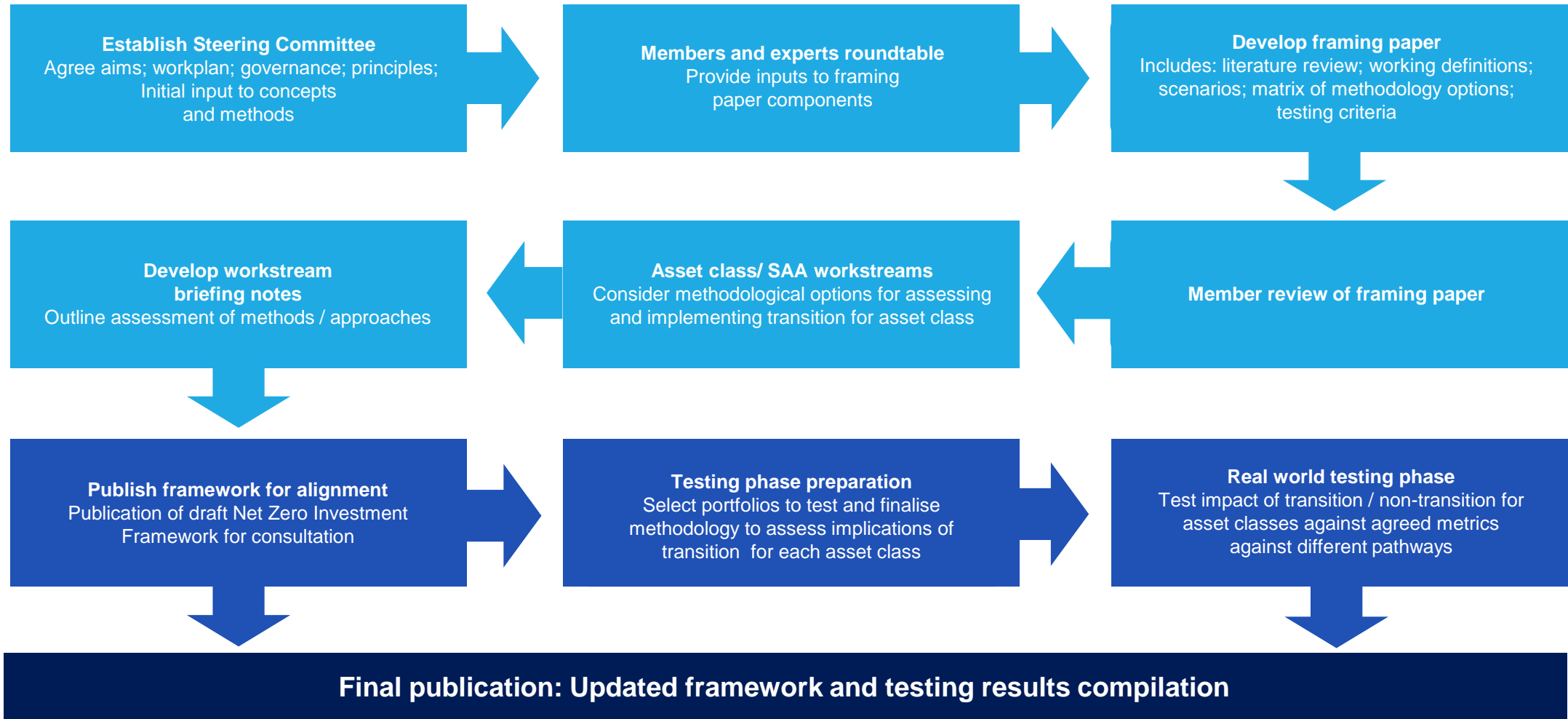
The Institutional Investors  
Group on Climate Change



Participation from **70+ IIGCC members** representing over **\$16 trillion** of assets under management

- The Paris Aligned Investment Initiative (PAII) was launched in May 2019
- Exploring how investors can align to the goals of the Paris Agreement
- Led and coordinated by IIGCC with a steering group of leading asset owners
- 4 working groups: Strategic Asset Allocation; Sovereign Bonds; Real Estate; Listed Equity and Corporate Fixed Income
  
- A framework for Paris alignment, including key definitions, pathways and methodologies
- Application of recommended methodologies to real world portfolios and testing of the financial implications of alignment





■ Complete   ■ In progress   ■ Forthcoming

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**NET** INVESTMENT  
FRAMEWORK  
**ZERO 1.5°C**

# The Net Zero Investment Framework

Produced by the Paris Aligned Investment Initiative

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## Why a Net Zero Investment Framework?

