Investor Group on Climate Change

The State of Net Zero Investment 2024

Analysis of $5 trillion managed for Australians

Published May 2024

About the Investor Group on Climate Change.

We are the leading network for Australian and New Zealand investors to understand and respond to the risks and opportunities of climate change.

Our members include our countries' largest superannuation and retail funds, specialist investors and advisory groups.

They are custodians of the retirement funds and savings for more than 14.8 million Australians and millions more New Zealanders.

Our members manage more than $35 trillion in global assets, and almost $5 trillion locally.

About This Report

Our Annual State of Net Zero report is Australia's most credible and comprehensive analysis of institutional investors' net zero investment practices.

This year's edition is based on survey responses from 63 firms managing AU$5 trillion on behalf of Australian beneficaries. Approximately 87% of survey respondents are IGCC members.

The report is organised around the elements of the international best-practice Investor Climate Action Plan framework; Investment, Corporate Engagement, Policy Advocacy, Disclosure, and Governance. We have also included a chapter focusing on physical risk, given the need for rapid investor action in this area.

Acknowledgments

Marwa Curran led this project, with input from across IGCC. Lonergan research provided survey data collection and management. Special thanks to the members and non-members who respond to our yearly survey. Your data shows IGCC, policy-makers and other stakeholders the industry's progress and suggests what's needed to accelerate action.

The report's lead sponsor is S&P Sustainable1, with case study sponsorships from ISS ESG, JANA and Pathzero, and we are deeply grateful for their support.

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01: A Message From our CEO

Rebecca Mikula-Wright
CEO, IGCC & AIGCC

Each year, IGCC conducts a detailed survey of our members and of the investment community more broadly, evaluating the current state of play of the climate investment sector, and utilising data from past surveys to provide trend analysis on where the roadblocks and the opportunities lie for climate investors.

While we have been collecting this data in one form or another for over five years, the latest survey was particularly important, given the unprecedented global headwinds being faced by climate-aware investors around the world.

Happily, our headline finding demonstrates that far from choking investor ambition on climate, the political attacks in some jurisdictions and the increased regulatory burden in others has only seen the appetite for good quality and transparent action on climate grow.

This is of course no surprise. The time is now for investors to take strong action on climate. We know climate risk is investment risk and one that investors need to manage as part of their fiduciary duty. We are observing heightened global physical risks to assets, at the same time as enormous opportunities emerge in terms of reducing costs for clean energy and increasing market demand in developing economies.

Those investors taking early action to build climate-related factors into their investment strategies and practices will be well placed to benefit from this coincidence of megatrends, and as community awareness grows of the critical role that finance will play in an orderly transition to net zero, transparency and integrity in communications will be increasingly important.

IGCC stands ready to work with our members to drive climate ambition at a regulatory level, to assist in engagement with companies to ensure that ambition is genuine and sustained, and to facilitate access to the latest guidance and information on climate investment practices.

The information contained in this report will inform IGCC's activities throughout the year, and will form the basis for the market's understanding of investor progress on climate.

I thank the sponsors who have contributed to this important work, and encourage all to read the information presented here and use it in your own internal communications around climate investment!

A Message From our Sponsor

S&P Global Sustainable1

Lauren Smart
Chief Commercial and Market Engagement Officer
S&P Global Sustainable1

S&P Global is proud to sponsor the Investor Group on Climate Change (IGCC) – united by a shared mission of equipping the investor community with decision-useful insights along the journey to net-zero.

By bringing together key market actors, the IGCC is helping to facilitate industry best-practice and is also helping to evolve the market beyond stated commitments towards the real-world achievement of global net-zero and transition goals.

Together with other service providers, we are pleased to support the work of the IGCC by supplying investors in Australia, New Zealand, and beyond with the intelligence they need to navigate what has the potential to become the largest industrial-scale transformation the world has seen since the industrial revolution.

These unprecedented shifts to the global financial system, however, will not be without challenges. The inherent complexity of the climate challenge requires careful consideration of a variety of data insights in support of a just and equitable transition.

Moreover, despite a declining share of fossil fuels in total energy demand, our base-case future energy scenario *still* predicts an implied temperature rise of 2.4˚C above pre-industrial levels by 2100, drastically overshooting the objectives of the Paris-Agreement.[1] This, coupled with an estimated $18 trillion dollar financing gap,[2] underscores the importance now – perhaps, more than ever – for global coordination and collaboration among investors, companies, and policymakers alike.

Above all else, it is for this reason that the work of the IGCC continues to be invaluable to the future of the investment landscape in Australia, New Zealand, and the world at large.

1 https://www.spglobal.com/_division_assets/images/special-editorial/look-forward-volume-1-2023/lookforward_volume1_2023.pdf
2 https://www.bcg.com/publications/2023/bridging-the-vast-gap-in-net-zero-capital

02: Executive Summary

The key findings from the data and how we expect the landscape to develop.

Australian investors are staying the course despite global and local headwinds

Over the last 12 months, Australian investors have faced significant headwinds on climate from global and local influences, ranging from an aggressive 'anti-esg' agenda from sections of the US political establishment, through to increasing regulatory requirements that challenge local investors' disclosure around climate ambition.

Despite these pressures, our survey findings suggest that investors remain determined to act on climate. Key indicators across Investment, Corporate Engagement, Policy Advocacy, Investor Disclosure, and Governance, generally reflect a steady upward trend.

Positive developments are:

- Nearly all investors have set organisational climate strategy and portfolio climate risk monitoring as a board level matter.
- 62% of Australian investors already align their climate reporting with major international standards, positioning them well for upcoming mandatory disclosures.
- Investors are increasingly measuring financed emissions, even in traditionally challenging asset classes like private equity.
- A remarkable 97% of respondents have engaged in climate finance related policy advocacy, at the least indirectly. Moreover, there has been a notable decrease in the number of investors citing policy uncertainty as a barrier to climate transition investments.

Our survey analysis reveals six focus areas for valuable progress in capital markets.

1. Investors setting whole-of-portfolio interim targets will increase stakeholders' confidence that they are on track to reach their longer-term net zero commitments.

Background: Interim targets add credibility and integrity to investors' long-term targets and commitments. A 2030 or 2035 target requires investors to take immediate action to be on track for their Paris-aligned targets of net zero by 2050.

Our survey results show: Noticeably more investors have set interim targets, with 57% now setting them for either their entire portfolio or specific asset classes (both public and non-public), up from approximately 40% in 2022.

The limited availability and reliability of information in portfolio companies' disclosures and the changing regulatory landscape around climate disclosures present challenges for investors setting interim targets. Nevertheless, a further 29% of investors are actively considering setting an interim target for all or part of their portfolio.

Our recommendation: IGCC supports members to set ambitious, rigorous, and credible targets and recommends the Paris Aligned Asset Owner (PAAO) and the Net Zero Asset Manager (NZAM) initiatives as platforms to do so. They help investors to develop and disclose their climate goals in the context of industry-developed best practice methodologies, including the Net Zero Investor Framework (NZIF).

2. Action on adaptation and resilience must significantly increase to safeguard the value of investments.

Background: In Australia, investors are managing mounting challenges to safeguard their investments in the face of increasing climatic extremes. Investment decisions must include robust assessment of potential climate-related damage and disruption. Scenario analysis, advocated for by the International Sustainability Standards Board (ISSB), emerges as a vital tool for developing resilient strategic plans. Under Australia's soon-to-be-legislated climate disclosure regime, reporting entities will probably need to disclose the implications of different climatic scenarios for their strategy and business model, and how they would need to respond.

Our survey results show: Collectively, investors have made little headway on physical risk and resilience over the past two years. Only 16% of respondents report conducting whole-of-portfolio physical risk analysis, with a mere 3% translating analysis into action across the portfolio. Moreover, just 32% of investors said they have undertaken scenario analysis, with only a quarter publishing their approach and subsequent actions.

Our recommendation: Investors should be developing robust and credible approaches to manage the risks and opportunities arising from climate-related damage and disruption. This includes early adoption of scenario analysis, both to comprehensively fulfil their fiduciary duties and to prepare for Australia's forthcoming climate disclosure requirements. IGCC suggests assessing at least three scenarios, including a 1.5˚C aligned scenario and a 3˚C or higher scenario, these being plausible future states. For policymakers, the National Adaptation Plan could present the groundwork to help direct private investment into resilience and adaptation.

3. Continued improvement in Australia's policy environment will drive local investment in climate solutions.

Background: Long-term policy visibility and stability are crucial for investors, particularly super funds and investment managers that seek returns over multiple decades. Since the inception of the State of Net Zero survey, investors have said policy and regulatory uncertainty on climate change hinders climate investment in Australia.

Our survey results show: For the first time, less than half of respondents selected 'unattractive risk/return; and/or 'policy uncertainty' as current barriers to climate solutions investment in Australia. In 2021, 70% of investors cited policy and regulatory uncertainty as a key barrier, dropping to 40% in 2023 – a 30-point decrease in two years.

Our recommendation: This improvement in market sentiment, largely due to significant policy progress by Australia's governments, suggests potential for increased action in the coming years. To capitalise on this momentum, IGCC advocates for ongoing improvement of the policy environment to continue removing barriers to investment in climate solutions, adaptation, and resilience. The government can support certainty by addressing fossil fuel subsidies and having a transparent plan for phasing out fossil fuels.

4. Addressing the perceived scarcity of suitable local investments in climate solutions will reduce capital flight risk.

Background: Policy settings are an important factor influencing whether investors allocate capital to climate solutions in each market.

Our survey results show: While the number of investors citing policy and regulatory uncertainty as a key barrier to investment has dropped dramatically, the availability of appropriate local investments remains a consistent concern for respondents.

Our recommendation: To drive private capital investments into local climate solutions, Australia will need globally competitive, proportional, and smartly targeted financial incentives, designed to suit our economic strengths and values. The Governments' Future Made in Australia budget measures are a good first step, and their effective implementation will maximise comparative advantages in the global shift to net zero emissions. However, economy-wide mechanisms, including 1.5° aligned emissions-reduction targets and sector decarbonisation plans, would also stimulate the investment required for Australia.

