

# Net Zero Stewardship Toolkit



The Institutional Investors  
Group on Climate Change

# Foreword

Time is running out for governments, businesses and society to take the urgent level of action required to avoid the worst impacts of climate change. The most recent [Intergovernmental Panel on Climate Change](#) assessment declared a 'code red for humanity' – we are on the precipice of irreversible change.

Investors are looking to play their part in the transition to net zero and are committing to align their portfolios to net zero. Over the past two years both asset owners and managers, together responsible for nearly USD 50 trillion in assets, have committed to the goal of net zero by 2050.<sup>1</sup> To achieve these ambitions, investors will need to drive changes in the real economy. They must be active stewards that ensure the companies they own take the necessary action and produce net zero transition plans to deliver 1.5°C aligned short-, medium- and long-term targets.

Portfolio alignment tools such as the [Net Zero Investment Framework](#) have therefore emphasised the strong role that stewardship needs to play. For example, asset managers that have committed to net zero through the Net Zero Asset Managers initiative have committed to “implement a stewardship and engagement strategy, with a clear escalation and voting policy, that is consistent with [an] ambition for all assets under management to achieve net zero emissions by 2050 or sooner”.<sup>2</sup> Likewise, Paris Aligned Asset Owners have committed to “implementing a stewardship and engagement strategy, with a clear voting policy that is consistent with an objective for all assets in the portfolio to achieve net zero emissions by 2050 or sooner”.<sup>3</sup>

To achieve net zero by 2050 and limit warming to below 1.5°C GHG emissions must halve by 2030, requiring rapid adoption of ambitious short term GHG targets by companies. To deliver this, investor stewardship must be swift and bold. With every year of delay the pace of decarbonisation must accelerate further if the net zero goal is to be achieved by 2050 and carbon budgets not exceeded.

This unprecedented challenge will require an unprecedented shift in stewardship practices. While private dialogue will likely remain a key tool for investors, more specific, time bound objective setting paired with escalation will likely need to become the norm. With a growing pool of investors now focused on engagement, there is also a need for structured alignment between asset owners and asset managers in the stewardship process which the document attempts to inform on.

The good news is investors have a range of stewardship tools at their disposal to make this change happen. Ranging from director votes to shareholder resolutions and now 'Say on Climate' votes, there are a number of voting tools available to investors. In addition, there are a number of non-voting escalations and other approaches like engagement through peer collaborative initiatives, engagement through an asset owner's external managers, engagement with other actors in the company value chain and public policy engagements.

The role of this toolkit is to provide investors with a foundational process to enhance their stewardship practices to deliver the rapid acceleration in decarbonisation required to halve emissions by 2030 and give the world a chance of achieving net zero by 2050. It aims to raise the bar for investor climate stewardship by providing a systematic framework that focuses investors on ensuring they prioritise high impact engagement while systematically ensuring they have measures in place to hold laggard companies to account. Over time we anticipate supplementing it with additional guides on new strategies and approaches as they emerge as well as techniques for asset classes like private equity and infrastructure.

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1 As of October 2021, 42 Paris Aligned Asset Owners from Australia, Europe, the UK, and the US, have committed to net zero through the Paris Aligned Investment Initiative and 128 asset managers globally have made a net zero commitment.

2 Net Zero Asset Managers commitment statement (2020) Source: <https://www.netzeroassetmanagers.org/>

3 Paris Aligned Asset Owner commitment statement (2021) Source: <https://www.parisalignedinvestment.org/media/2021/03/PAII-Net-Zero-Asset-Owner-Commitment-Statement.pdf>

# Contents

Foreword	2
The Net Zero Stewardship Toolkit – a framework for Net Zero Stewardship	4
Overview	4
<b>Step 1</b> Undertake portfolio analysis, set portfolio alignment goals and develop a stewardship prioritisation framework	9
<b>Step 2</b> Set net zero alignment criteria, alignment levels and time bound engagement objectives	10
<b>Step 3</b> Develop an engagement strategy for priority companies	
<b>Step 4</b> Baseline engagement and voting policy approach	21
<b>Step 5</b> Asset owner and manager alignment, engagement and transparency	27
Challenges and Limitations	31

# The Net Zero Stewardship Toolkit – a framework for Net Zero Stewardship

## Overview

The role of this toolkit is to provide all types of investors with the foundational framework and guidance to enhance their stewardship practices to deliver the rapid acceleration in decarbonisation required to halve emissions by 2030 and put the world on course for net zero by 2050 or sooner. It specifically aims to provide a core process aligned with the Net Zero Investment Framework recommended targets and stewardship actions ([p17-18](#)) to help investors implement their own net zero commitments (see Box 1).

This toolkit is intended to be an iterative document which will be updated by the Institutional Investors Group on Climate Change and its members in accordance with best practice. It is currently focused on listed equity but should be applicable to corporate fixed income portfolios. Over time the Toolkit will be built out to address further sector and asset classes.

### Box 1 – Net Zero commitment stewardship requirements

The toolkit is designed to support investors that have made net zero commitments. Guiding commitments are outlined below.

- **Net Zero Investment Framework targets and stewardship requirements:** Asset owners and asset managers committing to use the Net Zero Investment Framework need to set the following the following asset level goals:
  - Portfolio coverage goal: Increase % AUM in net zero or aligning assets (using a net zero alignment criteria framework) – **set 5-year goals, progressively reaching 100% of assets classified as aligned or net zero by 2040**
  - Engagement goal: Achieve a coverage of **assets aligned or under active engagement to 70%** of financed emissions from material sectors (also using a net zero alignment criteria)
  - Select two or more of the four forms of engagement contributions listed above and set their own outcome-based KPI from the common KPI framework ([here](#)).
- **Net Zero Asset Manager Initiatives (NZAM) stewardship requirements:** Asset managers that have signed the Net Zero Asset Managers commitment have committed to develop and implement “a stewardship and engagement strategy, with a clear escalation and voting policy, that is consistent with an ambition for all assets under management to achieve net zero emissions by 2050 or sooner.” ([here](#))
- **Paris Aligned Asset Owner (PAAO) stewardship requirements:** Asset owners that have made the Paris Aligned Asset Owner commitment aim to implement “a stewardship and engagement strategy, with clear voting policy that is consistent with an objective for all assets in the portfolio to achieve net zero emissions by 2050 or sooner.” ([here](#))
- **Net-Zero Asset Owner Alliance (NZAOA) targets and stewardship requirements:** Asset owners that are part of the NZAOA can set three out of four overall targets (Sub-portfolio, sector, engagement and financing). However, all members are required to set engagement targets and activity which should:
  - Focus on 20 companies with either the highest owned emissions or those responsible for combined 65% owned emissions in a member’s portfolio
  - Set up a structured engagement approach integrated with their selection, appointment, and monitoring activities of asset managers

This Toolkit provides guidelines by which investors can shape their net zero stewardship strategy, as required by the initiatives set out in Box 1. It is structured in a step-by-step format to support stewardship practitioners with implementation, outlined in Box 2.

## Box 2: Net Zero Stewardship key steps

- 1. Undertake portfolio analysis and use the stewardship framework for prioritisation of key engagements:** A process to identify companies in scope for engagement, to prioritise these engagements and allocate resource based on the importance of key companies to achieving portfolio goals and real-world emissions reduction.
- 2. Set net zero alignment criteria, time bound company level objectives and portfolio goals:** Development of a framework of company net zero alignment criteria to be used to determine if companies can be classified as aligned and to set company level time bound objectives and milestones that drive stewardship priorities and enable measurement of portfolio alignment goals (Box 1).
- 3. Develop an engagement strategy for priority companies:** The establishment and implementation of strategies to increase alignment of priority companies, with clear escalation actions to be used where time bound objectives are not met. This step addresses the core portfolio alignment objectives under the various alignment frameworks (Box 1).
- 4. Develop a baseline engagement (minimum level) and voting policy approach for all companies:** The establishment and implementation of baseline engagement and voting approach, to be undertaken as a minimum for the maximum number of companies in material sectors within the boundaries of relevant portfolios and clear escalation actions to be used where time bound objectives are not met. This step addresses the requirement under NZAM and PAAO to implement a stewardship strategy across all AUM.
- 5. Asset owner and manager alignment and engagement:** Guidance to ensure alignment of engagement priorities and objectives to reduce duplication and enhance impact by collaborating where valuable.
- 6. Transparency:** A framework to inform disclosures on the net zero stewardship strategy.

## Step 1

# Undertake portfolio analysis, set portfolio alignment goals and develop a stewardship prioritisation framework

### Outcomes

At the end of this step, an investor will be able to set out:

- A list of companies that have been identified as ‘high priority’ to achieving portfolio goals
- A list of companies considered within the bounds of net zero alignment goal setting and therefore that should be subject to a baseline (minimum level) of engagement and net zero voting
- Expected outcomes for priority company engagements (e.g. emissions impact, accelerated coal phase out)

### Overview

The first step in the net zero stewardship strategy process is to carry out portfolio analysis to identify which companies account for the majority share of financed emission. This enables investors to determine which companies can be classified as aligned to achieving net zero (or not), and which should therefore be subject to engagement. This is necessary to deliver the engagement and stewardship targets required by investor commitments and frameworks (as outlined in Box 1).

From within the pool of companies under the scope of portfolio objectives, it is then important to identify which offer the most potential to delivering portfolio alignment goals (Box 1) and where engagement can make a real difference. For example, to drive real world impact, it may be most impactful for an investor to prioritise companies in energy demand sectors like heavy duty transport, where accelerated decarbonisation can reshape demand for fossil fuels instead of in sectors where engagement may have a lower probability of leading to meaningful decarbonisation effects

### Approach

The approach described below draws on the Net Zero Investment Framework and supplements it with a range of additional metrics that can be used to help identify which companies are ‘high priority’ and that should be subject to enhanced engagement.

Investors can be guided by the Net Zero Investment Framework recommendation to focus on material sectors.<sup>4</sup> However, asset owners and managers may also want to consider additional factors alongside the potential to reduce real-world emissions, such as, whether a high emitting portfolio company has failed to set any emissions targets, the potential for engagement to deliver a large emission reduction, or the fact that data availability (typically the lack of Scope 3 disclosure) may mean that stated emissions figures do not reflect the full emissions footprint of the portfolio company.

<sup>4</sup> Material sectors is defined as those in NACE code categories A-H and J-L. The EU TEG provides a mapping of NACE to GICS and BICS.