- First output of the PAII, reflecting overall objective to achieve global net zero emissions by 2050 – consistent with 1.5°C
- Provides consensus on objectives, and a clear transparent set of best practice approaches to enable effective action

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**NET** INVESTMENT  
FRAMEWORK  
**ZERO** 1.5°C

## Aims of the Framework

- Translate the goals of the Paris Agreement into practical guidance for asset owners and asset managers
- Establish a common understanding of effective approaches and methodologies to guide the ambitious action required
- Support the decarbonisation of the real economy, help minimise the negative impacts of climate change, and seize investment opportunities
- Enable all investors to maximise their efforts and impact to achieve climate goals

## How should the Framework be used?

- As a basis for a commitment to align to the goals of the Paris Agreement and net zero global emissions by 2050
- The recommendations, methodologies and key actions should be used to develop and implement an effective net zero investment strategy
- The Framework can be used by asset owners to set their strategies and by asset managers to implement them

To be considered aligned to the temperature goals of the Paris Agreement, investors should have an **investment strategy consistent with achieving a global target of net zero emissions by 2050**

## Two dimensions for investors:



**Decarbonising investment portfolios** in a way that is consistent with achieving this net zero goal



**Increasing investment in 'climate solutions'** required to meet that goal, such as renewable energy, low-carbon buildings, and energy efficient technologies

Investors should use **a range of levers – top-down and bottom-up** – to achieve Paris alignment

The Framework identifies **5 components** of a net zero investment strategy:

- Governance and strategy
- Setting targets and objectives
- Strategic asset allocation
- Asset class alignment
- Advocacy and engagement

