HERBERT SMITH FREEHILLS

Building a Net Zero Framework for Funds

A JOINT PUBLICATION

Introduction

As the UNFCC Conference of the Parties in Glasgow (COP26) approaches its final throes, it is practically impossible to escape climate change in all aspects of professional and private life. In Europe, the topic has clearly moved from niche to mainstream in any discussion, with countless conferences, workshops, seminars, training sessions, and products offered as "green" or "good for the climate". It is no surprise that climate change is back at the top of the agenda, after having been temporarily replaced by the COVID19 pandemic in 2021, as stated in this year's Future Risks Report published by AXA at the end of September 2021. It is becoming more and more difficult to cut through the noise down to the real action, even for those dealing with this topic on a daily basis.

A lot has been written on climate funds and Net Zero investment strategies lately. Without downplaying the current criticism of the concept and its crucial role in future-proofing sustainable investment, the scope and purpose of this article is different. With a multitude of Net Zero strategies available for each type of player in the financial services industry, it has become increasingly clear *what* a Net Zero investment fund will have to achieve. There is much less clarity on *how* a fund manager can achieve this, however, notably the procedural steps and organizational requirements that are essential to transform any climate ambition into real action.

After providing a short introduction to the science underlying Net Zero (Section 2), we will, on the basis of the four process criteria established by the Race to Zero campaign, look at how fund managers can set appropriate targets (Section 3 = **Pledge**), design a suitable Net Zero strategy on the basis of these targets (Section 4 = **Plan**), implement the strategy in the fund's governance and daily administration (Section 5 = **Proceed**), and finally disclose and report on the strategy and its achievements (Section 6 = **Publish**). Combining Herbert Smith Freehill's ESG expertise and regulatory capabilities with ISS ESG's in-depth expertise on the topic of climate modeling, scenario analysis, data mining and data management, we will cover some of the main aspects of the multi-faceted Net Zero topic.

What does "Net Zero" mean and why is this relevant for asset managers?

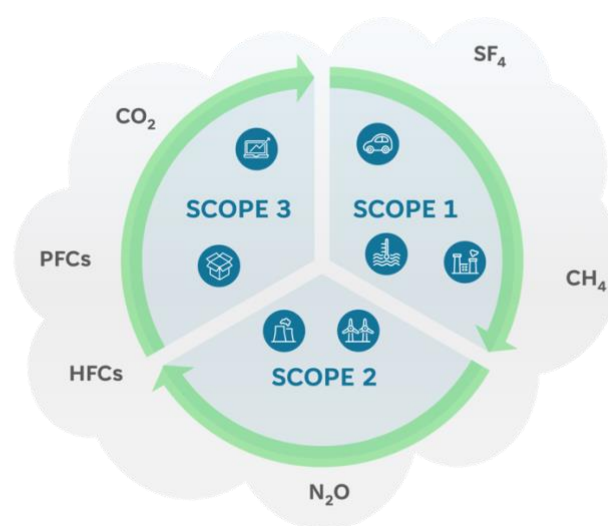
Paris Agreement alignment

Published in August 2021, the Sixth Assessment Report (Climate Change 2021, The Physical Science Basis, Summary for Policymakers) of the Intergovernmental Panel on Climate Change (IPCC) has made it clear that immediate, rapid and large-scale reductions of greenhouse gas (GHG) emissions will be required to stabilize global temperatures in line with the targets of the Paris Agreement. At COP21 in Paris in 2015, governments agreed to limit global warming to well below 2°C and to pursue efforts to limit temperature increases to 1.5°C, each above pre-industrial levels. While any temperature increase affects the global climate system and leads to weather extremes like heatwaves, heavy precipitation, droughts and intense tropical cyclones, the thresholds of 1.5°C and 2°C, respectively, are considered by the IPCC as levels at which climate change may still be manageable on a global scale. Nowadays, when speaking of "Paris-aligned" strategies this usually refers to the more ambitious 1.5°C threshold.

Reduction of greenhouse gas emissions

To achieve the Paris targets, emissions of the so-called "greenhouse gases" (GHG) responsible for heating up the atmosphere will need to be cut down drastically. In line with the Kyoto Protocol (Kyoto Protocol Reference Manual on accounting of emissions and assigned amount) the following six gases are considered to be GHGs: carbon dioxide (CO2); methane (CH4); nitrous oxide (N2O); hydrofluorocarbons (HFCs); perfluorocarbons (PFCs); and sulphur hexafluoride (SF6). Greenhouse gas emissions of companies are usually divided into three categories (according to The Greenhouse Gas Protocol Corporate Standard Revised (2015)): Scope 1 covers direct emissions from sources owned or controlled by the company, for example office heating, plants, and company vehicles. Scope 2 accounts for emissions from the generation of purchased energy (electricity, heat, cooling, steam) consumed by the company, and Scope 3 includes all other indirect emissions, such as from the use of sold products or services or, in the case of investments, the emissions generated by the economic activities financed by the investment. All GHG are measured in tons of CO2 equivalents (CO2e).

Figure 1: GHG emissions overview

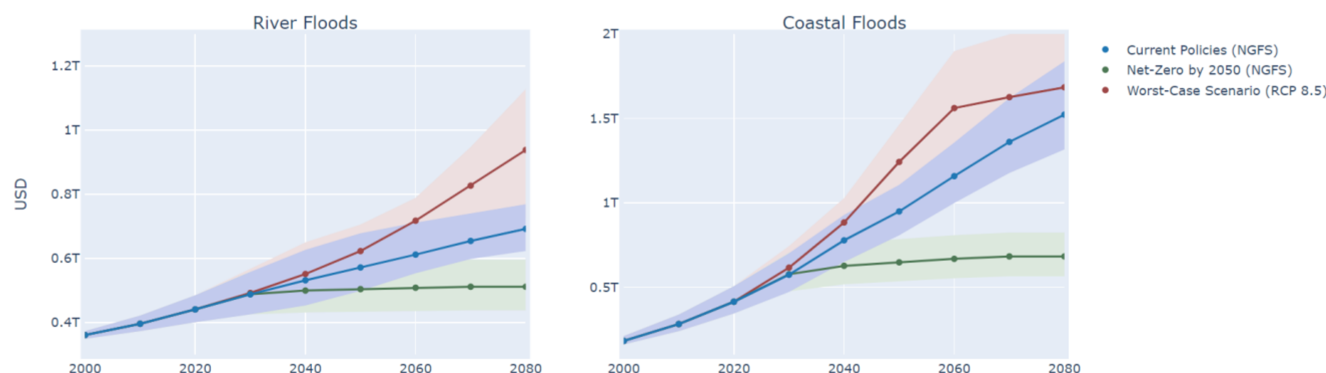


Source: Herbert Smith Freehills

All GHG emissions must be reduced to Net Zero by 2050. A particular focus lies on carbon dioxide. It is the most widespread GHG with potential long-term effects on global temperature levels, and there is an expectation that its emission should be reduced to Net Zero within this decade.

Failure to achieve this ambition will likely see the world pass the symbolic level of 1.5°C warming as soon as the early 2030s, with significant consequences in terms of physical impacts on human lives and economies. According to current estimates, global GDP may decrease by 18% if no mitigating actions are taken, with a particular impact in Asia where China could lose almost one quarter of its GDP by 2050. Economic losses resulting from natural disasters such as floods are expected to increase exponentially if global temperatures continue to increase above the Paris thresholds.

Figure 2: Expected Annual Damages Worldwide



Source: ISS ESG Physical Risk Data

Net Zero calculation

"Net Zero" means that on a net basis, a country, company, portfolio, or individual investment stops emitting all or certain GHGs. Since the calculation is made on a net basis, this does not necessarily mean that the country, company, portfolio, or investment no longer emits CO2 or, if relevant, other GHGs. The Net Zero calculation also considers the removal of emitted CO2 from the atmosphere via so-called carbon capture, utilization, and storage (CCUS) processes.

CCUS ranges from nature-based solutions (mainly reforestation and preservation of natural areas) to the use of new technologies to filter carbon dioxide from the atmosphere and store it underground or recycle emitted GHG to build new materials. The lack of uniform standards to assess the efficiency of such measures and avoid double counting currently makes it challenging to determine their actual benefit, which is why the "Net Zero" or even "net negative" claims of certain companies need to be taken with a pinch of salt. Crucially, there are currently no existing technologies that would allow for the actual implementation of CCUS on the scale required. Nevertheless, the International Energy Agency (IEA) promotes CCUS as a contributor to an interim solution until "real zero" can be achieved across all industry sectors and technologies. Accordingly, creating a reliable voluntary carbon market is regarded as a major pillar of a global framework to price the externalities of carbon emissions, something regarded as essential by all experts but which governments have been reluctant to put in place.

