
NET INVESTMENT FRAMEWORK ZERO 1.5°C

Produced by:
**The Paris Aligned
Investment Initiative**

IIGCC
The Institutional Investors
Group on Climate Change

The Paris Aligned Investment
Initiative is supported by:



**Environment Agency
Pension Fund**



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- IIGCC established PAII in May 2019
- 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.



Ceres



Investor Group on
Climate Change

- From 2021, the Paris Aligned Investment Initiative will be delivered by four investor networks. The networks are supporting investors globally to implement the Net Zero Investment Framework 1.0.
- **Asia Investor Group on Climate Change** in Asia
- **Ceres** in North America
- **Investor Group on Climate Change** in Australasia

Paris Aligned Investment Initiative (PAII) 2019 - 2021



Participation from over **110 IIGCC members** representing more than **\$33 trillion** of assets under management

Phase I (2019-2020) led by IIGCC and leading group of asset owners:

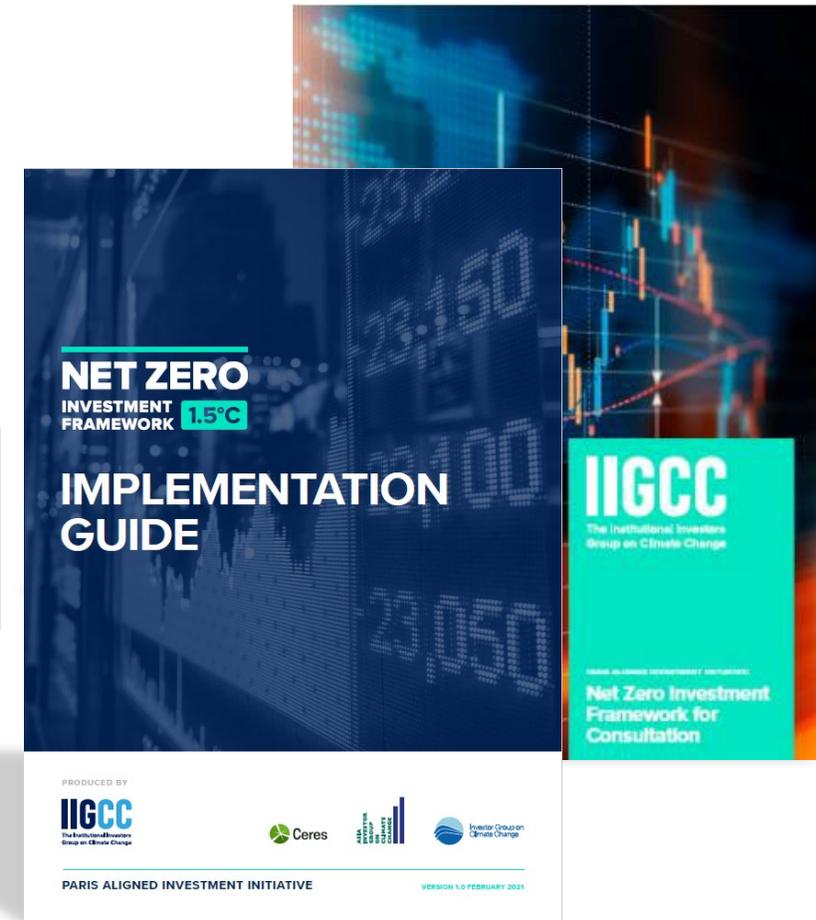
- Aim: definitions, pathways, methodologies for Paris-aligned portfolios
- Four working groups: SAA, Listed Equity & Corporate Fixed Income, Sovereign Bonds, Real Estate + portfolio testing on five portfolios
- Output: draft Net Zero Investment Framework for public consultation (August 2020)
 - 90 responses, 780 stakeholders engaged

PAII becomes global initiative & Net Zero Investment Framework 1.0 published (March 2021)

Networks provide implementation support globally

Phase II (2021)

- Five IIGCC working groups: Infrastructure, Private Equity, Investment in Climate Solutions, Adaptation & Resilience, Implementation
- Output: The Net Zero Investment Framework 2.0 (ahead of COP26)



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The Net Zero Investment Framework 1.0

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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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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 commit to the goal of achieving net zero portfolio emissions by 2050 or sooner, and adopt an investment strategy consistent with this goal.