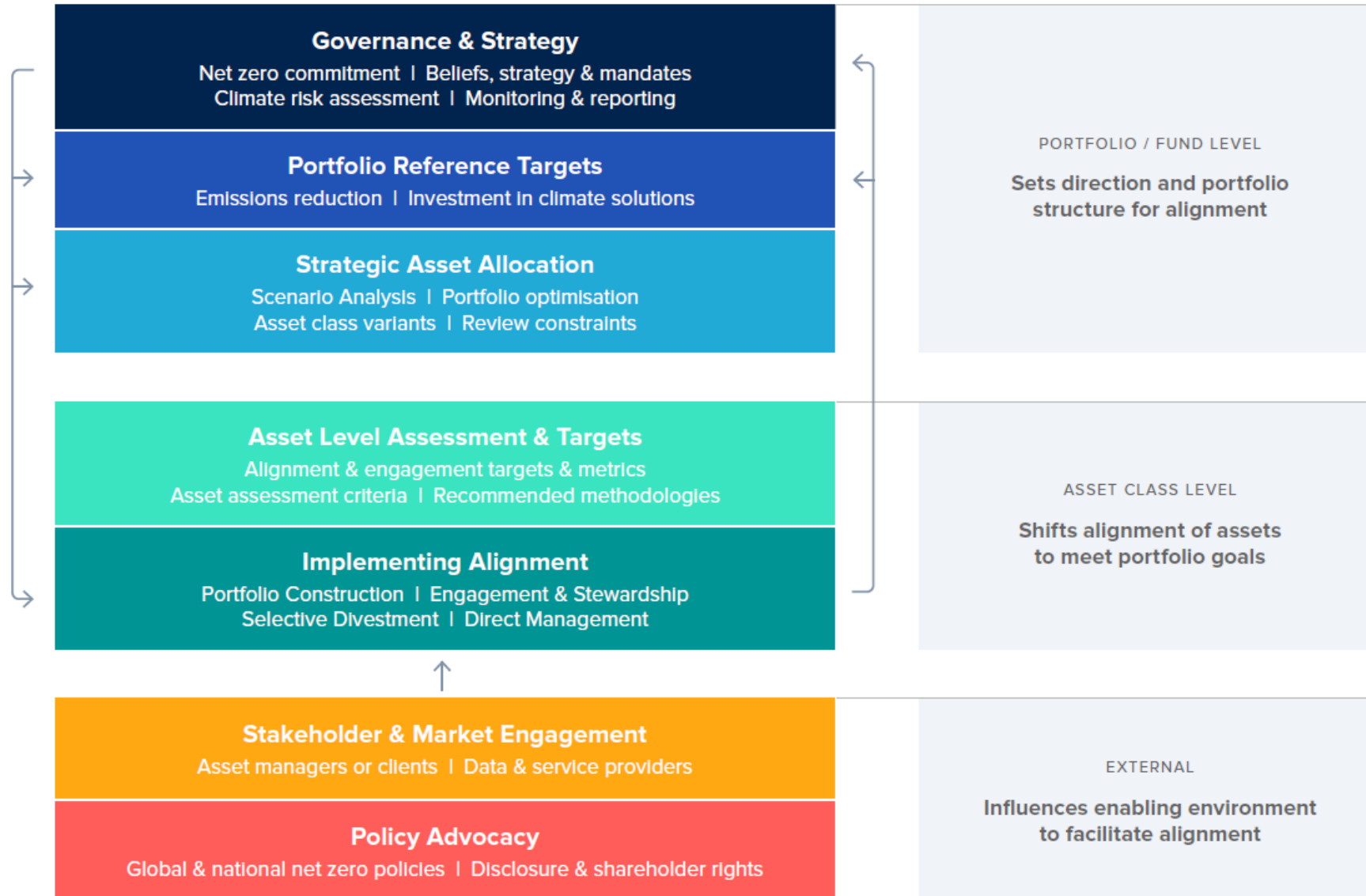


An investor's approach to alignment should be guided by the following five principles

- **Impact**
  - *Maximising long-term emissions reductions in the real economy*
- **Rigour**
  - *Science-based and consistent with achieving Paris goals*
- **Practicality**
  - *Feasible for a range of investors to implement*
- **Accessibility**
  - *Approaches and methodologies should be clear and easily applied*
- **Accountability**
  - *Clients, beneficiaries and stakeholders can assess whether investors are aligned*



# Framework overview



## **Actions for the board or investment committee**

- Include a commitment to aligning an investment strategy to net zero emissions by 2050
- Agree investment beliefs and set principles for adopting net zero alignment
- Establish relevant mandates and performance objectives for asset managers
- Review implementation of these mandates and work with asset managers to further develop net zero aligned strategies and products
- Monitor implementation of the net zero investment strategy and performance against objectives and targets set

## **Climate risk assessment and management should be undertaken in line with TCFD requirements**

- Including scenario analysis
- To reduce exposure to potential stranded assets under a credible transition pathway

## **Define an investment strategy consistent with achieving global net zero emissions by 2050**

- Addressing the 5 components set out by this Framework
- Taking an iterative process, based on portfolio emissions intensity, allocation to climate solutions, and asset level alignment