5. Enhanced corporate engagement and stewardship practices will accelerate industry emission reduction efforts.

Background: It is an investor's fiduciary duty to respond to climate change risks, both the physical impacts and the risks and opportunities of a decarbonising economy. This responsibility includes actively engaging with portfolio companies on sustainability issues to protect and maintain long-term shareholder value in alignment with beneficiaries' interests.

Our survey results show: Whilst most Australian investors are directly engaging with high emitting portfolio companies, only 26% have formal engagement targets. Time-bound, measurable, and outcomes-focused engagement targets are essential for ensuring that long-term climate commitments translate into near-term actions and tangible outcomes. Moreover, investors predominantly rely on a limited set of stewardship methods and escalation strategies, with only 14% pre-declaring their voting intentions.

Our recommendation: Investors have significant opportunities to enhance corporate engagement and stewardship practices by establishing clear engagement targets and leveraging a broader range of engagement and escalation activities when targets are not met.

6. Further engagement and collaboration between asset owners and asset managers will improve climate-related outcomes.

Background: Alignment between asset owners and asset managers on climate issues will help safeguard investments, particularly where investment services are outsourced to managers by asset owners.

Our survey results show: While 78% of survey respondents have mandates that incorporate climate considerations, discrepancies exist between asset owners and asset managers regarding the specific factors to include. Only 29% of asset managers – as compared to 54% of asset owners – cited the expanding interpretation of fiduciary duty as including climate as a key driver of net zero investment. This suggests misalignment between the motivation and time horizon of asset managers and asset owners when it comes to climate investment.

Our recommendation: Enhanced engagement and collaboration between asset owners and asset managers would establish clear market expectations for climate-related practices. This includes asset managers reporting not just on the materiality and management of climate risks, but also on the real-world outcomes associated with their active ownership practices. Additionally, a deeper exploration of fiduciary duty will help show which sustainability factors should be part of investment management agreements.

03: Climate Practice Indicators

IGCC tracks the climate performance of the Australian investment market according to a set of headline Climate Practice Indicators. These give a high-level view of the work that is required by investors if the Australian economy is to undergo an orderly transition to net zero by 2050.

The data collected in our survey late last year shows:

- Despite significant headwinds from global and local influences, the climate ambition of Australian investors has held firm.
- There has been a significant increase in the number of investors reporting the presence of a climate action plan, representing a move from 'saying' to 'doing' in terms of implementation.
- Despite increasing evidence of systemic risks to the Australian economy related to the physical impacts of climate change, the relatively low level of action on adaptation and resilience signals a need for further work on this topic by IGCC, our members, and the broader community of stakeholders in the investment space.

Staying the Course

Investors around the world have clearly signalled their intentions to consider climate in their investment practices. The foundations of this include setting credible targets, adopting achievable and pragmatic policies, and – importantly – being transparent around progress.

Over the last 12 months, however, institutional investors have faced a barrage of pressure on each of these fronts, ranging from an aggressive 'anti-esg' agenda from sections of the US political establishment through to increasing regulatory requirements that challenge local investors to talk about their climate ambitions.

Pleasingly, our key indicators of climate targets, climate policy and climate reporting show that Australian investors are staying the course despite the headwinds.

Investing in the Transition

IGCC's 2022–2025 Strategy commits us to working with our members to ensure that climate commitments translate into real-world action. In this context, it was encouraging to see that Australian investors are increasingly looking to develop climate transition plans that will allow them to frame their action on climate in the coming years, and communicate progress to stakeholders.

In 2022, roughly 36% of survey respondents reported having a climate action plan. In the latest survey, this number has increased significantly to 65% of respondents, demonstrating that Australian investors are increasingly looking to build climate risks and opportunities into their investment practices, as they move past commitments and start to demonstrate real-world action.

There is more work to be done here, and investors will continue to face pressure to demonstrate alignment with a transitioning economy as more jurisdictions around the world make transition plans mandatory.

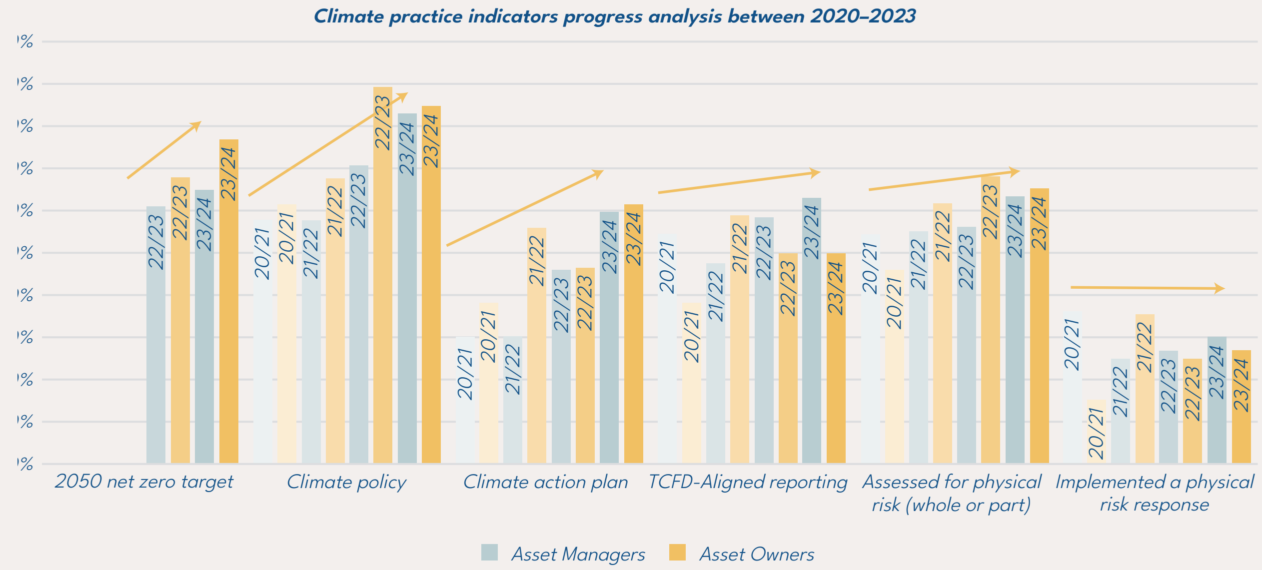
The Future is Risky

The physical risks associated with climate change pose both direct risks to assets, and indirect risks to an orderly transition because they reduce economies' capacity to deal with natural disasters. Local economies will face costs in the order of hundreds of billions of dollars in the coming decades as a result of the changes to the climate that are already unavoidable.

Unfortunately, while investors have made some progress over the last couple of years on assessing physical risk in all or part of their portfolios, the number of investors reporting that they have taken the next step and responding to these risks remains relatively stable.

At the 2023 IGCC Summit, Senator Jenny McAllister launched the Road to Resilience: Physical Risk Strategy, 2023–25, noting: "It's about finding the right tools that will give investors the confidence to take the leap. Investment in adaptation is investment in our long-term stability." This topic has become an ongoing strategic focus for IGCC.

IGCC Members' Climate Practice



IGCC has data showing the climate performance of its Australian members over the last four years.

The data points reflected in this table pertain to only IGCC members' YoY analysis. The data sample reflected in this graph (i.e. IGCC investor members) is different from the data sample reflected in the remainder of this report, which also includes data points from non-IGCC members.

Based on our knowledge of the market, we would expect that the IGCC membership has a bias towards larger and more climate progressive investors than the market overall.

Summary

Investors remain committed to action on climate, despite significant global and local headwinds. Their progress on transition planning is encouraging, but more work is needed to ensure that investors are building adaptation and resilience into their climate practices.

The following chapters will cover the topics raised above and explore other areas relevant to the climate investment sector in Australia.

04: Focus on Physical Risk & Resilience

In Australia, a land of wide-ranging climatic extremes, the physical impacts of climate change are already being felt and are predicted to increase. Damage to infrastructure caused by extreme weather events and the disruption to business operations have flow-on economic and financial impacts.

For investors to responsibly protect the value and resilience of their investments, robust risk assessment and the integration of physical climate risks into investment decision making will be crucial.

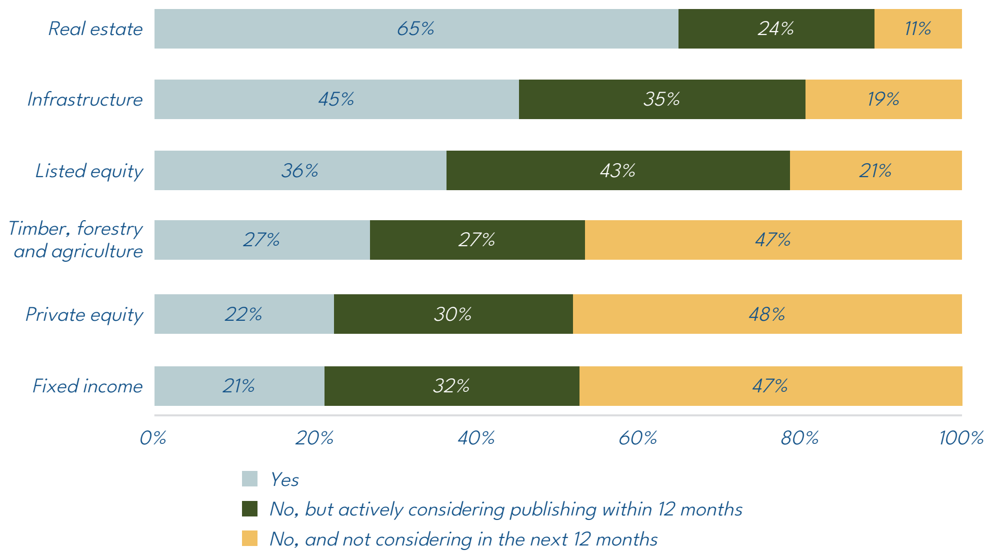
Investor action on physical risk and resilience (PRR) has been relatively stagnant over the last two years. Only 16% of survey respondents are conducting whole of portfolio risk analysis. A smaller number, 3%, report turning this analysis into concrete action.[3]

Indeed, one investor noted that 'assessment of physical climate risk and undertaking adaptation actions remains a much lower priority than mitigation and the two are not being assessed in a holistic or integrated manner'.

