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PRI Principles for Responsible Investment

UN-Convened Net-Zero Asset Owner Alliance

# Elevating Asset Manager Net-Zero Engagement Strategies

## A foundation for asset owner expectations of asset managers

November 2023

# Antitrust and regulatory disclaimer

The Net-Zero Asset Owner Alliance (the Alliance) and its members are committed to comply with all laws and regulations that apply to them. This includes, amongst others, antitrust and other regulatory laws and regulations and the restrictions on information exchange and other collaborative engagement they impose.

For the avoidance of doubt, the content set out within this paper do not constitute advice to members of the Alliance. This paper is not prescriptive as to actions or decisions to be taken by members—the Alliance's members set individual targets and make their own unilateral decisions. As such, the Alliance takes no liability for actions or decisions taken by members when applying the principles of this paper.

# Introduction

Members of the UN-Convened Net-Zero Asset Owner Alliance ("the Alliance") have committed to transitioning their investment portfolios to net zero greenhouse gas (GHG) emissions by 2050, aligned with 1.5°C pathways[1] and focused on real-economy outcomes.[2] A key element of this commitment includes "advocating for, and engaging on, corporate and industry action" to deliver "a low-carbon transition of economic sectors in line with science."[3]

Engagement is a key mechanism for investors seeking to mitigate systemic climate risks and working towards net zero emissions in the real economy.[4] Alliance members explored how a systemic perspective could be incorporated into their engagements through the foundational discussion paper, The Future of Investor Engagement: A call for systematic stewardship to address systemic climate risk. The paper argues that bilateral corporate engagement—a common form of investor engagement best deployed to address idiosyncratic risks—should be complemented by other, more systemic forms of engagement like value chain, policy, and asset manager engagement.

The asset owners' relationship to their asset managers presents an important strategic focus for those asset owners seeking to strengthen management of climate risk in their investment portfolios. Asset managers are well positioned to conduct effective engagement at scale, while asset owners can provide complementary oversight, accountability, insights from beneficiaries, and desired practices for the management of their portfolios. **For Alliance members, it is critical that their long-term interests are consistently represented by their asset managers. For this to be the case, asset managers must adopt a consistent, transparent, and outcomes-oriented climate engagement strategy, which recognises that climate change poses systemic risks to asset owner portfolio returns. This alignment of engagement outcomes to portfolio management and stewardship decisions is critical for asset managers' continued ability to win mandates of clients committed to net zero.**

1 The Alliance seeks to align with science-based scenario pathways, such as those generating from the work of the Intergovernmental Panel on Climate Change (2023): ipcc.ch/sr15/.

2 The Alliance's Commitment is made with the expectation that governments will follow through on their own commitments under the Paris Agreement.

3 The Alliance's Commitment Document for Participating Asset Owners (2022): unepfi.org/wordpress/wp-content/uploads/2022/07/AOA-COMMITMENT-DOC-2022.pdf.

4 The role of investors to engage to avoid the adverse impacts of climate change on beneficiaries is echoed in international frameworks, including the 2023 OECD Guidelines: mneguidelines.oecd.org/mneguidelines/ and the Alliance's Target Setting Protocol: unepfi.org/industries/target-setting-protocol-third-edition/.

For a robust understanding of the Alliance's view on the topic, this document should be read in conjunction with two complementary discussion papers, Elevating Climate Diligence on Proxy Voting Approaches, and Aligning Climate Policy Engagement with Net-Zero Commitments. Both of these papers elevate stewardship practices that are relevant and related to the principles set forth in this document.[5] The principles, transparency requests, and best practices outlined in this document are applicable to all asset managers investing in public and private asset classes across different markets.[6] This includes asset managers operating in private markets as highlighted by the Alliance Call to Action to Private Market Asset Managers.

The Alliance already requests that all asset managers make their own independent net-zero commitments.[7] However, regardless of an asset manager's net-zero commitments, the principles, requests, and practices outlined in this document are applicable to all of the Alliance members' asset managers. Furthermore, the asset managers that represent the Alliance members' portfolios—and are therefore responsible for addressing climate risk and opportunities on members' behalf—should align their climate engagement programs with the Alliance's net-zero ambitions.

In turn, Alliance members should use the principles, requests and practices set out in this document to inform their selection, appointment, and monitoring (SAM) processes, including by making them an explicit expectation within the investment mandate for asset managers. Due diligence practices conducted in the selection of asset managers offer a key opportunity for asset owners to transmit their climate expectations to asset managers.

The goal of this document is to deepen confidence, transparency, and authenticity in the climate engagement dialogue between asset owners and asset managers. In addition, this document aims to enable both owners and managers towards allocating their resources efficiently, so as to 'work smarter, not harder'. This means focusing, systematically, both on common stewardship expectations and on the most value-added outputs of asset managers' engagement programs.