The sub-steps to undertake are (note: Steps 1 and 2 may be undertaken iteratively):

- 1.1 Set scope** – Net Zero commitments set out in Box 1 expect that investors will consider at least all assets within listed equity and corporate fixed income portfolios and funds. Within this, all sectors considered “material” to the net zero transition should be considered in scope for assessment and subject to the portfolio coverage goal. Investors should seek to have aligned or otherwise continue to engage at least 70% of financed emissions from companies in these material sectors, rising to 90% by 2030. From within the group accounting for 70% (and rising to 90%) it will not be possible to do highly intensive engagement with all companies. Therefore, investors need to stagger and prioritise effort based on a range of criteria while ensuring all material companies receive a baseline level (minimum quantity of engagement).
- 1.2 Establish prioritisation criteria** – Once the companies in scope have been determined, investors should establish criteria to determine which companies are of highest priority to the achievement of decarbonisation goals and real-world impact. Key factors for consideration may include:
  - **GHG emissions** – Proportion of Scope 1, 2 & 3 financed emissions a company accounts for in the portfolio.
  - **Progress to date** – The company’s net zero alignment progress to date (see next section, note: this may be undertaken iteratively with the first step. With an overarching emphasis on contributions to portfolio financed emissions, investors may choose to prioritise companies that have made very little progress or be more selective or strategic, for example, by targeting companies that have taken good steps to align but need to adjust ambitions, targets or investment plans or companies whose net zero transition can be examples to emulate within a sector).
  - **Likelihood of success** – Assessment of whether investor engagement will lead to progress on decarbonisation and tangible improvements on climate-related practices at investee companies.
  - **Risk of duplicative effort** – Extent of collaborative engagement already underway with the company: this could provide the opportunity to leverage and collaborate with other parties to magnify impact, optimise resources and avoid duplication of effort.
  - **Climate-related financial risk level** – Financial value of the holding (this is already captured by the financed emissions calculation but to the extent the absolute holding amount along with the sector and company specific detail present additional consideration).
  - **Jurisdiction** – Jurisdiction of company and feasibility of engagement, based on shareholding and governance factors such as the level of state ownership (note: state-owned enterprise engagement is an area identified for future work).
  - **Future GHG emissions potential** – Where existing emissions data may not fully reflect the full emission footprint (e.g. if the company is new and growing and will generate greater emissions in the future).
  - **Addressing critical thematic issues** – Delivering a rapid decline in emissions is critical to achieving net zero. A range of activities need to happen urgently to deliver this which are not all quantifiable in the same way. For example, above all else, coal phase out must be achieved as urgently as possible. It would be legitimate to identify a company with major interests in coal mining or power generation that may not account for a high proportion of financed emissions due to a low financial holding.
  - In many cases, equity and bond investors will have aligned interests that enable combined engagement approaches (this is common in Climate Action 100+). However, bond investors may wish to take a more dynamic approach to identifying priority companies based on the cycle of issuances and the opportunity to make more strategic choices regarding which companies they have openings to engage with. For bond investors specifically, there is a discussion to be had around creation of collaborative forums through existing industry associations or formation of new ones to create and define accountability mechanisms for companies to their bondholders (discussed further in Sections 3 and 4).
- 1.3 Weight prioritisation criteria** – Where multiple criteria are adopted in the step above, a weighting could be applied to ensure a consistent approach to determining prioritisation.
- 1.4 Establish priority companies for engagement** – A priority list of companies critical to impact should now have been identified in this step.

## Exhibit A – Illustrative table of how investors can report on their priority companies

Metric	Listed equity	Corporate Fixed Income
Companies in scope of engagement (covering 70%/90% of financed emissions)	[count, e.g. 342]	[count, e.g. 123]
Priority companies	[count, e.g. 35]	[count, e.g. 16]
Priority company contribution – portfolio financed emissions	[X%/count] of portfolio emissions	[X%/count] of portfolio emissions
Priority company contribution – Addressing critical thematic issues targeted & companies in scope	[count targeted] – Rapid coal phase out resulting in near term reductions of x%	[count targeted] – Cessation of negative corporate climate lobbying
Companies in scope of collaborative engagement efforts	[X%/count] of portfolio emissions [X%/count] of priority companies	[X%/count] of portfolio emissions [X%/count] of priority companies
Remainder – companies in material sectors that will be covered by baseline engagement (if any)	[X%/count] of portfolio emissions	[X%/count] of portfolio emissions

### Case study: Railpen Net Zero and climate-related engagement

Stewardship, engagement and voting continue to be core activities for Railpen in their strategic approach to climate change. In 2021, Railpen announced their Net Zero plan and targets, identifying the key emitters in their portfolio and the roadmap to alignment and engagement. In 2022, Railpen detailed the Net Zero engagement plan which explicitly focuses on analysis, steering and aligning the key engagement targets with a net-zero trajectory.

The prioritisation process was based on the Net Zero Investment Framework (NZIF) and used financed emissions as a parameter to assess which companies in material sectors were key contributors to 70% of portfolio financed emissions. This prioritisation led to 47 companies identified as key emitters across 15 broad sectors. The companies are then assessed based on a proprietary framework broadly aligned with IIGCC, CA100+, TPI and TCFD. The assessment includes climate risk by sector and company and factors the various pillars of climate risk including policy, governance, data, capital allocation etc. This assessment highlights key areas of misalignment for companies with the Net Zero pathway and is further supplemented with the analysis of physical and transition risk and company adaptation potential across companies. The areas of misalignment are then reflected as key themes in the discussion, engagement, voting and escalation policy for these companies.

## Step 2

# Set net zero alignment criteria, alignment levels and time bound engagement objectives

### Outcomes

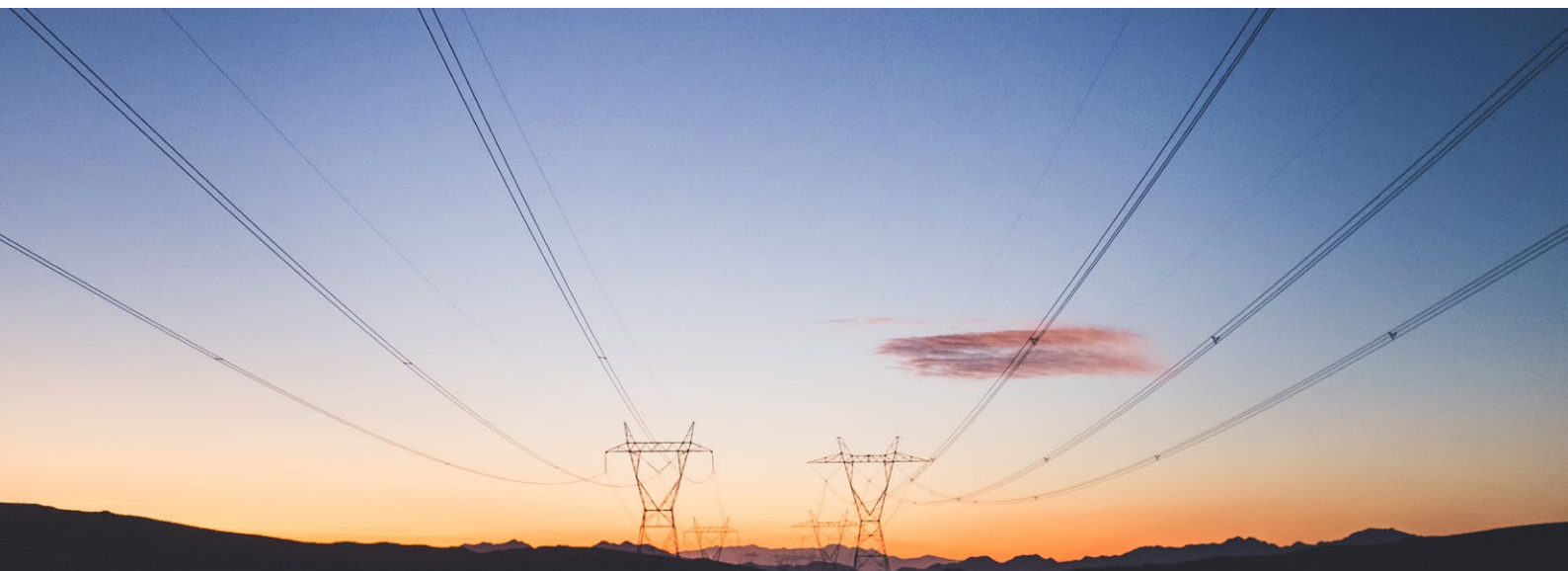
At the end of this step, an investor will be able to set out:

- The net zero alignment criteria and categorisation being used to assess companies
- Time bound objectives for engagement set for each company in scope (milestones towards delivering each five-year goal)
- The Net Zero Investment Framework portfolio coverage target: a five-year target for companies to be classified as aligned or net zero (reaching 100% at least aligning by 2040 or sooner)

### Overview

Once the scope of assets targeted for engagement activities has been defined and priority companies identified, the next step in the net zero stewardship strategy process is to determine how the priority companies will be assessed and what they need to do in a specific timeframe to support delivery of portfolio goals and impact outcomes. The process for company and portfolio alignment assessment should be the same for priority companies and companies subject to baseline engagement with the difference being the approach to engagement (see Steps 3 and 4).

The Net Zero Investment Framework sets out that investors should set a target to increase the proportion of assets which are assessed as aligned or net zero to reach 100% by 2040 or sooner. **Investors should, however, note that to have any chance of achieving net zero by 2050 or sooner consistent with a 1.5C pathway, they need to secure steep emissions reductions from companies in the near term, meaning short term objectives should be prioritised.**



## Approach

The sub-steps to undertake are (note: Steps 1 and 2 may be undertaken iteratively):

**2.1 Establish net zero alignment criteria** – The first sub-step is to establish a set of alignment criteria with which to assess companies. The concept of “net zero alignment” is increasingly comprehensive. For a portfolio company to be considered aligned, they require not just a net zero target covering Scope 1, 2 and material Scope 3 emissions but a number of criteria based on the key climate pillars that equate to a credible transition plan (Box 3), all leading to an emissions pathway consistent with a 1.5°C budget. This will vary by sector, but typically necessitates short and medium term targets and evidence that current emissions intensity and future pathway is on track to meet these goals.

