THE PATH TO NET ZERO

Investing in a carbon neutral future

November 2020

ABOUT THE IA

The Investment Association is the trade body that represents UK investment managers, whose 250 members collectively manage over £8.5 trillion on behalf of clients.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

Our members help to grow people's savings in a wide range of ways, including through authorised investment funds (schemes where several investors 'pool' their assets and invest in a professionally managed portfolio), pension funds, and stocks & shares ISAs. The UK is the second largest investment management centre in the world and manages over a third (37%) of investments across Europe.

Investment Association (IA) members hold in total over one third (36%) of the value of UK publicly listed companies. We use this collective voice to influence company behaviour and hold businesses to account.

More information can be found at
www.theia.org

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INTRODUCTION

THE COP26 CLIMATE CONFERENCE TO BE HELD IN GLASGOW IN 2021 MAY BE THE MOST IMPORTANT INTERNATIONAL CLIMATE CHANGE EVENT SINCE THE SIGNING OF THE PARIS AGREEMENT IN 2015. IT MARKS A SIGNIFICANT OPPORTUNITY TO REFLECT ON AND SHOWCASE HOW WE ARE MAKING PROGRESS TOWARDS THE PARIS AGREEMENT GOALS AND FACILITATING THE TRANSITION TO A GREENER, MORE SUSTAINABLE FUTURE.

The UK investment management industry, as major global investors in companies and infrastructure projects, is already playing an important part in bringing about such a transition. Our commitment to the UK's vision for a COP26 that drives change stems from our view that climate change is one of the most urgent and significant systemic risks the world faces.

Put simply, if the threat of climate change is not addressed it will fundamentally undermine the basis on which our economy, businesses and jobs are founded. For the sake of the ordinary savers and pension funds we serve, we must change course now to protect the value of their long-term investments. But this isn't just a story about managing risk. As long-term investors there is significant economic opportunity to be found in the new industries and technologies that are emerging to tackle climate change and to adapt to its impacts.

As part of the efforts to decarbonise our economy and achieve net zero emissions, the investment management industry is setting out fresh commitments on climate change and sustainability. This report sets out those commitments and proposes policy solutions that should be taken by government, supported by industry, to address the systemic risk we face from climate change and embrace the long-term investment opportunities arising from building a more sustainable economy.

WHAT IS COP?

The Conference of the Parties (COP) is an annual international climate change conference that began in 1995. It is attended by over 190 countries that signed the United Nations' landmark climate change treaty: the UN Framework Convention on Climate Change (UNFCCC). The COP meets each year to discuss how best to achieve the aims of the Convention, which includes a framework for how countries can stabilise greenhouse gases.

POLICY COMMITMENTS ON CLIMATE ACTION

OVER THE COURSE OF THE NEXT YEAR, INVESTMENT MANAGERS WILL CONTINUE TO STEP UP THEIR EFFORTS ON CLIMATE CHANGE AND SUSTAINABILITY. THEY TAKE THIS ACTION BECAUSE IT IS IN THE LONG-TERM INTERESTS OF THEIR CLIENTS. CLEARLY, THIS TOPIC ALSO HAS PARTICULAR SIGNIFICANCE IN THE UK IN THE YEAR LEADING UP TO COP26 AND THESE POLICY COMMITMENTS FORM AN IMPORTANT PART OF THE PRIVATE FINANCE SECTOR'S ACTIVITY AHEAD OF THE SUMMIT.

Commitment 1:
Engagement with investee companies on climate-related disclosures

We commit to helping our members to continue to engage with listed companies to improve the quality of their climate-related disclosures and to support companies to make an orderly transition.

Commitment 2:
Working with pension fund clients to help them meet their climate-related disclosure requirements

IA members commit to working with their pension fund clients to help them meet their own climate-related disclosure requirements. This includes helping them find solutions to issues on data quality and consistency, including in relation to standardisation efforts and accessibility of data and information.

Commitment 3: Development of investment managers' TCFD disclosures

The IA will support its members to develop a full set of TCFD disclosures at entity level in the 2021/22 reporting round.

Commitment 4: Support improvement of sustainability-related disclosures at fund-level

The IA is committed to supporting its members to improve their sustainability-related disclosures at fund-level, finding the best way forward for clients at present, considering the practical implications of providing disclosures that are decision-useful to investors, and based on robust investment data:

- **First**, we are developing best practice guidance on how firms should communicate the responsible investment characteristics of products to investors to help investors make better informed sustainable investment, decisions building on the terms set out in the IA Responsible Investment Framework.

- **Second**, we are supporting members with the practical implementation of incoming regulatory requirements, with a particular focus on the EU Sustainable Finance Disclosure Regulation (SFDR). This also includes engaging with UK authorities on the future of sustainable finance rules in the UK.