5 Some key external resources that provide guidance on building a successful investor engagement program and that were referenced in the creation of this document include The Institutional Investors Group on Climate Change (IIGCC)'s Net-Zero Stewardship Toolkit (iigcc.org/resources/net-zero-stewardship-toolkit), the UK Stewardship Code (frc.org.uk/investors/uk-stewardship-code), and the PRI's Active Ownership 2.0 (unpri.org/investment-tools/stewardship/active-ownership-20).

6 The Alliance also notes the "common but differentiated responsibilities", recognised under the Paris Agreement, as a key principle that investors should continue integrating into their engagement practices.

7 The Alliance's Target Setting Protocol (2023, p.20): unepfi.org/industries/target-setting-protocol-third-edition/.

# Defining climate engagement

Investors have a range of interactions with companies, issuers, and other stakeholders as part of their investment and stewardship processes. There are various purposes for these interactions, including exchanging information, building relationships, sharing insights, and influencing and/or collaborating. In some cases, asset managers may have board seats or observing rights that give them access to strategic discussions. While all these interactions are essential elements of active ownership and stewardship, including those focused on information gathering and monitoring, not all of them are directly relevant to the analysis of asset managers' climate engagement strategies.

For the purposes of this document, climate engagement with issuers is defined as meeting the two key criteria listed below. This definition is intended to guide investor activity towards the Alliance's commitment to support the net-zero transition and aligns with the definition of engagement as active dialogue, put forward by the Investor Forum.[8]

1. **Climate risk and/or opportunity is raised with an issuer.**
Climate engagement consists both of raising climate risks and/or opportunities that an investor has identified through a process driven approach (such as scoring, thematic research, or consideration of portfolio- and economy-wide impact) and of providing the investor's description of why it is important that the issuer addresses the specified topic.
2. **Investor sets expectations for issuer action.**
All climate engagements—including with individual issuers, policymakers, or industry bodies—should have clear and well-defined objectives linked to public accountability frameworks, standards, or equivalent to ensure rigor and transparency.

The Alliance encourages investors to expand the constructive dialogue on their engagement programs by discussing not only their successes, but also the limitations and challenges they encounter. Furthering the identification of these barriers can help move engagement practices forward and support the finance industry to accelerate decarbonisation.

8 The Investor Forum (2019, p.1): "Engagement is active dialogue with a specific and targeted objective. It is intended to put the stewardship role into effect. The underlying aim of the engagement dialogue should always be to preserve and enhance the value of assets on behalf of beneficiaries and clients." Read more here: investorforum.org.uk/wp-content/uploads/securepdfs/2019/04/Defining-Stewardship-Engagement-April-2019.pdf.

# Principles for asset managers' climate engagement

## 1. Governance and integration

**Key principle**

Asset managers should put in place governance and oversight structures that ensure engagement activities are integrated across their businesses in a manner that supports their broader climate engagement strategies.

Strong governance and integration of engagement across an asset manager's business help ensure three key outcomes: 1) activities are consistent across the business so that all asset manager representatives consistently reflect the asset managers stated ambition, 2) all relevant stakeholders at the firm have clarity on how to make use of and apply the outcomes of climate engagement activities in their roles, and 3) the asset manager's broader climate strategy is supported by engagement strategy feeding into all other business activities.

To meet this level of governance and integration, asset managers should undertake the activities 1-3 listed below.

1. Demonstrate documented standards to ensure consistency of messaging, ambition, and reasoning for action across stewardship, portfolio management, and executive management teams. The documented standards should include:
   a. Core principles of climate engagement;
   b. Sector-based expectations of issuer action and transition planning (for further detail, please see the following section);
   c. A process to integrate climate considerations into investment processes, including in private markets (e.g., through due diligence, 100-day plans and exit plans, and management compensation);
   d. Merit-based proxy voting policies (for listed equity) that incorporate key principles of engagement and set clear criteria for evaluating resolutions and director votes.

2. Show how climate engagement outcomes are communicated and integrated across teams and functions, including:
   a. Ensuring that information is shared, at a minimum, with management teams and teams responsible for investment decisions and portfolio management, proxy voting, public affairs, and marketing;
   b. Ensuring consistency in messaging and practices used with issuers across different teams.

3. Adopt governance structures that ensure clear accountability for the oversight, implementation and verification of engagement activities, through:
   a. At a minimum, an annual process with an executive or board-level committee that involves:
      i. Setting and reviewing an asset manager's engagement strategy (including decisions on engagement prioritisation, channels chosen, and escalation approaches), and
      ii. Ensuring the quality of the engagements conducted and that these deliver value in line with the asset manager's expectations and ambitions;
   b. Where possible, internal or external verification, or assurance on engagement processes and standards.[9]

9 This could be conducted by internal compliance teams or external audit services.

# 2. Setting and publishing a climate engagement strategy

**Key principle**

Asset managers should publish their vision and strategy for climate engagement. This vision should include their investment beliefs related to climate change, how climate engagement contributes to their overall climate strategies, their time-bound expectations for issuers, and plan of action for when issuers do not meet expectations within the set time frame.