The core criteria that investors should incorporate into alignment assessments are set out below, as adapted from the Net Zero Investment Framework. Investors may wish to modify these to the relevant indicators where they are using the Science Based Targets initiative for Financial Institutions (SBTi FI) or Asset Owners Alliance Target Setting Protocol. Investors may also wish to supplement this with sector-specific alignment criteria and can use resources such as sector papers published by IIGCC and CA100+ (papers on Oil and Gas<sup>5</sup>, Steel<sup>6</sup> and Power and Utilities<sup>7</sup> are available. Further work is being undertaken by IIGCC, TPI, CDP, GFANZ and others to increase sector specificity of transition plan frameworks and data. IIGCC is also working closely with a range of data providers to generate alignment of services).

### Box 3 – Criteria that can be adopted for assessing alignment of portfolio companies

(Broadly adapted from the Net Zero Investment Framework and based on the CA100+ benchmark indicators)

#### Core

##### 1. Ambition

A long-term emissions goal based on Scope 1, 2 and material Scope 3 consistent with limiting the increase in global temperatures to 1.5°C with limited or no overshoot (“net zero”). This may imply emissions falling to net zero before 2050 in some sectors (e.g. Electricity).

##### 2. Targets

Short- and medium-term emissions targets (for Scope 1, 2 and material Scope 3) should aim to be consistent with the trajectory implied by the long-term target and the science-based net zero pathway. The expected impact of medium-term targets on absolute emissions should be stated and short-term targets should be backed by remuneration policy.

##### 3. Climate Governance

The company provides clear evidence of net zero transition planning (based on established targets, strategy and board oversight). Executive remuneration should ideally be linked to delivering targets and transition with links to increases in fossil fuel production/usage removed.

##### 4. Emissions performance

Current emissions intensity performance on a metric consistent with targets should be disclosed and show a trajectory consistent with that needed to meet emissions targets.

5 Net Zero Standard for Oil and Gas companies (2021) Source: <https://www.iigcc.org/resource/net-zero-standard-for-oil-and-gas-companies>

6 Global Sector Strategies: Investor interventions to accelerate net zero steel (2021) Source: <https://www.iigcc.org/resource/global-sector-strategies-investor-interventions-to-accelerate-net-zero-steel/>

7 Global Sector Strategies: Investor interventions to accelerate net zero electric utilities (2021) Source: <https://www.climateaction100.org/approach/global-sector-strategies/electric-utilities/>

## 5. Disclosure and verification

Scope 1, 2 and material Scope 3 emissions should be disclosed along with satisfactory review of the company's measurement and verification process

## 6. Climate risk and accounts

The company provides disclosures on risks associated with the transition through TCFD reporting and financial accounts state the climate scenario under which they were generated as well as any material, climate sensitive, assumptions (e.g., fossil fuel prices, carbon taxes) and outcomes (e.g.: write-downs on coal assets, useful life impact on gas assets). Where assumptions are not consistent with a net zero scenario, the impact of a net zero scenario on financial statements should be indicated.

## 7. Decarbonisation Strategy

A quantified plan setting out the measures that will be deployed to deliver GHG targets, including proportions of revenues that are considered "green" where relevant and the use of neutralising actions such as CCUS (Carbon Capture, Utilisation and Storage) and offsets are clearly disclosed.

## 8. Capital Allocation Alignment

Capital expenditure plans should be set out and consistent with the overall decarbonisation strategy. The methodology for determining any claims of alignment with net zero should also be disclosed.

## Additional

## 9. Climate Policy Engagement

The company has a Paris aligned climate lobbying position and demonstrates alignment of its direct and indirect lobbying activities.

## 10. Just Transition

The company considers the impacts from transitioning to a lower-carbon business model on its workers and communities.

## Examples of sector specific net zero alignment criteria that could be used (additional criteria are in development)

### 1. Oil and Gas

As established by the Oil and Gas Net Zero Standard, integrated oil and gas companies should set additional upstream and Scope 1 & 2 emission targets (these targets also include commitments on methane).

### 2. Electricity

As established by the IEA in its NZE scenario and set out in the IIGCC sector paper, power utilities in developed markets should seek to reach net zero by 2035 and should set additional targets for electricity and energy sales.

- 2.2 Develop alignment staircase to inform objective setting** – Once core criteria for assessing alignment are established, investors should develop alignment levels to categorise the overall alignment of a portfolio company. This set of alignment levels or "staircase" should set out clearly what criteria a portfolio company needs to meet in what timeframe to be considered committed, aligning, fully aligned and net zero, noting that the Net Zero Investment Framework defines the core criteria in Box 3 as the basis for assessing companies as 'aligned'. Investors can develop their own approach, adding additional levels or precursory expectations. A staircase approach enables investors to track progress over time.

- 2.3 Baseline assessment: identify where companies in scope are on the alignment staircase** – Once both the prioritisation criteria and the alignment levels have been established, companies can be located across alignment levels or steps on the staircase. This matrix allows engagement resources to be appropriately targeted and progress to be monitored. Additionally, it prevents ‘cliff edge’ effects where no escalation or engagement takes place on companies that are slightly ahead on the levels by providing a progressive staircase that companies must move up quickly from wherever their start point is.
- 2.4 Set time bound (ideally annual) objectives and longer-term goals for companies depending on the baseline position** – Once companies are located across the levels, a gap analysis with the next level up can be carried out to identify time bound annual objectives for companies. These should be formed of the criteria the company has yet to meet on the next level up. Annual time bound objectives for each company are critical for structuring engagement and escalation processes. On an annual basis, objectives should be reviewed and reset. Investors should factor where objectives have not been met into engagement.

## Exhibit C – Illustrative example of how portfolio companies can be prioritised and distributed across alignment levels

Outstanding actions and delivery dates represent annual time bound objectives

Company	Outstanding actions*	Date required*
<b>Not aligned</b>		
Company A	Ambition (1) Disclosure (4) Policy (7)	December 2022
Company B	Ambition (1)	January 2023
Company C	Ambition (1)	October 2022
<b>Committed</b>		
Company D	ST+MT targets (2) Climate risk and acc. (9)	September 2021
Company E	Capex plans (6)	December 2021
Company F	Capex plans (6)	February 2022
Company G	Governance (8)	October 2021
<b>Aligning</b>		
Company H	Decarbonisation strategy (5)	November 2021
Company I	Decarbonisation strategy (5)	April 2022
Company J	Just Transition (9)	December 2021
<b>Aligned</b>		
Company K	N/A	N/A
Company L	N/A	N/A
Company M	N/A	N/A

\* Remaining criteria required to be fulfilled before moving to the next level of the staircase at the date by which they should be completed

Exhibit B – An illustrative high-level example of a net zero alignment criteria staircase

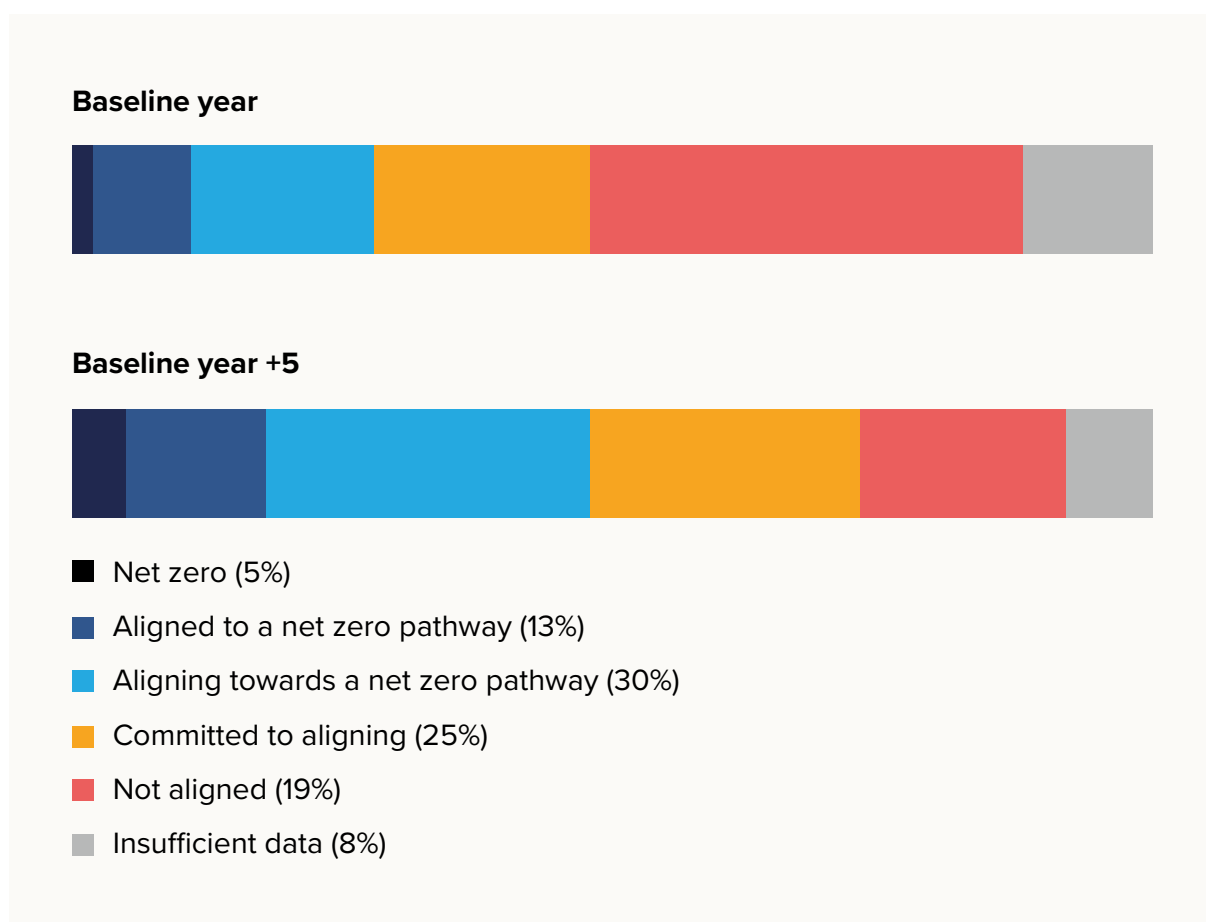
(Based on the Net Zero Investment Framework and forthcoming PAll target setting guidelines)

