

---

# NET ZERO

INVESTMENT  
FRAMEWORK **1.5°C**

# IIGCC NET ZERO INVESTMENT FRAMEWORK: CONSULTATION RESPONSE

PRODUCED BY

**IIGCC**

The Institutional Investors  
Group on Climate Change

---

VERSION 1.0 MARCH 2021

## Contents

	Introduction	3
<b>1.</b>	Setting Portfolio Targets, Objectives and Reporting	5
<b>2.</b>	Strategic Asset Allocation	8
<b>3.</b>	Listed Equity and Corporate Fixed Income	9
<b>4.</b>	Application of the Framework by Asset Managers	12
<b>5.</b>	Emissions Accounting and Offsetting	13
<b>6.</b>	General feedback	15
<b>7.</b>	Issues emerging from the portfolio testing exercise	17
<b>8.</b>	Additional points addressed	19
	Annex 1: IIGCC draft Net Zero Investment Framework Consultation Questions	20

## Acknowledgements

IIGCC would like to thank the steering group of the Paris Aligned Investment Initiative and the co-leads of the four working groups for their guidance, support and leadership in the development of the Framework.

Members of the steering group: **Adam Matthews** (Church of England Pensions Board), **Claudia Kruse** (APG Asset Management), **Lucian Peppelenbos** (APG Asset Management/ Robeco), **Christina Olivecrona** (AP2), **Peter Smith** (TPT Retirement Solutions), **Michael Marshall** (RPMI Railpen), **Faith Ward** (Brunel Pension Partnership), **David Adkins** (Lloyds Banking Group Pensions Trustees), **Dewi Dylander** (PKA).

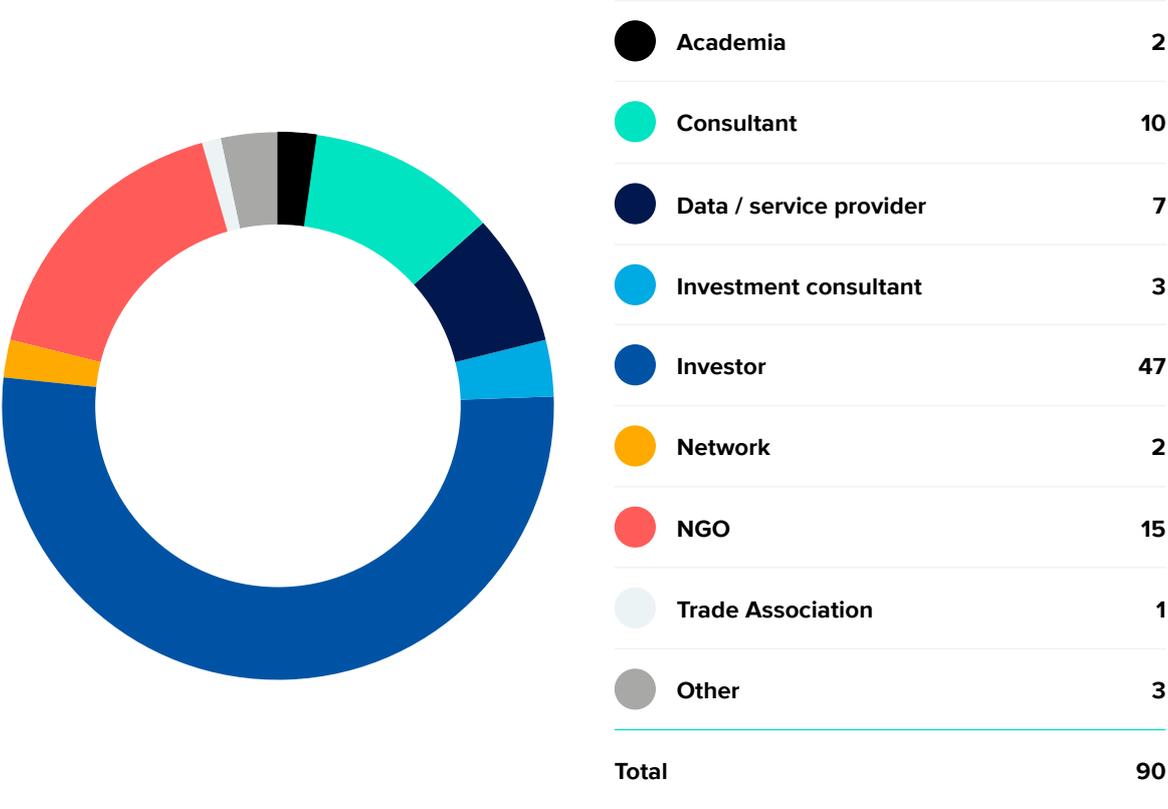
Co-leads of the four working groups: **Craig Mackenzie** (Aberdeen Standard), **Bart Kuijpers** (BMO GAM), **Inger Huus-Pedersen** (PKA), **Lupin Rahman** (PIMCO), **Kaisie Rayner** (Scottish Widows / Royal London), **Francis Condon** (UBS Asset Management), **Murray Birt** (DWS) and **Faith Ward** (Brunel Pension Partnership).

IIGCC would like to thank Vivid Economics and Planetrics for their expert input and peer review of documents.



# IIGCC Net Zero Investment Framework: Consultation Response

IIGCC’s Paris Aligned Investment Initiative published a draft Net Zero Investment Framework in August 2020 for public consultation. During the 6 week consultation period IIGCC engaged more than 780 stakeholders through events and roundtables. 90 written responses to the consultation were received. IIGCC is extremely grateful to all those who contributed to the consultation.



The consultation requested feedback on 15 questions (see Annex 1), and general feedback on the Net Zero Investment Framework ('the Framework') as a whole.

IIGCC has analysed all responses to the consultation and determined areas of the Framework where:

- Clarification of the intention or implication of the Framework is required
- Updates or changes to the Framework would be beneficial
- Further work is required to address feedback or to support implementation with more detailed guidance

During the consultation period, the [Paris Aligned Investment Initiative](#) (PAII) also tested the Framework with five investors applying the recommended methodologies to construct Paris-aligned portfolios. These portfolios have been tested to assess financial implications of alignment using scenario analysis and modelling by Vivid Economics. IIGCC has also captured lessons from this process to clarify and update the Framework.

IIGCC would also like to highlight that a number of additional methodologies and approaches relating

to Paris-alignment have been published since the publication of the draft Framework. These include the Partnership for Carbon Accounting Financials (PCAF) standard, the SBTI FI methodology, the UN Net Zero Asset Owners Alliance Target Setting Protocol, and the COP26 Private Finance Hub report on Measuring Portfolio Alignment. IIGCC has also reviewed these publications and engaged with the organisations involved as additional inputs to the consultation process.

The following sections summarise the main areas of feedback received and how IIGCC has addressed these points in the update to the Framework or via its workplan for Phase II of the Paris Aligned Investment Initiative. Alongside this response IIGCC is publishing the updated version of the Framework which focusses on the key components and recommendations for implementation. The [Net Zero Investment Framework 1.0](#) is presented as an implementation guide and can be used by investors as the basis for net zero commitments and to develop net zero investment strategies.

IIGCC has been pleased with the positive response to the Framework and the significant overall support for the Framework and the recommendations set out. A selection of points made in general feedback is provided in Box 1.