- **Third**, we are helping our members to develop TCFD disclosures at a portfolio level, including supporting them to overcome current obstacles, in particular, the current lack of data and data quality.

Commitment 5: Link with advanced initiatives to support Disclosure of Paris-Alignment of Portfolios

The IA is convening representatives of initiatives that have progressed work on Paris-alignment methodologies to date to identify where industry can learn from, build on and develop work already undertaken. For example, on 14 July 2020, the IA held a session with representatives from the joint FCA-PRA Climate Financial Risk Forum (CFRF) and the Institutional Investors Group on Climate Change (IIGCC) to understand progress to date and identify opportunity for further work. The IA continues to engage with such groups to express industry views, including in response to the IIGCC's consultation on its net zero Investment Framework. We will be taking this work forward into 2021.

Commitment 6: Supporting the FCA-PRA Climate Financial Risk Forum work

The IA continues to actively support the work of the joint FCA-PRA Climate Financial Risk Forum (CFRF) and is committed to sharing knowledge from the CFRF Handbook through our membership and building on its work to date.

Commitment 7: Support creation of investable opportunities

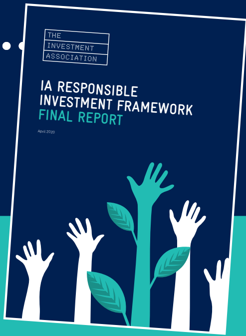
We are committed to working together with UK Government to create the investable opportunities necessary for the transition.

HELPING SAVERS TO CHOOSE SUSTAINABLE AND RESPONSIBLE INVESTMENT

IN THE UK, WE HAVE SEEN A MARKED INCREASE IN DEMAND FROM OUR CLIENTS FOR SUSTAINABLE AND RESPONSIBLE INVESTMENT. IA FIGURES SHOW NET RETAIL SALES TO RESPONSIBLE INVESTMENT FUNDS GREW TO £7.1BN IN THE FIRST NINE MONTHS OF 2020, COMPARED TO £1.9BN IN THE EQUIVALENT PERIOD OF 2019.

Investment managers are playing an important role in improving access to this market for retail investors in the UK – developing new funds and communicating more clearly and consistently with clients to help them choose responsible and sustainable investment products to meet their goals.

The IA is working closely with its members to produce best practice guidance on how to explain clearly and consistently the ways in which funds have different sustainability characteristics that are suitable to different investors.



IA RESPONSIBLE INVESTMENT FRAMEWORK

The IA launched the Responsible Investment Framework in November 2019: the first industry-agreed framework to define investment managers' approaches to responsible investment. Using this framework as a starting point, our goal is to help savers better access opportunities in the sustainable and responsible investment landscape, thanks to clearer common language. In a speech at the IA's Sustainability Conference in September 2020, the Economic Secretary to the Treasury, John Glen MP, welcomed the framework alongside other industry initiatives promoting sustainability.

THE RISE OF RESPONSIBLE INVESTMENT FUNDS IN THE UK

Since the start of this year, we have asked investment managers to identify which of their funds should be classified as having responsible investment characteristics, based on the IA framework. This has helped chart recent growth which has gained momentum during the Covid-19 pandemic. We have seen an 89% increase in responsible investment funds under management from January 2019 to June 2020.

SOCIAL IMPACT INVESTING

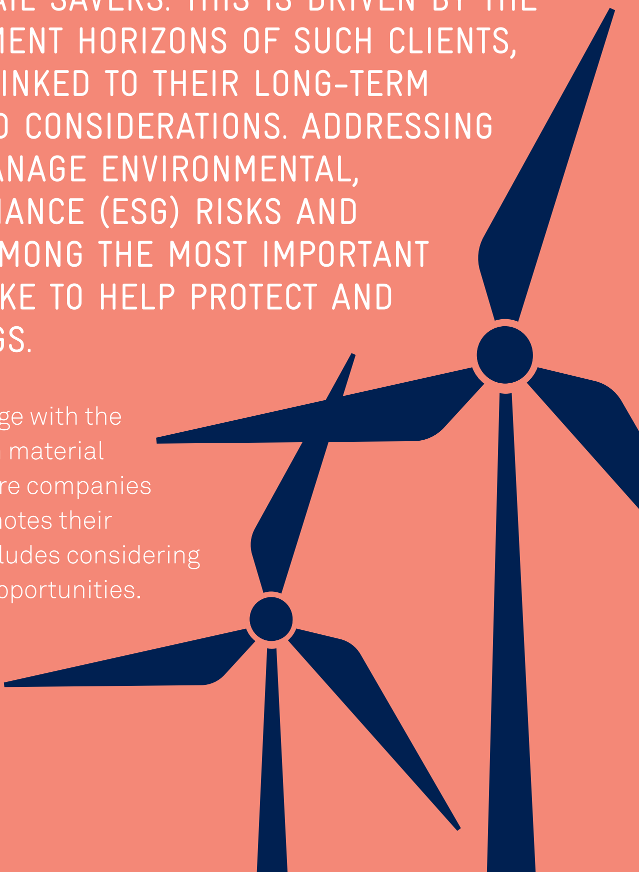
We are also seeing increased interest in social impact investing – clients are wanting to invest their money in ways that solve pressing social or environmental challenges, while generating a financial return. This is likely to be an area of future growth for the UK.