	Criteria / Milestone	Milestone 1 Committed (To be delivered within 1 year of engagement)	Milestone 2 Aligning (To be delivered within 2 years of engagement)	Milestone 3 Fully Aligned (To be delivered within 3 years of engagement)
Core	Ambition	Net Zero ambition covering all Scopes	Net Zero ambition covering all Scopes	Net Zero ambition covering all Scopes
	Targets	Medium-Term Target (at least aligned with Beyond 2°C Scenario [B2DS])	Medium-Term Target (at least aligned with Beyond 2°C Scenario [B2DS]) Revised Short, Medium and Long Term targets aligned with IEA Net Zero Emissions by 2050 scenario (NZE)	Medium-Term Target (at least aligned with Beyond 2°C Scenario [B2DS]) Revised Short, Medium and Long Term targets aligned with IEA Net Zero Emissions by 2050 scenario (NZE)
	Governance	Board capabilities and competencies to manage climate change Board member nominated responsible for climate oversight	Board capabilities and competencies to manage climate change Board member nominated responsible for climate oversight Board member nominated responsible for climate and Net Zero oversight Climate metrics linked to executive remuneration	Board capabilities and competencies to manage climate change Board member nominated responsible for climate oversight Board member nominated responsible for climate and Net Zero oversight Climate metrics linked to executive remuneration
	Emissions Performance	Current emissions intensity metric disclosed and consistent with trajectory needed to reach emissions targets	Current emissions intensity metric disclosed and consistent with trajectory needed to reach emissions targets	Current emissions intensity metric disclosed and consistent with trajectory needed to reach emissions targets
	Emissions Data Disclosure and Verification	Scope 1, 2 and 3 emissions reporting	Scope 1, 2 and 3 emissions reporting Emissions measurement and reporting system in place	Scope 1, 2 and 3 emissions reporting Emissions measurement and reporting system in place Emissions measurement, verification and reporting system in place
	Decarbonisation Strategy	Climate Strategy Disclosure as per TCFD recommendations	Climate Strategy Disclosure as per TCFD recommendations TCFD Report with Quantitative Scenario Analysis and Transition Analysis	Climate Strategy Disclosure as per TCFD recommendations TCFD Report with Quantitative Scenario Analysis and Transition Analysis A quantified plan setting out measures to be deployed to deliver GHG targets, (% of green revenues, use of neutralising actions such as CCUS and Offsets clearly disclosed)
	Capital Allocation	Quantified target delivery plan	Quantified target delivery plan	Quantified target delivery plan Generating and disclosing ‘green revenues’ and their share in overall sales. Targets to increase the share of ‘green revenues’ in overall sales Capital expenditure plans set out and consistent with decarbonisation strategy, and disclosed methodology. Disclosed investment in fossil fuel based assets and reducing rapidly and disclosed investment in “green” energy capacity
Additional	Climate Policy Engagement	Disclosure of climate lobbying position and all direct lobbying activities and its Paris alignment Disclosure of memberships of trade associations and associated lobbying	Disclosure of climate lobbying position and all direct lobbying activities and its Paris alignment Disclosure of memberships of trade associations and associated lobbying Paris alignment of trade associations memberships and associated lobbying	Disclosure of climate lobbying position and all direct lobbying activities and its Paris alignment Disclosure of memberships of trade associations and associated lobbying Paris alignment of trade associations memberships and associated lobbying
	Just Transition	Transition risk analysis and disclosure of transition plan	Transition risk analysis and disclosure of transition plan Impact analysis of the transition plan and the Paris aligned business model on its workers and communities	Transition risk analysis and disclosure of transition plan Impact analysis of the transition plan and the Paris aligned business model on its workers and communities
	Climate Risk Accounting and Audit	Climate-related issues included as CAM/KAM in auditor reports Accounting judgements and consistency with other sustainability reporting (impairments, asset useful lives and retirement obligations)	Climate-related issues included as CAM/KAM in auditor reports Accounting judgements and consistency with other sustainability reporting (impairments, asset useful lives and retirement obligations) Inclusion of climate assumptions in financial accounts and auditor reports Use of internal carbon price and disclosure around the same	Climate-related issues included as CAM/KAM in auditor reports Accounting judgements and consistency with other sustainability reporting (impairments, asset useful lives and retirement obligations) Inclusion of climate assumptions in financial accounts and auditor reports Use of internal carbon price and disclosure around the same Effect of climate targets on financial accounts and audit reports

- 2.5 Tailor milestones for companies as required** – A transparent framework identifying how investors intend to engage with portfolio companies (what they will ask for and when) helps build trust. However, a rigid framework may not be applicable in all circumstances. Portfolio companies may be restricted from setting or achieving targets by national policy or universal service obligations for example. Diversified conglomerate companies may have limited ability to exert direct control over subsidiaries. Recognising the imperative created by net zero to reduce absolute emissions as quickly as possible, engagement may need to recognise these constraints and incorporate flexibility to deliver the best long-term result. Investors should adjust objectives where deemed necessary.
- 2.6 Set asset level targets and impact metrics** – Once the baseline alignment assessment of companies is complete and the proportionate alignment status of companies in the portfolio has been determined, and the initial engagement work and expectations are modelled out, investors will be able to set their sets of goals (in 5-year increments for those using the Net Zero Investment Framework) or increasing the proportionate alignment status of companies in the portfolio.

## Exhibit D – Illustrative demonstration of shifts in portfolio alignment across different levels of alignment

(see IIGCC's Supplementary Target Setting Guidance<sup>8</sup> for further information)



<sup>8</sup> Net Zero Investment Framework: IIGCC's Supplementary Guidance on Target Setting (2021) Source: <https://www.iigcc.org/download/net-zero-investment-framework-iigcc-supplementary-target-setting-guidance/?wpdmdl=5224&refresh=620f87a8d48341645184936>

## Exhibit E – An illustrative framework for disclosing key objectives and outcomes

Alignment Assessment Level	Not aligned	Committed	Aligning	Aligned
<b>Baseline no. of companies</b>	(no.) X% of companies, covering X% of financed emissions	(no.) X% of companies, covering X% of financed emissions	(no.) X% of companies, covering X% of financed emissions	(no.) X% of companies, covering X% of financed emissions
<b>5-year alignment target for companies</b>	(no.) X% of companies, covering X% of financed emissions	(no.) X% of companies, covering X% of financed emissions	(no.) X% of companies, covering X% of financed emissions	(no.) X% of companies, covering X% of financed emissions
<b>Time bound objectives for engagement (company level)</b>	List of company level objectives expected to be delivered by level			

### Case study: LGIM's Climate Impact Pledge

LGIM has been engaging with some of the world's largest companies on their strategic approach to climate change since 2016. In 2020, the engagement programme was expanded and deepened to explicitly focus on encouraging portfolio companies' alignment with a net zero trajectory.

As an equity index broadly representative of its clients' assets and where LGIM in the main has voting rights, the MSCI ACWI was selected as the starting universe. 15 broad sectors were selected for engagement, constructed from 32 GICS sub-industries, representing approximately 1,000 issuers and 60% of emissions\* from material sectors.\*\* A quantitative assessment framework aligned with the TCFD and CA100+, tailored to the specific sectors, was constructed using datasets from the likes of CDP and Sustainalytics and applied to the issuers. The results of the assessments are made publicly available on [LGIM's website](#), to encourage improvement across the market, and performance on certain critical indicators such as climate board governance, emissions reduction targets and reducing emissions intensity are linked to voting.

The quantitative scores were then used to identify approximately 60 issuers who would be subject to direct engagement. These are issuers who, considering their market cap size, have relatively poor scores – i.e. large, leading companies who are not yet meeting best practice expectations but who would have a significant trickle-down impact on their respective sectors by aligning to a net-zero trajectory. These companies are assessed according to publicly available frameworks, again closely aligned with external best practice and publicly available on the [LGIM website](#). Companies who fail to respond to engagement efforts are subject to voting sanctions against the chair, and ultimately divested from applicable funds.

\* Based on MSCI ACWI as starting universe

\*\* As defined by PAII, NACE sectors A-H and J-L.

## Step 3

# Develop an engagement strategy for priority companies

### Output

At the end of this step, an investor will be able to set out:

- The approach to net zero alignment engagements
- The engagement approach they will deploy for priority companies
- How escalation actions are built into each priority company engagements