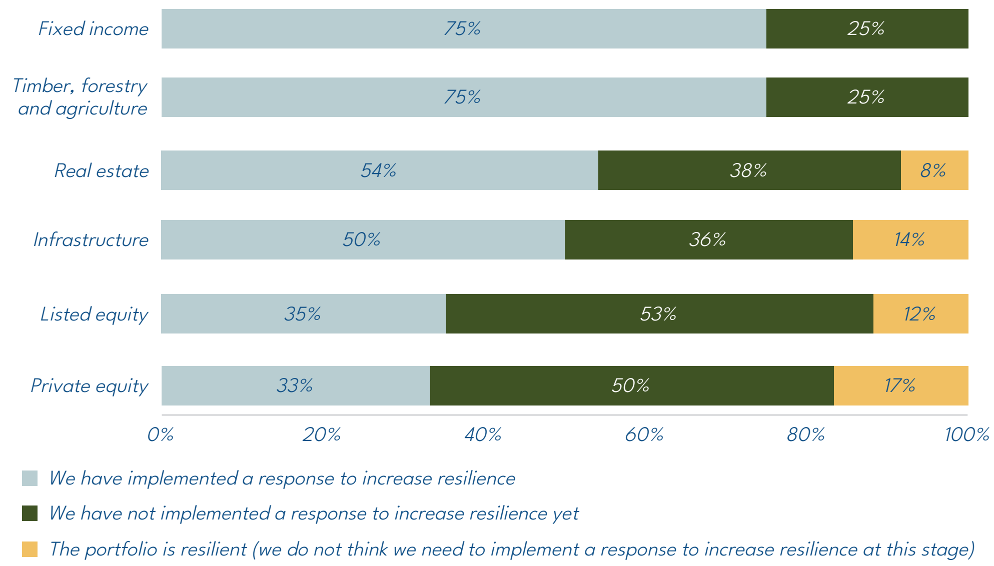
3 This is a decrease on the results seen over last two years which were around 22% for analysing risk and 9% for implementing a response to increase resilience. These relatively large decreases may be a result of i) differences in the sample ii) of investors now applying a more rigorous definition of adequately analysing and responding to risk and/or iii) conducting analysis and implementing a response across specific asset classes rather than on the whole of portfolio.

Physical Risk and Resilience Analysis in Portfolios

Have you undertaken a climate-related physical risk or resilience analysis of your portfolio?



Which of the following best describes your risk or resilience analysis of your portfolio?



The table above looks more closely into these averaged results, breaking them down by asset class.

Investors in Real Assets appear most advanced when it comes to both analysis of physical risks and implementing a response to increase resilience:

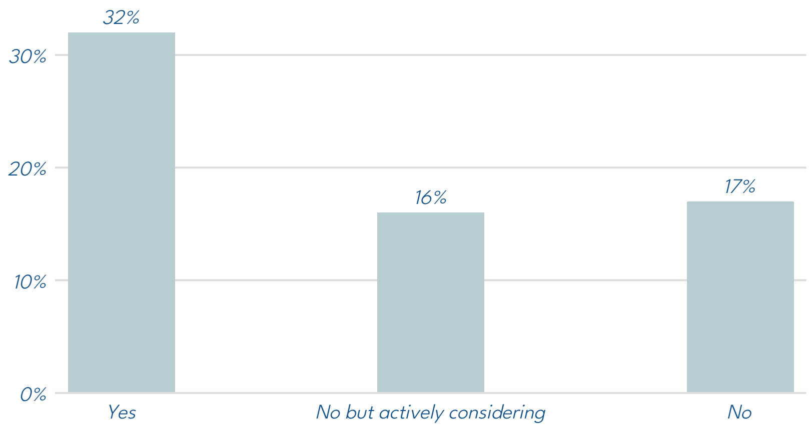
- Real estate – 65% of those invested in this asset class report having undertaken specific physical risk and resilience analysis. Of these, 54% have implemented a response, 38% have not implemented a response and 8% deem their portfolio 'resilient'.
- Infrastructure – 45% of those invested in this asset class have undertaken analysis and of these 50% have implemented a response, 36% have not implemented a response and 14% deem their portfolio resilient.

This is a shift from last year, which saw listed equity as the most advanced asset class when it came to physical risk and resilience analysis. However, a significant proportion of investors (43%) are considering publishing physical risk analysis of their listed equity portfolio within the next 12 months.

More asset owners are conducting analysis of physical risks and resilience across almost all asset classes compared with asset managers.

Scenario Analysis to Assess Resilience

Have you undertaken scenario analysis of your portfolio (eg, against 1.5˚C, 2˚C or 4˚C)?



The total does not add up to 100%. Investors were also given the option of selecting "Not Applicable", and 35% chose this; a response which requires further investigation.

The TCFD recommends that organisations use scenario analysis to assess and disclose the resilience of their portfolio to both physical risks and transition risks that might arise under future climate warming scenarios. As noted in the box below, this is likely to become mandatory for many investors active in Australia.

The IFRS S2 Climate-related Disclosures standard specifies how entities should disclose which scenario analysis has been applied, the results of the analysis, and what they mean for the resilience of the entity's strategy.

This year, IGCC's survey found that of the investors that disclosed, 32% have undertaken scenario analysis on their whole portfolio, with another 16% actively considering doing so and publishing within 12 months, and a further 17% not considering. 35% responded that the question was not applicable, which requires further investigation.

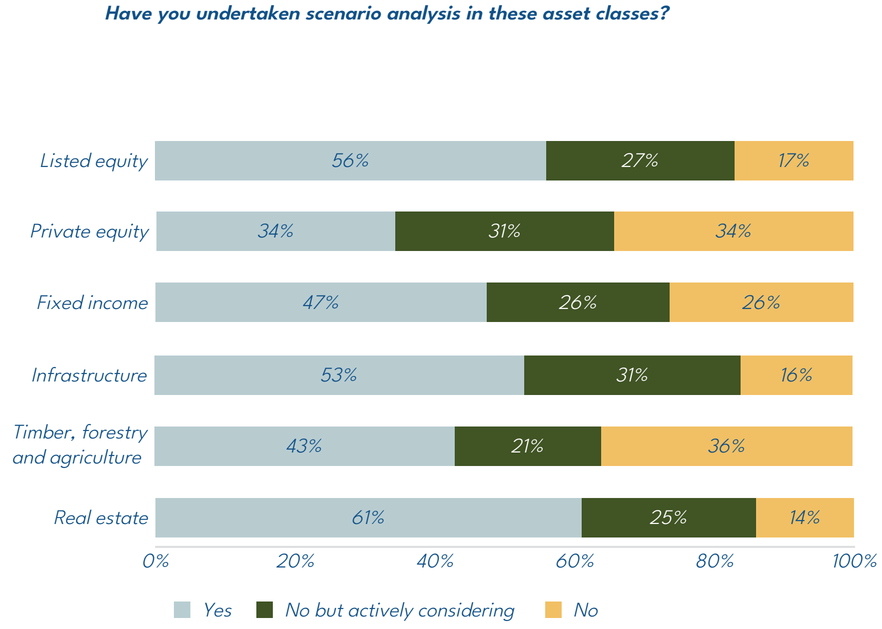
Of the 32% who have undertaken the analysis, only a quarter (25%) are publishing their scenario analysis approach and detailing their actions taken as a result.

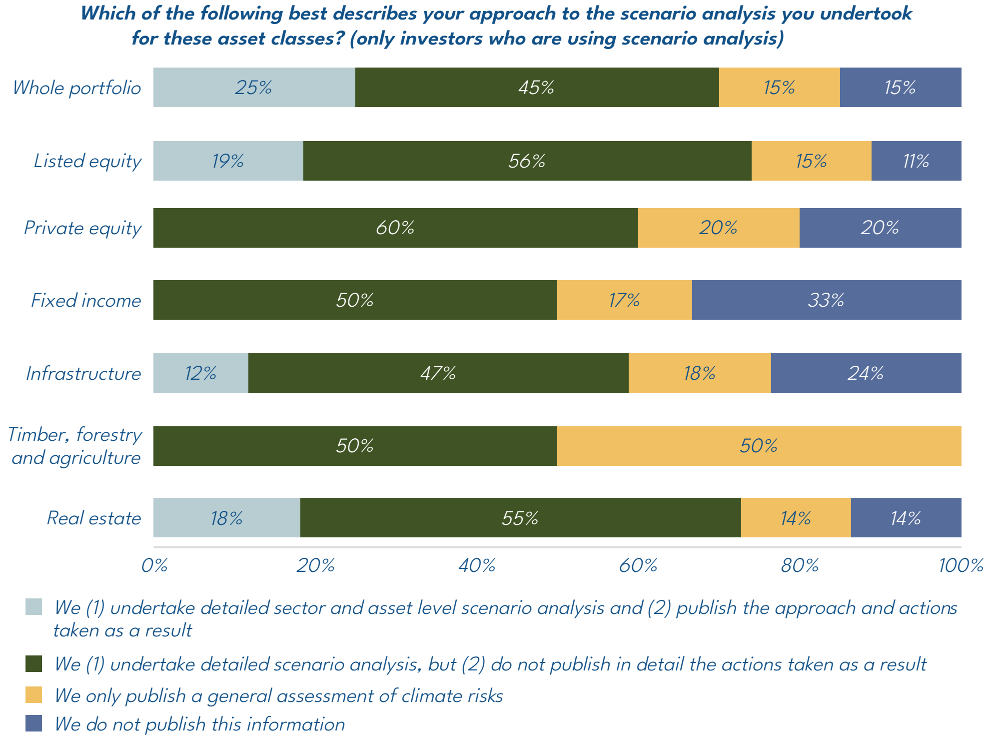
Investors to be covered by Australia's climate disclosure regime will benefit from starting early in conducting and disclosing the results of scenario analysis.

Mandatory Physical Risk and Resilience Disclosures

Australia's proposed climate disclosure regime requires entities to disclose information about climate-related physical risks.

