UN-convened Net-Zero
Asset Owner Alliance

Addressing Climate Impacts

An overview of NZAOA asset owners' long-term interests and responsibilities

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In partnership with:

Antitrust and regulatory disclaimer

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Glossary

- **Idiosyncratic risk:** An event or shock that affects only one or a few assets and is not directly correlated with other events.
- **System-level risk:** Non-diversifiable risks that are comprised of either systematic risks and/or systemic risks.
- **Systematic risk:** Risks that are inherent in the market, sometimes also referred to as 'market risk' or 'non-diversifiable risk'. It cannot be avoided, hedged, or diversified away from as it affects the entire market. Examples include inflation, economic cycles, and sweeping policy changes, as well as widespread, increasingly frequent, severe, and unpredictable natural disasters due to a changing climate.
- **Systemic risk:** Risk associated with the breakdown of an entire system rather than simply the failure of individual parts. In a financial context, it denotes the risk of a cascading failure in the financial sector caused by linkages within the financial system, which results in a severe economic downturn.
- **Climate risk:** Denotes both physical and transition-related risks. It is used when discussing the overarching risks generated by climate change, including general disruption of business operations and infrastructure or unpredictability of future economic activity.
- **Asset manager:** The partner whom an asset owner relies upon to allocate capital. This could be an internal function, as with large asset owners that have brought management of public markets in-house, or it could refer to an external third-party asset manager. Unless explicitly differentiated, the term is used to cover both categories.

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Executive summary

This paper articulates why addressing climate change, and the mitigation of global warming, aligns with asset owners' long-term economic interests and responsibilities to generate long-term and dependable returns. It also explains why, by extension, managing climate risk falls within the fiduciary duty of asset managers working on their behalf. The commitment of United Nations-convened Net-Zero Asset Owner Alliance (NZAOA) is grounded in scientific evidence that shows climate change will impact nearly every aspect of society and the global economy. These effects are projected not only to be significant, but to grow cumulatively more serious with increases in planetary temperature.

Climate change presents unprecedented system-level risks that cannot be fully diversified away, threatening the foundation of financial markets and capitalism itself. At the same time there is a unique opportunity to benefit from the unprecedented investment needs created by technological and economy wide changes. This paper establishes that pursuing net-zero aligned portfolios by 2050—consistent with scientific consensus regarding the emissions reductions needed to avert the worst impacts of climate change—represents prudent risk and opportunity management.

Part 1 of this paper includes the following three key points:

1. The world economy is on the cusp of unprecedented rates of environmental, economic, and technological change that pose system-level risks; without mitigating action, these risks will rapidly accelerate.
2. Asset owners cannot diversify away from system-level risks; moreover, tipping points cannot be reliably forecasted or timed. Therefore,
3. Supporting efforts to mitigate climate change is in the long-term interest of asset owners to ensure continued economic growth and resilience of their portfolios.

These three key points are used to underline the imperative for asset owners to address climate risks and opportunities at executive strategic levels. This involves comprehensively considering such risks and opportunities in firm strategy and integrating efforts across functions. As critical strategic partners, asset managers also have a responsibility to represent their clients' long-term interests regarding resilient modern portfolio management, taking into account new markets and opportunities while considering climate change mitigation consistently across their activities.

Part 2 of this paper details how asset owner long-term interests cascade from their own organizational approach to the duties and interactions with their stakeholders. Asset owners and asset managers often have natural incentives to focus on different time-horizons, risks, performance needs, and scopes of influence. Mandates are a useful means of ensuring better alignment between respective interests. Asset owners must clearly define their interests in ways that are communicable to asset managers. Asset managers should then work to understand their clients' interests and compete to offer products and services best suited to asset owner interests.

Beyond direct investment activities, NZAOA recognizes that the transition requires action from a broad group of stakeholders. This includes engaging directly with governments and regulators to address policy uncertainty and to help support effective climate policies that make more resilient and well-functioning markets. Asset owners can also conduct sovereign assessment by analysing governments' climate approaches as a factor in debt attractiveness, for example, and subsequently call for greater clarity in national climate pathways, where needed. Additionally, blended finance mechanisms can help mobilize private capital towards developing markets and emerging technologies that often lack the necessary funding to realize their full capabilities.