### Box 1: Feedback on the draft Framework

"The goals of the initiative are laudable, and the ability to provide concrete guidance to define Paris Alignment for asset owners is critical."

"We see the IIGCC framework as a strong implementation guideline for investors that have a climate ambition and want to operationalize it."

"The Net Zero Investment Framework provides a comprehensive and consistent series of considerations and steps that complements traditional return/risk and informs investment decisions."

"We welcome the work of the PAII in developing this framework and have used the draft outputs we saw as members of two working groups in our own climate change policy."

"[Asset owner] welcomes that the explicit purpose of this comprehensive and systematic framework is to deliver impact in the real economy."

"A very useful and detailed resource to start the journey."

"The framework is a great example of collaboration across the investment industry."

"This Framework reflects a great level of initiative and effort in reviewing and translating existing methodologies for investors. Initiatives like this and CA100+, will help to provide consistency and transparency to support net zero investment strategies, as well as constructive and targeted engagement and ultimately is likely to influence net zero capital allocation decisions."

"We believe that this framework comes at the right time, both to incentivise investors' action to align their investment with net zero trajectories based on available data and to accelerate the development of necessary methodologies to assess alignment."

# 1. Setting Portfolio Targets, Objectives and Reporting

## Consultation questions:

1. Do you agree with the combination of targets that are proposed to guide investor alignment with net zero global emissions by 2050?
2. Do you agree that targets should incentivise an investor's contribution to emissions reduction in the real economy by including a main focus on the alignment of underlying assets?
3. What threshold for % of portfolio emissions in material sectors to be net zero aligned or subject of engagement do you consider to be feasible to achieve while achieving a sufficiently ambitious level of action?
4. a) Do you currently use a methodology for calculating avoided emissions or relative impact of investment in climate solutions?  
b) Do you currently use a methodology for calculating aggregating emissions reduced?

Of the 79 responses to question 1 there was a balance between those who positively supported the combination of targets (42%) and those who were unsure (40%). Almost 80% agreed that targets should incentivise real economy emissions reductions through a main focus on aligning underlying assets to net zero pathways (question 2). The queries with regard to targets focussed on three aspects:

- the relative merits of absolute versus intensity metrics for the overall portfolio emissions reduction target
- the relevance of additional levels of targets (asset class; sector)
- the risk of targets for investment in climate solutions creating 'green bubbles'.

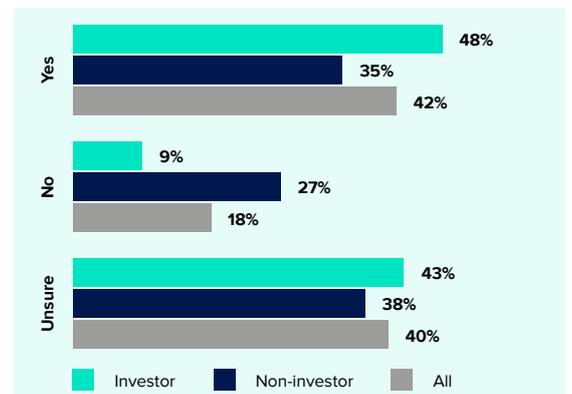
There was divergence of views between respondents who preferred intensity metrics as a better option to accommodate funds whose assets are growing (and avoiding unintentionally 'rewarding' funds that are shrinking) compared to those who highlighted the potential drawbacks of intensity metrics (primarily due to changes in performance being affected by non-relevant variables such as exchange rate, interest rate, etc). Several respondents also advocated absolute metrics as being more clearly transparent and relevant given the ultimate goal of achieving absolute emissions reductions in the real economy.

The reason IIGCC included the potential for both an intensity and absolute emissions reduction metric was driven by these different perspectives. Acknowledging the importance of achieving absolute emissions reductions in the real economy **IIGCC has updated the recommendation that**

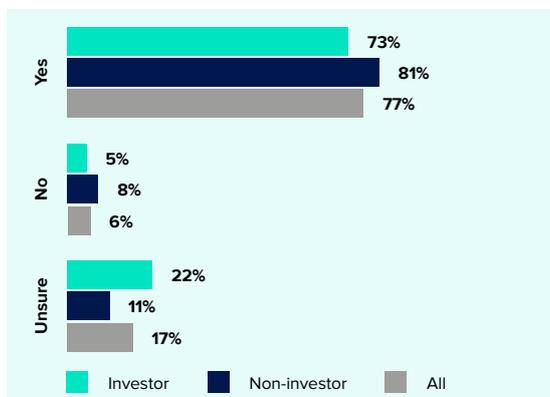
**investors should set the emissions reduction portfolio reference target based on the absolute emissions reductions needed to achieve global net zero emissions by 2050. Investors may express their target in absolute or intensity terms. However, when doing so they should provide the following to the extent possible:**

- evidence of how the target has been determined and a) reflects net zero pathways that will meet absolute emissions reductions required over time, and b) is adjusted to take account of factors that are not related to real economy emissions reductions as relevant.
- when monitoring and reporting progress annually, measure a) absolute emissions reductions achieved in aggregate at the asset level, and b) progress towards an absolute or intensity target at the portfolio level

### 1. Do you agree with the combination of targets that are proposed to guide investor alignment with net zero global emissions by 2050?



## 2. Do you agree that targets should incentivise an investor's contribution to emissions reduction in the real economy by including a main focus on the alignment of underlying assets?



Some investors highlighted that additional targets should be included at sector and / or asset class level. IIGCC recognises that, optimally, overall portfolio targets will need to be 'built' through consideration of relevant sector pathways, and asset class specifics, as well as the expected exposures (regional, sectoral, company) of a given investor. Conversely, IIGCC also notes that, although there was significant support for top-down and bottom-up targets to ensure effective outcomes, several investors already noted that more than one layer of targets could be seen as onerous. IIGCC has therefore decided not to include an expectation that additional sector or asset class targets should be specified and reported against. However, the Framework recommends that portfolio level targets should take these components into account in order to

specify appropriate overall targets. The Framework does not preclude investors from setting these additional targets, and as regional sectoral pathways that are aligned to net zero by 2050 become available, this may be an additional best practice set of metrics for investors to include to demonstrate portfolio performance and progress.

While many respondents welcome the flexibility for investors to set their own targets, some requested further guidance and examples of best practice to guide implementation. Phase II of PAII will look to provide this guidance.

A number of respondents mentioned that it would be appropriate to have the opportunity to revise targets over time to take account of changes to the portfolio, and developments in data and methodology. IIGCC agrees and added a **recommendation to the Framework that targets are reviewed and revised as necessary at least every 5 years. It was also noted that all targets should have timeframes, and this has been clarified in the updated Framework.**

Several respondents mentioned the importance of including scope 3 emissions in portfolio level targets over time. **IIGCC agrees, and has clarified that these should be phased in, and if possible, in line with the emerging European timetable.**<sup>1</sup> However, while challenges in data and aggregation remain, any portfolio scope 3 target or measurement should be separate from scope 1 & 2.