These disclosures include a description of the risks, their financial impacts on the entity (including percentage of assets vulnerable to these risks), and how the entity has responded and plans to respond.





Scenario Planning

"A strategic planning tool to:

- Enhance critical strategic thinking by challenging 'business-as-usual' assumptions
- Help organisations understand how they could perform in different future scenarios
- Improve companies understanding of future risks and develop suitable resilience strategies aligned with a 1.5˚C world
- Offer insight into opportunities including energy efficiency, changes in energy sources and/or technologies, new products and services, new markets or assets, and increased resilience." – CDP[4]

Which Scenarios to Choose

The draft Australian Accountability Standards Board (AASB) Standard requires at least two scenarios to be used, including a 1.5˚C aligned scenario. IGCC believes that at least three scenarios should be required with an additional mandatory scenario of 3˚C or higher.[5] This would ensure that companies and investors consider the medium and long-term impacts of a warming scenario that is likely to be experienced should current government policies around the world remain unchanged.

4 CDP (2022) Insight Note – Introduction to Climate Scenario Analysis https://cdn.cdp.net/cdp-production/comfy/cms/files/files/000/007/617/original/CDP_Reporter_Services_Insight_Note_Scenario_Analysis.pdf
5 IGCC (2024). "Submission – Treasury Laws Amendment Bill 2024: Climate-related financial Disclosure." Investor Group on Climate Change. https://igcc.org.au/wp-content/uploads/2024/02/Final-IGCC-Submission-climate-disclosure-draft-legislation.pdf

Summary: Looking Forward

The sector remains in an early stage of managing exposure to physical climate risks, IGCC is working with investor members to drive economy-wide adaptation and resilience with the aim to protect investors' beneficiaries' long-term retirement savings and take advantage of opportunities to build resilience.

IGCC's Road to Resilience strategy (2023–2025) revolves around four key objectives:
- integrating physical risk and resilience into existing climate-related activities;
- developing a shared understanding of physical climate risks among stakeholders;
- advocating for investable policy that proactively addresses climate risks; and
- mobilising private capital into resilience and adaptation measures.

To this end, physical risk and resilience has been integrated across all IGCC workstreams. Key projects include defining investors' expectations of companies' physical risk disclosures and plans, policy advocacy related to Australia's National Adaptation Plan, and supporting investors to consider physical damage and disruption in investment decision-making and management, including using scenario analysis where appropriate.

A Super Fund Charts Its Path to Net Zero

Sponsored Real World Example: S&P Global Sustainable1

S&P has worked with an Australian superannuation fund that, in the service of strong long-term returns, is committed to investing in firms with good ESG management, and that has established a net zero target for 2050, via the Net Zero Asset Managers' initiative. The fund's ESG team was charged with devising action plans to reach this target and needed access to comprehensive data.

Pain Points

The ESG team needed to truly understand the carbon footprint of their portfolios, and the risks to investments given climate change. They wanted to identify third-party capabilities that would enable them to:

- **Create a carbon footprint benchmark** from which to measure progress being made on the journey to net zero.
- **Evaluate potential earnings at risk from transition costs** associated with any government policies that could increase the price of carbon.
- **Identify physical risks** that could impact investments.
- **Track their portfolios** against the goals of the Paris Agreement to assess company- and portfolio-level alignment and changes in carbon footprints over time.

The Solution

Sustainable1 represents S&P Global's integrated sustainability offerings. This includes Trucost, the data and analytics engine that powers many of S&P Global's ESG solutions. Sustainable1 discussed numerous capabilities that would enable the super fund to:

- **Evaluate the carbon intensity of its portfolios**
  The Dataset contains information on over 22,000 companies, covering Scope 1, 2, and 3 with metrics on quantities and intensities of carbon-equivalent emissions (tCO_2e, tCO_2e/US$ revenues) and their estimated damage cost equivalents (US$), along with impact ratios.
- **Assess the ability of companies to absorb future carbon prices**
  Trucost Carbon Earnings at Risk Dataset can be used to stress test a company's ability to absorb future carbon prices and understand potential earnings at risk.
- **Delve into asset-level details on physical risks**
  Trucost Physical Risk Analytics offers an asset-level approach to the assessment of physical risk at the company and portfolio level.
- **Track a company's progress on meeting goals of the Paris Agreement**
  Trucost Paris Alignment Dataset assesses company-level alignment with the Paris Agreement goal enabling investors to track their portfolios and benchmarks against the goal of limiting global warming to 1.5˚C and 2˚C climate change scenarios.

Key Benefits

The team was able to do deep dives on portfolio companies to align investments, over time, to net zero targets. The team members valued access to:

- **Seasoned ESG professionals** to answer questions and discuss different findings.
- **One source of comprehensive and standardized environmental information,** plus a well-tested methodology to estimate the carbon intensity of non-reporting firms.
- **An analysis of potential transition risks** as government policies are introduced to encourage companies to move to a greener economy.
- **Highly-detailed geolocation information** to assess physical risks from acute hazards, such as more frequent and extreme weather events, or the chronic and longer-term effects of climate change, such as sea level rise.
- **An evaluation of how portfolio companies are aligned with the Paris Agreement** to track progress being made over time.

Data-driven analysis based on information and tools developed by a well-recognized player in the sustainability field provides credibility to funds reporting on their ESG stance in annual reports and other documents.

05: Practice Area 1: Investment

To achieve the goals of the Paris Agreement which is to hold 'the increase in the global average temperature to well below 2˚C' and pursue efforts 'to limit temperature increase to 1.5˚C' above pre-industrial levels, the world's economy must significantly increase investment in low-carbon technologies, energy efficiencies, and transition away from high-emitting business models and activities.

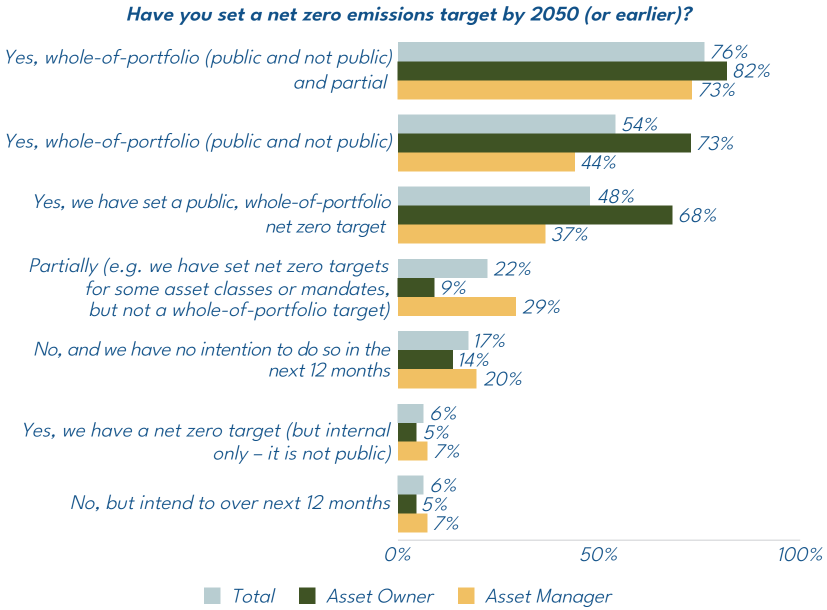
The Dubai COP28 in 2023 highlighted the urgency of these actions. Australia joined over 115 countries (including the United States, Canada, and Norway) pledging to triple global renewable energy capacity and double global average annual rate of energy efficiency improvements, both by 2030. The Conference's concluding statement also included the first direct reference to a transition away from fossil fuels.

In March 2024, the Australian Government introduced into Parliament legislation to mandate climate-related disclosures.[6] Additionally, climate transition plans are increasingly becoming a requirement in current and upcoming regulation in peer economies including the UK, EU and are being encouraged in the US.

Investors are therefore under increasing pressure to strengthen and communicate their approach to managing the risks and opportunities associated with a transforming economy. The ICAPs Expectations Ladder (ICAPs) shows the most useful focus areas for investors looking to develop a formal climate transition plan. This chapter focusses on the 'Investment' focus area of the ICAPs ladder, which covers a plethora of investor actions including, measurement of emissions in portfolios, the objectives and targets set to reduce real-world and portfolio emissions, and the shorter, intermediate and longer term activities that investors are taking and considering.

6 IGCC's submission regarding the **draft legislation** can be found here and submission on the **draft AASB standards** is here.

Climate Targets



Setting and communicating robust science-based climate targets is a core component of investor climate action. Clear targets, both long- and intermediate-term, provide investors with tangible goal to work towards, and also help key stakeholders assess investors' progress towards these targets.

Investors can choose from a variety of target setting methodologies, and work towards a range of different targets, these include portfolio decarbonisation, asset alignment, engagement and climate solutions targets.

For targets to be credible, investors need to back the commitments made with an action plan. A transition plan – sometimes known as a climate action plan or roadmap – setting out the actions and mechanisms for achieving targets is an indispensable part of investor climate action.

Read more about investor transition plans in the 'Disclosure' section.

Long-term Targets (2050 or Earlier)

Over three quarters of investors surveyed have set a net zero by 2050 (or earlier) target either across whole or part of portfolio (i.e. for some asset classes or mandates). This includes both public and non-public targets.

This figure was 70% in our 2022 survey, so we are seeing an increase in the collective ambition of investors in setting long-term targets.