Introduction

Recognizing both the severity of climate risks and the many profitable opportunities of investing in the net-zero transition prompted many of the world's largest asset owners to join Net-Zero Asset Owner Alliance (NZAOA). In doing so, asset owners of NZAOA independently pledged to transition their investment portfolios to net zero greenhouse gas (GHG) emissions by 2050. This commitment puts them in line with the Paris Agreement's more ambitious goal to limit the temperature increase to 1.5°C above pre-industrial levels, a target to which asset owners of NZAOA expect governments to similarly adhere. In forming this, participating asset owners publicly acknowledged their shared views that minimizing transition risks and the physical impacts of climate change was and continues to be strongly aligned with their long-term economic interests and investment performance of their portfolios.

As the negative impacts of climate change continue to grow, the view of NZAOA aligns with broad-based finding of a range of other expert reviews, including the Principles for Responsible Investment's (PRI)'s Inevitable Policy Response; namely, public pressure will eventually prompt a rapid acceleration of the policy response to address GHG emissions (PRI 2023). The earlier this occurs, the more orderly the transition can be and the more effectively capital can flow to where it is most economically advantageous over the long term. In contrast, the later this policy response occurs, the more disruptive and value-destroying the transition is likely to be and the higher the embedded physical climate risks.

A gap persists between how asset owners of NZAOA and other like-minded asset owners view net zero, on the one hand, and how other stakeholders within the economic system see it, on the other. The purpose of this paper is to more explicitly detail asset owner interests as collected from asset owners of NZAOA.

Part 1 of this paper starts by laying out the rationale of asset owners of NZAOA for addressing climate change. This is underpinned by two fundamental positions: first, the need to head off the systemic risks that climate change poses to financial markets, and; second, the importance of curbing the systematic risks from climate change that threaten the broader global economy on which asset owners' portfolios and businesses rely (together termed 'system level risks'). In Part 2 this paper explains how addressing climate change is in line with asset owners' long-term interests, and, therefore, also part of the fiduciary duty of asset managers. Finally, Part 2 concludes by exploring ways to exchange with other important stakeholders in the act of field building. It does so in the belief that this can advance the discourse on real-economy regulation and policy, business practices, and societal actions to address the underlying drivers of climate change.

Part 1:
Why climate risk matters to asset owners' businesses

Nearly every aspect of society and the global economy is already feeling the impacts of climate change, with the scientific consensus indicating that these impacts will increase in the future. Climate change impacts refer to the materialization of physical and transition risks resultant from a warming planet. These impacts are prompting actions to mitigate the underlying drivers of this warming. **For investors, the impacts of climate change pose serious risks to the underlying performance of portfolio assets and to broader financial market stability.** For asset owners specifically, these impacts (hereby referred to as 'climate risks') threaten their ability to secure the long-term, consistent returns on which their stakeholders depend. For some asset owners of NZAOA—most notably insurers— this places their underlying core businesses in potential jeopardy. In addition addressing climate change also presents an extraordinary opportunity for the rapid deployment of capital to build future-proofed economies at an unprecedented scale (WEF 2024). Below we outline further the nature of these long-term interests and the key implications for asset owners and their asset manager partners.

Outlining NZAOA's long-term perspective

There is a disclaimer given at the beginning of almost any investment presentation; "Past performance is not indicative of future results". While this statement is easily overlooked, it is relevant to present-day discussions about system-level risks created by climate change. The future of our climate is going to look very different than the recent past. Indeed, by all accounts, it appears that portfolio risks from climate change will be higher than previously understood or expected.

By "future", however, what time frame is meant? To answer that question, **consider a new customer or pensioner entering the workforce in 2025: he or she is set to retire after 2065, and could be alive in the next century.** Within this time-horizon, asset owners of NZAOA have the responsibility to consider the short-, medium-, and long-term positioning of their portfolios and the economy that sustains it. A future-looking scenario analysis can prompt scepticism about the practicality (or even the possibility) of achieving net zero GHG emissions by 2050. This is understandable: both the breadth and scale of the challenge are unprecedented. Thus, a reasonable question arises: does an asset owner's commitment to net zero align with its responsibilities?