Availability of GHG emissions data

No Net Zero calculation is possible without current and projected future emissions data for countries and companies. Currently, there are only sporadic obligations for companies to disclose GHG emissions, and even companies willing to do so on a voluntary basis struggle to refer to uniform global standards. The widely accepted recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) require a company to disclose its metrics used to assess climate-related risks and opportunities, including current, historic and projected GHG emissions. In order to calculate GHG emissions for the purpose of TCFD disclosures, companies should use commonly accepted taxonomies or methodologies such as the new sustainability disclosure standards to be developed by the International Sustainability Standards Board (ISSB) formed by the IFRS Foundation and announced in the first week of COP26. According to a preparatory draft this will be measured by Scope 1, 2 and 3 GHG emissions expressed as metric tons of CO2 equivalent in line with the internationally accepted standards for corporates, cities and governments of the Greenhouse Gas Protocol. Again, disclosure will not be limited to current GHG emission levels, but also include the company's climate-related targets for the future, as well as the steps adopted to achieve these targets. This is relevant for most Net Zero strategies that aim to achieve Net Zero GHG emissions within a certain period of time (usually by 2030, in line with the IPCC assessment for GHG emissions reductions).

Mandatory climate-related disclosure obligations and/or standards are currently being developed in

several countries across the globe, such as New Zealand, Singapore, and the UK. The aim is to make the TCFD recommendations binding for certain types of financial, listed, or larger companies. The European Union's new corporate sustainability disclosure rules are applicable from 2024 and will be accompanied by their own set of sustainability reporting standards designed by the European Financial Reporting Advisory Group (EFRAG).

Regardless of the standard applied, a particular challenge for any financing activity is the determination of Scope 3 emissions, that is the emissions attributable to the financing of companies and/or activities provided under an investment or lending activity. To achieve this the financial industry often refers to the guidance issued by the Partnership for Carbon Accounting Financials (PCAF) on how to determine such "financed emissions" based on the global Greenhouse Gas Protocol standards.

Why Net Zero matters for asset managers

So why should asset managers care about the Paris Agreement's goals and the IPCC's dire warnings? Aside from sharing the same threatened planet and being subject to the consequences of climate change in their personal lives, there are also solid financial reasons. According to the IEA's report "Net Zero by 2050" published in May 2021, a massive clean energy expansion will be required in the coming years, including both energy production and increased use of clean electricity, and in applications such as transport and manufacturing. Moreover, until 2030 major innovation efforts must occur to develop new technologies and bring existing technologies to the market, including for batteries, hydrogen electrolyzers and direct air capture and storage of CO2.

At the same time, global access to electricity for underserved populations must be improved using clean energy technologies. The IEA expects a significant increase in government spending and private investment as well as up to 14 million newly created jobs. According to an estimate provided by BloombergNEF, achieving Net Zero carbon emissions by 2050 will require as much as $173 trillion in investments. Annual investments in energy supply and infrastructure will need to more than double, rising from around $1.7 trillion per year today, to somewhere between $3.1 trillion and $5.8 trillion per year on average over the next three decades. At the same time, demand for fossil fuels for combustion (coal, oil, and gas) are expected to decline sharply, being replaced by renewables, electricity, and hydrogen.

These numbers make it clear that there are high rewards ahead for a fund manager that participates in this unprecedented boom, and at the same time high potential losses for those who back the wrong horse. It is therefore no surprise that many important players in the global financial industry have pledged to support the transition, for example as members of the Glasgow Financial Alliance for Net Zero (GFANZ) which claims to have $130 trillion of private capital committed to transitioning the economy to Net Zero.

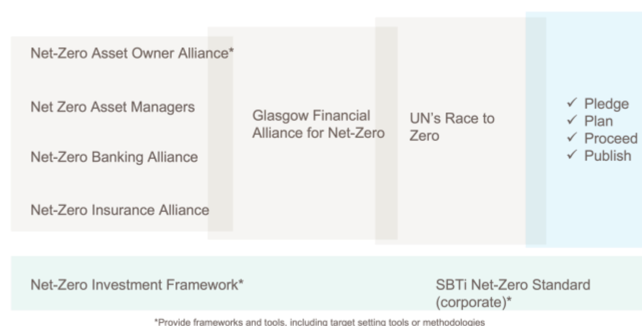
Setting a Net Zero commitment and targets at fund level (= "Pledge")

Any Net Zero strategy starts with a target, so it is no surprise that the first step of the Race to Zero is dedicated to making the right pledge: reaching Net Zero GHG emissions as soon as possible and by 2050 at the latest, in line with the Paris Agreement target of limiting global warming to 1.5°C. Organizations joining the Race to Zero must also set an interim target for 2030, reflecting maximum efforts to achieve or even surpass the 50% global reduction in CO2 emissions identified in the IPCC's 2018 Special Report on Global Warming of 1.5°C (according to the IPCC's 2021 Sixth Assessment Report (see Section 0) limiting global warming to below 2°C will now require going Net Zero on CO2 by 2030).

Available Net Zero initiatives

When it comes to specific target setting, financial services industry members are spoiled for choice: from the Net-Zero Asset Owner Alliance through the Net-Zero Banking Alliance to the Net-Zero Insurance Alliance, not to mention the Net-Zero Asset Managers and the Paris Aligned Investment Initiatives, there is no lack of global movements spelling out Net Zero for their members. Although most of them have an investment angle and admit both asset and fund managers, it is probably justified to say that those with the most current and specific guidance for the investment industry are the Paris Aligned Investment Initiative (PAII) (including asset managers and asset owners) and the Net-Zero Asset Owner Alliance (NZAOA) (driven by asset owners). Both PAII and NZAOA provide their members with specific frameworks and tools to implement Net Zero strategies. For PAII this is the Net Zero Investment Framework (NZI Framework) published in May 2021 and for NZAOA the Inaugural 2025 Target Setting Protocol launched in October 2020.

Figure 3: Net Zero initiatives map



Source: ISS ESG

Overview of the NZI Framework

Since this publication deals with fund level Net Zero implementation driven by asset managers, we will focus on PAII's NZI Framework in its version 1.0 (a new version 2.0 including additional asset classes and aligned with the IPCC's latest findings is expected to be published in due course).

PAII is supported by four investor networks spanning the globe: Institutional Investors Group on Climate Change (IIGCC) for Europe, Ceres for North America, Asia Investor Group on Climate Change (AIGCC) for Asia, and Investor Group on Climate Change (IGCC) for Australasia. The NZI Framework consists of six components adjusted to the investment process. For the purposes of this publication, we will cover only the internal components relating directly to the fund: governance and strategy; targets and objectives (= "Pledge"); strategic asset allocation (= "Plan"); and asset class alignment (= "Proceed"). In addition to these components, the NZI Framework recommends implementing disclosures in line with regulatory requirements (if available) and the TCFD reporting structure (= "Publish").

Figure 4: NZI Framework - Overview

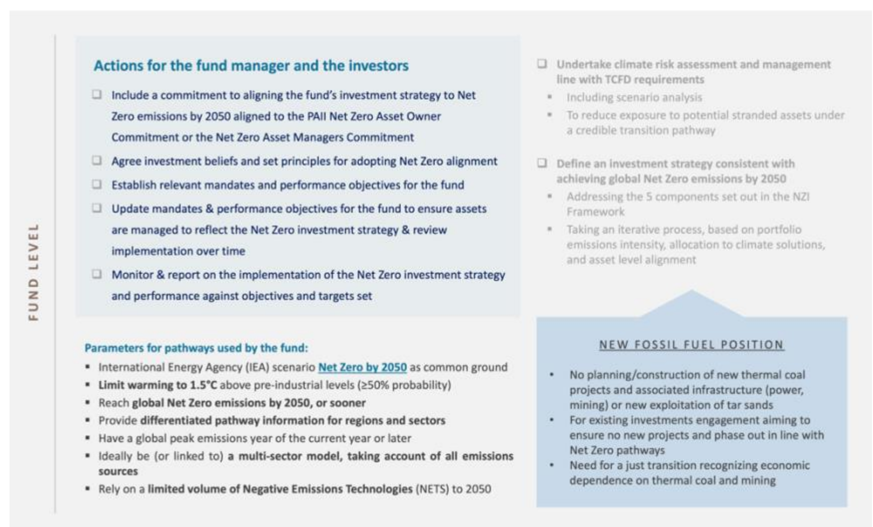
Source: Paris Aligned Investment Initiative – Investing for a Net Zero future

Fund commitment to align investment strategy to Net Zero

In line with the Race to Zero expectations, committing to the goal of Net Zero portfolio emissions by 2050 or sooner, and adopting an investment strategy consistent with the achievement of global Net Zero emissions by the chosen date, are the first components of the NZI Framework. The PAII recommends making a public commitment in line with the Net Zero Asset Managers Commitment with respect to the PAII's Net Zero Asset Owner Commitment attached to the NZI Framework (Appendix C and Appendix D). Both apply at entity and not at fund level and will need to be modified for the fund level.