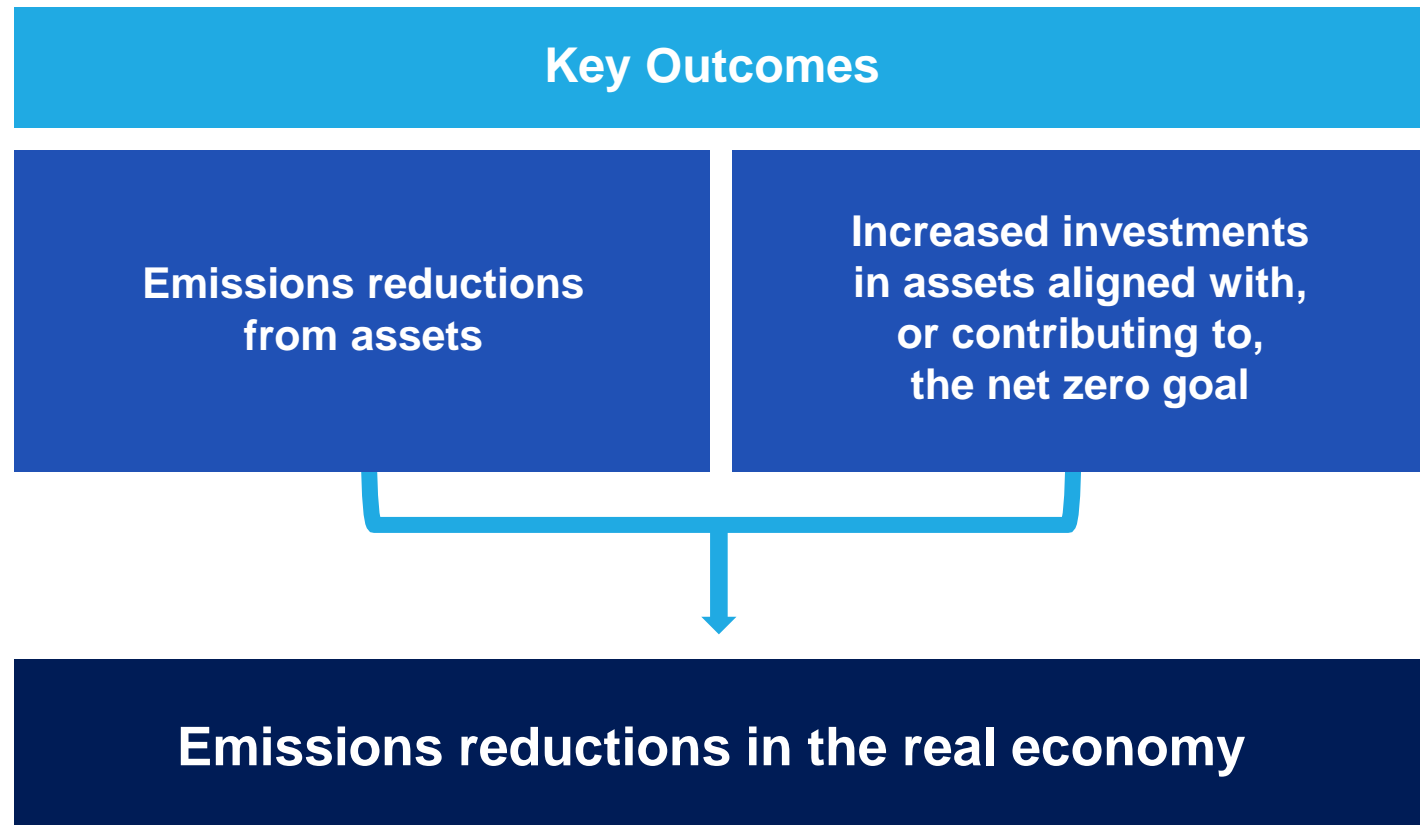
Science based **net zero pathways** are a central tool to assess appropriate portfolio targets and assess **alignment of assets**.

**A critical challenge for credible alignment by investors is the availability of robust pathways for net zero emissions and investment trajectories broken down by sector and region**

**At a minimum, pathways used by investors, companies and data providers should:**

- Be associated with **limiting warming to 1.5°C above pre-industrial levels** with at least 50% probability (or at least well below 2°C with >66% probability)
- Reach **global net zero emissions by 2050, or soon after**
- Provide **differentiated pathway information** for regions and sectors which may require net zero emissions earlier or later, consistent with the global goal
- Have a global peak emissions year of the current year or later
- Ideally be (or linked to) a **multi-sector model, taking account of all emissions sources**
- Rely on a **limited volume of Negative Emissions Technologies (NETS)** to 2050

Objectives and targets set the direction and ambition of an investment strategy towards net zero, and act as a means to monitor the effectiveness of this strategy



PORTFOLIO/FUND LEVEL

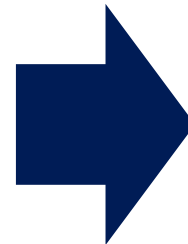


## Portfolio level, top-down reference targets in line with science based net zero pathways

An emissions intensity reduction goal and <10 year reference target, for equity, fixed income and real assets, covering scope 1 and 2 emissions *and/or*

An absolute aggregate asset emissions reduction goal and a <5 years reference target, covering scope 1, 2 and 3 emissions

A target for % of revenues or capex from AUM allocated to climate solutions



### Steps to set these targets

- Measure the current emissions intensity of the portfolio *and* allocation to climate solutions
- Assess global, sector and regional pathways that define required emissions reductions and investment trajectories (as far as current pathway development allows)

## Asset class level, bottom up target and objective in line with science based net zero pathways

A 5 year goal for increasing % AUM invested in net zero or aligned assets in material sectors

A minimum threshold for % emissions in material sectors to be aligned, or subject to engagement



### Steps to set this target

- Assess the current proportion of assets already at net zero emissions or aligned to net zero
- Determine the maximum extent to which portfolio construction can be adjusted and the rate at which assets are expected to respond to engagement strategies