As a starting point in response, NZAOA reinforces the scientific community's call for limiting warming to 1.5°C as a necessity to mitigate the most severe climate change impacts. Further, there can be tensions between the rapid and large-scale changes needed to reach net zero, on the one hand, and the current trajectory of the economy, on the other hand. By setting their portfolios on course for net zero, coupled with a strong engagement approach, asset owners of NZAOA lower their transition risk and demonstrate support for the mitigation of physical risks in the real economy. They also provide incentives to those handling their assets to proactively seek out and shape opportunities created by a decarbonizing world. These actions are taken with the assertion that asset owner portfolios that are on track for net zero by 2050 remain well-prepared for the variety of economic and climate trajectories that could come.

The economy of the future will look drastically different from the economy of the past. Directionally, the economy will continue to accelerate its decarbonization as low carbon energy becomes increasingly cheaper and thus move towards reaching net zero well within the relevant time-horizons of asset owners' investments. Despite this, climate transition risks will differ depending on the speed at which the economy moves and will still be accompanied by physical risks whose impacts continue to grow.

Insurers are already grappling with physical climate risks. The business cases for offering risk coverage in entire regions are worsening due, in part, to the rising cost of more frequent and unpredictable weather events, such as intense floods, droughts, fires, and storms (Krauss 2024; Gupta & Venkataraman 2024; FT 2024). Swiss Re notes that the insurance industry faces the prospect of substantial near-term losses:

> **"Global insurance losses from natural catastrophes continue to follow the 5-7% annual growth rate (in real terms) that has been the norm of recent years. If the trend holds, insured losses will approach USD 145 billion in 2025."**
>
> **Swiss Re 2025**

This is not just bad for insurers; it is bad for capitalism, national economies, and society at large. If the fundamental ability to insure risk and protect against losses in the real economy is compromised, a foundational pilar of capitalism begins to crumble. As Günther Thallinger, Allianz SE Board Member and former Chair of NZAOA, states:

> **"[climate change] is a systemic risk that threatens the very foundation of the financial sector. If insurance is no longer available, other financial services become unavailable too. The economic value of entire regions—coastal, arid, wildfire-prone—will begin to vanish from the financial ledgers... Markets will reprice, rapidly and brutally."**
>
> **FT 2025**

By contrast, as the global economy moves towards decarbonisation, asset owners have the opportunity to diversify and increase the resilience of their portfolios by investing in a multitude of profitable emerging opportunities from clean energy, transportation, sustainable materials, carbon capture solutions etc.

Uncertainty about the future is inherent to all aspects of investing. The lack of certainty around exactly when climate risks and opportunities will manifest should not preclude investors from taking action today. The 20-year capital market assumptions (CMA) and the Monte-Carlo model of asset allocation studies are examples of how investors use tools to project into the future amidst uncertainty. Reasonable investors do not consider a 20-year CMA as invalid or useless when results do not align exactly. Instead, it is seen as a useful reference point for those seeking to understand the ever-changing risks and opportunities of the future.

Investors should apply similar reasoning to net zero. It is not possible to predict with precise certainty when the global economy will achieve net zero. Even so, NZAOA maintains with a high degree of confidence that the economy will continue to decarbonize and adapt to increasing climate risks. Addressing climate risks and opportunities thoughtfully and aggressively is more prudent than understating or disregarding climate risks' existence.

Key points on asset owners' long-term interests and fiduciary duty

There is no universal legal definition of fiduciary duty. Each jurisdiction defines and interprets the concept differently depending on its legal system and each investor is independently responsible for aligning within their own context. For this paper, fiduciary duties (or equivalent obligations) are understood to exist to ensure that those who manage other people's money act in their beneficiaries' interests rather than their own. These duties, in many jurisdictions, are grounded in principles of prudence and loyalty: i.e. prudence in managing long-term risks and opportunities, and loyalty in serving the best interests of asset owner key stakeholders, including shareholders, customers, and beneficiaries. NZAOA views the pursuit of a Paris Agreement-aligned future as an important element of fulfilling these duties to represent asset owners' interests.

This view is supported by robust research. In the report, *Legal Framework for Impact* (Freshfields 2021), the international law firm Freshfields establishes that **investors can—and often should—consider climate change within their fiduciary duties**. Freshfields found that consideration of financially material system-level risks is consistent with fiduciary duties in all 11 jurisdictions studied.[1] The Net Zero Lawyers Alliance (NZLA) complements this finding, arguing that "maximizing financial returns on investment means actively pursuing climate mitigation and ensuring that investee companies and public authorities do so, too" (NZLA 2024). Another recent example comes from the International Court of Justice (ICJ). The ICJ confirmed that nation states have an obligation to prevent significant harm to the climate under international law (ICJ 2025). Each of these examples indicate that there is an increasingly robust legal argument for the need to take action to mitigate climate change. Accordingly, preparing portfolios to mitigate climate risk and capture opportunities is prudent investment management and avoids litigation risk for inaction.