Such an individual commitment would be limited to target setting, target implementation, and stewardship and engagement relating to the fund's assets, and should be included in the fund documentation. This process will involve the fund manager and the investors agreeing on the fund level commitment. The fund manager must also choose one or several so-called "pathways" to determine whether its investments contribute to achieving the 1.5°C global warming limit of the Paris Agreement. "Pathways" can be emission, technology and investment trajectories required to deliver Net Zero GHG by 2050 in line with the Paris goal, as set out, for example, in the IEA's Net Zero by 2050 report. Investments with emissions that reduce in line with the reduction goals, or which support the development of clean technologies or clean energy capacities (climate solutions), are considered to be "Paris aligned" under the NZI Framework.

Figure 5: NZI Framework – Governance & strategy



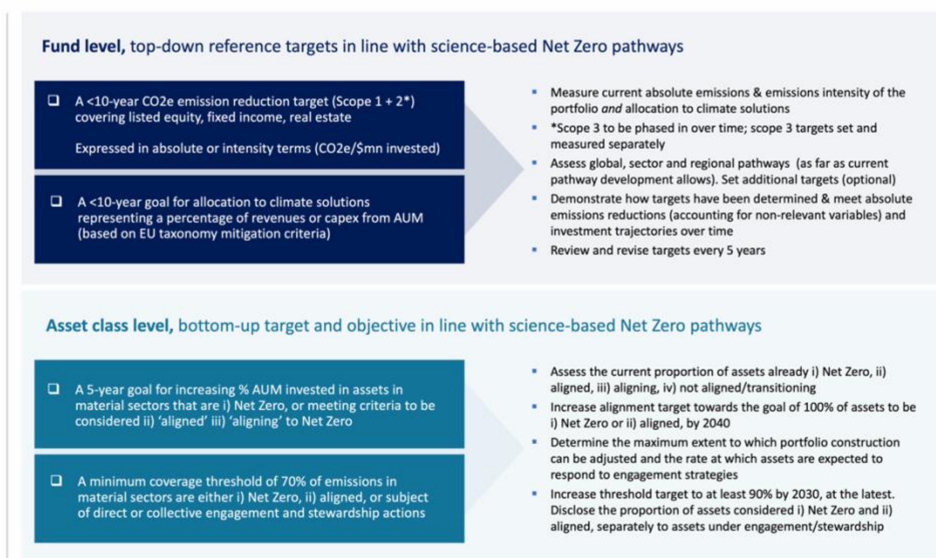
Source: Paris Aligned Investment Initiative – Investing for a Net Zero future

In the next step, the overall commitment is broken down into specific targets at fund and at asset class level, in line with science-based Net Zero pathways. The fund level investment strategy should include two specific targets for the next 10-year period (or less):

- an emissions reduction target (Scope 1 and 2, phasing in Scope 3) expressed in absolute (total tons of CO_2e) or intensity terms (CO_2e/USD million invested); and
- a goal for the allocation of a percentage of revenues or capital expenditure from the assets under management (AUM) to climate solutions.

At asset class level the fund will need a portfolio coverage goal for increasing the percentage of AUM invested in Net Zero or Paris aligned sectors (with the first goal to be achieved within 5 years, 100% by 2040). It will also need an engagement goal ensuring that at least 70% of financed emissions are Net Zero, Paris aligned, or the subject of direct or collective engagement and stewardship actions, with the aim of increasing the threshold to at least 90% by 2030.

Figure 6: NZI Framework – Objectives & targets



Source: Paris Aligned Investment Initiative – Investing for a Net Zero future

All fund targets and goals must be aligned with the fund's pathways and enable the fund to meet its overall commitment of achieving Net Zero GHG emissions by 2050. They will also have to be included in the fund documentation. Given its fiduciary responsibilities, the fund manager should in any case clearly communicate the chosen targets and parameters and secure the investors' informed consent and support.

Additional product level regulation to consider

This is not where the exercise ends, unfortunately. The fund industry is currently experiencing an increase in the number of legal frameworks dealing with different aspects of environmental, social and governance (ESG) issues. Some of the most advanced frameworks can be found in the European Union (EU).

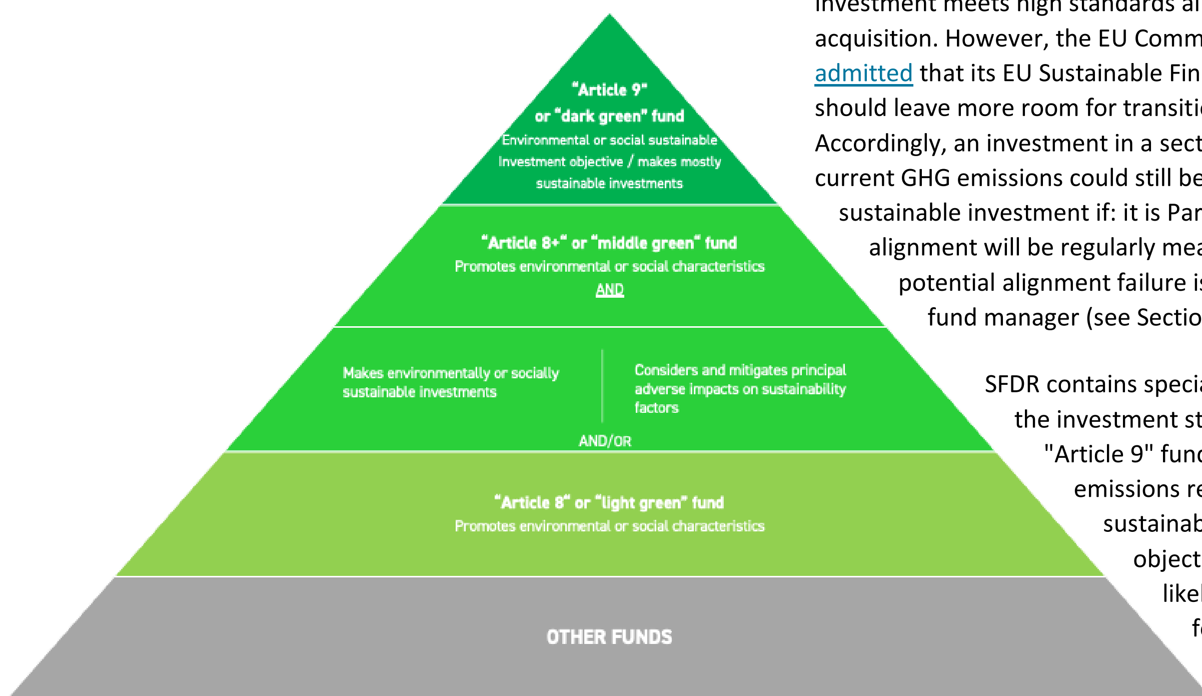
EU: EU Sustainable Finance Disclosure Regulation

EU Sustainable Finance Disclosure Regulation (SFDR) at first glance only covers disclosures at asset manager and fund level (see Section 0 below), but in fact leads to a product categorization which already needs to be considered when designing the investment strategy of a fund domiciled and/or marketed in an EEA country. Although SFDR is agnostic on the topic of Net Zero and covers any type of fund with environmental or social targets, investors in a Net Zero fund subject to SFDR will likely expect it to comply with the SFDR's product categories for more advanced "greener" funds. Such fund types include:

- an "Article 9" or "dark green" fund which has sustainable investment as its objective (for example through the mitigation of climate change as an environmentally sustainable investment objective in line with the Taxonomy Regulation);
- an "Article 8" or "light green" fund which promotes environmental characteristics (such as the reduction of GHG emissions or improving energy efficiency) but does not necessarily make "sustainable investments" as defined in the SFDR; or

- an "Article 8+" or "middle green" fund (a category introduced not by the SFDR, but by the new concept of customer/investor sustainability preferences in the Insurance Distribution Directive (IDD) and the current version of the Markets in Financial Instruments Directive (MIFiD II)). This type of fund promotes environmental characteristics and, in addition, makes at least some "sustainable investments" and/or considers and mitigates principal adverse impacts on sustainability factors, each as defined in the SFDR.