## Strategic asset allocation (SAA) can optimise the way assets are allocated for achieving Paris alignment by incorporating alignment objectives within this process

### Key recommendations

- ❑ Use scenario analysis to ensure SAA is informed by climate risks and opportunities
- ❑ Supplement standard SAA objectives with climate-related metrics, such as carbon intensity and allocation to climate solutions, then implement portfolio construction accordingly
- ❑ Consider other asset classes such as renewable energy infrastructure
- ❑ Specify variants of asset classes that use more systematic approaches to reduce carbon intensity and increase exposure to climate solutions
- ❑ Review constraints to alignment and consider greater flexibility to enable greater alignment

### Metrics for alignment

- Carbon emissions intensity (scope 1 and 2)
- Climate solutions allocation as % of portfolio
- Plus supplementary metrics (e.g. fossil fuel reserves)

### Portfolio optimisation

- ❑ PAlI recommends optimising for achievement of alignment metrics in portfolio construction, alongside traditional risk/return and other indicators
- ❑ Allowing investors to identify portfolios that maximise Paris aligned objectives while achieving the same, or better, risk-return.

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# Sovereign Bonds

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## Scope

- ❑ All national sovereign bond issuance, except domestic issuance used for liability matching purposes
- ❑ Regional/municipal issuance as and when data permits
- ❑ Government owned assets (e.g. SOEs) apply corporate fixed income methodology

## Assessment

- ❑ Assessment should account for all emissions associated with the territory on a production basis
- ❑ Emission measurements should be normalised by GDP or per capita
- ❑ Investors should account for differentiated pathways towards net zero amongst countries of different levels of development
- ❑ Assess performance based on **current and forward-looking** indicators, including
  - GHG performance in relation to a net zero pathway
  - Performance of key policies / sectors relevant to alignment
  - Other national and international policy measures and positions

## Methodologies

- The PAII considers Germanwatch Climate Change Performance Index to be the leading scoring framework
- No equivalent comprehensive performance assessment exists yet for municipalities



## A. Portfolio construction

- ❑ Increase weighting, or use tilted benchmarks, towards higher climate performing issuance to the maximum extent possible
- ❑ Increase allocation to green or SDG climate bonds, including municipal green bonds

## B. Engagement

- ❑ Active direct engagement with highest impact sovereigns or largest exposures that do not score highly across the scoring criteria.
- ❑ Participate in collective engagement both directly with governments or indirectly through networks such as IIGCC, the Investor Agenda etc.
- ❑ Engage with issuers, investment banks and development agencies to increase issuance of Paris aligned green and SDG climate bonds

## C. Selective divestment

- ❑ Consider exclusion of continued poor performers from portfolios

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# Listed Equity & Corporate Fixed Income

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An aerial photograph of a coastline, showing a range of mountains in the upper half and a body of water in the lower half. The water is a deep blue, and the land is a mix of brown and green, indicating a natural, somewhat rugged landscape. The coastline is irregular, with several bays and peninsulas.

## Scope & assessment

- Identify assets in material sectors for assessment and alignment action (NACE sectors A-H, J-L)
- Assess assets against 8 criteria for a) achieving net zero; b) alignment; c) transition potential; d) not aligned/transitioning
- Assess asset revenues from climate solutions (EU taxonomy mitigation criteria)



## Alignment Criteria

The PAII sets out the key criteria investors can use to assess an asset's achievement of net zero, alignment or transition potential:

1. Current emissions intensity performance (scope 1,2 and material scope 3 emissions)
2. A long term 2050 goal consistent with global net zero
3. Short and medium term emissions reduction targets consistent with that goal
4. A credible investment plan or business model for achieving targets
5. Revenues and capex consistent with achieving targets
6. Clear governance responsibilities for targets/transition
7. Executive remuneration linked to delivering targets/investment plan
8. Disclosure and reporting of scope 1, 2 and material scope 3 emissions

### Leading methodologies for assessment identified:

- The Transition Pathway Initiative carbon performance and management quality indicators
- The forthcoming CA100+ Benchmarking framework
- Science Based Targets Initiative company assessments

To encourage the maximum impact on real world emissions the PAll supports a performance based inclusion and weighting approach combined with engagement with companies in high impact sectors