Investors are not expected to follow a "one-size fits all" approach. For example, NZAOA does not espouse a single methodology for achieving 1.5°C-aligned trajectories or a single approach to supporting real-economy decarbonization. Instead, asset owners of NZAOA employ a combination of diverse unilaterally determined approaches in the way that they best see fit. These approaches range from strategic asset allocations to engagements with companies and asset managers. This allows asset owners of NZAOA to set the approach most suited to their local context and strategic goals. Regardless of context, NZAOA believes three key points are crucial for all asset owners:

Key point 1: The world economy is on the cusp of unprecedented rates of environmental, economic, and technological change that pose system-level risks; without mitigating action, these risks will rapidly accelerate.

The effects of climate change are expected to manifest at a system level and will be cumulatively worse with higher levels of planetary warming (JP Morgan 2024). This includes direct effects like extreme and volatile weather events, rising sea levels, increased ocean acidity, and higher atmospheric temperatures. It also includes substantial indirect effects (Carleton & Hsiang 2024), such as disruption to financial markets, weakened food systems, biodiversity loss, the spread of invasive species/diseases, climate refugees, mass migrations, and potentially armed conflict (CEPR 2024).

As climate change becomes more disruptive, it is expected that societal motivation to address climate change and its impacts will also rise. The later the measures to mitigate climate change occur, the more disruptive they will be to the global economy. This generates increasingly significant transition risk that threatens to put substantial capital at risk of becoming stranded.

Key point 2: Asset owners cannot diversify away from system-level risks; moreover, tipping points cannot be reliably forecasted or timed.

1 Jurisdictions included the European Union, Australia, Brazil, Canada, China, France, Japan, South Africa, the Netherlands, the United Kingdom, and the United States

Despite the lack of certainty on future economic orientations and the rate of decarbonization, the economy is moving directionally towards net zero. Therefore, investors have a twofold responsibility: first, to anticipate and understand the system-level nature of these risks (including the myriad of ways they will impact their portfolios), and; second, to position themselves according to their perceived best risk/return orientation.

The risks associated with climate change cannot be substantially mitigated through portfolio diversification or hedging instruments. Nor is there any reliable method to precisely predict when natural, social, economic, or financial tipping points will occur. **While asset managers can still relatively outperform peers or benchmarks in falling markets, asset owners depend on adequate absolute returns to meet their obligations**. Despite these differences, all investors in the financial markets will face fundamental challenges to their business models if system-level risks result in significant and prolonged market disruptions, including asset managers.

Key point 3: Supporting efforts to mitigate climate change is in the short- and long-term interest of asset owners to ensure continued economic growth and resilience of their portfolios.

The UK Sustainable Investment and Finance Association states, "for long-term investors, portfolio returns depend more on the health of environmental, social, and financial systems than on outperforming benchmarks" (UKSIF 2025). Given the challenges that climate poses to these systems (as outlined in Key point 1), coupled with the impossibility of predicting when and at what magnitude tipping points in these systems will occur (as described in Key point 2), a need emerges for asset owners to take further action to protect their financial interests in both the short and long term.

As climate-related disruptions become increasingly impactful over time, it is logical that investors seek to act with a long-term horizon. For example, **based on current liabilities, the investment horizons of pension funds and life insurance providers now span beyond 2100.** Should emissions not come down rapidly, the scale of potential climate catastrophe projected by scientists could massively destabilize the global economy. This makes the long-term choice easy because ultimately climate risk needs to be addressed in order to preserve a functioning global economy.

But asset owners do not need to rely only on these arguments of long-term interests to justify action that protects their economic interests. **Climate risks are already manifesting in the near-term** (NOAA, 2018; IPCC, 2022). The physical risks cited above in relation to insurance are just one example of this. Central banks have also published new short-term scenarios, helping financial institutions better understand how both the transition to net zero and the increasingly severe and plausible climate events could affect markets in the near term (NGFS, 2025).