Figure 7: Fund categories according to SFDR



Source: Herbert Smith Freehills

The category in which a Net Zero fund will fall under SFDR will depend on the nature of its commitment to achieving Net Zero. Without anticipating any required fund level analysis, based on the targets and objectives to be set under the NZI Framework it is likely that the fund will qualify as an "Article 9" fund having an environmental investment objective alongside its financial objective. Climate change mitigation is one of the six environmental objectives specifically covered in the EU Taxonomy Regulation (Taxonomy Regulation) according to which sustainable investments can be classified in the disclosures required under SFDR. It is important to note that the Taxonomy Regulation is not exclusive since it only covers specific economic activities and sets a "platinum standard" of what is considered to contribute significantly to climate change mitigation. Accordingly, a Net Zero fund could still be considered an "Article 9" fund even if its sustainable investments do not qualify under the Taxonomy Regulation.

An "Article 9" fund is expected to make mostly sustainable investments, that is investments with a measurable and measured environmental or social objective, complying with additional "do no significant harm" standards and ensuring good governance. In this context it is important to note that SFDR's sustainable investment concept does not specifically acknowledge impact-led strategies or pathways. Instead, fund managers would have to ensure that the sustainable investment meets high standards already at acquisition. However, the EU Commission has recently admitted that its EU Sustainable Finance Strategy should leave more room for transition activities. Accordingly, an investment in a sector with high current GHG emissions could still be considered a sustainable investment if: it is Paris aligned; such alignment will be regularly measured; and a potential alignment failure is sanctioned by the fund manager (see Section 0 below).

SFDR contains special requirements for the investment strategy of an "Article 9" fund that has carbon emissions reduction as its sustainable investment objective, a category likely to be triggered for an "Article 9" Net Zero fund. Such funds will need to demonstrate the achieved reduction by reference to one of the two types of climate benchmarks defined in the EU Benchmarks Regulation or, in case no such benchmark is available (such as for alternative assets such as real estate), apply the methodology set out in the EU Benchmarks Regulation for these climate benchmarks. At first glance the climate benchmarks methodology has common features to the NZI Framework's requirements, but it differs in various ways, for example by demanding hard exclusions of sectors unrelated to fossil fuels, such as controversial weapons and tobacco, topics not covered by the NZI Framework.

If the reduction of GHG emissions as part of the fund's Net Zero strategy is an additional element to the prevailing financial investment objective and does not determine the investment decision, the fund may also qualify as an "Article 8" or "Article 8+" fund under

SFDR. It would probably not qualify as a Net Zero fund under the standards of the NZI Framework, however.

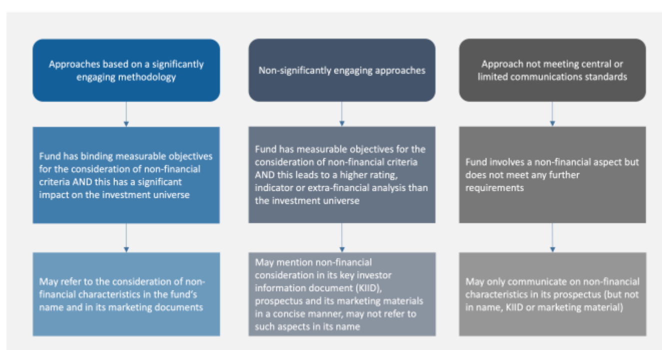
France and Germany: Retail fund regulation to combat greenwashing

In March 2020 the French Autorité des Marchés Financiers (AMF) published a policy on disclosures to be made by funds marketed in France to retail investors. Similar to SFDR, AMF's Position/Recommendation DOC-2020-03 (Position) targets disclosures, but effectively leads to a product classification since funds using sustainability references in their name, marketing materials or fund documentation will need to provide for the information required under the Position.

Funds are divided into three categories: "significantly engaging", "non-significantly engaging" and "central/limited communication", and the Position sets out for each of the three categories which characteristics the fund must have and disclose to investors, and how non-financial characteristics can be described in the fund name and marketing documents.

According to AMF, these rules apply in addition to the SFDR provisions set out above. Therefore, a Net Zero fund marketed to retail investors in France must not only comply with the NZI Framework and the SFDR, but also with the Position. For example, a fund considered by AMF as "significantly engaging" must have measurable objectives for non-financial criteria and the consideration of these criteria must have a significant impact on the fund's investment universe (as defined in detail in the Position). Without having assessed this in detail we assume that a Net Zero fund following the NZI Framework and qualifying as "Article 9" fund under SFDR will be likely to meet these requirements as well.

Figure 8: AMF Position – Retail fund categories



Source: Herbert Smith Freehills

The German regulator Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) is currently consulting on a similar guideline for new or amended retail funds domiciled in Germany. Such funds may only have a sustainability reference in their fund name (such as "Net Zero" or "Green") if they fall into one of the three categories set out in the guideline:

- 75% sustainable investments according to SFDR;
- a sustainable investment strategy; or
- replication of a sustainable index.

According to BaFin's interpretation sustainable investments may not include issuers or portfolio companies with:

- more than 10% of their turnover derived from fossil fuel energy, fossil fuels or nuclear energy; and
- more than 5% of their turnover from coal and oil, with a total exclusion of oil sands/oil shale.

While the latter should probably not be an issue for a Net Zero fund considering the fossil fuel position of the PAII members, the former may be an issue with respect to the nuclear power industry, given some issuers and portfolio companies have Paris aligned pathways that still provide for such business activities.

UK: Greenwashing regulation and upcoming classification rules

There isn't as yet a codified ESG-related regulatory regime focused on investment funds in the UK. A recent letter published by the Financial Conduct Authority (FCA) addressed to the managers of UK authorized firms clearly indicates the broader regulatory expectations in this area, however. Of particular relevance to the present discussion is the FCA's direction that a fund's ESG/sustainability focus should be reflected consistently in its design, delivery, and disclosure. References to ESG (or related terms) in a fund's name, financial promotions or fund documentation should fairly reflect the materiality of ESG/sustainability considerations to the objectives and/or investment policy and strategy of the fund.

The FCA states that where investor stewardship forms part of a fund's responsible or sustainable investment strategy, the fund manager should develop an engagement policy and clarify how stewardship contributes to achieving the fund's intended

ESG/sustainability characteristics, themes, or outcomes. The FCA further states that it should be clear how monitoring, engagement and voting activity in respect of ESG/sustainability matters are integrated with investment decisions, and how escalation and divestment decisions are made.

On the delivery of investment outcomes, the FCA also suggests that the resources that a fund manager applies in pursuit of a fund's stated ESG objectives should be appropriate. Factors considered include the skills and experience of personnel, and the technology, research, data, and analytical tools made available to them.

On 3 November 2021 the FCA published a discussion paper on a proposed labelling regime for investment products (DP21/4). DP21/4 proposes five labels for investment products – impact, enabling, transition, responsible and other – with the first three being classified as "sustainable". Although DP21/4 does propose indicative criteria for these labels, these are not very comprehensive – further detail will be available when the FCA consults on the labelling regime in Q2 2022. Although DP21/4 only proposes indicative criteria for these labels, it does emphasize that in order to be labelled as "sustainable", products would either need to have the objective of delivering net positive social and/or environmental impact alongside a financial return, or have sustainability characteristics, themes, or objectives.

Separately, work is also currently ongoing to create a UK-specific green taxonomy which is expected to be structured similarly to the EU's Taxonomy Regulation. This taxonomy framework may be in place in the UK over the next 12-18 months.