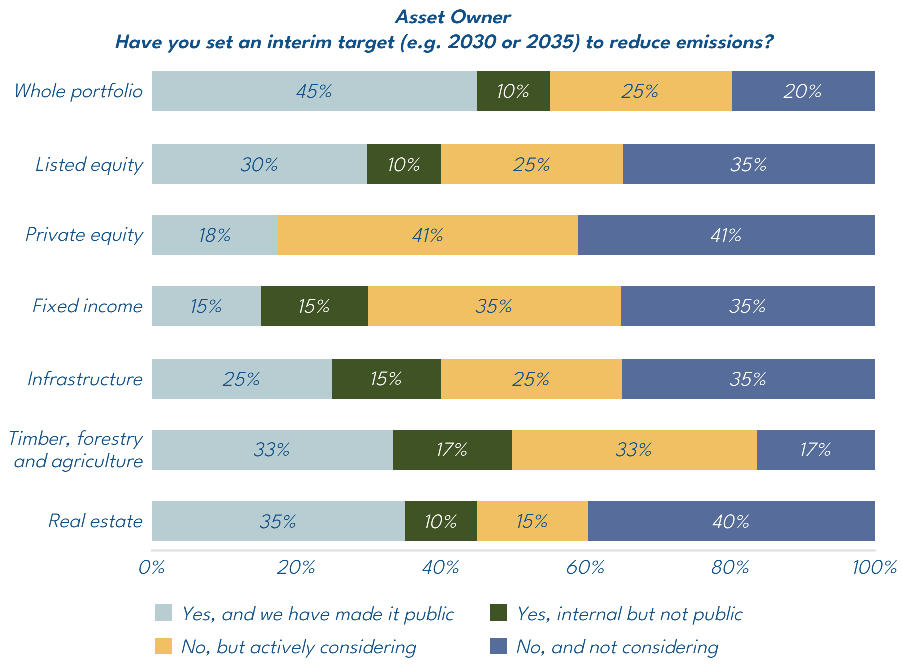
More asset owners, such as large superannuation funds, have set a long-term target than have the asset managers that provide them with services. These groups may come into alignment, as asset owners increasingly include targets as a KPI in their mandates, and as regulators require greater transparency around investor climate action.

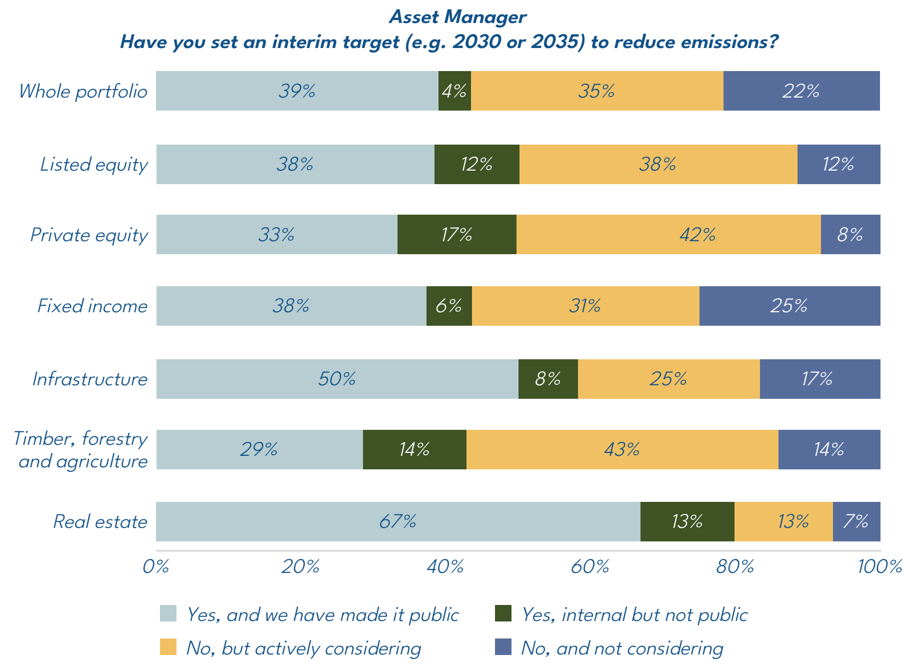
An even larger increase is seen in the proportion of investors that have set part-portfolio targets – up from 13% reported in 2022 to 22% in 2023. This includes a higher proportion of asset managers than asset owners. This may reflect that many asset managers have mandates (that include climate target KPIs) for specific asset classes.

We expect investors will become more confident about setting public targets across multi-asset portfolios as datasets, methodologies, and tools for different asset classes continue to improve. IGCC's Investor Practice workstream is designed to help build investors' knowledge on how to set and implement asset class-specific net zero targets and methodologies. The workstream predominately draws on the approaches and tools recommended in the Net Zero Investment Framework – a globally recognised and widely-used methodology.

Expectations upon asset managers to recognise climate change as a systemic risk to client portfolios is likely to increase over time. Asset owners are implementing more robust processes when procuring asset managers' services, which include requirements for asset managers to demonstrate ongoing alignment of their stewardship activities and portfolio management, and provide asset class-specific reporting.

Interim Targets (2030 or 2035)





Interim targets add credibility to investors' longer-term targets and integrity to additional net zero commitments. A 2030 or 2035 target prompts investors to take immediate action to be on track for their long-term climate ambitions. Interim targets are therefore commonly required by global net zero initiatives including the Paris Aligned Asset Owners (PAAO) initiative and the Net Zero Asset Managers (NZAM).

When combining asset managers and asset owners together, there is upward movement with 57% of investors setting interim targets over the whole or part of their portfolios (both public and non-public), up from approximately 40% in 2022. However, investors are mostly setting an interim target over part of the portfolio (e.g. specific asset classes) rather than over the whole of portfolio.

42% of investors have set a whole of portfolio interim target; seven points up from 2022. This slower increase on a whole of portfolio interim target implies that the bulk of the increase in interim target setting is associated with only parts of investors' portfolios, potentially those associated with specific mandates and/or classes with readily available climate methodologies.

When analysed separately, more asset owners (55%) than managers (43%) have set a whole of portfolio interim target. The percentage of asset owners setting interim targets has increased by 22 points since last year, compared with only a one point increase for asset managers. A further 25% of asset owners are actively considering a whole-of-portfolio interim target down from the 38% reported in 2022, suggesting investors that were considering setting an interim target in 2022 have started to turn these ambitions into action.

One reason for the disparity between asset owners and managers may be attributable to the mandates and agreements asset managers have in place with clients (generally asset owners, but also retail investors). Until most clients require their managers to integrate net zero commitments into fund management, managers are unlikely to be able to set interim targets across their entire portfolio.

Barriers to Setting Interim Targets

Although interim targets are critical to meeting long-term net zero targets, investors highlighted some challenges associated with setting such targets.

They commonly reported concerns with the availability and reliability of information around issuer disclosures. While data is improving across the board, some investors have reported that datasets remain incomplete and inconsistency of methods used to calculate greenhouse gas (GHG) emissions in some asset classes – such as private equity and sovereign credit. This makes it difficult for investors to aggregate comparable data across such asset classes, which erodes investors' confidence to set interim targets.

Other investors noted that the changing regulatory landscape around investor climate disclosures makes it challenging to commit to transparency in this area until the requirements are finalised. This is likely to be the explanation for the non-public interim targets identified in the survey.

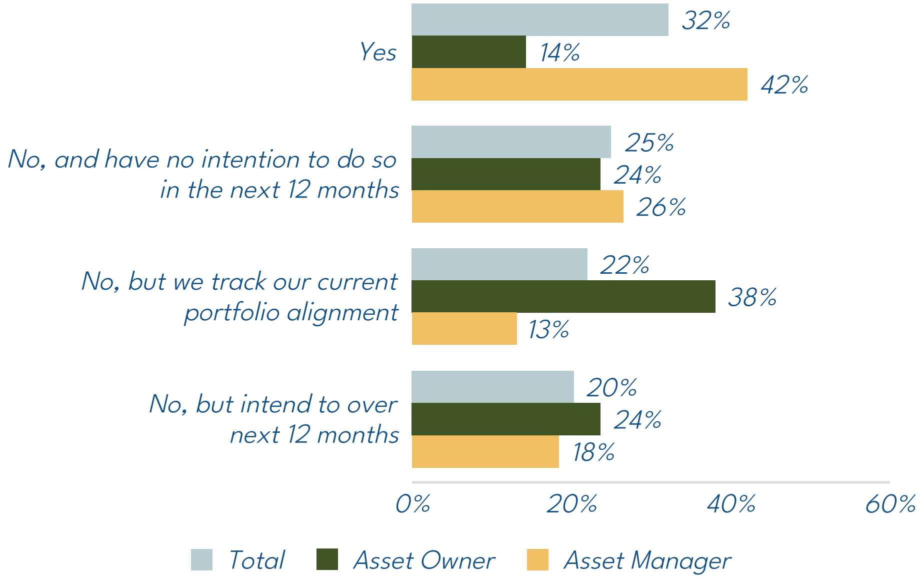
Despite the challenges, it is worth noting that 29% of investors have indicated that they are actively considering setting an interim target for all or part of their portfolio. Drivers identified by survey respondents include:

- Emerging regulatory requirements;
- Increasing demand from clients and key stakeholders;
- A desire to remain competitive with international peers; and
- A need to implement and accelerate credible climate transition plans.

IGCC works with members to support the setting of ambitious and rigorous targets.

Asset Alignment Targets

Have you set a portfolio coverage target (an asset alignment target)?



This is the first year that IGCC has surveyed investors' activities that improve asset level alignment with net zero objectives. The asset alignment target focuses on investors' contribution to decarbonisation through driving change within investee companies and at asset level.

Investors begin by assessing the alignment of their assets to a net zero future and disclosing what proportion of these assets classify as 'achieving net zero', 'aligned', or are 'aligning' to net zero.[7] The assessment indicators include whether an asset has a credible target, a decarbonisation strategy, adequate emissions disclosure, and alignment of capital allocation. Following the baseline assessment, investors then set a target to improve the overall alignment of their AUM.

Bottom-up targets such as asset alignment targets help to inform investors the extent to which their assets are aligned with net zero, and helps to guide investors' efforts to further improve asset alignment through various stewardship practices and portfolio strategies including engagement, voting and strategic asset allocation. Such stewardship efforts contribute to decarbonisation in the real world.

Read more about some of the stewardship efforts deployed by investors to influence the alignment of assets to net zero in the 'Corporate Engagement' and 'Policy Advocacy' sections.

For this reason, global climate initiatives such as the Net Zero Asset Managers Initiative (NZAM) encourage investors to pair their emissions reduction targets with an asset alignment target. Including an asset alignment target discourages investors from achieving their portfolio-level emissions reduction targets by simply divesting from high-emitting assets held in portfolios, which does not contribute to a reduction in absolute GHG emissions, and therefore overall economic risk. Conversely, it is difficult to monitor the overall impact of an asset alignment target without tracking portfolio emissions.