Part 2:
Implications of asset owners' long-term interests

The perspective and key points outlined above have implications for how asset owners set strategy within their own organization and conduct business with others. Below, we outline what these implications are for their own organizations, before moving to the asset managers that they partner with and policymakers globally.

The strategic need for asset owners to invest in climate capabilities

There is a strategic need for asset owners to address climate risks and opportunities starting at executive strategic levels and then filtering down to all areas of the business. Often such topics and functions within asset owners have been siloed, with the result that they have not been able to directly inform firm strategy in a comprehensive way. NZAOA has always encouraged its asset owners to independently pursue strategic, firm-wide approaches to how they address climate risks and opportunities. For this reason, NZAOA's Target-Setting Protocol (TSP) is drafted to enable firms to develop comprehensive and adaptable commitments that are signed-off at executive levels.

But, does it make sense for an asset owner to take action now to integrate climate risk and opportunities? Or would it be more prudent to wait until climate risks and opportunities become more manifest? An argument supporting a 'wait and see' approach is that it avoids effort at an organizational and strategy level until such action (and associated costs) become necessary. This approach is imprudent for at least four reasons:

- **Change is already here:** Climate risk is not hypothetical; it is already impacting the economy. As such, there is a need to develop the talent and structured systems that allow for understanding and acting on both the risks and opportunities associated with a changing climate, and economy, today. Seizing these opportunities necessitates careful preparation and well-defined strategies.
- **Timing the transition is a risky endeavour:** Macro-economist Rudiger Dornbusch said that; "In economics, things take longer to happen than you think they should, until they happen faster than you thought they could." In applying this concept to decarbonization, a prudent investor would take steps to prepare their portfolio before a rapid transition in market sentiment and pricing rather than after.

- **Building organizational capacity does not occur overnight:** The decision to build structures and expertise on climate change should be done before disruptive impacts escalate. The expertise, partnerships, and pipeline of investments that are needed to adequately address climate risk and opportunities within portfolios requires time intensive efforts and strategic foresight.
- **Current savings pale in comparison to future risks and losses:** Getting caught unprepared for the repricing and stranding of assets could considerably surpass the costs of upfront readiness. This could leave organizations unprepared to navigate the transition and mean the portfolios of lagging asset owners' could lack resilience to the expected changes described in Key points 1-3.

Connecting asset owners of NZAOAs' long-term interests to the fiduciary duty of asset managers

Asset managers are one of the most important strategic partners for asset owners. It is the fiduciary duty (or equivalent obligation) of asset managers to represent the interests of their clients (ICGN 2018). **Given that many asset owners actively recognize that their long-term interests align with mitigating climate risks**, as outlined above, **this puts climate action within the fiduciary purview of their asset managers**. Capital allocation activities that meet the portfolio decarbonization targets of asset owner clients is necessary but inadequate. Instead, asset managers should also represent their clients' long-term interests congruently across all the activities of their respective organizations. This includes offering products that focus on decarbonization solutions and lucrative emerging opportunities that derive from these, integrating climate considerations across their portfolio management, and conducting robust and effective climate stewardship. Asset managers should especially align their public discourse, influence, and messaging with climate goals.

Asset managers that are best at serving client interests will be rewarded through asset owners' independently exercised selection, appointment, and monitoring activities. Further, as climate risks and opportunities continue to manifest, those asset managers that are not incorporating climate change considerations into their decision-making approaches (and are thus not demonstrating prudent risk management on their client's behalf) risk seeing their mandates in jeopardy.

Integration of asset owners' interests across all asset manager activities

NZAOA has been clear that **asset owners should be integrating best practices relating to climate alignment into their expectations of asset managers** (NZAOA 2024a). NZAOA's discussion paper *The Future of Investor Engagement* contextualizes why corporate engagement—a linear tool often best suited for idiosyncratic risks—is necessary but insufficient for investors to effectively address climate change and system-level risk (NZAOA 2022a). The paper also details how asset managers need to align all the activities that they conduct on behalf of their underlying clients and beneficiaries. Additional guidance and expectations are detailed in separate discussion papers by NZAOA on proxy voting (NZAOA 2022b), policy engagement (NZAOA 2023a), and corporate engagement (NZAOA 2023b).