A small number of respondents advised against setting targets in relation to investment in climate solutions on the basis that this may lead to green 'asset bubbles'. IIGCC notes that the EU Technical Expert Group considered this issue in its impact assessment for the EU taxonomy and did not find



1. In line with the emerging European timetable for the Sustainable Finance Disclosure Regulation.

a risk of green asset bubbles<sup>2</sup>, citing the broader context of advancing climate policy that should increase the supply of relevant investments over time. IIGCC would also emphasise that the Framework describes the portfolio level targets as ‘reference’ targets, recognising that these targets should be pursued in the context of investors’ duties to undertake appropriate due diligence and relevant valuation of assets and companies. Indeed, the role of the strategic asset allocation (SAA) recommendations regarding optimisation etc is designed to ensure a relevant feedback loop for appropriate allocations to new asset classes, and would not expect investors to meet targets where an acceptable overall risk return profile cannot be achieved. At the same time, a clear goal and reporting against this is a relevant incentive to promote investor action to identify new asset classes and develop capability to assess and invest in these assets. Therefore, the target relating to increasing investment in climate solutions remains unchanged in the updated Framework.

Several asset managers noted that ‘portfolio wide’ targets will have a different meaning for asset managers than for asset owners, depending on the mandates they are implementing for clients and which funds, products or strategies are being managed in line with net zero. **Asset managers should establish what proportion of assets is being managed in line with a net zero investment strategy and set (and, to the extent possible, aggregate), emissions reduction and investment in climate solutions targets for all AUM that are being managed in line with net zero emissions strategies or mandates.** See Section 4 on asset manager implementation and Section 10 of the updated Net Zero Investment Framework 1.0

Question 3 asked for feedback on the threshold investors should meet for assets that are either aligned or, if not, subject to active engagement. Some feedback highlighted the need to clarify that the % coverage of engagement includes both direct engagement, and engagement undertaken by fellow investors in collective initiatives (such as CA100+).

In terms of the threshold number the majority of feedback ranged between slightly less ambitious levels (60-65%), and higher ambition 90%-100%. IIGCC recognises that, ideally, investors would

engage with all assets in a portfolio that are not aligned, however given the diversity of many portfolios this is unlikely to be practical, certainly in the short term where alignment is low meaning high levels of engagement are required. IIGCC noted that many respondents suggested a practical but ambitious approach could involve a rising threshold. **IIGCC, therefore, recommends that investors set a minimum threshold of 70%, increasing over time, to at least 90% by 2030 at the latest.**

Several respondents also suggested the scope for this threshold should include all assets, rather than exclusively those in material sectors, and respondents asked for clarity on asset classes in scope. Investors may choose to include all assets but should ensure this does not result in material sectors being put ‘out of scope’ of the threshold. However, IIGCC recognises that including all assets will increase the volume of action required, and therefore recommends that the focus remains on material sectors to avoid excessive burden of implementing a net zero investment strategy.

For transparency, it was suggested by a number of respondents that investors should report a disaggregated number for the assets assessed as being already net zero or ‘aligned’ and also the remaining proportion under active engagement. **IIGCC agrees that investors implementing the Framework should provide disaggregated information, and this recommendation has been reflected in the Framework accordingly.**

Several respondents also noted that clarification on what counts as ‘sufficient’ engagement would be helpful. The Framework lists a range of engagement actions that should be employed as part of a sufficient engagement strategy and these key actions are highlighted in the final Framework.

In question 4, IIGCC also asked for feedback on potential methodologies that could be used to underpin and strengthen the measurement of aggregated emissions reductions by underlying assets, and to capture the relative impact of investment in different climate solutions. IIGCC received a number of suggestions, although no clear consensus on a single robust methodology in either case. We will, therefore, consider potential methodologies as part of the further work of the PAII.

2. EU Technical Expert Group ‘Taxonomy Technical Report’, June 2019

## 2. Strategic Asset Allocation

### Consultation questions:

5. For funds that do not use Strategic Asset Allocation, are the actions set out in the framework transferable to your equivalent process (e.g. Total Portfolio Approach)?
6. If not, what alternative approaches can be applied to support alignment through that process, that should be referenced in this framework?
7. Do you agree that investors should aim to increase the contribution towards decarbonisation and investment in climate solutions to the maximum extent possible even if that constitutes more than a 'fair' share distributed among investors?

Only 10% of respondents did not think that the SAA approach was transferable to equivalent processes, although a significant proportion (62%) were unsure. In the written comments, generally the feedback indicated that some, though not always all, components would be relevant actions for a range of funds, or the principles could be translated into alternative processes.

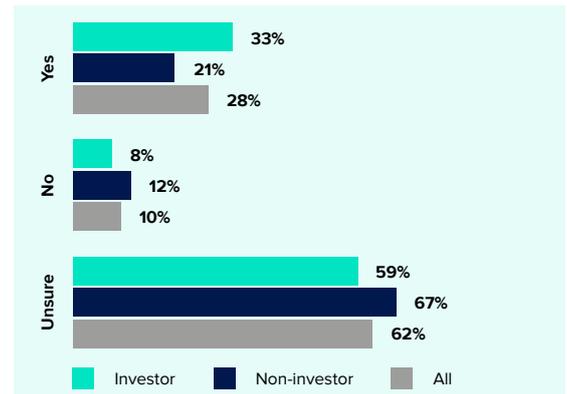
A number of respondents indicated that the metric for emissions reduction objective in SAA should be tCO2e/m\$ invested, rather than revenue. IIGCC has clarified the preference for the tCO2e/m\$ invested metric.

Feedback also emphasised that the implications of climate scenario analysis should be more systematically incorporated in risk/return expectations, including at the stock specific level. This involves updating terminal values, adjusting discount rates, altering revenue assumptions, etc.

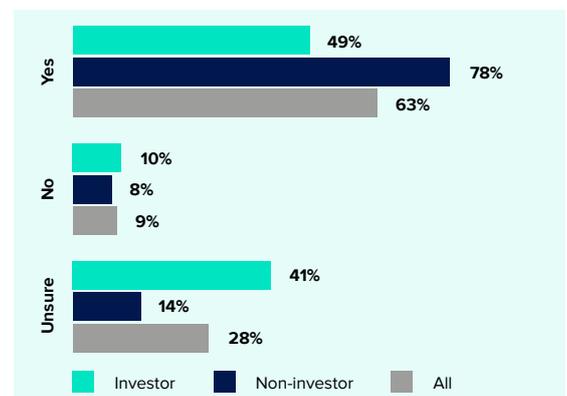
As suggested in a number of responses, IIGCC will look to provide examples of how the elements of the SAA approach can be applied across alternative styles of top-level asset allocation to suit a range of funds during Phase II work to support implementation.

With regard to the question on whether investors should maximise the contribution towards decarbonisation and investment in climate solutions, 63% agreed and only 9% percent disagreed. In response to the feedback, IIGCC can also clarify that this aim will need to be achieved within the limits of fiduciary and regulatory constraints, and will therefore be defined by each investor. However, investors should report transparently on how they consider their actions to represent the maximum ambition possible, how they have sought to maximise impact, and how they are addressing any constraints to taking action.

### 5. For funds that do not use Strategic Asset Allocation, are the actions set out in the Framework transferable to your equivalent process (e.g. Total Portfolio Approach)?



### 7. Do you agree that investors should aim to increase the contribution towards decarbonisation and investment in climate solutions to the maximum extent possible even if that constitutes more than a 'fair' share distributed among investors?