Two dimensions for investors:



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



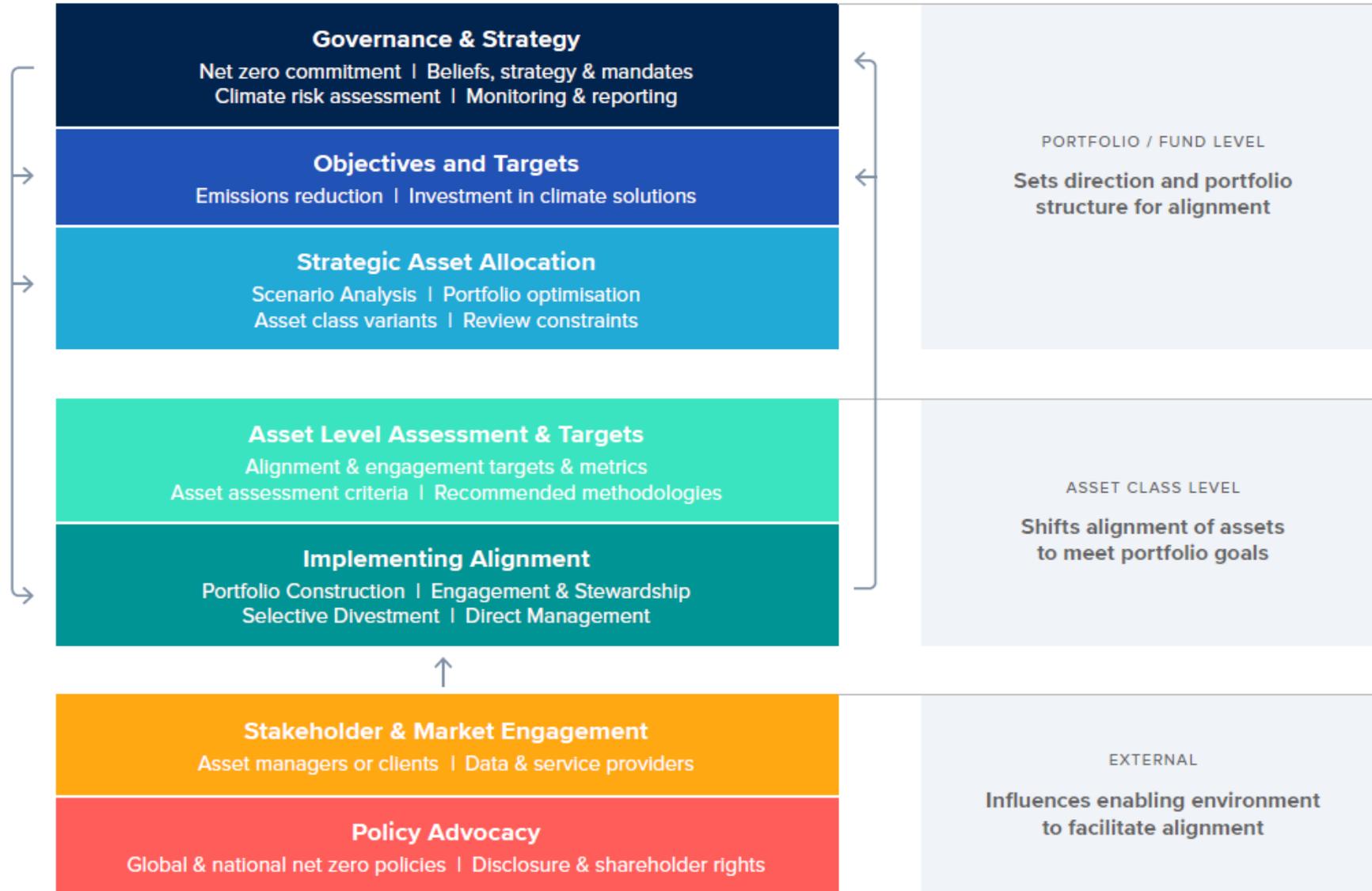
Increasing investment in the range of 'climate solutions' required to meet that goal

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

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

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

Overview: Net Zero Investment Framework 1.0



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Governance and Strategy

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Actions for the board or investment committee