## Overview

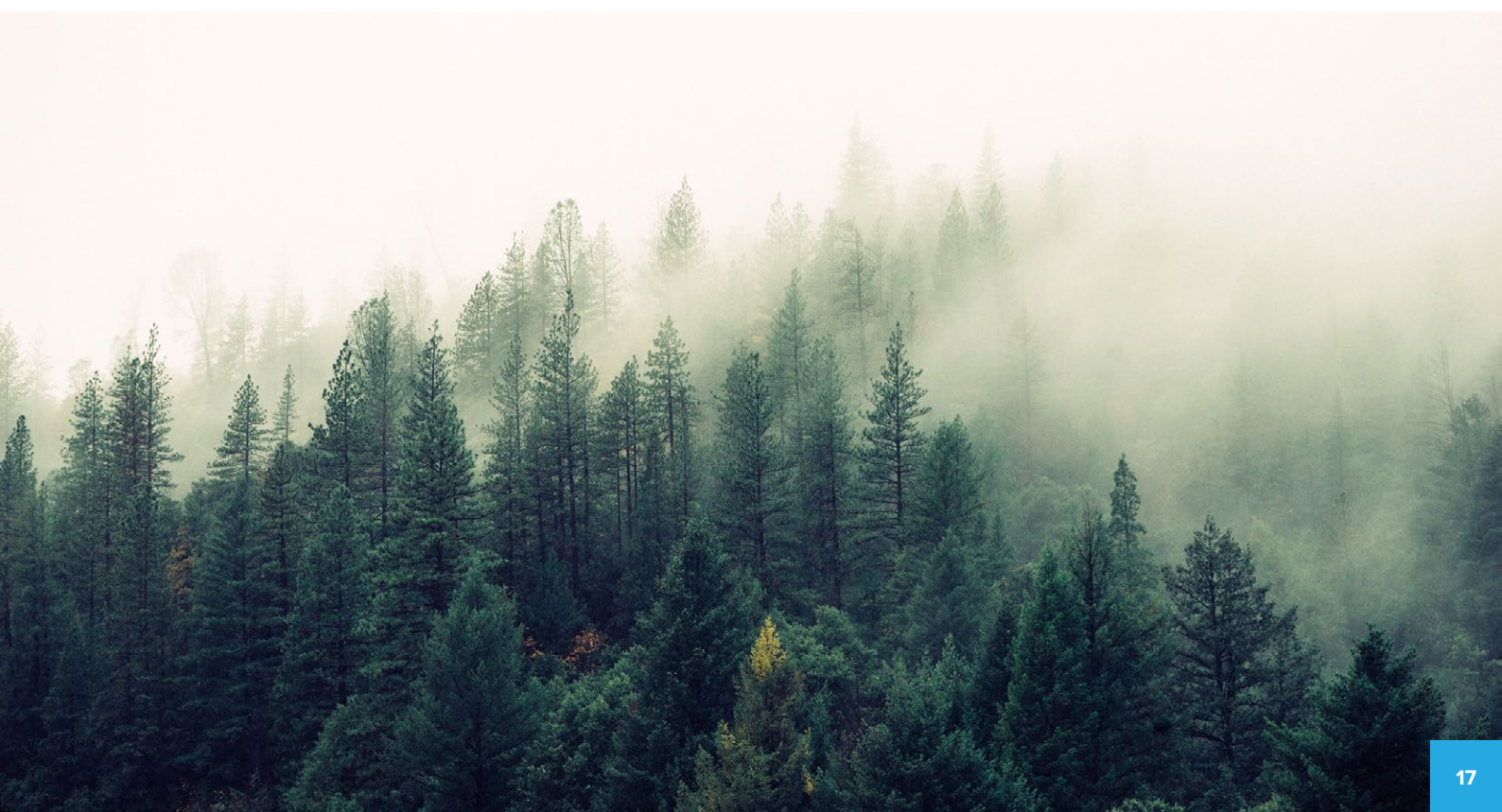
Priority companies are those identified for enhanced engagement and related stewardship escalation based on portfolio net zero engagement materiality and their need and prospects for change, as described in the first step of the net zero stewardship strategy. Enhanced engagement involves increased dialogue and escalation planning for priority companies on key net zero criteria (the transition plan) and the gaps, initial and ongoing assessment of their progress, with clear objectives and stewardship strategies based on the alignment status and gaps, all guiding the engagement. The enhanced engagement strategy assumes that investors have confirmed appropriate management support and approvals for basic costs and compliance signoffs internally, in order to undertake stewardship strategies. The enhanced engagement should be premised on an approved internal process on company and portfolio alignment assessment, accompanied by a simple tracking mechanism and a clear delivery strategy to steer and escalate necessary actions if progress against objectives is not achieved through dialogue with priority companies. This section focuses on detailing how investors should design “a stewardship and engagement strategy, with clear escalation” to deliver on their net zero commitments (see Box 1), noting that detailed implementation including the voting policy element is covered in the next section.

## Approach

The sub-steps to undertake are:

- 3.1 Internal preparation of priority company engagement strategy** – The first stage in the process is to prepare the engagement strategy internally. The following steps can be used to ensure engagement preparation is thorough.
- **Setting objectives and progress monitoring** – As set out in Step 2, investors should set time-bound (annual) objectives to ensure continual improvement and to act as the foundation for organising engagement. Priority company objectives should be set early in the process using the net zero alignment criteria. Systems should be put in place to track the progress of the company against objectives.
  - **Identifying key stewardship strategies and escalation plan** – While dialogue will be the initial route for engagement, investors should identify suitable key stewardship strategies and preparation required for these for each engagement in advance of commencement. It is important to determine an escalation plan in advance to ensure sufficient time is left for the plan to be executed. For example, lead times to file shareholder proposals can be multiple months. A set of key stewardship strategies are detailed in Exhibit F below.

- 3.2 Priority company dialogue** – Each priority company should be engaged in a consistent manner to ensure that it is made aware of investor expectations of the necessary action on climate change, in line with the investor's net zero investment strategy and related targets. This will involve explaining to each company the detailed applicable expectations for action on climate change, tailored as appropriate to its own circumstances (such as sector, geography, business model). In many cases, this will involve discussions with C suite-level executives and certain executive functions (usually strategy, finance, sustainability) to ensure the company is fully aware of investor expectations and to better understand any company context and its transition pathway rationale. The investor should communicate the timeframe of actions required and the likely results if action is not achieved within this, including engagement escalation options and the likely approach to voting, which should all be clearly communicated. Modes of communication that should be utilised where possible include letters, private dialogue, discussions with the Board and/or independent directors, a statement at the AGM and/or public statements, if needed.
- 3.3 Progress assessment** – At a defined point in line with the deadlines communicated to companies and the milestones used in the alignment assessment, a review should be carried out to determine if the initial dialogue has been successful or not. If not, a final effort engagement can be launched; for example, writing to the company notifying them of the intent to deploy a key stewardship strategy or use of voting rights.
- 3.4 Key stewardship strategies for escalation** – There are two key stewardship escalation strategies outlined here which may be deployed in tandem or consecutively.
- A. Non-voting escalation action** – The first escalation option includes non-voting options that could be as varied as identifying and nominating a director for appointment to the board or filing a shareholder proposal. These options are further elaborated in Exhibit F.
- B. Recourse to the voting policy** – If the company has resisted engagement it may also be appropriate to use voting rights to signal that the company should change course, for example by voting against the re-election of a responsible director. The next section of this toolkit addresses the design of voting policy. **Note: voting options are outlined in section 4 of this toolkit because they can be applied more widely than the companies identified as 'priority companies.' This however does not mean that they should not be integrated into the approach to engaging priority companies.**
- 3.5 Review and reset** – At the end of each annual cycle, company and portfolio alignment assessment should be carried out to determine which companies have progressed sufficiently, affirm their status as a priority company and/or include new priority companies to the extent applicable.



## Exhibit F – Non-voting escalation actions which can be deployed if dialogue does not succeed

Key stewardship strategy	Approach overview	Key deployment considerations
<b>Generic Engagement Strategies</b>		
<b>Direct outreach to companies</b>	Direct engagement typically leads to accelerated action by companies.	It helps to articulate investor expectations to companies.
<i><b>Engaging with Management</b></i>	Having regular engagements meetings with management implementing objectives.	Regular engagement meetings established.
<i><b>Board level engagement meetings</b></i>	Escalating engagements to more senior levels as required. Securing or increasing the 'check ins' with Board members as well.	Usually, the Chair for shareholders and Financial Director for Bondholders.
<b>Use of collaborative engagements</b>	Investor collaboration typically leads to accelerated action by companies.	It helps to articulate to companies a consensus of investor expectations.
<b>Expanding the engagement team</b>	Increasing the number of investors involved and the resources each can devote to the engagements.	Raising any concerns with other investors and deploying additional / and more senior personnel.
<b>Letters to the Board (private)</b>	Writing privately and formally to the Board to give a summary of investor expectations, progress of engagement to date and required changes.	Providing advance notice of expectations, asks and intentions to escalate can help concentrate Board thoughts.
<b>Public statements and public letters to the Board</b>	Sharing concerns and details of a lack of progress with other investors and stakeholders through own website and media channels.	Timely and appropriate communication of investor expectations and progress of engagement can give impetus to engagement and help companies to make progress more rapidly.
<b>Increasing the frequency of engagement and communications</b>	An intensification of engagement to a greater depth and frequency.	Establish any reasons for slow progress and to unblock either misunderstandings or technical barriers of how to meet expectations.
<b>Raising these concerns with other investors</b>	Sharing concerns and details of a lack of progress with other investors.	This helps prepare the ground for increased collaborative action when required.
<b>Collaboration with external fund managers / brokers</b>	Open new channels to achieving objectives.	Helps line up increased levels of support to demonstrate to Boards the issue is material.
<b>Collaborative letters</b>	Public or private letters to companies from groups of likeminded investors.	Investor collaboration typically leads to accelerated action by companies, as it helps to articulate to companies a consensus of investor expectations.
<b>Engage with company advisors</b>	Open new channels to achieving objectives by engaging with advisers.	Examples are: engaging with auditors of audit practices and statements; lawyers on specific jurisdiction issues; or technical discussions on mitigation mix.

<b>Engagement with key actors in the value chain</b>	Open new channels to achieving objectives with key elements of companies' value chain.	Value chain demand and supply engagement can have longer-term benefits for investors.
<b>Litigation</b>	Legal recourse against companies or specific directors can be an effective tool and help secure positive outcomes, objectives or returns.	Actions to seek redress from companies for losses may be practicable. In some jurisdictions Board members can be held more accountable for inaction on risks or other actions that potentially contributed to the loss of assets.
<b>Selling down / Divesting</b>	Reducing holdings and divesting to reduce exposure to investments may help align portfolios.	Investors might choose to switch shares / bonds to more decarbonised peers and sectors.
<b>Shareholder Specific Strategies</b>		
<b>Questions and statements at Shareholder Meetings</b>	This helps help raise visibility on material issues for other voters.	Investors can present their concerns over a company's approach to climate change, or ask questions of management to elicit a response.
<b>Shareholder meetings – Investor positions on resolutions</b>	Voting on both shareholder and management resolutions. Meetings where the company and/or holders of shares seek shareholder approvals are an effective platform for indicating concerns.	<p>This includes:</p> <ul style="list-style-type: none"> <li>• Voting in opposition to management resolutions if there are concerns; and</li> <li>• Potentially publicly pre-declaring opposition or support for resolutions.</li> </ul>
<b>Shareholder meetings – Shareholders proposing resolutions</b>	Shareholders have the right in most markets to submit resolutions for voting consideration by other shareholders. This can help owners of companies overcome reticent management/ Boards by going to fellow owners.	<p>Support for, and potentially proposing shareholder resolutions helps drive discussions and initiate change.</p> <p>Supporting management and shareholder climate related resolutions where they are aligned with objectives. Opposing where counter to these.</p>
<b>Nomination of new board directors</b>	If Boards are deemed to be entrenched or lacking specific skills, owners can propose additions.	Helps ensure Boards have the necessary skills in place to understand the risks and opportunities of the transition.
<b>Campaign to remove directors</b>	Directors can be held accountable for companies lack of progress on meeting investors' expectations.	If directors are held accountable for their actions, or lack of mitigating action on climate related risks, then moves to not re-elect the relevant directors.
<b>Bondholder Specific Strategies</b>		
<b>Bondholder Meetings</b>	Questions and statements submitted at meetings of bond holders.	This helps help raise visibility on material issues for other bondholders.
<b>Engaging with bond holders</b>	Include bondholders in equity engagements for inputs in Net Zero alignment assessments.	Helps with effective target setting and decarbonisation strategies.
<b>Inclusion of climate transition considerations in bond indentures and prospectuses</b>	Creation of an industry bondholder specific forum in partnership / as an offshoot of existing equity investor forums to highlight and address bondholder specific issues.	Inclusion of Net Zero and Climate alignment assessment status in indentures. Embedding climate related KPIs in agreements.