The role of data in fund classification

Whatever the applicable level of voluntary or binding regulation, it is clear that from now on labelling a fund as sustainable will not suffice. Fund managers will need to be able to back up those claims with a data driven approach, alongside qualitative, subjective, and transparent disclosures as to how that data is applied.

This does not only apply to the fund's Net Zero objectives and targets, but also to additional elements of the investment strategy such as good governance, the "do no significant harm" principle under SFDR, and the minimum safeguards under the Taxonomy Regulation monitoring compliance with essential human, labor, and social rights. Fund managers will likely need to be able to point to external data sources and support from data and methodology providers to underline their Net Zero and ESG claims.

Impact of ESG regulatory requirements on fund manager governance

Although this publication focuses on the fund, it is important to note that under various regulatory frameworks, pursuing a Net Zero strategy will also mean that the fund manager will have to meet additional requirements. For example, the SFDR's fund manager and fund level disclosures lead to governance and procedural requirements for fund managers, including:

- the consideration of sustainability risks in their investment decision-making process;
- the alignment of their remuneration policies with sustainability risks; and
- the consideration of principal adverse impacts on sustainability factors in the due diligence and ongoing monitoring process for investments.

Further, upcoming amendments to the EU Alternative Investment Fund Managers Directive's (AIFM Directive) implementing regulation require that the fund manager retain the necessary resources and expertise for the effective integration of sustainability risks, that its senior management is responsible for the integration of sustainability risks into investment decision-making, and that its conflict of interest and risk management policies specifically take sustainability risks into account. More generally, fund managers are required by the AIFM Directive to implement an appropriate, documented and regularly updated due diligence process for each fund that reflects the fund's investment objectives and strategy. The risks associated with each investment position of the fund and their overall effect on the fund's portfolio should also be properly identified, measured, managed, and monitored on an ongoing basis. Consequently, care should be taken to ensure that all aspects of the investment fund's design and ongoing management are consistent with its ESG ambitions.

Such integration is crucial from a practical perspective as well. Automation and technology are playing an increasingly important role in investment processes. For most asset managers product design, ongoing management, and engagement, are carried out by different teams. As a result, it is vital that the systems and processes established for investment funds integrate sustainability risks and are consistent with the ESG ambitions of the relevant fund.

In the UK, the rules which the FCA is currently consulting on relating to TCFD disclosures to be made by UK-authorized funds managers (further detail in Section 0 below) will also require disclosures relating to the governance and risk management systems of funds managed by in-scope managers. This disclosure will, therefore, focus regulatory and investor attention on the design and implementation of Net Zero investment funds.

As a result, from both a regulatory and practical perspective, it is vital that the systems, processes, and procedures put in place by the fund manager in relation to a Net Zero investment fund should be consistent with its investment strategy and should be robust enough to withstand the regulatory and investor-led scrutiny which results from the ongoing disclosures the fund manager will be required to make.

Designing a Net Zero fund portfolio (= "Plan")

The next step in the Race to Zero is to plan the actions to be taken toward achieving the commitment, and the long-term and interim goals associated with it. At fund level, this can be equated to the top-level process performed for allocating assets across different investment objectives, often referred to as a fund's strategic asset allocation (SAA). As part of their SAA, fund managers should use tools to optimize asset allocation in order to achieve Paris alignment, such as:

- climate scenario analysis/climate stress testing;
- supplementing financial objectives with climate change objectives;
- integration of climate targets;
- consideration of other, Paris aligned asset classes (for example renewable energy and infrastructure);
- use of asset classifications with more systematic approaches to carbon intensity reduction; and
- integration of Paris alignment targets as key performance indicators in regular assessment and reporting.

Figure 9: NZI Framework – SAA

Source: Paris Aligned Investment Initiative – Investing for a Net Zero future

How can the fund's commitment and targets effectively be transposed into a fund's SAA? This is above all a question of data and modelling, as demonstrated by ISS ESG's work in the field.

Note to self...

When embarking on a Net Zero investment strategy, the key characteristics required include:

- Pragmatism: Net Zero requires a technological shift at an unimaginable speed. Be clear on the political and technological assumptions required to reach the targets and provide alternative pathways for when things do not work out as expected. The ambition and political will to achieve this transition are currently in short supply, but this situation may well be remedied by an ambitious set of targets coming out of COP-26.
- Decarbonization: Net Zero is about one thing and one thing only. Net Zero emissions means that the most important thing is decarbonization, and the focus should be on genuine reductions in the amount of carbon dioxide and equivalent gases being released into the atmosphere, and less on accounting strategies to 'net' emissions via the use of offsets or shorting tactics.
- Immediacy: Most Net Zero by 2050 pathways require a strong reduction of emissions within the next decade, with the reduction rate becoming flatter in the decades after. This is required to ensure that the global economy stays within the overall carbon budget available.

So how can companies and in turn funds currently be assessed? ISS ESG is of the view that it is critical that a conservative approach be taken. The topic is too urgent and the challenge too great to lose oneself in wishful thinking. Transparency and, if in doubt, the assumption of less rather than

more alignment should therefore underpin any portfolio construction.

When is a target a good target?

The ISS ESG Net Zero analysis report and accompanying data set looks at approximately 120 metrics to assess the Net Zero status of issuers and portfolios. The focus is on the quality of the issuers' target setting. Key questions to answer for any company and in turn fund are:

- What proportion of companies in the fund are disclosing emissions? This constitutes the very basis of any Net Zero assessment.
- What proportion of companies can be considered aligned, aligning, or committed to aligning to Net Zero?
- What are the Scope 1, 2 and 3 emissions of a given portfolio, and how does that compare to the emission reduction pathway the world needs to follow to reach the target?
- What companies in the portfolio are expanding their fossil fuel-related activities and are therefore incompatible with a Net Zero by 2050 scenario?
- What is the revenue in my portfolio associated with activities contributing to the mitigation of climate change?

What does this mean practically? Or to put the question another way: following the terminology of the NZI Framework, when *is* a company considered aligned, aligning, or committed to aligning to Net Zero?

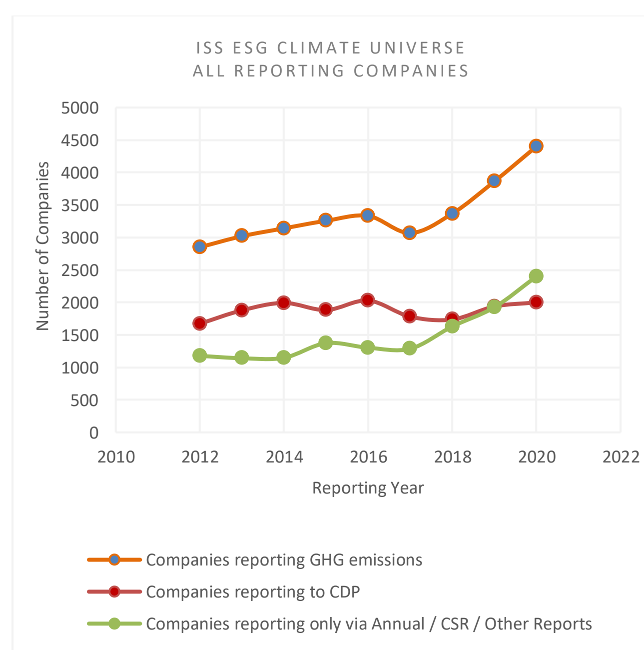
Given the current state of disclosure, government policy, and technology, it is impossible to define any entity as "aligned" with the Paris goals. While perhaps a strong statement, it links to the previously mentioned necessity for transparency and conservatism. Ultimately, it will be more harmful for the achievement of global climate targets if companies are assessed as aligned when they are not, than the other way around. Companies are currently setting themselves targets for Net Zero emissions by 2050, but the targets are collectively so recent that the action required to implement them is still underway. And this is before we consider the fact that there are as yet a number of unknowns in terms of how to practically achieve Net Zero.

The best assessment a company can therefore currently achieve is that it is considered to be "aligning" to a Net Zero by 2050 pathway. This is the case if a company:

- has formally committed to aligning to Net Zero by 2050;
- specifies an interim target; and also
- details a decarbonisation strategy.

The status of a company is assessed as "Committed to Aligning" if the company has set a formal Net Zero target for 2050.