- ❑ Include a commitment to aligning an investment strategy to net zero emissions by 2050 via the PAll Net Zero Asset Owner Commitment or the Net Zero Asset Managers Initiative
 - ❑ Agree investment beliefs and set principles for adopting net zero alignment
 - ❑ Establish relevant mandates and performance objectives for asset managers
 - ❑ Update mandates & performance objectives for asset managers, portfolio managers, and other personnel to ensure assets are managed to reflect the net zero investment strategy & review implementation over time
 - ❑ Monitor & report on the implementation of the net zero investment strategy and performance against objectives and targets set
- ❑ **Undertake climate risk assessment and management 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 in the Net Zero Investment Framework
 - Taking an iterative process, based on portfolio emissions intensity, allocation to climate solutions, and asset level alignment

Robust, science based net zero pathways are a central tool to assess appropriate portfolio targets and assess alignment of assets

The investor networks expect the IEA 2050 net zero scenario to become the broad basis for methodologies for assessing net zero alignment when released in May 2021.

Parameters for pathways used by investors, companies, and data providers:

- **Limit warming to 1.5°C** above pre-industrial levels ($\geq 50\%$ probability)
- Reach **global net zero emissions by 2050, or sooner**
- Provide **differentiated pathway information for regions and sectors**
- 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

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Objectives and Targets

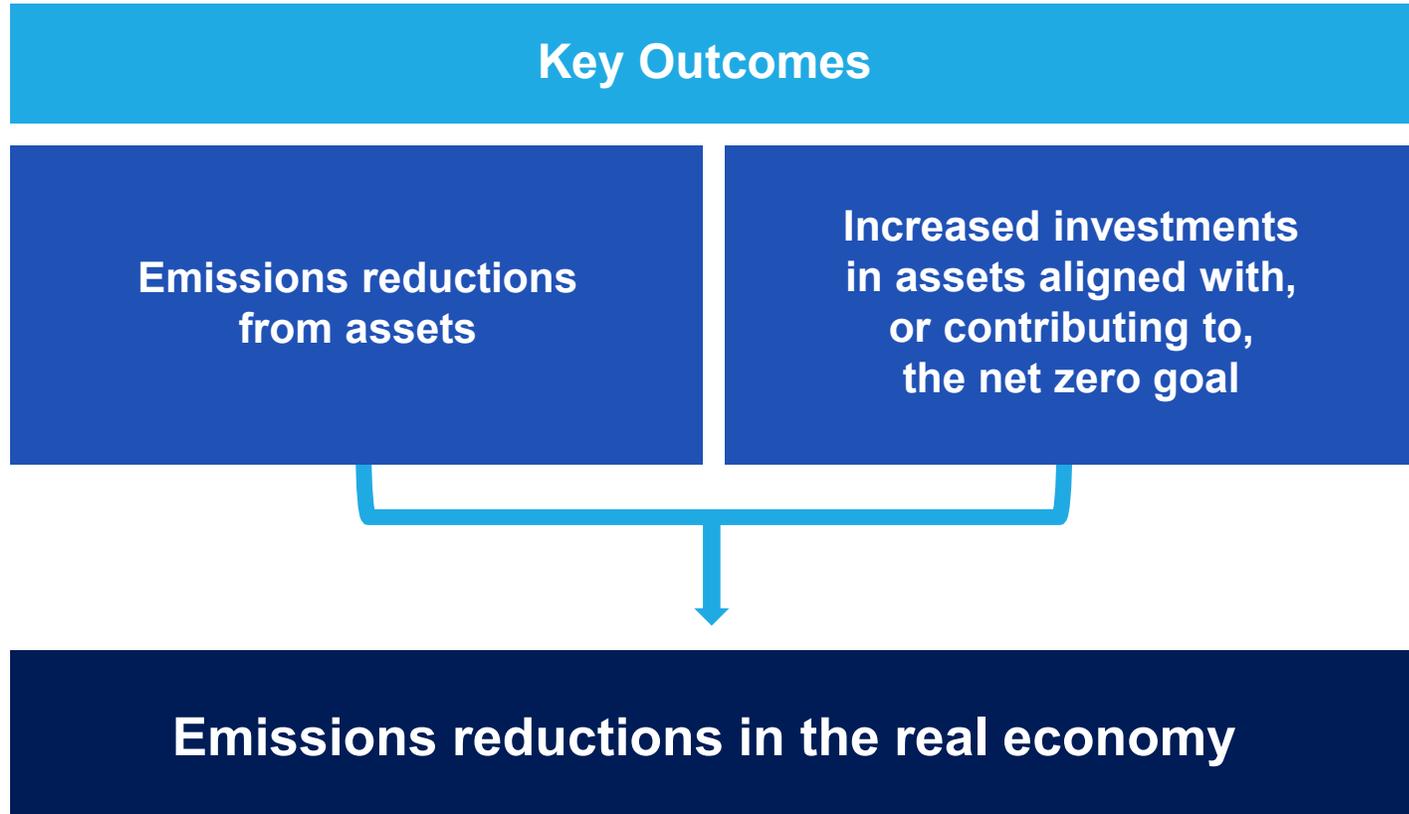
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Objectives and targets set the direction and ambition of an investment strategy towards net zero, and act as a means to monitor the effectiveness of this strategy