The Alliance recognises that many asset managers already publish their climate stewardship policies and engagement priorities. The details provided should allow asset managers to articulate what outcomes they are targeting with a focus on quality over quantity of engagements. The climate engagement strategy should also give enough information to allow asset owners to assess whether an asset manager's climate approach and climate engagement activities are aligned with their own expectations and long-term interests. Recognising that engagement strategy may differ by investment mandate, asset managers are encouraged to differentiate between climate engagement approaches pursued at a firm-level and the approaches that are strategy or mandate specific.

Asset managers' climate engagement strategies should deliver on the points 1–4 listed below.

1. Describe how climate engagement fits into broader climate risk management approaches and investment portfolio activities, by including:
   - **a.** An asset manager's climate investment views, including which climate scenarios the manager considers most likely and key risks and opportunities associated with key scenarios considered;
   - **b.** A list of assumptions relating to factors like temperature outcomes, fossil fuel demand, carbon-pricing, and sectoral transition pathways;
   - **c.** An explanation of how climate engagements and outcomes have influenced investment and/or portfolio management decision-making.

2. Illustrate how climate engagements are planned, by indicating:
   - **a.** Targeted outcomes for climate engagement, as well as long- and short-term goals within the associated timeframes;
   - **b.** Selected and preferred methods, depending on circumstances, including prioritisation of efforts between collaborative versus direct engagement;
   - **c.** Perceived challenges of achieving engagement outcomes and/or limitations of engagement, along with an approach on addressing such challenges;
   - **d.** The circumstances that may require additional forms of engagement, such as sector/value chain engagement and policy engagement;
   - **e.** Plans to maximise effectiveness and ensure climate alignment for mandates where the asset manager seeks board seats or other forms of substantive governance responsibility.

3. Set sector-based expectations for companies' and issuers' climate action. Expectations should make use of public standards or benchmarks, including:
   a. Climate-risk disclosure, ideally with reference to widely accepted standards such as the Task Force on Climate-Related Financial Disclosures (TCFD) as a starting point and/or the International Sustainability Standards Board (ISSB);
   b. Emissions reduction action, adapted to the realities of different sectors and geographies, and based on public third-party frameworks, such as the Transition Pathway Initiative, Science Based Targets initiative, Climate Action 100+ Net Zero Company Benchmark, the Global Net Zero Standards for Oil and Gas,[10] and Responsible Climate Lobbying: The Global Standard;[11]
   c. A clear description of how the credibility of transition plans and/or targets are assessed, including baseline requirements for a transition plan, making use of transition plan guidance such as the Institutional Investors Group on Climate Change (IIGCC)'s Investor Expectations of Corporate Transition Plans: From A to Zero[12] and We Mean Business's guidance on Climate Transition Action Plans.[13]

4. Clear accountability and escalation frameworks should include the points listed below.
   a. For the cases where an issuer does not meet climate expectations in set timeframes, asset managers should outline a toolkit of actions, which could include investment decision-making, execution of covenants or other terms previously negotiated, collaborative engagement, proxy voting, sharing or publishing vote rationales, filing shareholder resolutions, public statements, and management and/or director accountability
   b. Asset managers should also include a description of how their accountability and escalation framework considers the context of the issuer. This should include analysis on whether the bounds of engagement have been met[14] and the context in which the asset manager would shift its approach to take actions at a more systemic level to support the creation of the enabling environment for the issuer's decarbonisation.

10 IIGCC (2023) Net Zero Standard for Oil & Gas: iigcc.org/resources/net-zero-standard-for-oil-gas.
11 climate-lobbying.com/.
12 IIGCC (2023): iigcc.org/resources/investor-expectations-of-corporate-transition-plans-from-a-to-zero.
13 We Mean Business (2022): wemeanbusinesscoalition.org/wp-content/uploads/2022/10/WMBC-Climate-Transition-Action-Plans.pdf.
14 The Net-Zero Asset Owner Alliance (2022, p4) The Future of Engagement: unepfi.org/wordpress/wp-content/uploads/2022/03/NZAOA_The-future-of-investor-engagement.pdf.

# 3. Climate engagement practices

**Key principle**
Climate engagement practices should reflect asset managers' individual, published climate engagement strategies.

The effectiveness of an asset manager's climate engagement strategy is contingent upon the strategy's implementation; thus, asset owners have an interest in this process. The implementation process refers to how an asset manager resources and tracks climate engagements, drives internal alignment, and identifies and shares knowledge relating to the nuance and hurdles of climate engagements. This focus on implementation should help asset managers further develop their climate engagement strategies.