INVESTORS' STEWARDSHIP ROLE: HOLDING BUSINESS TO ACCOUNT ON CLIMATE CHANGE

INVESTMENT MANAGERS WANT COMPANIES TO GENERATE SUSTAINABLE RETURNS FOR THEIR CLIENTS IN THE LONG RUN, INCLUDING FOR PENSION FUNDS, CHARITIES AND RETAIL SAVERS. THIS IS DRIVEN BY THE LONG-TERM INVESTMENT HORIZONS OF SUCH CLIENTS, WHICH IS IN TURN LINKED TO THEIR LONG-TERM SAVINGS' NEEDS AND CONSIDERATIONS. ADDRESSING HOW COMPANIES MANAGE ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) RISKS AND OPPORTUNITIES IS AMONG THE MOST IMPORTANT ACTIONS WE CAN TAKE TO HELP PROTECT AND GROW THESE SAVINGS.

Investment managers engage with the companies they invest in on material ESG issues in order to ensure companies are run in a way which promotes their long-term success. This includes considering climate-related risks and opportunities.

The activities conducted by investment managers to promote the



long-term success of the companies and assets they invest in are collectively known as 'stewardship.' Stewardship can involve:

- Setting out expectations of companies in responsible investment and voting policies
- Researching and monitoring investments to ensure risks and opportunities are being identified
- Engaging with companies to ensure concerns are being addressed
- Collaborating with other investors or making public statements in the media to escalate concerns
- Exercising rights and responsibilities associated with ownership of investment securities, for example voting at annual general meetings (AGMs) of listed companies.

A key focus of investors' stewardship activity on climate change is engaging with companies to support them to adapt and strengthen their business model and strategy to ensure they are prosperous in a decarbonising economy. Investors need clear disclosures from companies to help them to work together.

Climate change presents a huge risk to the long-term value of our clients' assets, and as global investors, we feel keenly the impact of climate change across different geographies. This is why we strongly support renewed action on climate change at 2021's COP Summit. Ahead of COP26, and beyond, investors' stewardship role can play an important part in supporting companies to transition to a low-carbon economy and help build momentum in the UK towards a net zero future.

FOCUS ON TCFD IN THIS YEAR'S AGM SEASON

During the 2020 AGM season, the Investment Association called on FTSE companies to start disclosing against the Task Force for Climate-related Financial Disclosures (TCFD) recommendations, so investors, and all of us, can better understand how companies are managing climate-related risks and hold them to account on this. We know that good data is crucial to inform our investment decisions and protect clients' returns. This call saw a doubling in the number of FTSE100 companies making disclosures in line with TCFD between 2019 and 2020. But there is still more work to do to ensure these disclosures demonstrate how companies are managing their strategy in response to the impact of climate change.

ASSET MANAGEMENT TASKFORCE REPORT ON STRENGTHENING STEWARDSHIP IN THE UK

In 2019, John Glen MP, the Economic Secretary to the Treasury asked the Asset Management Taskforce which he chairs to establish a stewardship working group and stakeholder working group to make proposals for how stewardship and responsible investment could be strengthened in the UK. This report, which was published in November 2020, sets out recommendations to improve stewardship and ensure that the UK maintains and enhances its position as a centre for excellence in stewardship globally.

THE ROLE OF GLOBAL INVESTOR COALITIONS: CLIMATE ACTION 100+ AND IIGCC

Global investor initiatives and coalitions have become increasingly important in helping combat the threat posed by climate change. Climate Action 100+ and the Institutional Investors Group on Climate Change (IIGCC) are global initiatives comprised of hundreds of investors, engaging with companies to improve climate-related disclosure and align business strategy with the Paris Agreement goals.

WORKING TOGETHER TO MAKE A SUCCESS OF COP26

THE INVESTMENT MANAGEMENT INDUSTRY LOOKS FORWARD TO CONTINUING TO WORK WITH POLICYMAKERS ACROSS ALL PARTIES TO ADDRESS THE SERIOUS CHALLENGE WE FACE IN CLIMATE CHANGE.