## Bondholder considerations

Bondholders even in public companies do not have the same mechanism as shareholders to hold companies to account due to the absence of voting rights. However, bondholders fund 55-80% of a company's capital structure and can have significant influence on a company's business and climate strategy, decarbonisation pathway, covenants and cost of capital depending on concerted action. As a first step, it is suggested that large bondholders can be involved in the equity engagements of their respective holding companies and provide inputs on net zero alignment assessment and decarbonisation strategies. While bondholder choice to invest only in companies with credible climate and net zero transition plans and in green bonds is an alternative tool, involvement in equity engagements on holding companies can be a first step to steering decarbonisation in holding companies as additional mechanisms are being constructed. In this regard, creation of collaborative forums through industry associations (through the IIGCC, LMA, ELFA, ICMA) are also encouraged. Additional thoughts and considerations from key bond investors are invited in this regard.



## Step 4

# Baseline engagement and voting policy approach

### Output

At the end of this step, an investor will be able to set out:

- Standard processes for communicating expectations with companies
- Their approach to linking company level objectives with voting actions for all companies
- Their approach to Say on Climate Votes

## Overview

While enhanced engagement with priority companies provides an important platform to achieve significant real-world emissions reductions and meet portfolio decarbonisation targets, incorporating climate into baseline engagement (e.g. ensuring a minimum level of engagement is delivered) is also a critical part of meeting these goals. This is also important to manage resource and support investors with large portfolios.

Asset owners and managers committed to net zero must implement an engagement and stewardship strategy for all assets (within scope) in the portfolio, with a clear voting policy. The objective of this section is to detail what baseline engagement should constitute and what a clear voting policy element means.

## Approach

The sub-steps to undertake are:

**4.1 Communicate net zero alignment expectations (as determined in Step 2) where feasible:** Where feasible, define a process for communicating investor expectations for action on climate change to all companies, including the milestones and appropriate timeline to achieve these. This may be a single letter or a meeting(s) and discussion, subject to resource. It may also be delegated by asset owners to asset managers or to a new collaborative engagement effort like the SBTi net zero targets letter campaign that reaches over 2,000 companies. Equally, if resource is severely constrained, a generic statement issued on the investor website covering the points below could act as a critical reference point for the market. Investors should set out:

- Their request for full alignment to be achieved
- Which objectives they have set or prioritised for the company/companies
- Deadlines or timelines for delivery
- The voting action that may take place if a company does not meet these expectations.

Where a company is part of a collaborative engagement initiative (e.g. CA100+, PRI) then investors should make efforts to align their expectations and collectively communicate these. Engagement to discuss a company's response and its viable transition pathways should also take place collaboratively, to the extent practicable, in line with the appropriate collaborative engagement guidelines.

**4.2 Define ‘Net Zero’ voting policy for routine votes:** For listed equity a ‘Net Zero’ voting policy will provide a critical tool for both priority companies and all other companies in scope of alignment goals. The ‘Net Zero’ voting policy should also expand to the full equity portfolio universe as practical. Best practice voting would leverage the voting options of all assets under management where feasible rather than just the assets managed in line with net zero. For example, where an investor holds 1% of Company A in a NZ portfolio and 2% in other portfolios, they should align the voting of the aggregated 3% holding overall where feasible. Investors should define how they will vote on different routine votes when key net zero alignment criteria have not been met after a defined period, where this has been signalled to companies or when a specific time-bound engagement objectives has not been met. Where practical, investors should extend voting to incorporate the Net Zero Investment Framework additional criteria, ideally at a minimum for CA100+ focus list companies. Investors may wish to specify additional ‘catch-all’ criteria to ensure all companies deliver on basic features of a climate strategy, such as those contained within the TPI [Management Quality Framework](#).

The table below provides an overview of the types of policies that could be implemented on different routine votes. Where practical the voting policy should be tailored to take into account any material failure by investor initiatives like the CA100+ flagging process and the Investment Association (through the red topping<sup>9</sup>). Investors may need to identify where additional information is required to inform vote decisions on complex issues and topics. For example, climate data verification and measurement, accounting and audit, remuneration and M&A votes.

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9 A red-top is the highest level of warning that the IVIS issues and is applied to those companies whose investors should have the most significant and serious corporate governance concerns: <https://www.downthewireblog.com/2019/02/investment-association-red-top-for-2019-agm-season/>



## Exhibit G – Example of a model ‘net zero’ voting policy on routine votes

Routine vote	Example Net Zero policy actions	Relevant criteria	Conditions for deployment or vote triggers
<b>Chair &amp; Director appointment, re-appointment, or committee chairs</b>  <b>Ideally companies should identify which directors are responsible for the NZ transition strategy</b>	<p>Vote against chair/ re-appointment of relevant directors when there is an absence of 1.5°C GHG target and/or disclosures demonstrating the company is ‘aligning’ with net zero</p> <p>Note a different approach may be taken to voting on the chair versus other directors.</p>	<b>Ambition</b> <b>Targets</b> <b>Climate Governance</b>	<p>After a deadline to deliver on criteria /time-bound objective has elapsed</p>
<b>Remuneration</b>	<p>Vote against remuneration where climate not addressed or using the principle of a ‘climate underpin’ whereby until a comprehensive net zero strategy has been set the remuneration policy should be considered misaligned with investor interests</p>	<b>Ambition</b> <b>Targets</b> <b>Climate Governance</b> <b>Sector specific metrics such as whether the company continues to expand fossil fuel production</b>	<p>When a catchall or baseline expectation has not been met (E.g. an expectation that all companies have a ST target by 2025 at the latest)</p> <p>When the vote has been flagged or ‘red topped’ by an initiative like CA100+ or the IA or a proxy advisory has identified a material governance failure linked to climate</p>
<b>Annual Report &amp; Accounts</b>	Vote against the annual report & accounts where no reference to climate risk is made in the notes on the preparation of the financial statements	<b>Climate risk and accounts</b> <b>Climate Governance</b>	
<b>Auditor re-appointment</b>	Vote against where the audit report does not reference climate risk (e.g., in line with forthcoming CA100+ indicators)	<b>Climate risk and accounts</b> <b>Climate Governance</b>	
<b>Mergers &amp; Acquisitions</b>	Consider voting against where no disclosures have been made setting out whether the new/expanded entity will ‘align’	<b>All Net Zero criteria</b>	When votes arise
<b>Shareholder proposals</b>	Consider voting for where there is consistency with net zero alignment criteria	<b>All Net Zero criteria</b>	When votes arise

**4.3 Define Say on Climate Vote policy:** The ‘Net Zero’ voting policy should be supplemented by a specialist approach to so-called Say on Climate votes, where a company has made the choice to submit its net zero transition plan to investors for approval. In the event a company has been bold enough to submit a plan for approval investors should exercise caution when endorsing plans and identify clear evaluation criteria for support related to the net zero components being used to determine alignment. In some cases, supplemental analysis may be needed.

The table below sets out core evaluation criteria for the support of Say on Climate votes which investors may wish to adapt or enhance. Investors should define their core criteria for supporting votes as well as voting on implementation progress. Where votes on implementation progress are provided and the underlying plan has not met critical standards for net zero alignment, investors should consider voting against.

## Exhibit H – A template for application of Evaluation Criteria for the support of Say on Climate Votes, linked to key NZ components with the provision of additional sector specific examples

Say on Climate Relevant Topics	Evaluation Criteria for Say on Climate	Relevant strategy for companies not meeting Minimum Standard actions	Recommended requirements to get support
Net Zero Ambitions (NZ criteria: NZ ambition)	The company has a clear Net Zero target for 2050 or sooner covering all relevant emissions (or appropriate sector trajectory)	Vote against plan and request new one	Public evidence of compliance or intent to comply with minimum standards, commitment to set 1.5C Net Zero targets across all relevant scopes and produce a transition plan aligned with a CA100+ benchmark
Medium Term Targets aligned with 1.5C (NZ criteria: Med term target)	The company has sufficient medium-term targets present for Scope 1 and 2 and relevant Scope 3 GHG emissions that are aligned to 1.5C (assessed by TPI or SBTi)		
Quantified decarbonisation plan and investment plan (NZ criteria: decarbonisation strategy)	The company has quantified how it will deliver its medium-term targets and set out an investment plan (approach could be varied)		
Additional sector specific minimum standards (NZ criteria: supplemental sector requirements and/or additional analysis)	For example: For oil and gas: no new investment in new production  For power: achievement of zero emissions electricity by 2035 is specified for companies in OECD countries		

- 4.4 Voting communications:** To incentivise companies to understand the level of investor concern, investors should look to publish details of their net zero voting approach ahead of each proxy season, where possible. Voting intentions and approach should be communicated to the company before the vote itself, to make clear the need for change in line with investor expectations. All voting decisions on priority companies should ideally be publicly communicated following each vote. In addition, consideration should be given to publicly communicating voting intentions either ahead of the proxy season (at policy level), or before a particular vote at a company during the proxy season where, in the judgement of the investor, this is likely to give impetus to any final ongoing engagement, prior to the vote itself.
- 4.5 Stewardship integration:** The results of stewardship at a company, including the progress made and prospects for further changes, should be considered by reference to the investor's expectations for change consistent with meeting its climate change investment strategy and targets and then used as an input into the investment process and decisions on investment holdings. It is noted that the Net Zero Investment Framework identifies that stewardship should be the main tool by which to achieve change at companies in line with investor expectations and that divestment should only be used as a last resort (in the case it can be used at all) where escalation has been exhausted or change is otherwise seen as infeasible. Investors may however wish to tie investment actions – either positive or negative – to progress made by companies in much the same way as voting actions. For index portfolios, given divestment is not feasible, stewardship should be pursued instead while ensuring adequate understanding of the priority companies and targeting engagement efforts towards these.