Figure 10: Companies Reporting GHG Emissions (Global)



Source: ISS ESG

The need for a conservative approach focusing on companies publishing key data points also becomes evident when looking at Figure 10 above, which illustrates that in a universe of over 25,000 companies, less than a fifth are reporting GHG emissions.

Beyond the data

Engagement is an important element not only of the NZI Framework (see Sections 0 and 0 on engagement targets and asset class alignment via engagement), but also more broadly of any Net Zero strategy acknowledging that a rapid economic transition is required. The overall set-up of a fund should consider

going beyond a focus on the data points and portfolio construction alone. It is also important to consider the inclusion of active ownership strategies. Engagement is a key tool in this context for investors seeking to effect corporate change and support the transition to a low-carbon economy. In the climate sphere it can encompass a range of objectives focused on Net Zero target setting, including calls for investee companies to:

- undertake TCFD-aligned disclosure;
- implement a decarbonization strategy;
- incorporate climate-related issues into governance frameworks; and
- ensure capital expenditure alignment with Net Zero goals.

Engaging as part of a joint investor effort can be a resource-efficient solution for fund managers, enabling them to fulfil their fiduciary duty to protect their assets whilst sharing the time and effort required to engage with issuers. Collective influence can be a powerful tool, particularly when companies are unresponsive to one-to-one dialogues with investors.

In 2020 the Carbon Disclosure Project (CDP) reported that companies targeted in their Non-Disclosure Campaign were more than twice as likely to disclose as a result of joint investor pressure compared with companies not in their target list; the figures increase to almost two thirds of engaged companies disclosing after two consecutive years of engagement. Collaborative engagements are also a valuable way to gain knowledge and insights into particular sectors or regions, through the sharing of knowledge between signatory members.

Figure 11: Investor Initiatives

	Signatories AUM	Engagement and/or voting required	Corporate engagement focus areas*				
			Metrics (2050 Net Zero target / medium short-term target)	Strategy (decarbonization strategy / capital allocation alignment)	Policy engagement	Climate governance	TCFD disclosure
CA100+	$60T (617 investors)	X	X	X		X	X
CDP Non-disclosure campaign**	$12T (108 investors)	X	X	X		X	X
CDP SBT campaign	$29.3T (220 investors)	X	X				X
UN-convened Net-Zero Asset Owner Alliance	$10T (60 investors)	X	X	X	X		X
Net Zero Asset Managers Initiative	$43T (128 investors)	X					
Paris Aligned Investment Initiative	$2.35T (40 asset owners)	X					
Initiative Climate International	$700B (90 private equity firms)	x					

*building on CA100+ Benchmark disclosure indicators
**based on the 2020 campaign signatories

Source: ISS ESG

Engagement is now a core element of many investor initiatives. Climate Action 100+ is one of the most prominent collaborative engagement platforms, with 615+ investor signatories representing $60 trillion in assets under management. Alongside this and the PRI's Collaboration Platform, engagement is included as an expectation of many other initiatives or groups (see also Table 1 "Investor Initiatives").

In the context of this multiplicity of initiatives, the focus for investors should be on establishing clear expectations around investee company transparency, including:

- A clear Net Zero ambition, the more detailed the better.
- Specific targets, both interim and long term, that cover all relevant emissions.
- Detailed decarbonization strategies with quantified steps of how the targets are to be met.
- A focus on decarbonization based on known and proven measures, such as changing power supply or existing technologies, as a means to reach the targets.
- Ambitious decarbonization strategies should not rely on CCUS technologies, and to the extent that they do, investors should confirm that alternative roadmaps on how to reach those targets are in place should the technology prove not to be viable.
- Targets should be adaptable. As scenarios are updated, as new technologies are developed or discarded, investee corporations should be prepared to amend their targets accordingly.

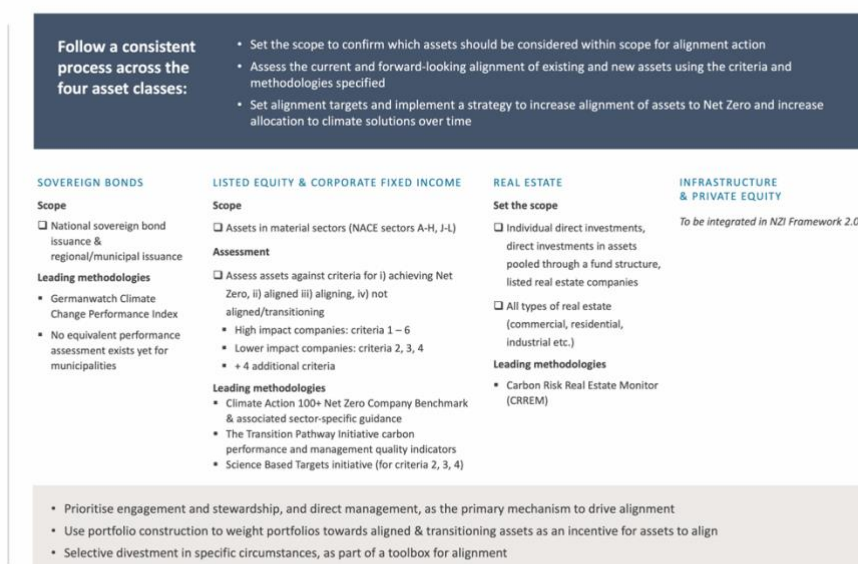
Implementing the Net Zero investment strategy at asset level (= "Proceed")

The fund's SAA (see Section 0 above) will necessarily have to be complemented by a specific alignment at asset level, with Net Zero pathways, tools and methodologies differing from asset class to asset class. For each of the asset classes held in the fund, the fund manager should:

1. define which assets are aligned or can become aligned; then
2. assess the current and forward-looking alignment of all assets (existing and new) using specific criteria and methodologies for each asset class; and
3. set asset level alignment targets and implement an asset-class based strategy to increase alignment and allocation to climate solutions over time.

The credibility of targets and pathways of individual corporate investments can be validated externally, such as by submission to the Science Based Targets initiative.

Figure 12: NZI Framework – Asset class alignment



Source: Paris Aligned Investment Initiative – Investing for a Net Zero future

Currently, the NZI Framework only covers three asset classes: sovereign bonds; listed equity/corporate fixed income; and real estate. The next version of the Framework will see this extended to include private equity and infrastructure (see also Section 0 above). In comparison, the NZAOA's Inaugural 2025 Target Setting Protocol already covers infrastructure, but also excludes private equity, unlisted corporate debt, mortgages and covered bonds from its scope.

Divestment versus engagement

Implementing a Net Zero strategy at asset level is not limited to target setting and monitoring - it will necessarily have to include actions available to the fund manager if asset level targets are not met. In line with the NZI Framework, there are two main options available: divestment and engagement. For NZI divestment is usually the second option after engagement and stewardship. It may be preferred where an investment is subject to substantial climate financial risk, as an escalation following unsuccessful engagement, or for companies whose primary activity is not permissible within a credible Paris aligned pathway (for example coal or oil exploration for combustion purposes).

To divest or not to divest?

Before diving deeper into the question of divestment, a word of caution from NZAOA may be required on the actual impact of investor climate pledges, strategies, and actions on emissions reduction in the real economy. Although this publication is focused at the fund level, it is important to keep in mind that the overarching objective for any Net Zero strategy – ensuring the Paris global warming

goal of 1.5°C – cannot be achieved by simply making a fund or a portfolio Net Zero without effecting any change in the real economy. While engagement and stewardship strategies have been criticized for being ineffective, one must concede that such activities have been undertaken regarding GHG emissions reduction for only a relatively short period of time, and have in the past delivered results on other, non-ESG related topics such as board governance and stakeholder inclusion.

In its Greening Finance roadmap published on 18 October 2021, the UK government clarified its expectations for asset owners and asset managers alike to "actively monitor" and "challenge companies" in order "to promote long-term, sustainable value generation". Such stewardship efforts may escalate to "withholding capital or divestment where a company is not taking appropriate action to transition to Net Zero." This governmental guidance is the latest example showing that in the debate of engagement versus divestment, the discussion has moved away from simple binaries to a more holistic view in which the two practices are simply different techniques in the investor toolbox that can be used strategically and complementarily to achieve positive outcomes.

Divestment, sometimes referred to as the "Wall Street Walk", is probably one of the oldest investor techniques – it certainly appears rational for investors to sell their shares where they have concerns with the management or strategy of a company based on ethical, financial or sustainability reasons. What is the best option to influence companies' behaviour: voicing investor concerns or exiting the investment? This is sometimes referred to as the "exit" or "voice" dilemma.