### 3. Listed Equity and Corporate Fixed Income

#### Consultation questions:

- 8. Given the large number of assets in a portfolio, and the need to provide a practicable approach for investors, are high impact NACE (and associated BICS/GICS) codes the best option to define the relevant scope for alignment for listed equity and corporate fixed income portfolios?
- 9. Do you agree that divestment should not be the standalone strategy for achieving the portfolio emissions reduction target, and increasing % of aligned assets?
- 10. Do you agree with the thresholds for a company to be considered net zero; aligned to a net zero pathway; transition potential?
- 11. Are there methodologies in the market, other than those specified in the Framework, that provide robust assessments of one or more of the criteria for assessing alignment and should be recommended for use by investors through this framework?

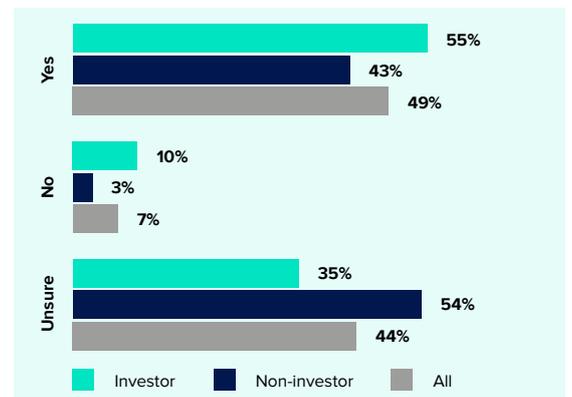
In response to question 8 on the use of NACE codes to identify sectors that should be in scope for alignment, the response was positive 49% agreeing the approach and only 7% disagreeing. However, among those who were unsure, many investors noted that these are not the standard classifications used in investment processes and for non-EU jurisdictions. Translation of these NACE codes to GICS would be needed. As noted in the draft Framework, the EU has provided a mapping, and an additional number of sources and providers of similar mappings were highlighted by respondents. Some respondents also questioned whether all high impact sectors were included in the listed NACE sectors. IIGCC can clarify that it is not only the activities for which there are EU taxonomy standards, but all categories of activity under the main codes listed, unless otherwise stated. This ensures that sectors such as aviation and various types of manufacturing are included.

Alternative suggestions were made for setting the scope of assets to include, such as simply ensuring a % of portfolio emissions are included, or a more limited number of high impact sectors. IIGCC considers it relevant to specify the sectors in scope to avoid poor performing assets that are in sectors material to the transition to net zero being put 'out of scope' in a % threshold. IIGCC also considers it relevant to identify a significant number of sectors to promote the ambitious action necessary across the economy to reach net zero. However, IIGCC notes that it may be challenging to assess all assets against the alignment criteria set out. Therefore, a two tier approach regarding high impact sectors is set out below. As noted in the draft Framework, data availability may be a challenge in the short term and IIGCC, therefore, expect addressing the full scope of assets in the specified NACE codes across geographies may be achieved over time

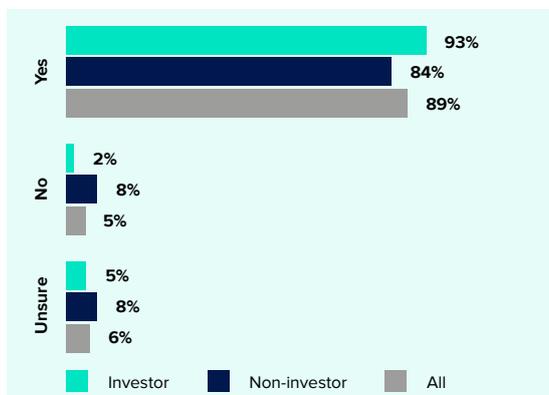
while coverage of methodologies and datasets to assess alignment improves.

There was strong agreement (88%) that divestment should not be a standalone strategy. However, many respondents emphasised that to be effective, engagement does need to include a genuine escalation process with the potential for divestment as the ultimate outcome, which is reflected in the approach already set out in the draft Framework. There was also support for the planned PAII Phase II work to develop more detailed guidance on science-based timeframes and thresholds for specific high-emitting activities that are permissible or not permissible within a net-zero aligned pathway.

**8. Given the large number of assets in a portfolio, and the need to provide a practicable approach for investors, are high impact NACE (and associated BICS/GICS) codes the best option to define the relevant scope for alignment for listed equity and corporate fixed income?**



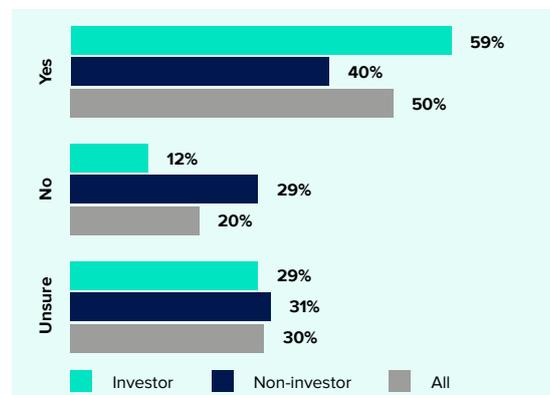
**9. Do you agree that divestment should not be the standalone strategy for achieving the portfolio emissions reduction target, and increasing % of aligned assets?**



Several respondents suggested that the criteria to be considered aligned involving tracking 8 data points for a large range of companies was not realistically achievable and that such data sets are not yet fully available or robust. The Framework acknowledges the issue of data availability and recognises that the ability to assess companies will evolve over time as data improves and measurement against the criteria becomes more systematic. Where investors are using partial data or alternative indicators for alignment this should be reported transparently. **However, to ensure proportionality in assessment requirements, IIGCC is proposing that 6 of the criteria are core criteria for assessing high impact companies, which constitute the key components of a Net Zero Transition Plan.**

- 1. Ambition:** A long term 2050 goal consistent with global net zero
- 2. Targets:** Short- and medium-term emissions reduction target (scope 1, 2 and material scope 3)
- 3. Emissions performance:** Current emissions intensity performance (scope 1, 2 and material scope 3)
- 4. Disclosure:** Disclosure of scope 1, 2 and material scope 3 emissions
- 5. Decarbonisation Strategy:** A quantified plan setting out the measures that will be deployed to deliver GHG targets, proportions of revenues that are green and where relevant increases in green revenues
- 6. Capital Allocation Alignment:** A clear demonstration that the capital expenditures of the company are consistent with achieving net zero emissions by 2050

**10. Do you agree with the thresholds for a company to be considered net zero; aligned to a net zero pathway; transition potential?**



**The high impact category should include: companies identified as part of CA100+; companies in high impact sectors consistent with Transition Pathway Initiative sectors; banks; and real estate. Appendix B of the updated Framework provides the relevant GICs classification for TPI sectors.**

**Other companies in scope should be assessed on criteria 2, 3 and 4.**

Investors are then also encouraged to assess, and engage companies to meet the following complementary indicators, which are relevant to the likelihood of a company achieving and contributing to the transition to global net zero emissions. **This recognises feedback in the consultation that a company's lobbying positions should be taken into consideration, and aligns with the criteria in the CA100+ benchmark.**

- 7. Climate Policy Engagement:** The company has a Paris-Agreement-aligned climate lobbying position and demonstrates alignment of its direct and indirect lobbying activities
- 8. Climate Governance:** Clear oversight of net zero transition planning and executive remuneration linked to delivering targets and transition
- 9. Just Transition:** The company considers the impacts from transitioning to a lower-carbon business model on its workers and communities
- 10. Climate risk and accounts:** The company provides disclosures on risks associated with the transition through TCFD Reporting and incorporates such risks into its financial accounts

Regarding the thresholds for companies to be considered 'Net Zero'; 'Aligned to a Net Zero pathway'; and 'Transition Potential', 59% of investors agreed with a criteria-based threshold approach (question 10), although some requested clarification of the different thresholds.