## A. Portfolio construction

- Active. Screening and/or weighting new investments based on alignment criteria and climate solutions revenues
- Invest in specialist products/funds (alignment/solutions focussed)
- Passive. Apply benchmark with positive weightings for alignment criteria and climate solutions revenue metric

## B. Engagement

- Set engagement strategy with clear milestones and escalation
- Undertake engagement and voting to improve company performance against metrics in line with strategy

## C. Selective divestment

- Selective divestment based on a) climate financial risk or b) escalation following engagement
- Exclusions based on inconsistency of company activity with credible net zero pathways over time

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# Real Estate

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**Aligning a real estate portfolio involves improving the energy efficiency of buildings and utilising renewable energy technologies to reduce the emissions associated with buildings in line with pathways to global net zero emissions by 2050**

## Assessment

- ❑ Current and forward-looking alignment based on carbon emissions and energy use in line with net zero pathways (CRREM tool)
- ❑ Investors should assess current and future expected carbon and energy intensity, taking into account:
  - ❑ Assumptions about the energy mix and demand in different buildings and locations
  - ❑ Retrofit opportunities and other investments to decrease energy usage and emissions intensity
- ❑ Scope 1, 2 and relevant scope 3 emissions should be assessed, recognising methodologies to measure areas such as embodied carbon are still nascent

## Methodologies

- The working group identified the Carbon Risk Real Estate Monitor (CRREM) as the leading carbon/energy efficiency standard. CRREM, or equivalent tools, should be used to determine asset alignment with a 1.5°C pathway.
- The working group also outlined a set of key features a green building standard that claimed to assess Paris alignment would have to include and noted that BREEAM is incorporating a 'net zero' component, based on the CRREM standard, into its assessment.