This work includes proposing new policy solutions that can be taken forward by government, with the close support of industry. We welcome the close cooperation to date, including by way of the Asset Management Taskforce chaired by the Economic Secretary to the Treasury, John Glen MP, and its work on stewardship.

The Government needs to set out, as soon as it is able to, clear, long-term signals and guidance on the nature and speed of the UK's transition to net zero, including the sector-specific actions that will be necessary. The industry is keen to work with policymakers to identify clear pathways to transition for different sectors of the economy and help tackle the gaps between the intention and delivery of the Paris Agreement goals.

This will enable investment managers to factor climate transition risks more accurately into their investment decisions for the long-term benefit of our customers. It will also help support our role as stewards to support companies to make the capital allocation decisions they need to transition.

Action today by government will help minimise potential financial stability risks arising from stranded assets and cliff-edge policy decisions at a later date.

Policy solutions proposed by the investment management industry

UK GOVERNMENT TO FACILITATE SECTOR-SPECIFIC PATHWAYS TO TRANSITION

We ask to work together with UK Government to ensure the requisite policy interventions are brought in to facilitate the transition to net zero for the following sectors:

- Heating and cooling buildings
- Carbon capture and storage
- Electric vehicles
- Low-carbon power
- Land use
- Heavy goods vehicles
- Removal of Fossil Fuel Subsidies

TCFD REPORTING BY LARGE PRIVATE COMPANIES

Large private companies should be required to report in line with TCFD and the UK Government should amend company law to require all large UK incorporated companies (public and private) to report in line with TCFD. We welcome the Government's recent efforts to set out a roadmap to ensure mandatory reporting right across the investment chain by 2025.

GREEN GILTS

We welcome the UK Government's announcement that it will issue its first sovereign green bond in 2021, subject to market conditions. We ask that the Government make good on this intention and stand ready to assist to help see this plan to fruition. The issuing of a sovereign instrument that attracts private sector capital into green recovery and growth will be an important signal and, crucially, will demonstrate the UK Government's commitment to its 2050 net zero target, clean growth and a green economy.

SECTOR-SPECIFIC PATHWAYS TO NET ZERO

THE COMMITTEE ON CLIMATE CHANGE'S (CCC) NET ZERO REPORT OF MAY 2019 SETS OUT SPECIFIC POLICIES THAT ARE REQUIRED TO ADDRESS "KEY AREAS OF EMISSIONS ACROSS THE [UK] ECONOMY". ACCORDING TO THE CCC, THESE POLICY INTERVENTIONS ARE A "PRE-CONDITION" OF ACHIEVING NET ZERO BY 2050.

Below is a list of recommended actions that we put forward as a matter of priority, drawing on the recommendations from the May 2019 CCC Report.

Heating and cooling buildings

UK Government should continue to develop the nationwide insulation programme to lead to a full decarbonisation of buildings by 2050. In this context, we would also draw the Government's attention to the importance of the work of the Green Finance Institute's Coalition for the Energy Efficiency of Buildings (CEEB). Their report from May 2020 sets out financial solutions to scale up retrofitting of buildings. Moreover, current new build regulations and industry standards should be improved to align with net zero.

Carbon capture and storage (CCS)

UK Government should take a lead on infrastructure development, with long-term contracts to reward carbon capture plants and encourage investment.

Electric vehicles

UK Government must continue to support strengthening of the charging infrastructure, including for drivers without access to off-street parking. By 2035 at the latest, all new cars and vans should be electric (or use a low carbon alternative such as hydrogen).

Low-carbon power

We must continue to expand rapidly the supply of low-carbon power. Despite existing successes to date with, for example, wind power, UK government intervention may still be needed, for example, by backing long-term contracts aligned to expected wholesale prices. Policy and regulatory frameworks should also encourage flexibility (e.g. demand response, storage and interconnection).

Land use

Forest cover should increase from 13% of UK land to at least 17% by 2050. With the UK having one of the lowest forest cover percentages in Europe, we would encourage the UK to be even more ambitious in its targets. Policy must also support land managers with skills, training and information.

Heavy Goods Vehicles (HGVs)

Vehicle and fuel taxation from the 2020s onwards should be designed to incentivise commercial operators to purchase and operate zero-emission HGVs.

Removal of Fossil Fuel Subsidies

Finally, we would urge the UK Government to use its G7 presidency to renew the commitment to phase out fossil fuel subsidies. Removal of subsidies to the oil sector is vital, in particular, for export financing. Initiatives like the Overseas Development Institute (ODI) G7 fossil fuel subsidy scorecard can provide a helpful tool to track progress.

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