Making use of this guidance helps ensure that asset managers are taking actions to build resilience and long-term returns into their portfolios. This is done by supporting companies across the proverbial economic 'playing field' as well as undertaking activities to understand sectors and values chains to help shape the playing field itself. Examples of such steps include the following measures:

1. Selecting portfolio companies
Active asset managers are selecting companies for their portfolio that they think will provide the best risk-adjusted return for their clients. This requires forecasting (explicitly or implicitly) how they believe companies will perform in different policy, regulatory, and operating environments—the 'playing fields'—both now and in the future.

As detailed in *Elevating Asset Manager Net-Zero Engagement Strategies* (NZAOA 2023b),[2] NZAOA asks **that asset managers are clear and transparent on what scenarios they use** to determine the playing fields that they think are most likely to emerge, **and what time frames they test their assumptions against**. If they are currently only doing this informally and without rigorous process, then they risk being inconsistent with, and having blind spots in, their investment rationale and stewardship approach.

2. Conducting stewardship to support companies' transition strategies
Asset managers' corporate stewardship on climate topics can support companies to reduce emissions and be better prepared to succeed in future regulatory and economic environments. Companies may take action to decarbonize their business as a way to differentiate themselves from competitors, capture opportunities, manage climate-related risks, or prepare for future economic incentives. However, **corporate engagement is not a sufficient approach to achieve net zero when that goal lies beyond the bounds of the playing field**. These bounds represent what is economically feasible for a company to achieve given its current and projected operating environment—something that corporate engagement can do little to influence.

3. Understanding and shaping the playing field
By conducting the two activities above, asset managers develop a strong understanding of the playing field and of the economic incentives for decarbonizing, as shaped by policy, regulatory, technological, and competitive forces. This means they also develop a fuller appreciation of the hurdles that companies face when seeking to decarbonize. Asset managers in private markets often have particularly unique views and insights to the systemic hurdles their underlying assets and companies are facing (see Box 1).

As discussed in *Elevating Asset Manager Net-Zero Engagement Strategies* (NZAOA 2023b), asset owners of NZAOA **expect asset managers to capture the lessons that they learned from engagements, and to then integrate these insights into their organization's institutional perspective, policies, operations, and public positioning.** They should also make use of this enhanced understanding of the bounds of the playing field to publish sector-specific research that addresses the hurdles preventing decar-

2 See: Chapter 2, Point 1a.

bonization. Finally, they should integrate their findings into their public discourse and engagement with policymakers, regulators, trade associations, and the wider financial community, while also following best practice guidelines on stewarding policy engagement of their portfolio companies (NZAOA 2023c).

Box 1: Addressing systemic risk in private markets and real estate

The need for private market and real estate asset managers to address system-level risks, including climate change, might appear as less important given that their portfolios tend to be more concentrated, and thus have less exposure to overall market beta (NZAOA, 2023b). However, the exposure of these managers to long-lived illiquid assets combined with the steady rise in funds focused on climate solution and the energy transition in private markets tie these managers financial interests to a predictable and orderly transition that is beneficial for their underlying investments. Similarly for real estate, physical risks to buildings are escalating and testing the resiliency of construction, while at the same time the need for net-zero-ready buildings is growing (IEA 2021). Real estate managers that are ill-prepared for these changes may be left with assets that have falling valuations and are in need of expensive refurbishment.

Private market asset managers also have unique opportunities to influence the companies and sectors in which they invest. General partners often already add value by engaging with underlying portfolio companies and their boards to address financially-material sustainability risks. NZAOA is calling on asset managers to also pursue opportunities to understand, analyse, and address the hurdles between net-zero decarbonization goals and the current trajectory of their investee companies (as incentivized by the current economic playing field). Furthermore, asset management firms can use their unique sector expertise and line of sight to relay needs and potential solutions to policymakers—both directly and indirectly through their public discourse.

The importance of mandates

Asset owners that work with external asset managers will often encounter the misalignment of natural incentives driven by different time-horizons, risks appetites, and scopes of influence (see Key point 2). As such, mandates are one useful way to ensure better alignment between respective interests. However, **mandates should not be overly prescriptive.** Too much specificity blurs the lines between the differentiated responsibilities and delegation of duty that is inherent to the asset owner-asset manager relationship. Instead, **asset owners first and foremost need to clearly state their interests in ways that are well understood by asset managers**. Where investment and stewardship actions are not explicit in the mandate, it is incumbent upon asset managers to still act with care and loyalty in line with their fiduciary duty towards their asset owner clients. Therefore, asset managers should continually work to understand their clients' interests, how these relate to their own firm's business activities, and offer consistent products and services that they think are best suited to represent asset owners' interests.