IIGCC has therefore reviewed and revised the approach. Investors should therefore determine whether an asset is:

- Achieving **net zero**, defined as: companies that have current emissions intensity performance at, or close to, net zero emissions with an investment plan or business model expected to continue to achieve that goal over time
- Aligned** to a net zero pathway, defined as:
  - Meeting criteria 1-6 (or 2, 3 and 4 for lower impact companies)
  - Adequate performance over time in relation to criterion 3, in line with targets set.
- Aligning** towards a net zero pathway, defined as:
  - Have set a short or medium-term target (criteria 2)
  - Disclosure of scope 1, 2 and material scope 3 emissions data (criteria 4)
  - A plan relating to how the company will achieve these targets (partial criteria 5)
- Committed to Aligning**, defined as:
  - A company that has complied with criteria 1 by setting a clear goal to achieve net zero emissions by 2050
- Not aligned** – all other companies

This assessment of categories enables investors to set and measure performance against the target to increase the proportion of assets that are aligning over time. It should also inform the strategy for actions by investors to improve the performance of companies against the criteria, as described in the Framework. Assets not aligning or showing progress towards meeting the criteria to be considered as "aligning" (such as being Committed to Aligning, or meeting the complementary indicators) should be the immediate and urgent priority for engagement or reweighting in portfolio construction.

This revision of the criteria, categories and implications for targets also aligns with the 'portfolio coverage' methodology proposed by the Science Based Targets Initiative methodology for Financial Institutions (SBTi FI). In this context, IIGCC is also setting **a similar expectation that the bottom-up targets relating to increasing coverage of 'net zero/aligned/aligning assets' should be set to increase year on year to reach full coverage no later than 2040.**

It was also emphasised by a number of investors that the Framework should clarify that **emissions reduction targets (long, medium, and short term) and investment plans of companies should be consistent with sector specific pathways related to emissions performance, that are in line with a global net zero emissions trajectory. IIGCC agrees and this clarification is reflected in the updated version of the Framework.**

In addition, some respondents noted there was potential for subjectivity in assessing some of the criteria. In particular, there is a lack of robust consensus on what would constitute 'credible investment plan or business model for achieving targets' and 'Revenues and capital expenditure consistent with achieving targets'. IIGCC acknowledges that consistent determination of this is an area to be further developed, and is doing so through the work of the IIGCC Corporate Programme and the Climate Action 100+ benchmark through which IIGCC expects to develop more detailed assessment criteria for a range of sectors.

The consultation also asked respondents to identify additional methodologies for assessing alignment of companies and investment in climate solutions that could be used by investors and not already identified (TPI, SBTi, EU Taxonomy).

Several investors highlighted private data and methodology providers that offer assessments relevant to at least some of the 8 alignment criteria. IIGCC has not recommended private sector providers, given the principle for the framework of providing methodologies that are accessible to all investors. However, IIGCC recognises and encourage private providers to develop methods and tools which support measurement of companies against the criteria, and where investors choose to use these methodologies, they should refer to the assessment used and how they consider the methodology meets the recommendations of the Framework in their reporting.

The feedback also highlighted the mixed views on use and validity of current temperature alignment metrics, reflected on p.26 of the draft Framework. While the Framework does not yet recommend a temperature alignment methodology, IIGCC continues to engage with potential temperature metric development to address methodological challenges and consider how these may be incorporated into the Framework in the future.

As an additional clarification, **with reference to corporate fixed income engagement when referring to "outside the issuance process" this means to engage in the months prior to issuance to ensure companies are meeting criteria on which decisions to invest or not can be taken.**

## 4. Application of the Framework by Asset Managers

### Consultation questions:

12. Does Box 4 describe how asset managers can apply this framework?

13. What further detail or ‘use cases’ are needed to enable asset managers to utilise the Framework?

Overall, around half of respondents thought that Box 4 in the draft Framework sufficiently described how asset managers should use the Framework. However, a number of useful suggestions were made as to additional clarity that could be given to ensure the Framework was sufficient. Several respondents affirmed the importance of a differentiated approach from asset owners and that certain components of the Framework e.g. target setting and portfolio construction to increase alignment may only be possible on a proportion of existing assets given the challenges of retrospectively applying the Framework to existing funds and products, and the different regulatory constraints that asset managers face in different jurisdictions.

At the same time there was support for **asset managers to specify how they are applying the Framework and to which areas of their portfolio**, as well as to the proposal that some components, such as engagement and voting, could be business wide strategies. There was also support for **clarification of disclosure that asset managers should provide in relation to their actions, such as engagement with both assets and clients**. For example, it was suggested that asset managers

should disclose their engagement strategy in relation to climate risk and carbon reduction and the resources they apply to their engagement and voting.

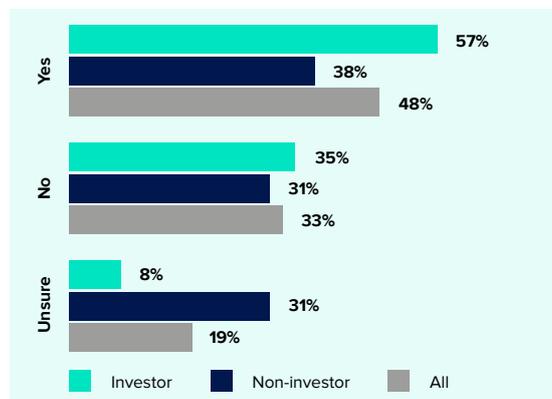
It was also highlighted that asset managers should be offering aligned products, using them as default options where feasible, and **providing supportive research and analytics**.

An additional element highlighted as key for **asset managers to undertake across all asset classes in the Framework on behalf of clients is appropriate risk assessment and management**, as part of their fiduciary duty.

**The above elements have been reflected in Section 10 of the updated Framework on asset manager implementation.**

Many respondents also noted that, more than further prescription, case studies and best practice examples would be beneficial. As part of Phase II of the PAI, IIGCC will be working with members to produce a suite of best practice case studies to promote effective implementation by asset managers.

### 12. Does Box 4 sufficiently describe how asset managers can apply the Framework?



## 5. Emissions Accounting and Offsetting

### Consultation questions:

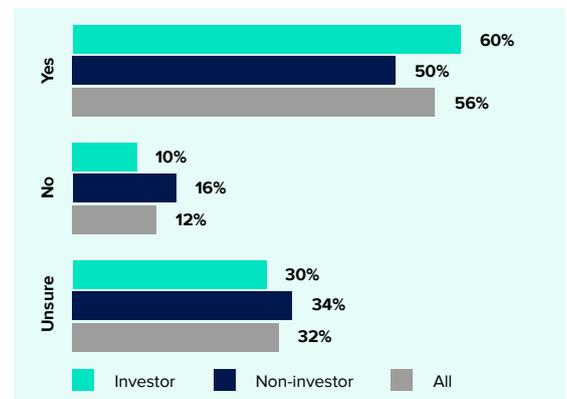
14. Do you agree with the approach taken to emissions accounting described in Annex 1? If no, please explain the approach you would recommend

15. Should the Framework provide a specific recommendation(s) on accounting methodologies to be applied by investors e.g. for re-baselining emissions intensity targets?