## A. Portfolio construction

- ❑ Screening and setting criteria for potential investments using CRREM tool

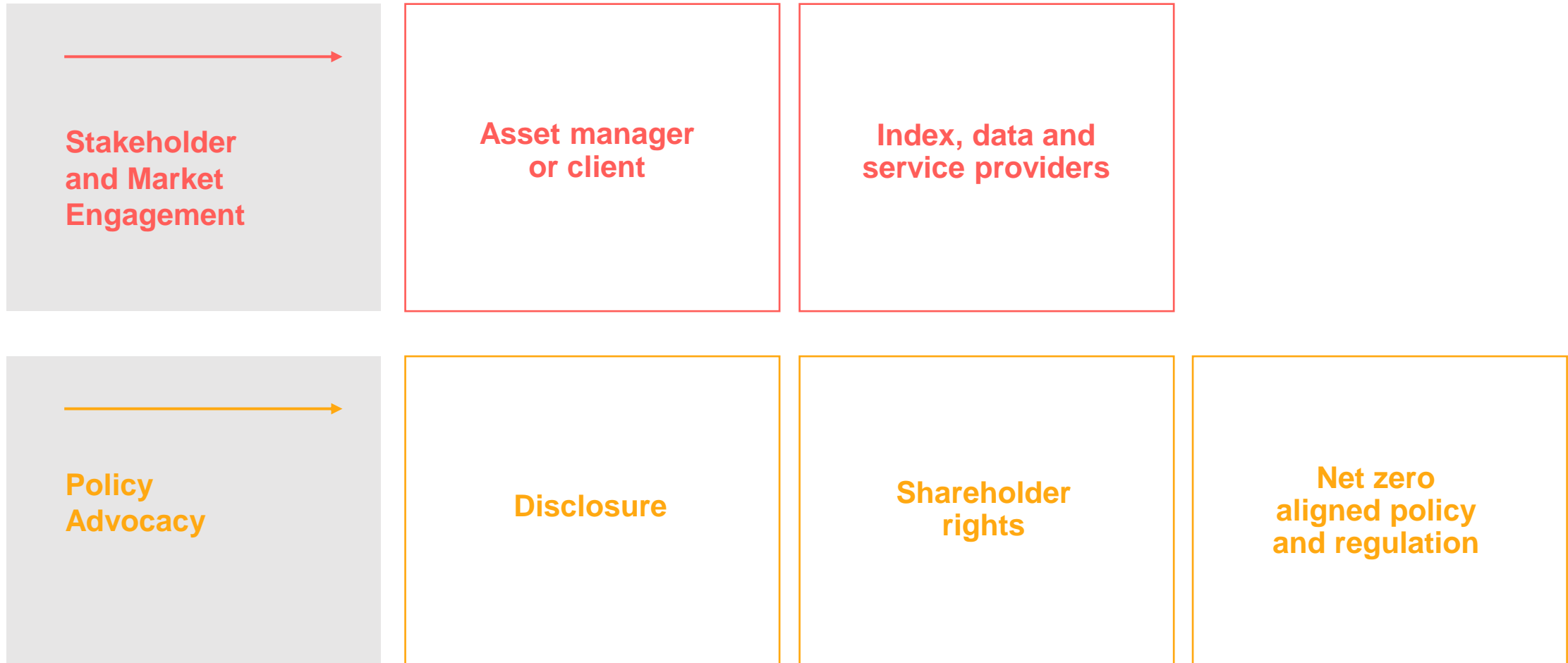
## B. Investment/management

- ❑ For direct investments (and own buildings) agree investment / management plans to align assets through retrofits to reduce energy use, increase renewable energy use

## C. Engagement

- ❑ Tenant engagement to improve data collection and facilitate investment/management for alignment of assets
- ❑ Report on and score positively against GRESB tenant engagement indicators relating to climate and energy use
- ❑ Alignment based escalation strategy and voting (for listed assets)
- ❑ Encourage corporate tenants to adopt targets and align including occupied buildings





**All types of asset manager (AM) should adopt a long-term objective of aligning assets under management and investment strategies to the goal of achieving global net zero emissions by 2050**

- ❑ Ability to adopt some components of the Framework across the whole AM business:
  - ❑ Policy advocacy, stewardship and engagement
- ❑ For other components, implementation will depend on AM, and should be adopted to the extent possible
- ❑ Where AMs are carrying out full management of a single client portfolio, all elements of the Framework can be applied
- ❑ AMs are encouraged to develop new Paris aligned products, funds and strategies across asset classes and educate clients regarding these offerings
- ❑ Client engagement is an additional key component of a net zero strategy for asset managers. An additional AM objective is:
  - ❑ **Increase the proportion of assets under management that are managed in line with a net zero investment strategy**
- ❑ For specialist AMs with high alignment already, managers to follow the principle of maximising the contribution to alignment



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# Consultation Process

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- Consultation opened for feedback from stakeholders 5<sup>th</sup> August
- Submit responses to consultation questions and general feedback via an online platform on the IIGCC website
- Close of consultation: Friday 25<sup>th</sup> September
- We are seeking input from a range of stakeholders and organisations – so please support us in promoting the publication
- Responses will be assessed by IIGCC and anonymised before being discussed with the steering group, involving further working group analysis as necessary
- The Framework will be adapted, as appropriate, to take into account responses to the consultation
- The final consultation will also reflect the results of the portfolio testing phase



## Portfolio Objectives

- The targets proposed in the Framework
- A feasible threshold for aligned, or assets under engagement
- Methodologies for:
  - Relative impact of climate solutions investment (e.g. avoided emissions)
  - Aggregated emissions reductions from assets

## Listed Equity and Corporate Fixed Income

- Scope for targeting alignment and focus on high impact sectors
- Approach to divestment
- Alignment criteria and thresholds for assets to be considered net zero, aligned or transition potential
- Other available methodologies for assessing alignment

## Strategic Asset Allocation

- Application of the Framework to equivalent processes
- Level of ambition required from investors

## Implementation by Asset Managers

- Comprehensiveness of the guidance provided to asset managers
- Whether further details specification is required

## Emissions Accounting and Offsetting

- Approach of the Framework
- Whether further specification of emissions accounting methodologies is required

# Phase II of the Paris Aligned Investment Initiative





## Expand the Framework

1) Analyse of methodologies and approaches for two additional asset classes:

- Infrastructure
- Private equity

2) Assess how investors can align portfolios to support the adaptation and resilience goals of the Paris Agreement

**Address key analytical gaps** identified in Phase I, including:

- Identifying and measuring scope 3 emissions
- Treatment of offsetting and negative emissions technologies
- Methodologies for avoided emissions and aggregating emissions reductions achieved at the asset level
- Pathways for increasing investment in climate solutions

## Support Implementation

Develop additional guidance to support implementation of the Net Zero Investment Framework.

For example:

- case studies on target setting
- work with proxy advisors to develop net zero voting policy


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**Q&A**

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# Thank you

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