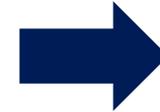
PORTFOLIO/FUND LEVEL



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

- ❑ A <10-year CO₂e emission reduction target (scope 1 + 2*) covering listed equity, fixed income, real estate

Expressed in absolute or intensity terms (CO₂e/\$mn invested)

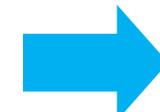


- ❑ A <10-year goal for allocation to climate solutions representing a percentage of revenues or capex from AUM (based on EU taxonomy mitigation criteria)

- Measure current absolute emissions & emissions intensity of the portfolio *and* allocation to climate solutions
- *scope 3 to be phased in over time; scope 3 targets set and measured separately
- Assess global, sector and regional pathways (as far as current pathway development allows). Set additional targets (optional)
- Demonstrate how targets have been determined & meet absolute emissions reductions (accounting for non-relevant variables) and investment trajectories over time
- Review and revise targets every 5 years

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 assets in material sectors that are i) net zero, or meeting criteria to be considered ii) 'aligned' iii) 'aligning' to net zero



- ❑ A minimum coverage threshold of 70% of emissions in material sectors are either i) net zero, ii) aligned, or subject of direct or collective engagement and stewardship actions

- Assess the current proportion of assets already i) net zero, ii) aligned, iii) aligning, iv) not aligned/transitioning
- Increase alignment target towards the goal of 100% of assets to be i) net zero or ii) aligned, by 2040
- Determine the maximum extent to which portfolio construction can be adjusted and the rate at which assets are expected to respond to engagement strategies
- Increase threshold target to at least 90% by 2030, at the latest. Disclose the proportion of assets considered i) net zero and ii) aligned, separately to assets under engagement/stewardship

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Strategic Asset Allocation

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

Key recommendations

- Use scenario analysis to ensure capital market assumptions are informed by climate risks and opportunities, or stress test portfolios
 - Set targets for these metrics in line with the portfolio-level targets
 - Consider less familiar 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 e.g. climate-titled indices, custom benchmarks, climate-focused variants
 - Review constraints to alignment and consider greater flexibility to enable greater alignment
 - Specify climate-related objectives in sufficient detail and clearly define performance objectives when setting investment mandates and benchmarks
 - Monitor achievement of alignment objectives, including portfolio carbon intensity and allocation to climate solutions
- Supplement standard financial objectives with climate change objectives:**
 - CO2e/\$m invested (at least scope 1 and 2)
 - Climate solutions allocation as % of portfolio (EU Taxonomy standards)
 - Plus supplementary metrics (e.g. fossil fuel reserves)
 - Portfolio optimisation**
 - Implement portfolio construction to include alignment objectives alongside standard indicators such as expected returns, expected volatility etc e.g.
 - Carbon intensity
 - Percentage allocated to climate solutions (EU Taxonomy)

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Asset Class Alignment

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Increasing alignment of assets is the key driver for achieving net zero and emissions reductions in the real economy

Follow a consistent process across the four asset classes:

- ❑ **Set the scope** to confirm which assets should be considered within scope for alignment action
 - ❑ **Assess the current and forward-looking alignment** of existing and new assets using the criteria and methodologies specified
 - ❑ **Set alignment targets and implement** a strategy to increase alignment of assets to net zero and increase allocation to climate solutions over time
- Prioritise **engagement and stewardship**, and direct management, as the primary mechanism to drive alignment
 - Use **portfolio construction** to weight portfolios towards aligned & transitioning assets as an incentive for assets to align
 - **Selective divestment** in specific circumstances, as part of a toolbox for alignment