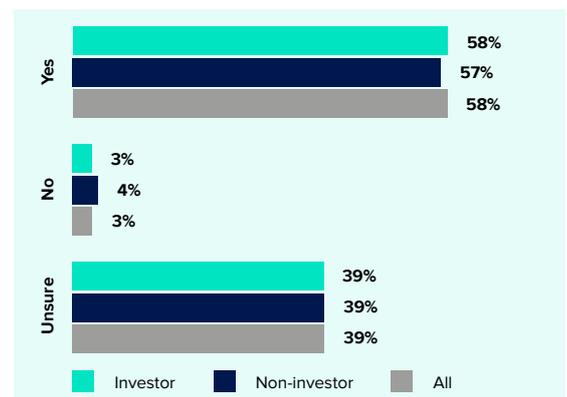
The draft Framework indicated some components of an emissions accounting approach and asked for feedback, including on whether the Framework should specify the approach more comprehensively. A majority supported the components indicated and there was strong support for setting out the approach in more detail. At the same time, many respondents noted the existence of emerging best practice standards that could be utilised. In particular, and as referenced in the draft Framework, the Partnership for Carbon Accounting Financials (PCAF) is developing a leading standard for financial entities to measure and report their financed emissions footprint. IIGCC also notes that PCAF is partnering with the Net-Zero Asset Owner Alliance, and is engaging with TCFD. IIGCC is supportive of finding harmonised approaches as investors have referenced use of both standards. IIGCC is now engaging with PCAF as part of work in Phase II, to assess how the PCAF’s Global GHG Accounting and Reporting Standard, backed by the GHG Protocol, can be utilised as the accounting approach for the Framework, and what further development would be necessary to ensure it is fully applicable.

A potential challenge identified for further developing the accounting approach is the potential distinction in emissions that should be included in scope at the asset level from an ‘Impact’ perspective versus those that are appropriate to include from a portfolio ‘aggregation’ perspective. For example, if all sovereign bond emissions associated with the full territory are included in the portfolio aggregation this results in double counting with corporate asset emissions, but also an outsize importance of those emissions in achieving portfolio targets. PCAF has historically focussed on the valid objective of emissions footprint aggregation (and attributing responsibility between investors). At the asset alignment level at least, a broader scope for emissions accounting may be relevant to ensure that there are incentives for companies to influence emissions reductions in their supply chain. As the current PCAF standard only includes a subset of asset classes, and has not

### 14. Do you agree with the approach taken to emissions accounting described in Annex 1?



### 15. Should the Framework provide a specific recommendation(s) on accounting methodologies to be applied by investors e.g. for re-baselining emissions intensity targets?



phased in scope 3 emissions, this issue has not been a challenge to address. IIGCC will consider this issue further in specifying the accounting standard, in consultation with PCAF, during Phase II.

PCAF also does not necessarily address potential discrepancies at company level reporting, such as emissions boundary. It was also noted that setting more specific expectations for company level reporting to ensure consistency would be important.

Some investors suggested that a broader scope for sovereign emissions should be used to assess performance, to incorporate imports and exports as a better reflection of the impact of a sovereign entity on global emissions. Including 'supply chain' emissions is consistent with the scope 3 approach recommended for companies, however, data availability and consistency for all supply chain emissions is not consistently available. A key

measure of alignment and also sovereign transition risk, as highlighted in the portfolio testing phase, is fossil fuel dependency of the economy. While fossil fuel imports are likely to be accounted for within the current recommended GHG metrics, fossil fuel exports are not recognised. **IIGCC, therefore, proposes to add an additional sovereign alignment metric to include economic dependency on fossil fuels.** However, this should be utilised in line with the recommendation to take account of developed vs emerging economy sovereigns to avoid this metric encouraging reweighting towards developed economies.

With regard to offsetting, there was generally positive feedback on the outlined precautionary approach, and approach to avoided emissions, while noting that offsetting would be important and necessary in some cases. Several respondents raised specific issues which will be incorporated into the work planned to deepen the guidance on offsetting in Phase II.



## 6. General feedback

Two particular themes were emphasised in many responses. First, that the science of data and methodologies is a work in progress, and therefore the Framework should remain flexible to emerging best practice as well as based on the overall expectation that recommendations will necessarily be implemented on a best efforts basis and to the extent possible until coverage of data and methodologies improves and is more consistent. IIGCC firmly agrees, and reflects this in a key component of the Framework about investor action to encourage relevant actors in the market to address these gaps.

Second, several investors emphasised a range of particular characteristics and constraints on different investors that may affect the ability of any individual investor to implement the Framework or particular components. IIGCC recognises this diversity and emphasises that the Framework is designed to be used on an 'implement or explain' basis, and aims to accommodate this differentiation while promoting leading practices and ambitious action by all investors.

Across the feedback a large number of respondents mentioned areas of the Framework where transparency and disclosure would be beneficial to help ensure implementation is being undertaken and on a sufficiently robust basis. The draft Framework made a general recommendation that investors should publish information on strategy and targets, and monitor and report annually on implementation. This includes information on how they consider their targets to be aligned to a pathway to achieve global net zero emissions by 2050, and represents the maximum ambition possible; and the strategy and actions they have implemented across all asset classes, and performance against the objectives and targets over time. It also recommends investors specifically report on how divestment has contributed to reaching targets and how those decisions are consistent with the recommended approach to divestment in the Framework. IIGCC noted a number of specific suggestions, particularly with regard to transparency on engagement, escalation and voting policies and record, as well as policy advocacy. **The updated Framework, therefore, indicates across the components what reporting and disclosure is specifically recommended per component to provide clarity on the overall recommendation.** At the same time, during the development of the Framework several investors were cautious about the potential for new and

onerous reporting and disclosure requirements. The recommendations in the updated Framework, therefore, seek to align to existing Frameworks, such as TCFD, and do not specify detailed content and format requirements.

Several respondents also suggested that further guidance on appropriate engagement actions, escalation strategies and voting policies would be helpful to ensure robust implementation. In addition to highlighting key actions that should form the core of an engagement strategy, IIGCC is developing these components through its corporate programme.

Several respondents referenced the need to see divestment from companies with significant revenues from coal and new fossil fuel exploration. **IIGCC recognises the need for rapid transition away from these activities in plausible net zero pathways, and the Framework therefore recommends that investors should not allocate additional capital<sup>3</sup> to companies which are planning or constructing new thermal coal projects and associated infrastructure (power, mining) or taking forward new exploitation of tar sands. Where investors are existing shareholders or bondholders in such companies, they should use active and escalating engagement to with the aim of ensuring no new thermal coal generation is developed and no further tar sand resources are exploited, and also that phase out of existing unabated capacity and activity is undertaken in line with net zero pathways. In advocating for these transition plans, investors should recognise the need for a just transition in countries or regions where there is significant economic dependence on thermal coal power or mining.**

Additionally, in Phase II, IIGCC will undertake work to provide an evidence base for investors to inform investment and divestment decisions for different activities in different regions, against net zero pathway compliant timeframes.