7 See the Net Zero Investment Framework and IIGCC Supplementary Target Setting Guidance for guidance on setting portfolio coverage targets.

Conflicting Objective Timelines within Net Zero Commitments

ISS ESG

Sponsored Real World Example: ISS ESG

The twin goals of ambitious decarbonization of portfolios and demonstration of increased progress towards alignment within corporate engagements can be in tension with each other. While switching funds to low-emitting sectors can be a tempting route to achieving rapid decarbonization in the medium term, the negative impact of such a strategy on a portfolio's alignment progress can be considerable in the long term. This is particularly so when existing investments may reside in high-emitting-sector leaders that may also have a highly developed and mature strategic approach not only to mitigating climate change within both their operations and supply chains in the near term (i.e., decarbonization targets), but also to strategically achieving Net Zero (as per the Net Zero Alignment criteria).

To provide context, in the 2021 reporting period, High-Impact sectors (as defined by ISS, albeit with a strong alignment to the Net Zero Asset Owner Alliance (NZAOA) definition) represented the following in the STOXX World AC:

- 14% of total weight
- 77% of absolute Scope 1+2 emissions
- 51% of Scope 3 emissions

For High Impact sectors between FY2019 and FY2021, reported emissions were mixed depending on the scope and basis of measurement. This mixed emissions data, some of which suggests progress towards Net Zero, would be lost if investors simply divested from these High Impact sectors without considering strategic progress towards Net Zero Alignment.

In the aggregate, High Impact sectors show low levels of Net Zero Alignment. However, beneath the highest level of assessment, a significant amount of granular evidence would allow for targeted engagement within the Index. Table 2 illustrates the variety of factors to be considered within any strategic capital allocation approach to achieving progress against multiple competing Net Zero (NZ) targets.

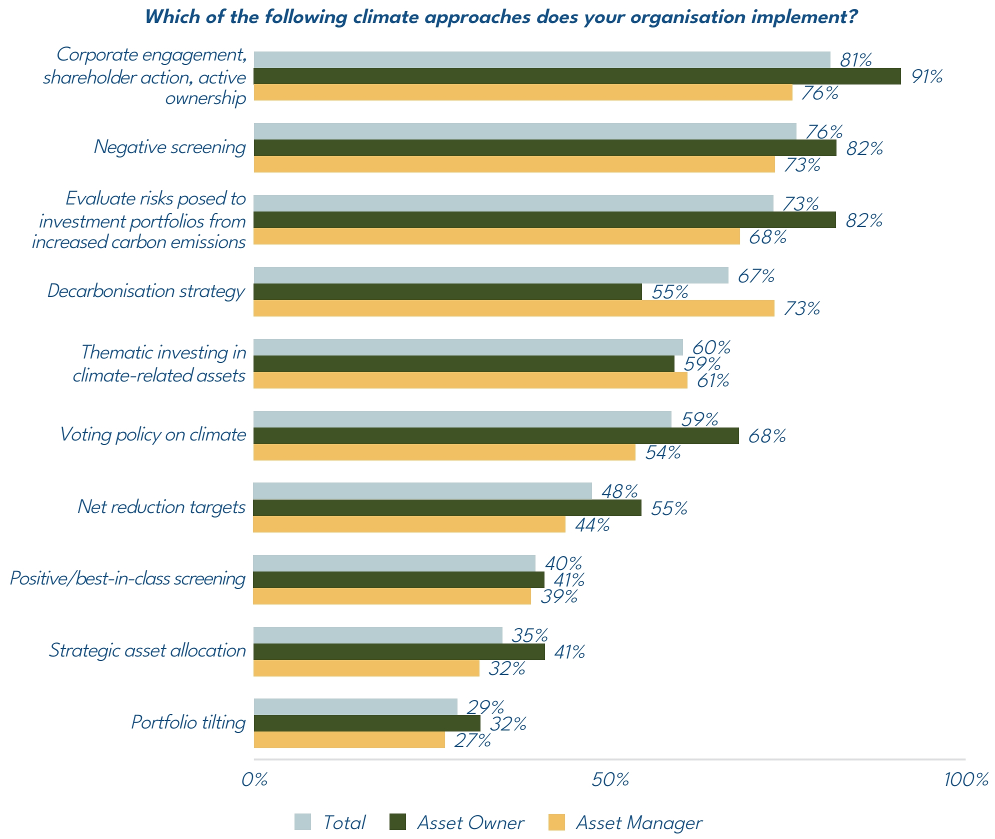
At the "Committed" level, there is a further 0.9% of STOXX by weight, which represents 5.2% of all financed Scope 1&2 emissions. The "Committed" level also shows evidence of relevant material disclosure, 2050 commitments, and Interim target-setting and/or Decarbonization strategy evidence. To divest, or to implement strategic capital reallocation without considering this evidence, could have a diminishing effect on overall portfolio alignment.

Indeed, the "Not Aligned" level in this aggregation of High Impact sectors shows significant evidence of progress despite the "Not Aligned" overall assessment. For example, a significant tranche of issuers, highlighted in red and representing 3.2% of AUM and 16.2% of all Scope 1 & 2 financed emissions, show progress, as measured by various criteria. Targeted engagement towards these issuers, with a focus on improving the quality and scope of Net Zero commitments and interim targets, may provide a clear route towards enhancing the percentage of financed emissions moving towards alignment.

Conclusion

An investment strategy that focuses on diverting funds to a low-emitting set of issuers may have an impact on a portfolio's Net Zero alignment progress. Further, a more granular understanding of how issuer-level commitments to Net Zero, decarbonization strategies, and target-setting are interconnected can assist investors with targeted engagement efforts to increase portfolio alignment with Net Zero objectives. You can read the full case study and other climate related thought leadership in the ISS ESG 2023 Global Climate Change Update report.

Climate Strategies



Respondents could select more than one option for this question.

Once an investor has set their targets, best practice is to then enact practical implementation strategies to achieve these targets.

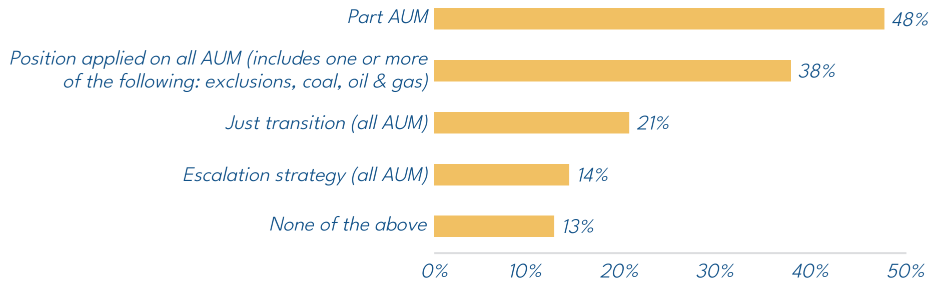
Under active ownership, the most common strategy, investors exercise their shareholder rights to influence corporate behaviour with the aim of improving long-term value and making their investments more sustainable.

The second most common approach, negative screening, can be done at a sector or activity level, for instance screening out certain types of fossil fuel production. It can also be used to avoid specific assets that perform worse than their peers on certain climate metrics. Negative screening offers a relatively straightforward way to reduce portfolio GHG emissions, but critics note that simply transferring ownership of shares from one investor to another does not necessarily result in real-world emissions reductions.

The wider finding here is that investors have built climate investment practices into most aspects of the portfolio management process, in line with a growing recognition that managing climate risk is an important part of an investor's fiduciary duty.

Fossil Fuel Investment Positions

With regards to your organisational position on fossil fuels, please indicate if you satisfy any of the following:



Respondents were able to select more than one of the categories.

Burning fossil fuels remains a leading source of GHG emissions. At COP28 in Dubai, there was the first international agreement to transition away from fossil fuels, with the UNFCC noting that proceedings closed:

> *"with an agreement that signals the "beginning of the end" of the fossil fuel era by laying the ground for a swift, just and equitable transition, underpinned by deep emissions cuts and scaled-up finance."*

Most target setting methodologies and frameworks are neutral on the approach taken by investors to the fossil fuel industry, leaving it up to the investor whether to screen out such activities or take one of the alternative approaches outlined above. However, almost all of the methodologies encourage investors to choose a clear approach to fossil fuels.

The proportion of investors that have applied an approach to fossil fuel investments across all AUM has risen from 26%[8] in 2022 to 38% in 2023.

A Just Transition Away from Fossil Fuels

21% of investors consider the concept of just transition in their approach on fossil fuels across all AUM.

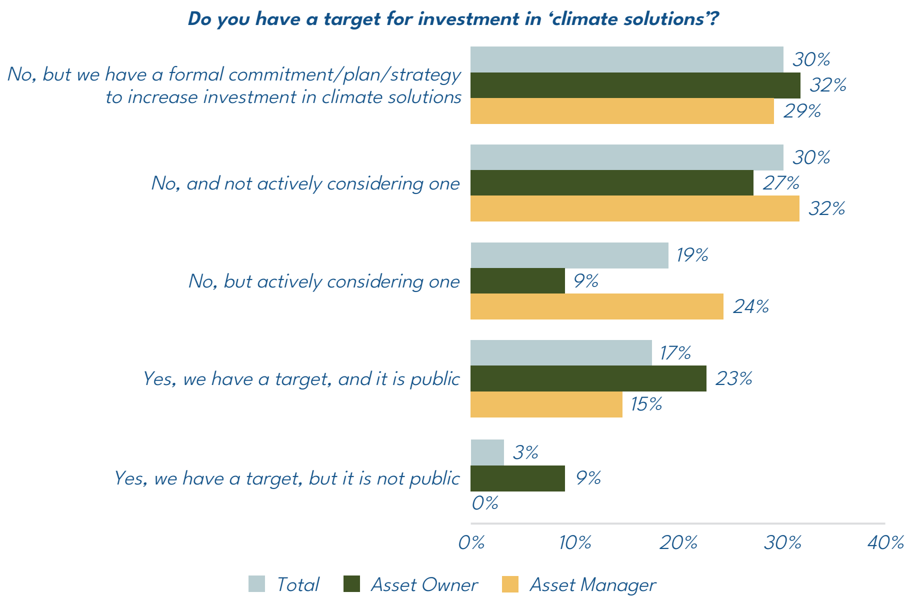
Investors working to transition specific industries away from fossil fuel intensive activities should take account of the potential impacts on communities and regions where these activities are taking place, including on employment in these communities and regions.