Exhibit I – A stewardship strategy tracker for priority company engagements

Company	Criteria	Engagement stage	Objectives	Dialogue planned	Deadline for objectives	Escalation actions		Real world impact
						Key stewardship strategy selected (escalations)	Voting policy action	
EM Power Utility Company A	Ambition	Year 1	Net Zero ambition and commitment	Letter to Chairman	End of Year 2	File shareholder resolution	Vote against Chair of Sustainability Committee or Chair of Board	Reduction of emissions by XXGt per year from 2023
	Targets		Set SBTi 1.5d aligned targets (LT, MT, ST)	Meeting with Board and Sustainability Team				
	Governance		Board oversight on Climate and Net Zero	AGM statement				
	Emissions data		Disclose Scope 1, 2 and 3 emissions	Last ditch meeting (by end of year 1)				
	Climate accounting							
	Decarbonisation strategy							
	Capital allocation							
	Policy engagement							
	Lobbying							
	Just Transition							
DM Oil and Gas Company B	Ambition	Year 2			End of Year 3	File shareholder resolution	Vote against Chair, Board Audit Committee and/or reappointment of auditor	Include climate risk in accounts, quantified capital allocation, phase out of coal and investment in renewables
	Targets							
	Governance		Climate KPIs / metrics linked to remuneration	Letter to Chairman				
	Emissions data							
	Climate accounting		Include Climate Risk in accounts	Meeting with Board and Sustainability Team				
	Decarbonisation strategy		Quantified decarbonisation and coal phase out	AGM statement				
	Capital allocation		Capital allocation and green capex disclosure	Last ditch meeting (by end of year 1)				
	Policy engagement							
	Lobbying							
	Just Transition							

## Step 5

# Asset owner and manager alignment, engagement and transparency

### Output

At the end of this step, an investor will be able to set out:

- A mapping of how engagement aligns with that of other asset owners and/or managers
- Plans for collaboration with other investors where there is alignment on priority companies to maximise impact
- Suggested framework and templates for asset owners and asset managers to report
- Company and portfolio net zero alignment and stewardship activity

### Overview

Climate and net zero stewardship and engagement is now being used by many asset managers and asset owners as the key tool to align portfolios with net zero. It is important to reconcile, sync and refine priority companies, alignment assessment frameworks and milestones and voting and escalation actions, across asset owners and managers. The main objective here is to ensure that engagement activity from an asset manager delivers what asset owners require to align their portfolios with net zero, optimises uses of resources, and ensures consistency of goals and approaches across asset owner portfolio engagement efforts. This step may equally be relevant or adaptable to the relationship between independent financial advisors and fund managers. In addition, the section covers transparency and consistent reporting from asset owners and asset managers on their overall portfolio Net Zero alignment and engagement strategy, assessment, tracking and reporting.

### Approach

The sub-steps to undertake are:

- 5.1 Engagement with asset managers that have not set net zero goals** – Where asset managers are yet to make a net zero commitment (e.g. by joining Net Zero Asset Managers), asset owners may wish to prioritise engaging asset managers to take this formative first step.
- 5.2 Asset owner agreement on company alignment expectations and communication to asset managers** – Asset owners should determine alignment criteria and milestones, as determined in Step 2. This should be communicated to the asset manager to incorporate into their ongoing Paris alignment assessment process across portfolio companies to the degree possible. For asset managers, given the number of portfolios, clients and companies being engaged with, a broadly standardised yet flexible approach to communicating and implementing stewardship objectives, ongoing progress and alignment with milestones, final outcomes and impact, with the asset owners becomes important. The determination and communication of the time-bound objective setting approach between the asset owner and asset manager may range from a discussion and/or e-mail to an agreed upon template documenting the objectives, approach and reporting. In case of decisions to use such templates, these can form an addendum to the Investment Management Agreement (IMA) between the asset owner and asset manager. An example of a draft template for company level Paris alignment assessment, portfolio level reporting and draft IMA language for overall alignment is as presented below.

## Illustrative example of an IMA template on net zero alignment, voting and stewardship activity

1. The Manager will be signed up to the [Net Zero Asset Manager (NZAM)] Initiative committed to supporting the goal of Net Zero greenhouse gas emissions by 2050 or sooner.
2. The Manager will adhere to the Principles of the [relevant regional Stewardship Code] in its management of the Portfolio. For instance: for the UK, the asset manager will adhere to the Principles of the UK Stewardship Code and will notify the Asset Owner as part of regular review and reporting questionnaires that it continues to be a signatory to the UK Stewardship Code, and/or, if applicable, that it has ceased to do so.
3. The Asset Owner will – for segregated portfolios – make its own arrangements and be responsible for voting rights attached to investments of the Portfolio except as expressly set out in this Agreement and, without limitation, will retain (either for itself or its designated voting agent) all rights relating to vote, or refrain from voting, with respect to securities in the Portfolio.
4. The Manager will - subject to legal and regulatory restrictions - provide opinions on voting where reasonably requested by Asset Owner, including, where it is reasonably possible for the Manager to do so, notification with regard to voting resolutions in respect of Portfolio investments of which the Manager is aware, together with Manager's voting recommendation and a brief rationale therefore.
5. The Manager will provide a copy of its annual TCFD disclosure covering climate risks and opportunities across its business.
6. Ideally, the Manager shall provide the Asset Owner at the portfolio-level with such information as it reasonably requires to review and monitor including but not limited to data on Scope 1, 2 and Material Scope 3 emissions and emissions intensity along with a list of data sources used, a classification of holdings with reported and estimated data (and associated estimation methodologies). In case of any contractual issues or restrictions between the Managers and the underlying data providers, these will be flagged and discussed with the Asset Owners.
7. The Manager will provide climate scenario analysis (including physical and transition risk assessment) on the portfolio for a range of publicly available, climate change scenarios along with a description of the associated methodologies.
8. The Manager and Asset Owner may from time to time engage in dialogue on future public policy activities, including areas of key focus such as climate change, relevant to the Portfolio.
9. The Manager will provide an update on climate and Net Zero engagement activities in respect of Portfolio to the Asset Owner including:
  - Quality reporting to the Asset Owner consistent with the expectations of the [relevant regional Stewardship Code] which shall include a brief summary of the engagement activities over the reporting period, including evidence of the effectiveness of those activities
  - Annual reporting of any stewardship conflicts of interest which arise in the Portfolio;
  - Regular reporting on material Net Zero and climate issues affecting the Portfolio, to be included in portfolio company analysis and reporting provided; and emissions alignment reporting in accordance with the table in Schedule 1
  - In relation to Net Zero compliance, except where the Manager has received the prior written consent of the Asset Owner, the Manager will agree to:
  - Take reasonable steps to track Scope 1 and Scope 2 emissions for each holding on an ongoing basis and calculate financed emissions in the Portfolio with a description of the associated methodology used;
  - Ensure that by pre-agreed appropriate timeframe, 70% of financed emissions in material sectors determined in accordance with this Agreement) is either aligned to Net Zero or subject to engagement on an ongoing basis, with such percentage increasing from “70%” to “90%” by 2030; and
  - Exercise such rights and powers as are available to it as discretionary manager under this Agreement to ensure that, by 31 Dec-2040, 100% of the Portfolio investments are either ‘aligned to net zero’ or ‘net zero’.

\*\*\* Material sectors are defined by the NACE codes in the EU taxonomy [https://ec.europa.eu/info/sites/default/files/business\\_economy\\_euro/banking\\_and\\_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy\\_en.pdf](https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf)

- 5.3 Asset manager reconciliation across asset owner clients on milestones and smoothing** – Asset managers typically manage assets across several asset owner clients, including pension funds, sovereign wealth funds, endowments, family offices and retail investors. It is inevitable that a portfolio company will be a holding across many client portfolios with the same asset manager. In this case, it is imperative that the asset manager is able to reconcile the objective setting approach and its specific outputs across all its client portfolios which are exposed to this company. The asset manager will ideally use all reasonable efforts to reconcile the objective setting approach across its asset owner clients, to avoid expressing varying views on a company's net zero alignment status. This may be achieved by providing fairly simple summaries to clients setting out how they are approaching the steps outlined above. However, as indicated, differences in individual net zero targets across asset owners amongst other considerations for asset managers could potentially result in differing views on Paris alignment assessments for the same company across different client portfolios. In such instances, asset managers are encouraged to engage with the asset owner clients to identify how to generate alignment to the degree this is permissible in the context of IMAs.
- 5.4 Transparency and reporting** – Stewardship and company engagement is a rich and varied activity across investors with major areas of overlap in climate change and net zero, and significantly heterogeneous and bespoke factors depending on client base, their engagement themes and priorities, stewardship policies, jurisdictional challenges, and organisational, regulatory and compliance considerations. Building on the above, this section attempts to incorporate consistent and transparent reporting into the key areas of common consideration, namely net zero alignment and stewardship, in line with the goals of the Toolkit. There are sample reporting templates in Appendix A that cover Scope 1, 2 and 3 emissions, reported versus estimated emissions data, company alignment status, portfolio alignment status, key voting issues and updates on engagement activity that asset managers and asset owners can choose to use to consistently track net zero alignment and stewardship impact.