Some respondents also suggested clarifying and specifying the 2050 goal associated with an investment strategy, as it relates to asset owners and asset managers. As set out in the Framework, investors should align their investment strategy with achieving global net zero emissions by 2050. **In general, for asset owners IIGCC therefore recommends this should include making a commitment to transitioning a portfolio to achieve net zero emissions by 2050, or sooner. For asset managers, this should include setting**

3. Additional capital refers to a) primary investment through new share or bond issuance and b) secondary investment in shares or bonds purchased on the secondary market.

an ambition to achieve net zero GHG emissions across their AUM, working with clients to achieve this ambition. The Framework also now encourages asset owners and managers to make public commitments in this regard, and includes relevant commitment statements (see Appendix C and Appendix D of the updated Framework). **Although the focus of commitments and the Framework remains on aligning portfolios to net zero (and 'financed' emissions), investors are also encouraged to set targets and take action in relation to their operational emissions, in line with achieving global net zero emissions by 2050.**

Several respondents also recommended clarifying and strengthening the policy advocacy requirement on investors. IIGCC has collated expectations regarding key areas of advocacy. **Investors**

**should ensure any direct and collective policy advocacy undertaken supports policy and regulation relevant for achieving global net zero emissions by 2050 or sooner, and should provide disclosure on direct and collective policy actions undertaken across the key areas for advocacy.**

Respondents broadly welcomed the focus of the Framework on investor action that promotes emissions reduction in the real economy. Several therefore also saw the opportunity to assess how those implementing the Framework are achieving such impacts, and for investors to contribute to the evidence base around actions that have greatest impact. **IIGCC agrees and encourages investors to report on impact and engage with other investors and organisations to share knowledge and further the evidence base in this respect.**



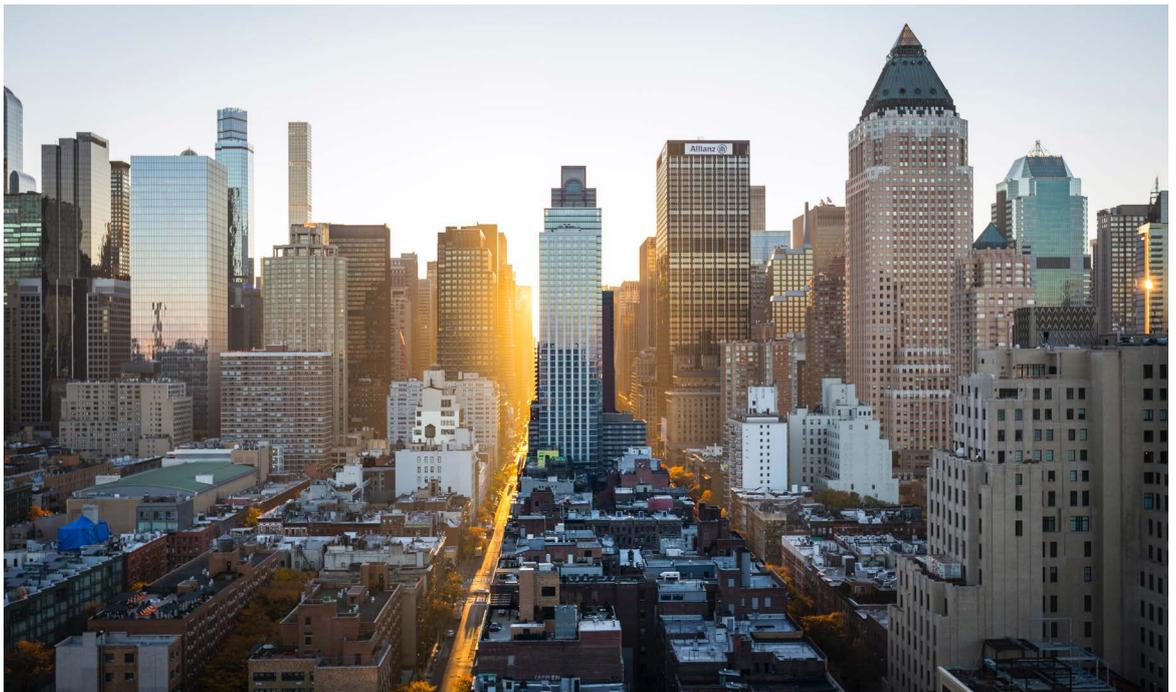
## 7. Issues emerging from the portfolio testing exercise

The portfolio testing process involved five investors using the methodologies recommended in the draft Net Zero Investment Framework to construct aligned portfolios. This provided useful learning on how the Framework would operate in practice. While the exercise highlighted some of the known constraints that investors will have, in particular with regard to data availability in the short term, it also demonstrated that it is possible to deliver on the recommendations of the Framework. Three specific challenges, however, were identified:

**Achieving targets for allocation to climate solutions:** The draft Framework noted that data and pathways to robustly set trajectories for future allocations to climate solutions do not currently exist. Therefore, the expectation for an increase in allocations was based on some very basic estimation of scale up required (to 8% green revenues, or at a minimum 150% of current level of green revenues to reflect different starting points). Achieving the 8% proved extremely challenging. To some extent this may be a function of the asset classes currently in scope, as the investor teams noted that greater allocation to climate solutions are currently to be found in the private market and infrastructure portfolios. However, it also points to the importance of work already planned for Phase II to provide relevant trajectories to guide target setting for allocation to climate solutions.

**Accounting for emissions associated with green bonds:** Some of the investor teams noted that green bonds are often associated with an issuer with high current carbon emissions, and therefore the objective to increase allocation to green bonds conflicted with efforts to underweight allocations to high emitting companies and deliver portfolio emission reduction goals. IIGCC has therefore considered whether to allow a carve out or differentiation of green bonds within emissions reduction goals. IIGCC considers that this is a more significant issue in a static exercise as required for the portfolio testing. Investors using the Framework should take into account potential short-term implications on their expected portfolio emissions trajectories and consequent targets, but should also benefit in the longer term as green bonds proceeds are likely to have positive impact on emissions trajectory of a company. However, **investors may wish to additionally report separately on emission associated with green bonds to demonstrate how these are impacting the overall performance against emissions reduction targets.**

**Use of the Carbon Risk Real Estate Monitor (CRREM) tool for assessing real estate alignment:** Investors participating in the portfolio testing found two current challenges of utilising the CRREM tool to assess alignment of real estate assets. In early 2020, the tool was only available for European commercial real estate which only makes up a



very small percentage of some investors real estate portfolio. Second, collecting the input data necessary to utilise the tool proved challenging in the limited time period of the testing phase. While this meant that the tool was not used for the portfolio testing, IIGCC and the investor teams consider that the CRREM tool will be able to be applied going forward. To address the first challenge, the pathways against which investors can assess their assets have been expanded and now include residential and commercial pathways for over 40 jurisdictions globally (see [www.CRREM.eu](http://www.CRREM.eu) for European pathways and [www.crrem.org](http://www.crrem.org) for global pathways). For portfolios with assets outside the EU, CRREM has recently issued recommendations for using the tool outside the EU, and the pathways are available for all global real estate markets. For indirect investors there might be a challenge to accessing the required data. However, their managers should be capable to deliver the required information. For investments in listed entities, investors are dependent on participation in GRESB or whether the entity discloses the required information. IIGCC expects availability of data to improve rapidly. For example, GRESB has automated the process of filling in the CRREM Tool with the asset-level performance data uploaded to the GRESB Asset Portal. This means that GRESB participants can already begin to leverage their asset-level reporting to assess individual assets against the CRREM pathways for the EU28. However, to improve data availability IIGCC would emphasise the importance of investors requesting disclosure of relevant data