By investing in alternative industries in these regions, investors can play a key role in ensuring a just transition for such communities and maintaining a social license for decarbonisation.

IGCC's recent report, Investing in Australia's Vital Regions, examines this issue in more detail.

8 This question is new to the 2023 survey, so we have drawn on the most reasonable comparative statistic from the 2022 survey for this analysis. The 26% pertains to investors that noted they have 'a policy on fossil fuels on our investments' see pg. 49 in the 2022/23 report.

Investing in Climate Solutions



COP28 in Dubai also saw a commitment from over 100 countries to triple global renewable energy capacity by 2030. Governments' targets signal a significant opportunity for investors looking to increase their investment in climate solutions. The first step in this process is to set a quantitative climate solutions target.

Climate Solutions Targets

Investors most commonly set climate solutions targets as a proportion of their AUM. Almost 70% of investors surveyed have set a target, intend to set one, or otherwise have a formal strategy to increase investment in climate solutions.

Investors seem to be less comfortable making their ambitions public. The 17% of respondents who have set a *public* climate solutions target is a slight decrease on the 2022 finding of 21%. As is discussed later in this report, investors note that higher ambitions on climate solutions investment are hampered by a low level of appropriate investment opportunities available in the local market.

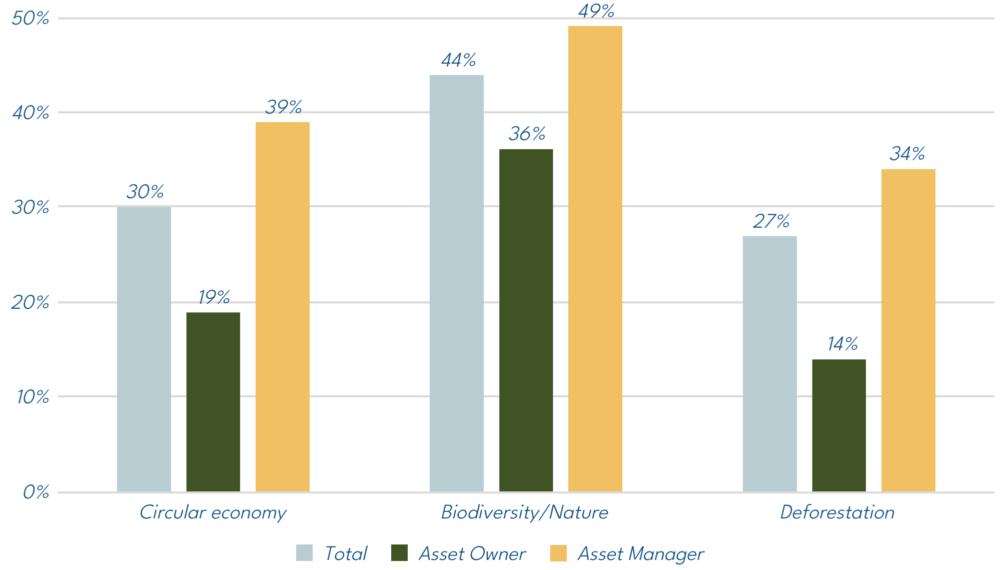
Support for Investors on Climate Solutions

IGCC continues to support investors with defining, measuring and increasing capital allocation to climate solutions. Recent activities include a member Working Group on the topic, a planned Climate Solutions Sub-Working Group to improve understanding of good practice and implementation challenges with investing in climate solutions, and support for the Climate Investor Forum event in Melbourne, which showcases cleantech start-ups. In addition the Australian Sustainable Finance Initiative (ASFI) is developing a sustainable finance taxonomy which will define climate solutions and support a shared understanding of terminology in this sector.

Refer to the Policy & Advocacy chapter for further insights into some of the challenges investors face with respect to directing capital to investment options that contribute to mitigation or transition activities.

Emerging Areas of Practice

Investors who have assessed or implemented a response to these emerging areas.



Investors are increasingly aware of the need to take a holistic approach to the management of climate risks and opportunities. Climate solutions and transition activities do not take place in a vacuum, and as society transitions towards net zero, there will be implications for the environment and economy in areas that are not traditionally associated with climate change.

In this year's State of Net Zero Survey, we asked investors whether they had assessed or integrated a response to address the following areas in their investment practices:

- Circular Economy
- Biodiversity and Nature
- Deforestation

Circular Economy

As the urgency of the action required to achieve net zero by 2050 becomes more apparent, many commentators note that systemic changes are required for an orderly transition of the economy. Circular economy thinking offers investors an opportunity to mitigate the risks associated with a linear economy such as climate change and biodiversity loss. As the Australian government develops sectoral decarbonisation plans, it will include 'circular economy' as a cross-cutting issue across sectors.[9]

Introducing circular economy analysis for the first time, the 2023 survey finds that while a proportion of investors are exploring the concept, it is not being widely adopted to date:

- 31% of investors have not yet taken any action to assess or integrate a response on circular economy.
- 15% of investors have conducted an initial high-level assessment.
- Only 12% of investors have integrated a portfolio-level response (either part or whole) that considers risks and opportunities in the context of a circular economy.

9 Bowen, Chris 'Address to Clean Energy Council' July 2023 https://minister.dcceew.gov.au/bowen/speeches/address-clean-energy-council

Biodiversity and Nature

Climate, biodiversity, and nature are interrelated. Global warming exacerbates biodiversity and nature loss, while biodiversity is also what the United Nations calls "our strongest natural defence".

Investors can help to reverse biodiversity and nature loss by assessing and integrating nature-related risks and opportunities into their investment management.

This year's survey findings show an increase in investors, primarily asset managers (over 70%), that have conducted *some* level of assessment, up from 25% in 2022 to 44% this year.

However, investors are slow in responding to the biodiversity and nature-related risks to investments:

- Only 14% of investors are integrating a response on either part or whole of their portfolio.
- 41% of investors have taken no action to assess or manage biodiversity and nature-related risks in their portfolios.

Where investors are attending to biodiversity and nature risk, their engagement strategies and bottom-up analysis includes:

- identifying and engaging with companies where biodiversity poses risks or opportunities to business; and
- assessing biodiversity risks during investment due diligence and inquiring whether measures have been taken to reduce impact on biodiversity, particularly for projects in construction and infrastructure.

Deforestation

Deforestation sits at the heart of the climate-nature nexus. As a significant source of global carbon emissions, there is an increasing recognition that net zero emissions cannot be achieved without halting and reversing deforestation.

This is a new area for Australian investors with only 27% reporting that they have conducted any level of assessment and/or integrated a response on deforestation risks and opportunities. When it comes to stewardship, 14% of respondents indicate they are conducting meaningful engagement with companies to reduce deforestation.

Just over half of the investors surveyed (51%) say they have taken no action on deforestation. This is a concern given emerging global regulation that may impact local markets.[10]

In addition, several global initiatives have responded to nature related risks, two are:

- The recent update of the Investor Climate Action Plan Expectations Ladder includes specific deforestation actions for investors to consider in their transition plans. The ladder update provides investors with context on the way that addressing deforestation can accelerate progress on climate change.

- The Taskforce on Nature-related Financial Disclosures (TNFD) has been piloted in Australia with strategic funding from the federal Government, with the Responsible Investment Association Australasia (RIAA) acting as the local convener. The pilot process covered businesses and financial institutions across five value chains including natural gas extraction for industrial manufacturing, property development and building construction, and critical mineral mining for producing clean energy technologies. All pilots have been published with deep-dive guidance documents to help organisations further build understanding and knowledge on nature and biodiversity loss as an investment risk.

10 EY & The Wilderness Society 'Following the money: Financial services' links to deforestation and forest degradation in Australia', 2023 https://www.wilderness.org.au/following-the-money

Summary: Looking Forward into 2024

It is encouraging that, for the first time, over half of investors surveyed have set both long term and interim climate targets.

However, target setting is only the first step of an investor's climate journey. Credibility in targets rests in the implementation of forward-looking actions and activities throughout an investor's investment management processes.

Investors continue to integrate and act on climate risks across their organisations' practices and processes, despite a rapidly shifting national regulatory landscape that is presenting challenges to make net zero targets and commitments public. Almost all investors surveyed are undertaking active ownership activities such as voting shares in line with climate policies. To raise the credibility of active ownership activities and prepare investors for mandatory climate disclosures, setting specific, time-bound and measurable targets will improve the transparency around investor climate actions.

The survey has identified encouraging indicators that investors are 'actively considering' such as setting interim, asset alignment and climate solutions targets. In addition, asset managers and asset owners will likely align on climate practices as owners adjust their manager selection and monitoring processes and identify managers that are well positioned to deliver on their climate goals and active ownership practices.

The pledges coming out of COP28 will reinforce these expectations, specifically that the Parties, (including Australia) agreed to transition away from fossil fuels. This offers a clear signal for investors and industry to translate net zero commitments into implemented action. It is therefore reasonable to expect that those investors who have already started will be better positioned to further progress these efforts and benefit from the opportunities of the transition.