Nevertheless, mandates do set out defined expectations on the type of strategies, benchmarks, sector exposure, country exposure, or exclusions that individual asset owners desire. In the same way, **asset owners can provide their asset managers with broad climate action expectations that they see being in their best interest**. These can include include, but are not limited to, the following:

- Making a commitment to support net zero;
- Defining minimum stewardship requirements such as;
  - policy engagement alignment,
  - linking engagement to proxy voting
  - clarifying expectations around underlying corporate transition plans;
- Providing a strategic approach on how to manage risk and approach potential investments in high-emitting entities;
- Detailing how net-zero climate scenarios are built into investment and stewardship activities.

It is then within asset managers' responsibility to align their investment or stewardship approach with the mandated expectations of asset owners. This assessment of consistency and appropriate level of ambition is also relevant for investor coalitions purporting a net-zero commitment. In these cases, strong and practical ambition that aligns with the best practices publications by NZAOA is encouraged. In turn, **it is the responsibility of the asset owner to independently assess the manager's level of success in representing its long-term interests on an ongoing basis**.[3]

Asset managers should not pursue strong climate stewardship approaches within one mandate while failing to support climate action at a firm level. By doing so, they fail to address climate risk in a manner that is effective and consistent, two characteristics that asset owners see as fundamental to a strong stewardship approach in relation to climate.

3 The PRI, IIGCC, ICGN, and others have guides on mandate design. See: icgn.org/model-mandate; https://www.unpri.org/investment-tools/asset-owner-resources/mandate-requirements-and-rfps

By asset managers being consistent in their messaging about the importance of addressing climate risk and opportunities across all their products and activities they showcase prudent forward looking investment strategies. That way, they can avoid this problematic situation of representing two types of clients' interests against each other. It also avoids sending contradictory messages to investee companies, policymakers, or other stakeholders on their of climate change and net-zero strategy. This need for alignment and consistency is particularly true in relation to asset managers' public messaging.[4]

Engaging on asset owners of NZAOAs' long-term interests with other stakeholders

Exchange with civil society organizations, policymakers, and stakeholders, including those involved in blended finance, can be a useful action. This kind of 'field building' is congruent with asset owners' fiduciary duty and represents asset owners' long-term interests. To quote from NZAOA's *Theory of Change*:

> **"*Field building* refers to changing the norms and standards in the ecosystem in which asset owners—together with asset managers, investee companies, regulators, and policymakers—are embedded (Marti et al. 2023; Macleod & Park 2011). Norms and standards are a precursor to the ambitious climate policies and regulation that are necessary to overcome systemic barriers to decarbonization. Thus, NZAOA sees that field building contributes in the medium term to a 'new normal' for asset owners and other financial institutions, whereby larger financial flows will go towards a sustainable economy and will incrementally increase support to the governmental and societal commitment to fully implement the Paris Agreement."**
>
> **(NZAOA 2024b)**

There is still untapped potential for financial institutions, civil society organizations, academia, and other stakeholders to explore beneficial exchange. Given the multi-faceted nature of climate change and its impacts, NZAOA will continue to require input and expertise from many stakeholders across the socioeconomic system to effectively address broad climate risks and opportunities.

Asset owners' roles in directly representing their interests to policymakers

As stated in NZAOA's 2024 *Call to Action to Governments*, implementing effective climate policy is the single "most important" factor to achieving the goals of the Paris Agree-

4 NZAOA defines 'public messaging' in this context as including (but not limited to) proxy policies, engagement strategies and rationale, and public policy approaches.

ment, mitigating systemic and systematic risks as well as seizing the opportunities of a net-zero transition (NZAOA 2024c). Stable and reliable policy action assists institutional investors to more accurately price and assess climate risk and opportunities and thus allocate capital. Increased investor engagement with policymakers will help address the following issues:

- **Policy uncertainty:** Government commitments to net-zero targets are part of the signalling effect that informs investor commitments. However, these commitments are thrown into doubt when they do not appropriately translate into consistent policy implementation. This creates risks for companies that invest heavily in transition strategies. Clarity and policy certainty is critical for asset owners when deciding to allocate capital to specific sectors in different countries. It similarly assists companies to conduct long-term planning and ideally avoid the largest risks of stranded assets.
- **Complexity of transition:** Achieving net zero will be challenging and complex, with financial risks in multiple directions. It is necessary to address this complexity with a clear and balanced approach that considers transition risks, societal considerations, and investment opportunities.
- **Ensuring effective policies:** Investors can provide valuable insights to policymakers on the financial implications of various real economy policies, helping to create more effective and economically viable climate transition strategies.