(i.e. kgCO<sub>2</sub>/m<sup>2</sup>/year and kWh/m<sup>2</sup>/yr per asset, and what proportion of assets are above or below their respective CRREM pathways) from asset managers, real estate companies, REITs, and from directly held assets to support efforts of the industry to assess alignment. The GRESB 2021 results will include all data needed by investors to assess Paris Alignment. Investor members of GRESB as well as participants in the GRESB survey will be able to access this information. For those who do not participate in GRESB, CRREM is developing reporting guidelines that can be used by real estate companies and auditors to assess the extent to which the real estate portfolio is Paris-aligned and compliant with TCFD requirements, which can be included in public disclosures. Furthermore, some Green Building certification schemes like BREEAM plan to incorporate the CRREM pathways into their schemes.

It was also noted by portfolio testing teams that have been working with the CRREM tool that investors will need to address the following points when utilising the tool:

- Approach to estimating tenant emissions where only partial data is available
- Approach to emissions factors (market or location based) and whether to use different factors per country location and per energy source
- Approach to phasing of renovations or interventions, and approach to including any planned sales.

## 8. Additional points addressed

Since publishing the Framework, IIGCC has been able to review new outputs from other relevant organisations including the Science Based Targets Initiative methodology for Financial Institutions (SBTi FI); the UN Net Zero Asset Owner Alliance; the Partnership for Carbon Accounting Financials standard (as discussed above).

It is encouraging that there are many aspects of emerging consistency between various providers and methodologies. IIGCC notes that the SBTi FI portfolio coverage approach aligns to the Net Zero Investment Framework recommendation to set targets for increasing the percentage of aligned assets in a portfolio. SBTi FI only requires companies to set targets to be considered aligned whereas the Net Zero Investment Framework uses additional criteria to ensure credible alignment of companies in high impact sectors going forward, which may make the expectation of a linear increase in 'aligned' companies more challenging. However, IIGCC notes that a similar 'linear increase' principle would be relevant for target setting for the Net Zero Investment Framework. As noted above with regard to sector targets, IIGCC sees sectoral decarbonisation pathways as the building blocks for the portfolio emissions reduction targets recommended by the Net Zero Investment Framework. Therefore, the Sectoral Decarbonisation Approach (SDA) approach provided by SBTi can be a basis on which to develop this overall reference target and monitor progress and impact. It remains the case that SDA pathways currently utilised by SBTi and others are not fully consistent with global 2050 net zero pathways, and IIGCC therefore welcomes the work initiated by SBTi to move towards providing net zero consistent SDA approaches in the future. Noting the concerns regarding temperature alignment metrics, the Net Zero Investment Framework does not at this time recommend this type of metric for assessing alignment. **Updated information on the use of SBTi methods is reflected in the final version of the Framework.**

The target setting protocol of the Net Zero Asset Owners Alliance (NZ AOA), as noted in the NZ AOA publication, proposes specific target setting

guidelines for portfolio emissions reductions building on IIGCC's Net Zero Investment Framework approach. The recommendations regarding portfolio targets for asset classes currently in scope aligns to the Net Zero Investment Framework approach, and provides a specific range for emissions reduction and recommendations on adjustments to targets that investors adopting the Net Zero Investment Framework may wish to draw from. **The updated framework therefore refers to the NZ AOA target setting protocol as a relevant methodology to use for portfolio target setting.** As described above, sector specific targets are not explicitly recommended in the Net Zero Investment Framework as an additional layer but could be adopted by investors who wish to do so and can be a useful monitoring tool for the trajectory of a portfolio. IIGCC notes that the AOA seeks a 'target setting' approach for corporate engagement and policy work, whereas the Net Zero Investment Framework focusses to a greater extent on the content and objectives of those engagements, with an emphasis on working collectively, and providing further guidance to inform the quality of those activities (such as through IIGCC's forthcoming recommendations on escalation and voting policies) rather than increasing the number of engagement actions which are more easily measured by a target.

IIGCC also highlighted the challenge of a lack of comprehensive robust net zero pathways for sectors and regions. Since the draft Net Zero Investment Framework was published, the International Energy Agency (IEA) has released the World Energy Outlook (WEO) including information on 2050 net zero pathways, and has announced it will publish a full 2050 scenario (NZE2050) in May 2021. IIGCC expects this to constitute a solid pathway for the decarbonisation of multiple industries and become the reference for investors trying to set portfolio targets and asset alignment of companies at a sector level. **The information on pathways in the Net Zero Investment Framework has therefore been updated based on the expectation that NZE2050 provides a robust and accepted basis for 2050 net zero pathways, and methodologies and assessments will no longer need to rely on less ambitious pathways.**

## Annex 1: IIGCC draft Net Zero Investment Framework Consultation Questions

1. Do you agree with the combination of targets that are proposed to guide investor alignment with net zero global emissions by 2050?
2. Do you agree that targets should incentivise an investor's contribution to emissions reduction in the real economy by including a main focus on the alignment of underlying assets?
3. What threshold for % of portfolio emissions in material sectors to be net zero aligned or subject of engagement do you consider to be feasible to achieve while achieving a sufficiently ambitious level of action?
4.
  - a) Do you currently use a methodology for calculating avoided emissions or relative impact of investment in climate solutions?
  - b) Do you currently use a methodology for calculating aggregating emissions reduced by underlying assets at the portfolio level?
5. For funds that do not use Strategic Asset Allocation, are the actions set out in the framework transferable to your equivalent process (e.g. Total Portfolio Approach)?
6. If not, what alternative approaches can be applied to support alignment through that process, that should be referenced in this framework?
7. Do you agree that investors should aim to increase the contribution towards decarbonisation and investment in climate solutions to the maximum extent possible even if that constitutes more than a 'fair' share distributed among investors?
8. Given the large number of assets in a portfolio, and the need to provide a practicable approach for investors, are high impact NACE (and associated BICS/GICS) codes the best option to define the relevant scope for alignment for listed equity and corporate fixed income portfolios?
9. Do you agree that divestment should not be the standalone strategy for achieving the portfolio emissions reduction target, and increasing % of aligned assets?
10. Do you agree with the thresholds for a company to be considered net zero; aligned to a net zero pathway; transition potential?
11. Are there methodologies in the market, other than those specified in the Framework, that provide robust assessments of one or more of the criteria for assessing alignment and should be recommended for use by investors through this framework?
12. Does Box 4 sufficiently describe how asset managers can apply the Framework?
13. What further detail or 'use cases' are needed to enable asset managers to utilise the Framework?
14. Do you agree with the approach taken to emissions accounting described in Annex 1?
15. Should the Framework provide a specific recommendation(s) on accounting methodologies to be applied by investors e.g. for re-baselining emissions intensity targets?

# IIGCC Net Zero Investment Framework: Consultation Response