Set the scope

- ❑ National sovereign bond issuance & regional/municipal issuance

Leading methodologies

- Germanwatch Climate Change Performance Index
- No equivalent performance assessment exists yet for municipalities

Assessment of assets

- ❑ Include all sovereign issuance in scope, except domestic issuance for liability matching
- ❑ Assess and score assets against performance criteria
- ❑ Prioritisation for engagement based on level of current performance, emissions and investor exposure

Alignment Metrics (M) and Targets (T)

- M.** Current and forward looking alignment criteria
 - ▶ Past and future expected emissions performance / capita or /GDP
 - ▶ Past and future performance on key sectors (energy use, and exposure of the economy to fossil fuels)
 - ▶ Other national and international policy positions
- T.** Increase average climate performance / AUM to the maximum extent possible, at a minimum exceeding the weighted average benchmark score for climate performance
- T.** Increase allocation to verified green or SDG climate bonds, if possible

Implementation

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, AIGCC, Ceres, IGCC, the Investor Agenda etc.
- ❑ Engage with issuers, investment banks and development agencies to increase issuance of Paris-aligned verified green and SDG climate bonds

C. Selective divestment:

- ❑ Consider exclusion of continued poor performers from portfolios

Scope

- Assets in material sectors (NACE sectors A-H, J-L)

Assessment

- Assess assets against criteria for i) achieving net zero, ii) aligned iii) aligning, iv) not aligned/transitioning
 - High impact companies: criteria 1 – 6
 - Lower impact companies: criteria 2, 3, 4
 - + 4 additional criteria

Leading methodologies

- Climate Action 100+ Net Zero Company Benchmark & associated sector-specific guidance
- The Transition Pathway Initiative carbon performance and management quality indicators
- Science Based Targets Initiative (for criteria 2, 3, 4)

Assessment of assets

- Identify assets in material sectors for assessment and alignment action
- Assess assets against criteria to assess: i) achieving net zero, ii) aligned, iii) aligning, iv) not aligned/transitioning
- Assess assets' revenues from climate solutions (EU taxonomy revenues or capex)
- Prioritisation for engagement based on emissions intensity/exposure

Alignment Metrics (M) and Targets (T)

- M.** Current and forward looking alignment criteria:
 - ▶ A long term 2050 goal consistent with global net zero;
 - ▶ Short & medium term emissions reduction targets;
 - ▶ Current emissions intensity performance (scope 1, 2, and material scope 3);
 - ▶ Disclosure of scope 1, 2 and material scope 3 emissions;
 - ▶ A quantified plan to deliver targets;
 - ▶ Capital allocation alignment;
- T.** Increase % AUM in net zero or aligning assets – 5 year goal
- T.** Set target for increasing % climate solutions revenues/AUM
- T.** Set goal for coverage of assets aligned or under active engagement to 70% of financed emissions from material sectors (combined with real assets)

Implementation

A. Portfolio construction:

- Active. Screening and/or weighting new investments based on alignment criteria and climate solutions revenues
- Invest in specialist products/funds (alignment/climate 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

Set the scope

- ❑ Individual direct investments, direct investments in assets pooled through a fund structure, listed real estate companies
- ❑ All types of real estate (commercial, residential, industrial etc.)

Leading methodologies

- Carbon Risk Real Estate Monitor (CRREM)

Assessment of assets

- ❑ Set scope for assessment and alignment
- ❑ Assess assets using CRREM tool to determine alignment with 1.5 degree pathway
- ❑ Prioritisation for engagement based on level of stranding risk and exposure
- ❑ For direct investments assess options for investment/management to achieve alignment

Alignment Metrics (M) and Targets (T)

- M.** Current and forward looking alignment based on carbon emissions and energy use in line with net zero pathways (CRREM tool)
- T.** Increase % AUM in net zero or aligned assets – 5 year goal
- T.** Total coverage of assets aligned or under active management or engagement 70% of financed emissions from material sectors (combined with equities and corporate fixed income)

Implementation

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;
- ❑ Alignment based escalation strategy and voting (for listed assets);
- ❑ Encourage corporate tenants to adopt targets and align including occupied buildings

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Stakeholder & Market Engagement & Policy Advocacy