Investors' roles in sovereign engagement

An often overlapping extension to direct policy engagement is that of sovereign engagement. Sovereign engagement focuses on governments' performance in addressing and mitigating climate change as an important factor in countries' ability to attract and retain capital.

NZAOA sees two discrete and important reasons for exchanging with governments and regulators. The first is to analyse the climate approach of the sovereign for the purpose of establishing a measure of attractiveness of its debt issuances. The foremost example of this analyses is the PRI's ASCOR project (PRI 2023), which investors can use to inform their underlying long-term economic growth assumptions based on a country's ability to manage climate change topics and continue to attract future capital.

The second rationale is to understand national climate pathways and planning for specific sectors or infrastructure, and, where appropriate, to call for greater clarity and ambition (see Box 2). The purpose of this exercise is to de-risk and mobilize the allocation of capital to these specific sectors and infrastructure within the respective country. **Opaque transition pathways reduce the clarity and certainty that investors seek, making it harder to invest in the transition effectively.** A clear understanding is particularly important given the regional or national variability that often exists between the timing and ways that sectors are likely to decarbonize.

Box 2: Example of sovereign engagement as a tool for investment decision-making

An asset owner wants to make a major investment in green steel, with options for investments in two different countries. Both projects have similar costs, value chains, and technical attributes. Both also share similar risk-return profiles based on the current policy and regulatory frameworks. However, there is uncertainty regarding the policy and regulatory trajectory for the two countries. When allocating capital to such a project, a country's sector-level transition trajectory (as supported by their policy and regulatory developments) carries significant investment implications. Lack of certainty regarding a country's trajectory represents a major risk that the asset owner wants to minimize. To more effectively allocate capital for this project, the asset owner will seek clarity on the intention (or otherwise) of the two governments to support specific sector pathways. Engagement to request this clarity, with supporting underlying policies to back it up, will inform the final investment decision of the investor, with the country perceived as giving more stable support for such projects likely to win out.

Development finance institutions and blended finance

The allocation of capital to developing markets and emerging technologies is crucial for global economic growth and fulfilling the commitments of the Paris Agreement, as well as advancing a just transition to net zero. It is in the interest of asset owners to unlock these potential markets as opportunities to find good returns while accelerating a just and resilient transition.

Nevertheless, **developing markets that hold untapped potential for innovation and development often lack the necessary funding to realize their full capabilities** (NZAOA 2023d). Certain enabling conditions and incentives are often still missing in order for private capital to flow at the desired level. These are detailed in NZAOA paper entitled *Scaling Blended Finance for Climate Solution Investments in Emerging Markets and Developing Economies* (NZAOA 2022c).

Conclusion

Asset owners that are seeking ways to responsibly measure, manage, and mitigate their climate risks and opportunities will better understand how they can ensure their long-term financial performance than those that are not taking such steps. This conviction is based on the system-level magnitude of the economic risks and opportunities that climate change presents. Scientific evidence supports this view. The experience of asset owners of NZAOA in navigating financial risks and economic disruption, coupled with direct evidence from business lines like property and casualty insurance, further substantiate this view. Considering this analysis, taking action to limit climate change to its lowest possible warming represents prudent decision-making in line with asset owners' long-term economic interests and performance. Asset managers working for asset owners have a fiduciary duty to represent this effectively.

Alternatives to climate action exist. These include, among other options: reinforcing trajectories closer to the status quo; not setting climate targets; failing to encourage asset managers to act in asset owners' best interests by considering climate risks and opportunities; and remaining silent about the alarming information received from stakeholders and business operators regarding climate risk. NZAOA believes that those asset owners who choose this course of action could eventually be seen as negligent in executing their duties and responsibilities.

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