Divestment from energy and fossil fuels can appear an attractive solution for investors wanting to "future-proof" their portfolios and reduce their portfolio carbon footprint. Investors may decide to divest if the company business is deemed to be wholly unacceptable on climate grounds (for example oil sands or oil shale) or if they do not believe a company will be able to adapt quickly enough to the clean energy transition. Divestment can also be required to align a portfolio with specific climate benchmarks, such as under the EU Benchmarks Regulation.

The risks of divestment

The costs and risks associated with divestment should not be underestimated, however. By reducing the investment universe, portfolio managers may find it more challenging to deliver alpha in the short-term. Divesting also means losing your seat at the table and giving up the opportunity to influence companies. As highlighted by State Street Global Advisors, "companies can be bought by investors who lack a clear climate strategy or they can go into the hands of private owners with no market scrutiny".

Some of the largest global investors have been supporting stronger active ownership instead. Thus, Norges Bank Investment Management, while publishing a divestment policy, still considers that "dialogue may be a more suitable approach than divestment" for their largest investments. Japan's Government Pension Investment Fund (GPIF) has taken the perspective of a "universal owner" and declared that they do not practice divestment, noting "if we were to exclude a company with a significant environmental footprint from our portfolio, the value of our assets may eventually be damaged by the negative impact generated by this company in the long run."

Academic evidence seems to support engagement as an effective way to create value and reduce risks. According to Dimson et al. (2015), successful engagements are followed by positive abnormal returns as well as improved accounting performance and governance, while Broccardo et al. (2020) found that "exit is less effective than voice in pushing firms to act in a socially responsible manner".

Through constructive individual or collaborative dialogue with portfolio companies on climate risks, investors can put their capital to work and build momentum for positive change. Investors can push companies to commit to 2050 Net Zero targets and articulate realistic decarbonisation strategies, and work with them along the way to be sure management meets the key milestones, using services such as ISS ESG's Collaborative Engagement Service.

Figure 13: Sample collective engagement process

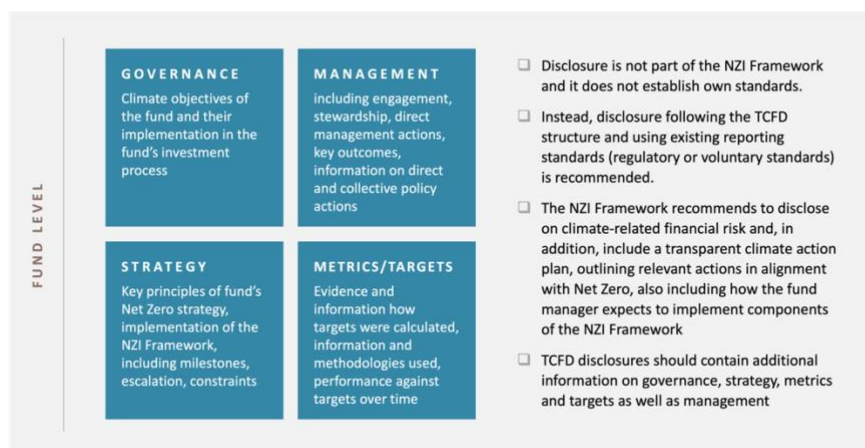
Source: ISS ESG

Capital allocation and engagement decisions are being progressively combined by investors through ESG integration policies. Divestment can be efficiently used in an escalation strategy when companies are unresponsive or do not respect their commitments. The possibility of divestment strengthens the chance of effective engagement.

Accountability through disclosure and reporting (= "Publish")

The final step of the Race to Zero is annual public reporting on progress against interim and long-term targets and actions taken. Recognizing that there is a range of reporting requirements and voluntary disclosures already available for asset managers and asset owners, the NZI Framework does not provide for its own reporting standards, instead referring to existing standards. Disclosures based on such reporting standards should be made annually in line with the TCFD recommendations, including certain additional information on governance, strategy, metrics, and targets as well as management.

Figure 14: Recommended disclosures for funds following the NZI Framework



Source: Herbert Smith Freehills

Global frameworks and standards

While it is understandable that the NZI Framework saw no need to add another reporting standard or framework to the "alphabet soup" of accounting standards, this leaves fund managers to choose the right disclosure framework and reporting standard. The NZI Framework strongly advocates for the TCFD disclosure framework, since this is the most accepted globally. It will also be incorporated in national legislation in some countries (see Section 0 above and below). Although there is currently no similarly accepted reporting standard, it is to be expected that the ISSB's new sustainability disclosure reporting standards (see Section 0 above) will become the globally accepted standard.

Additional regulatory reporting requirements

SFDR and other national requirements

We have already highlighted the impact of SFDR on fund classification in Section 0 above. The primary objective of SFDR is, however, to ensure proper disclosure to investors, inter alia on sustainability risks and other sustainability-related information for funds and other financial products, both pre-investment and as part of the fund's or product's periodic reporting.

Without digging deeper into the – rather intricate – disclosure rules of SFDR and the expected implementing standards, it is important to note that any fund manager of a Net Zero fund that falls under the scope of SFDR will also have to meet the respective disclosure obligations requiring information on specific questions and KPIs. Some of this information (such as GHG emissions) will already be available as part of the fund's Net Zero strategy, while other information (for example alignment with the Taxonomy Regulation, or compliance with human, labor, and social rights) are not necessarily built into a Net Zero strategy developed under the NZI Framework. Accordingly, it will be important to design any disclosure framework and choose reporting standards not only in line with the NZI Framework recommendations, but also with the regulatory requirements related to SFDR.

As mentioned above in Section 0, other national regulators may also have disclosure rules applicable to all or certain types of Net Zero funds (in particular retail funds). Disclosures for a Net Zero Fund marketed to retail investors in France have to be made in line

with the AMF's Position and must contain a baseline information set to allow the fund to be designated a "Net Zero" fund. If the intended guideline of the German BaFin comes into force, German Net Zero funds marketed to retail investors will have to take the specific definition of what BaFin considers "sustainable" into account. Similar rules are also likely to emerge in other jurisdictions.

New disclosure regime in the UK

In the UK, the FCA is presently consulting on introducing climate-related financial disclosure rules and guidance for asset managers (and the funds they manage) consistent with the TCFD's recommendations and recommended disclosures. A policy statement with the final rules is expected by the end of 2021.

The FCA proposes disclosure requirements for UK-authorized asset managers at two levels: (i) entity-level disclosures, which require firms to make climate-related financial disclosures annually in relation to the overall assets managed or administered by the firm on behalf of their clients; and (ii) product or portfolio-level disclosures, which require firms to make disclosures annually, in respect of the individual products or portfolio management services they offer.

It's the second of these which would be relevant to Net Zero funds. The product-level disclosures will apply to all products managed by an in-scope asset manager and not just those stated or intended to have an ESG focus (this is in contrast to the position under the SFDR, pursuant to which detailed disclosures going beyond the more general disclosure of sustainability risks are only required for "Article 8" (including "Article 8(+)") or "Article 9" funds).

Depending on the type of firm and/or product or portfolio, the product-level disclosures will either need to be: (i) published in a public TCFD product report (public TCFD product report); or (ii) made available upon request to certain clients (on-demand TCFD product report). A public TCFD product report must be made available in a prominent place on the main website of the respective asset manager, as well as be included (or cross-referenced and hyperlinked) either: (i) if in respect of a listed unauthorized alternative investment fund (AIF), in the TCFD entity report; or (ii) if in respect of an authorized fund, in the annual report or half-annual report which follows most closely after the 30 June annual reporting deadline.

The FCA recognizes that a public TCFD product report is not appropriate in some client relationships and proposes that on-demand reporting apply in such cases. These relationships are: (i) discretionary portfolio management services; and (ii) alternative fund managers of unlisted unauthorized AIFs. In these cases, the fund manager will be required to provide an on-demand TCFD product report when this is required by the relevant client/investor in order to satisfy climate-related financial disclosures obligations (whether under the FCA Handbook or as a result of other legal or regulatory requirements). In addition, if the client/investor requests further climate- or carbon-related data which is reasonably required to satisfy climate-related disclosure obligations, the fund manager must comply if it is reasonably practicable and permitted under the contractual arrangements governing the fund manager's use of data. Finally, even in cases where a client/investor is not eligible to request such a report, fund managers are still encouraged to consider making this available to the client, in a form broadly equivalent to the on-demand TCFD product report.