## Exhibit J – Illustrative example of reporting templates for asset managers

Net Zero Alignment and Stewardship Reporting Templates	Frequency, Format and Timing
Suggested stewardship template covering engagement activity, updates and key voting issues by company (or any other such template as asset owner and asset manager may agree from time to time)	The frequency, timing and format of reporting may be quarterly, semi-annual or annual with specific timelines dependent on discussion and mutual agreement between the asset owner and manager.
Suggested stewardship template covering engagement activity, updates, key voting issues by company, portfolio level voting statistics and metrics (or any other such template as asset owner and asset manager may agree from time to time)	
Suggested Net Zero alignment and emissions reporting template (or any other such template as asset owner and asset manager may agree from time to time)	

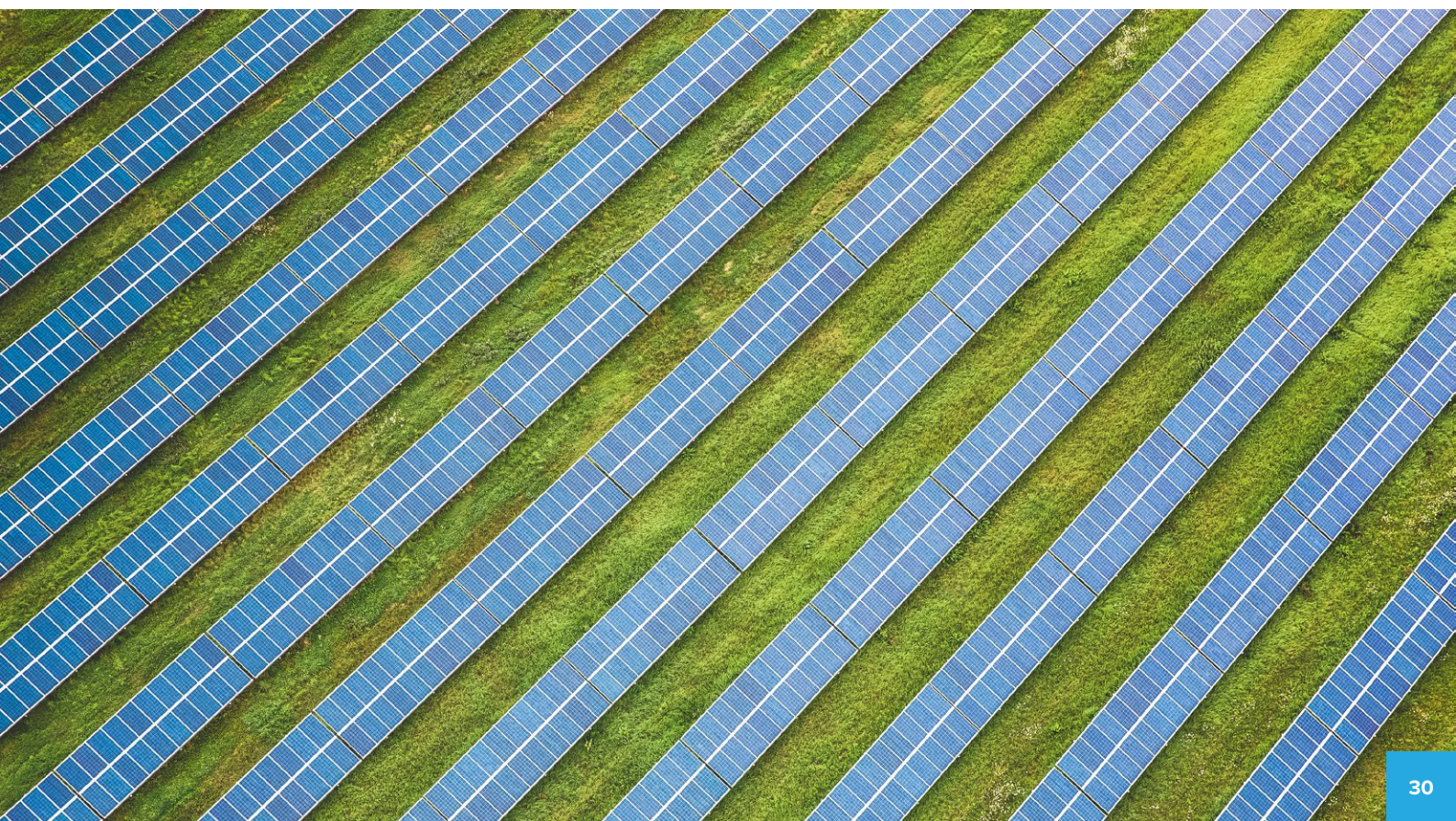
**5.5 Coordination and systematisation** – The Paris alignment assessment and the objective setting approach are both relatively new and necessitate subjective considerations for asset owners and asset managers. They are not yet standardised and provided by third parties like non-financial (ESG) ratings, or credit ratings. However, the long-term goal for the Net Zero Investment Framework is to ensure better coordination on net zero alignment assessment across the market; simple, transparent and consistent reporting on key metrics on alignment and engagement; and potentially even systematise the alignment criteria and outputs across asset owners, managers and corporates.

## Next steps

While the reconciliation and smoothing process can be handled through transparent reporting and standalone discussions between the specific asset owner client and asset manager, there is also the potential to be able to seamlessly integrate the basic IMA and reporting building blocks and facilitating the overall process through a centralised clearing house managed by IIGCC with the asset owners and managers as members. The clearing house can serve to:

- Provide a central repository to log, discuss, inform and update on alignment performance of a portfolio company based on ongoing individual and collective engagement with a portfolio company and investor reporting. Similar to a collective engagement initiative, a clearing house of this nature will allow for aggregation and highlight crucial alignment issues with portfolio companies. It can also provide valuable insights, observations and updates to investors both positive and negative, which may otherwise not have been made available to investors on standalone engagements and individual company-investor messaging.
- Be a central point of contact for smaller asset owners or those without the in-house teams or resources to provide a Paris alignment assessment framework for portfolio companies. In addition, it can also serve as a resolution point in cases where there is a discrepancy of views around the Paris alignment status of specific companies either due to milestone or timeline customisation from the asset owner and/or difference of views from the asset manager and its stewardship team on an individual company's alignment performance.

A clearing house can also provide a repository and an independent point of contact to maintain, refresh, discuss and update views on Paris alignment assessment as a concept and its alignment status as an ongoing metric based on developments in methodologies, data, tools, and portfolio company performance. In 2022 IIGCC will launch a new Net Zero Engagement Programme that may facilitate this need.



# Challenges and Limitations

## Overview

The overall approach of the document towards prioritisation of key companies, alignment assessment and baseline engagement is largely based on its direct application to listed equities and corporate fixed income holdings which are usually the largest components of asset owner and asset manager portfolios. In addition, the outlined stewardship approach loosely links itself to the Net Zero Investment Framework while also facilitating alignment with other target-setting and stewardship approaches from the NZAOA and SBTi amongst others. In maintaining a flexible approach and covering majority of asset owner and asset manager portfolios while also providing a reasonably prescriptive toolkit for investor use, it is unsurprising that the approach does have limitations.

The goal of this section is to highlight key challenges and limitations pertaining to prioritisation, alignment assessment and baseline engagement strategy development, at a very high level. A number of these limitations will be addressed in more detail in subsequent versions of the Toolkit which will target specific asset classes, jurisdictions and their challenges in more detail.

## The key challenges and limitations include:

- **Sector Prioritisation Methods:** NACE codes as set by the EU taxonomy are one way to classify sectors and prioritise emissions potential. There are other commonly used sector classifications like GICS and ICB. In addition, there are questions around the broad coverage of overall equity market leading to a broader definition of materiality. Investors can use other sector classifications allowing a narrow focus on high emissions sectors to start and subsequently broadening this scope. Scope 3 emissions also remain a key open question today. Investors may merit from considering which sectors and related holdings may account for significant Scope 3 emissions and use this information to refine the list of priority companies for engagement.
- **Unlisted Assets:** Asset owner and manager allocations to unlisted asset classes including private equity and debt, infrastructure, real estate and other alternative assets have been steadily growing over the past years. The respective contributions to emissions from these asset classes can vary significantly as can stewardship and engagement approaches, given their dependence on the ownership stake, control rights and accountability mechanisms, if any, available to investors. In addition, the prioritisation, analysis and engagement planning can be utilised for other unlisted asset classes as well. For property for example, tenant engagement for emissions measurement and alignment is a key area of focus. This can be applied for tenants as well which are publicly traded companies and potentially can derive the benefits of collaborative engagement forums to achieve emissions data collection, tracking, target setting and decarbonisation. For private markets and infrastructure, as net zero target setting methodologies develop further, the stewardship toolkit will look to cover these assets and their respective stewardship approaches in subsequent toolkit versions in much more detail.
- **Emerging Markets:** The milestone-based net zero alignment assessment criteria and baseline engagement strategy are generally applicable across listed equities and corporate bonds globally. However, certain markets and jurisdictions may offer challenges due to a variety of reasons including but not limited to, political, legal and regulatory challenges and delays in the development and implementation of policies and standards for climate governance, reporting and risk management. The stewardship approach in such cases may be a combination of public policy engagement, sovereign and company specific engagement. Investor should consider setting the timeframes around the milestones based on considerations around the jurisdiction, regulation, company specific challenges, investor ownership structure and voting rights.

# Investor Participation

The Toolkit was co-authored by the Institutional Investors Group on Climate Change and Railpen. This Toolkit has been developed with the IIGCC Net Zero Stewardship Working Group members who have been generous in providing comment during meetings and written feedback on multiple versions of this document. The co-chairs of the Working Group are EOS at Federated Hermes, J.P. Morgan Asset Management and Railpen. We are grateful for the insights provided by members and the time that has been dedicated to this work. We look forward to continuing evolution and development of the Toolkit and additional guidance for members in their stewardship activities. The names of the organisations involved are below.

abrdn	Los Angeles Capital
Aegon Asset Management	M&G
Aker Horizons	Majedie Asset Management
Allianz Investment Management	Martin Currie
Amundi Asset Management	Mercer Global Investments Europe Limited
AP7	National Trust
Arisaig Partners (Asia) PTE Ltd	NatWest Group Pension Fund
Artemis	NN Investment Partners
Atlas Infrastructure	Nordea
BankInvest	Northern Trust Asset Management
BMO Global Asset Management (EMEA)	Nykredit Asset Management
BNP Paribas AM	Pension Protection Fund (PPF)
Caisse de prévoyance de l'Etat de Genève (CPEG)	PGGM
Cambridge University	Phoenix Group
Canada Life	Railpen
Coutts (Part of NatWest Group)	Rathbone Brothers Plc
Environment Agency (UK)	Rathbone Greenbank Investments
EOS at Federated Hermes	River and Mercantile Group
Evenlode	Robeco
FIL Fidelity International Ltd	Ruffer LLP
GAM Investments	Russell Investments
Generation IM	Santander UK Group Pension Fund
GIB Asset Management, Gulf International Bank (UK) Limited	Sarasin & Partners LLP
Insight Investment	Schroders
Invesco	Scottish Widows
Irish Life Investment Managers	SEB Investment Management AB
James Hambro & Partners	State Street Global Advisors
J.P. Morgan Asset Management	Swedbank Robur
Jupiter Asset Management	Tesco Pension Investment
La Banque Postal	UBS Asset Management
Lane Clark & Peacock	Union Investment Institutional GmbH
Lazard Asset Management	University Pension Plan
Legal & General Investment Management	USS Universities Superannuation Scheme
LGT Capital Partners Ltd	Vert Asset Management
Local Pensions Partnership Investments Ltd (LPPI)	Wespath
Lombard Odier Asset Management (Europe) Ltd	WTW – Investments

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