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Stakeholder and Market Engagement

Asset manager or client

- Availability of net zero strategies & products
- Research / analysis to support climate risk assessment and net zero investing

Index, data and service providers

- Data and products based on alignment criteria, robust methodologies
- Consistency with net zero by 2050

Policy Advocacy

Disclosure

- Alignment / solutions disclosures
- Mandatory TCFD reporting by companies
- Energy use data

Shareholder rights

- Facilitate stewardship and influence transition
- Across jurisdictions

Net zero policy and regulation

- Carbon pricing
- Sector/ regional pathways
- CRREM integration
 - Retrofits

Asset managers should implement the Framework across their funds to the greatest extent possible.

Governance and Strategy

All recommendations in this component of the Framework. However:

- ❑ Work in partnership with asset owner clients on decarbonisation goals, with an ambition to reach net zero emissions by 2050 or sooner across all AUM
- ❑ Develop a strategy whereby
 - Components of the Framework are implemented across the business and all AUM: policy advocacy, stewardship, and engagement
 - Certain alignment actions apply to the proportion of AUM that are being managed in line with net zero goals
- ❑ Client engagement around Paris aligned mandates and awareness and ability to invest in aligned funds and products
- ❑ Develop new Paris aligned products, funds, strategies across asset classes and offer to clients

Targets and Objectives

- ❑ Engage with clients over time to secure mandates and adjust or design products to enable an increasing proportion of funds under management to be managed in line with net zero
- ❑ Short term: establish and disclose the proportion of assets to be managed in line with a net zero investment strategy and set the recommended targets across the specified AUM
- ❑ Increase the proportion of assets being managed in line with net zero to 100% over time

Strategic Asset Allocation

- ❑ If responsible for undertaking SAA on behalf of clients, follow all recommendations and actions set out in this component of the Framework
- ❑ Implement SAA recommendations for similar activities in the investment process, e.g. portfolio optimisation

Asset Class Alignment

For assets being managed in line with net zero:

- ❑ Use recommended assessment criteria and methodologies, targets, and alignment actions to measure alignment, and transition the portfolio over time

To ensure transparency and robust implementation of net zero commitments, PAIL recommends disclosing the following information related to implementation of the Framework, which can be done in line with the TCFD reporting structure

Governance

- The board/CEO level commitment to the goal of achieving net zero portfolio emissions by 2050 or sooner, as relevant for asset owners or asset managers, and responsibility for implementation of the commitment and strategy.
- How climate objectives have been incorporated into mandates and objectives for asset managers, portfolio managers, and other personnel as relevant.

Strategy

- Key principles and components of a net zero strategy and implementation of the Framework
- How climate metrics, targets and objectives have been incorporated into SAA or similar processes
- How constraints to achieving greater alignment have been addressed
- Key principles/ components of a net zero engagement and stewardship strategy, including escalation and milestones

Metrics and Targets

- Targets set and calculation method
- Science-based scenario(s) or pathway(s) used to guide target setting and company assessment
- Methodologies to assess alignment of assets
- Performance against targets over time

Management

- Portfolio construction approaches / products developed to facilitate allocation to products that support net zero aligned investing
- Engagement, stewardship and direct management actions undertaken in line with Framework recommendations for asset class alignment
- Voting policy and voting record
- Exclusion policy, and divestment decisions
- Information on direct and collective policy actions
- Information on market engagement actions

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Net Zero Commitments

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“Investors should align their investment strategy with achieving global net zero emissions by 2050”

PAII Net Zero Asset Owner Commitment

For asset owners, a net zero commitment should include transitioning a portfolio to achieve net zero emissions by 2050, or sooner.

Asset owners can make a commitment through the Paris Aligned Investment Initiative (PAII).

PAII is now a global effort to further develop the Net Zero Investment Framework as a key tool for implementation.

Asset owners making a commitment will be supported by PAII to implement their net zero strategies.



Net Zero Asset Managers Commitment

For asset managers, a net zero commitment should include setting an ambition to achieve net zero emissions across their AUM, working with clients to achieve this ambition.

Asset managers can make a commitment through the newly established Net Zero Asset Managers initiative.

At launch in December 2020, the initiative comprised 30 asset managers, covering 6 regions globally, who collectively manage \$9 trillion of assets.



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Thank you

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