Separately, the FCA's discussion paper DP21/4 mentioned in Section 0 above also proposes wider sustainability disclosure requirements (SDR) applicable to UK-authorized asset managers and FCA-regulated asset owners. The SDR will widen the scope of the TCFD disclosures discussed above to cover sustainability matters other than climate. The FCA also considers that the ISSB's new sustainability reporting standards will feed into the SDR in the context of (i) investment firms which form part of a listed issuer group; or (ii) investment firms which may rely on data disclosed by corporates to produce their own reports.

The FCA is proposing a 2-tiered disclosure system: (i) consumer-facing disclosures, which would be aimed at retail investors and would provide standardized information on the product's key sustainability attributes (such as investment product label and the objective of the product, including specific sustainability objectives); and (ii) detailed disclosures, to be made at the entity and product level, aimed primarily at institutional investors. These detailed disclosures will be compatible with and built on the foundation of FCA's TCFD-aligned entity- and product-level disclosure requirements.

In addition, the FCA is considering the use of market-led mechanisms that might support the establishment and verification of product-level disclosures. This could

potentially take the form of independent third-party auditors who would be responsible for verification of product-level disclosures. This could help instill additional confidence in investors and improve the quality of sustainability-related information given to consumers. The FCA acknowledges that there may be cost and capacity implications in following this approach and is currently seeking views on the issue.

Final observations

A closer look at the NZI Framework and its underlying scientific and market challenges clearly shows that Net Zero strategies may be "science-based" but are not pure science (yet). A lot depends on dealing adequately with interconnected legal and voluntary obligations such as SFDR, new UK FCA rules, and the NZAOA investor commitments. It is also important to consider the limitations of the NZI Framework, for example in relation to covered asset classes.

Managing a Net Zero fund is and will continue to be a moving target in a rapidly changing legal and economic environment. Fund managers will need to constantly recalibrate their targets, pathways and asset class assessments and update the fund's Net Zero strategy accordingly.

Finally, fund managers need to develop an increased tolerance for open questions – an uncomfortable notion for a sector whose business is managing risks and returns based on historical data and experience. There are many uncertainties around the Net Zero trajectories of listed companies, and it must be acknowledged that at the present time, there is no established transition pathway to Net Zero for the majority of corporations. In such an environment, fund managers are best served by transparency about what they can achieve, at the same time as acknowledging the many unknowns.

Glossary

TERM	MEANING
AIF	Alternative investment fund as defined in the AIFM Directive
AIFM	Alternative investment fund manager as defined in the AIFM Directive
AIFM Directive	EU Alternative Investment Fund Managers Directive, Directive 2011/61/EU of the European Parliament and the Council of 8 June 2011 on Alternative Investment Fund Managers
AIGCC	Asia Investment Group on Climate Change
AMF	Autorité des Marchés Financiers (France)
AUM	Assets under management, i.e., the total market value of the investments that a person or entity manages on behalf of clients.
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (Germany)
CCUS	Carbon capture, utilisation, and storage as an important emissions reduction technology
CDP	Carbon Disclosure Project, a not-for-profit charity that runs the global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts.
Ceres	Investor Group on Climate Change for North America
CH4	Methane, a GHG
CO2	Carbon dioxide, a GHG
CO2e	CO2 equivalents, metric used to measure GHG emissions
COP26	The 2021 United Nations Climate Change Conference, held in the city of Glasgow, Scotland, between 31 October and 12 November 2021
DP21/4	Discussion Paper on Sustainability Disclosure Requirements (SDR) and investment labels published by the FCA on 3 November 2021
EFRAG	European Financial Reporting Advisory Group, EFRAG's mission is to serve the European public interest by developing and promoting European views in the field of financial reporting and ensuring that these views are properly considered in the IASB's standard-setting process and in related international debates
ESG	Environmental, Social, and (Corporate) Governance, three categories of interest for what is termed "socially responsible investors"

TERM	MEANING
EU Benchmarks Regulation	EU Benchmarks Regulation, Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds.
Taxonomy Regulation	EU Taxonomy Regulation, Regulation (EU) 2020/2088 of the European Parliament and the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment.
FCA	Financial Conduct Authority (UK).
GFANZ	Glasgow Financial Alliance for Net Zero, launched in April 2021 and providing a forum for leading financial institutions to accelerate the transition to a Net Zero global economy.
GHG emissions	Greenhouse gas emissions, emissions primarily from the combustion of fossil fuels and industry.
GPIF	Japan's Government Pension Fund, has established "Investment Principles".
HFCs	Hydrofluorocarbons, a group of GHGs.
IDD	Directive 2016/97/EU of the European Parliament and of the Council of 20 January 2016 on Insurance Distribution.
IEA	International Energy Agency, committed to shaping a secure and sustainable energy future by providing a variety of programmes and initiatives, helping ensure energy security, tracking clean energy transitions, collecting data, or providing training around the world.
IGCC	Investor Group on Climate Change for Australasia.
IIGCC	Institutional Investors Group on Climate Change, European membership body for investor collaboration on climate change.
IPCC	Intergovernmental Panel on Climate Change, the United Nations body for assessing the science related to climate change.
ISSB	International Sustainability Standards Board.
MIFiD II	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance. Markets in Financial Instruments Directive II as a legislative framework aims to strengthen investor's protection and improve the functioning of financial markets, making them more efficient, resilient, and transparent.
N2O	Nitrous oxide, a GHG.
Net-Zero Asset Managers Initiative	Net-Zero Asset Managers Initiative, international group of asset managers committed to supporting the goal of Net Zero greenhouse gas emissions by 2050 or sooner.

TERM	MEANING
Net-Zero Asset Owner Alliance (NZAOA)	Net-Zero Asset Owner Alliance, international group of institutional investors committed to transition investment portfolios to Net Zero greenhouse gas emissions by 2050.
Net-Zero Banking Alliance	Net-Zero Banking Alliance, including banks worldwide, which are committed to aligning their lending and investment portfolios with Net Zero emission targets by 2050.
Net-Zero Insurance Alliance	Net-Zero Insurance Alliance, consisting of eight of the world's leading insurers and reinsurers, committed to individually transition their underwriting portfolios to Net Zero greenhouse gas (GHG) emissions by 2050.
NZI Framework	Net Zero Investment Framework developed by four investor networks, through the PAII. It provides a common set of recommended actions, metrics and methodologies through which investors can maximize their contribution to achieving global Net Zero global emissions by 2050 or sooner.
Paris Agreement	A legally binding international treaty on climate change. It was adopted by 196 Parties at COP 21 in Paris on 12 December 2015 and entered into force on 4 November 2016.
Paris Aligned Investment Initiative (PAII)	Paris Aligned Investment Initiative, collaborative investor network-led global forum enabling investors to align their portfolios and activities to the goals of the Paris Agreement.
PCAF	Partnership for Carbon Accounting Financials, The Global GHG Accounting and Reporting Standard for the Financial Industry.
PFCs	Perfluorocarbons, a group of GHGs.
Position	AMF Position/Recommendation DOC-2020-03 as of 11 March 2020.
Race to Zero	UN-led campaign, whose members commit to achieving Net Zero carbon emissions by 2050 at the latest.
SAA	Strategic asset allocation.
SDR	Sustainability disclosure requirements regime in DP21/4 currently being consulted on by the FCA.
SFDR	EU Sustainable Finance Disclosure Regulation, Regulation 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.
SF6	Sulphur hexafluoride, a GHG.
TCFD	Task Force on Climate-related Financial Disclosures, created to improve and increase reporting of climate-related financial information.
UNFCC	United Nations Framework Convention on Climate Change.

About the authors

Herbert Smith Freemills
Heike Schmitz, Partner, Corporate
Nish Dissanayake, Partner, Corporate
Shantanu Naravane, Senior Associate, Corporate

ISS ESG
Viola Lutz, Head of Climate Solutions
Fredrik Lundin, Head of R&D Climate
Erin Wood, Engagement Manager, Stewardship and Engagement
Edouard Dubois, Global Head of Stewardship & Engagement

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About ISS ESG

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For more information, please visit us at: www.iss-esg.com