To ensure a published climate engagement strategy is congruent with investment and stewardship practices, asset managers should undertake actions 1–3 listed below.

1. Outline how climate engagement efforts are prioritised across the firm and between teams, including:
   a. How resources are allocated to climate engagements;
   b. How and why priority issuers are selected for engagement.

2. Demonstrate how their internal tracking systems enable sharing of climate engagement insights and actions across teams and portfolio management activities. These systems should include:
   a. Engagement objectives;
   b. Engagement progress;
   c. Escalation triggers and actions;
   d. Ability to support reporting and disclosure tailored to client portfolios.

3. Consider regularly publishing engagement memos or research papers to highlight progress, practical expertise, and knowledge acquired from conducting climate engagements. This could include:
   a. Insights into systemic hurdles to climate action, encountered across multiple issuers within a sector, and reflections on how to alleviate or overcome said hurdles;
   b. Best practices on how to effectively conduct climate engagement in different sectors, geographies and markets;
   c. Examples of tangible company progress made following a climate engagement.

# 4. Transparency and accountability on climate engagement

**Key principle**

Asset managers should make appropriate disclosures relating to their climate engagement strategy implementation. These disclosures should both enable asset owners to assess alignment and foster transparency and learning across the market on the effectiveness of climate engagements.

Appropriate disclosures of non-confidential information assist assets owners in assessing effectiveness of asset manager engagement including the level of ambition, the consistency of requests or expectations set with companies and issuers, and the alignment with asset owners' long-term interests. Timely disclosure and transparency to clients, including reporting that is specific to client portfolios, is necessary for asset owners to understand and compare asset managers' climate engagement strategy and practices. Transparency helps asset managers demonstrate progress, evidence escalation, and contextualise challenges and other forms of climate engagement. Asset managers should also evolve client reporting to include reasons why the net-zero engagement was or was not successful.

Timely reporting and transparency on climate engagement activities and outcomes should be tailored to client portfolios where possible, and include points 1–3 below.

**1.** Timely transparency (to clients at a minimum and potentially broader public) on engagement objectives set and progress against these within the reporting period, covering:
   - **a.** How the asset manager's assessment of climate-related risks in investment portfolios, including portfolio alignment measurement, links to the set objectives;[15]
   - **b.** Outcomes achieved, including escalation and investment decisions;
   - **c.** Differentiation between issuer interactions for i) information gathering, and ii) outcome-focused climate engagement per the definition set out under the section Defining climate engagement above;
   - **d.** Details on climate engagements that did not achieve desired outcomes, including: challenges faced, lessons learned, and changes made to the asset manager's overall engagement strategy as a result;
   - **e.** Description of where the effectiveness of climate engagement with companies, issuers or sectors is decreasing.[16]

15 Such as the Glasgow Financial Alliance for Net Zero (GFANZ)'s Portfolio Alignment Measurement Report (2022): assets.bbhub.io/company/sites/63/2022/07/GFANZ-Portfolio-Alignment-Measurement-August2022.pdf.

16 For example, if there are currently no plausible pathways, business cases or incentives to support the issuer's decarbonisation under existing economic frameworks as discussed in the Future of Investor Engagement paper.

2. Transparency to the broader public relating to asset managers' messaging to issuers. This should include:
   a. Public disclosure of how climate expectations set in an asset manager's strategy have been communicated to issuers and reflected in engagements;
   b. An explanation for any instance where the asset manager does not deem it possible or productive to disclose their messaging publicly.

3. Transparency to the market on the actions asset managers have taken to address the systemic hurdles to net-zero pathways that cannot be addressed solely through corporate engagement, such as expanding beyond issuer engagement (into e.g., policy or sector engagement).

# Conclusion

Investor engagement has played a significant role in driving net-zero commitments among companies and issuers. To move these commitments to action, all investors must transparently share their expectations of issuers and, importantly, their successes and lessons learned from engagement. This is vital to the relationship between asset owners and asset managers. Clearly articulating engagement priorities within the context of a broader climate risk strategy helps asset owners understand how their long-term interests are being integrated into asset managers' activities. Alliance members believe it serves their long-term interests to have stewardship resources focused on outcomes. This includes sharing lessons learned with the market on how to better support real-economy decarbonisation.

The Alliance recognises that the world is not yet on track for a 1.5°C future and that the challenges associated with alignment vary by region and sector. Therefore, asset managers should be explicit and transparent about their expectations of stakeholders. This includes indicating where they see the opportunities to close the gaps between ambition and implementation at the company, issuer, sectoral, and policy level.

The Alliance encourages all asset owners committed to net zero to consider incorporating the four principles contained within this document into their RFPs, due diligences, and ongoing SAM processes—as a way to support their asset managers.

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unepfi.org/net-zero-alliance/