IGCC will continue to support its members' in related investment activities by:

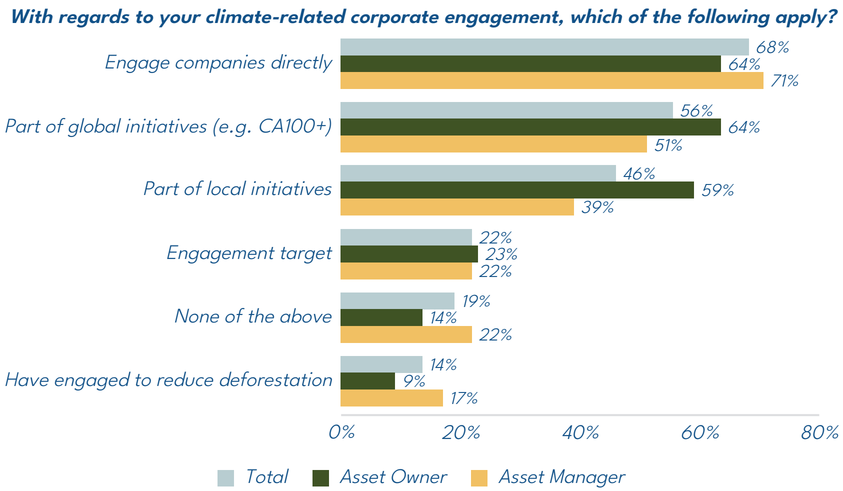
- Delivering asset class specific working groups to build investor understanding and application of international best practice guidance in net zero target setting and investor practice;
- facilitating dedicated investor-led groups to analyse the implementation challenges and improve knowledge of international guidance in specific asset classes or areas such as climate solutions;
- facilitating and representing investor feedback to the development of the Net Zero Investor Framework (NZIF) and on international investor initiatives such as NZAM and PAAO;
- ensuring complimentary support in climate related areas is provided to investors by similar industry organisations in the region; and
- acting as the peak climate investor platform in industry representing Australian and New Zealand investors and working to build investor expertise in climate related investor practices.

06: Practice Area 2: Corporate Engagement

Investors recognise their fiduciary duty to respond to a changing climate and the risks and opportunities associated with the decarbonisation of the global economy.

They are engaging with the companies they own on sustainability issues with the aim of driving positive environmental and societal change and maintaining long-term shareholder value, in line with the interests of their clients and beneficiaries. Priorities include ensuring companies set science-based targets, publish robust 1.5˚C-aligned climate transition plans, and have climate related financial disclosures aligned with global best practice and local reporting standards.

Corporate Engagement



Most investors in Australia are engaging directly with high emitting portfolio companies. Many are conducting these engagements via global and local collaborative initiatives.

Engagement Targets

Setting time-bound, measurable, and outcomes-focused engagement targets can help investors demonstrate how they are translating long-term climate commitments into near-term actions and tangible outcomes. Clearly defined milestones communicated to companies through engagement allow investors to periodically track progress against engagement targets to demonstrate the effectiveness of stewardship policies and support disclosures to stakeholders.

- Despite the importance of tracking progress on engagement against milestones, only 22% of respondents indicated that they have formal engagement targets in place. The bulk of these were public, with only 5% of respondents indicating they have non-public targets.

IGCC's Work to Improve the Impact of Engagements

The 2023 global assessment of company disclosures conducted by Climate Action 100+ (CA100+) using its Net Zero Company Benchmark ('the Benchmark') indicates that investor engagements are having some influence as companies show to be improving their climate commitments and associated disclosures. However, company commitments are yet to translate into real emissions reductions aligned with Paris goals at a sector level. The CA100+ Benchmark reveals several key areas for company improvement:

- Decarbonisation targets and strategies are often not aligned with a 1.5˚C warming outcome.
- Companies are not aligning capital allocation with their decarbonisation strategies and commitments.
- Value chain (Scope 3) emissions are not being adequately included in targets and plans, despite being the most material emissions for many high emitting companies.
- Companies are not adequately planning for a just transition, with suitable provisions for the impact of decarbonisation on their workers and communities.
- Companies are not proactively lobbying for policy conditions that will allow them to decarbonise further and quickly enough – and in some cases companies and their industry bodies are lobbying *against* these policy conditions.

These broadly inform investors' engagement objectives, with a primary focus on ensuring companies provide clear evidence that they are translating decarbonisation commitments into concrete action. Whilst corporate engagement through dialogue will remain a key tool, investors are increasingly likely to use other stewardship tools where progress falls short of expectations. Examples include letters to the Board or voting against director re-elections at Annual General Meetings (AGMs).

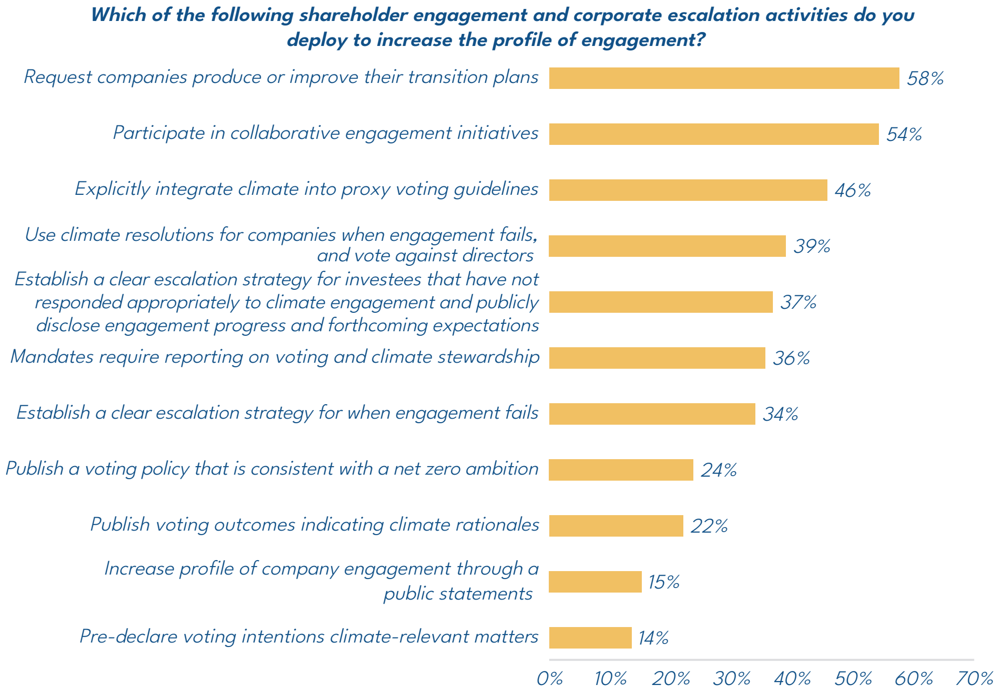
There is also a need to ensure alignment between asset owners and asset managers in this stewardship process. In particular, asset owners may formally reflect their expectations of managers on net zero alignment and stewardship activities through mandates and requests for reporting that demonstrates the effectiveness of stewardship activities. This is particularly important as regulators step up efforts to combat greenwashing, and as advocacy on climate action evolves within the broader community.

Mindful of this context, IGCC is supporting its members by:

- Helping to facilitate and support CA100+ investor engagements in Australia. Phase 2 of CA100+ aims to drive a shift in focus from corporate climate disclosure to action and offers new opportunities for investor-led engagement with a broad range of stakeholders to address system-level sector and thematic barriers to decarbonisation.
- Driving the development and testing of sector specific tools such as the Net Zero Standard for Diversified Mining, to assess company transition plans to net-zero in key sectors.
- Consulting members and organising round table discussions on key engagement challenges, such as investor considerations related to the sale and early closure of emission-intensive assets.

The Institutional Investor Group on Climate Change's (IGCC) Net Zero Toolkit provides a useful resource for investors to enhance their stewardship practices.

Stewardship and Engagement Strategies



When engagement through dialogue is not achieving adequate progress, investors can draw on other stewardship methods – as outlined in the Net Zero Stewardship Toolkit. This includes developing a public voting policy that encompasses pre-declaring votes on climate-related resolutions, filing resolutions, voting for or against directors or transition plans, and publicly reporting progress that is specific, time-bound and outcomes-focused. Many of the investors that have signed onto global net zero initiatives, such as the Net Zero Asset Managers (NZAM) and Paris Aligned Asset Owners (PAAO), have made commitments to implement stewardship and engagement strategies that entail clear voting policies consistent with the objective of achieving net zero emissions by 2050 or sooner.

Voting Approaches

In addition to the actions above, leading investors are developing a robust voting approach that incorporates climate as a key part of their stewardship strategy. However, our research shows that there is still room for improvement on this front: only 24% of investors surveyed have published a voting policy that is consistent with a net zero ambition.

Options for investors to improve their voting approach include:

- Developing public voting policies that align voting practices with climate ambition and net zero commitments. (24% of investors have published a voting policy consistent with net zero ambition).
- Disclosing voting outcomes with voting rationales which increases the transparency of active ownership efforts (22% of investors surveyed are publishing a selective account of voting outcomes indicating voting rationale on the grounds of climate).
- Pre-declaring voting intentions, aligned with voting policies that incorporate climate, on management proposals such as the re-election of directors, Say on Climate and other climate resolutions. (only 14% of investors are pre-declaring voting intentions).

A clear public voting policy is a critical tool to align an investor's net zero ambitions with its voting activities. It defines how an investor will vote when key net zero criteria, transition plan commitments, or investor engagement objectives are not satisfactorily achieved by a company. It thereby signals investor expectations to companies. Voting policies should cover the full equity portfolio and all assets under management.

Corporate Climate Transition Plans

Corporate climate transition plans have become a core institutional investor expectation of investee companies. They allow companies to disclose the strategies, projects and associated capital they are deploying to achieve their greenhouse gas emissions reduction commitments. These plans outline a company's emission reduction targets and the measures being undertaken to achieve these commitments. These detailed disclosures should allow shareholders to accurately understand an investee company's physical and transitional climate-related risks and opportunities. They should enable investors to understand and assess the suitability of strategies and investments to address these risks and take advantage of the opportunities presented by the global energy transition.

The Investor Group on Climate Change (IGCC) released a seminal guide to investor expectations on Corporate Climate Transition Plans in March 2022. This practical and detailed guide to "good" climate-related disclosure is built on IGCC's history of advocacy for robust and standardised corporate disclosures on climate risk and opportunity management.

Voluntarily reported climate plans have underpinned a growing number of 'Say on Climate' votes, which are non-binding, advisory votes offered to shareholders to express support for a company's climate transition plan. At the time of writing this report, nine out of the fourteen Australian CA100+ focus companies have held a Say on Climate vote for their shareholders.

In mid-2023, the Australian Government announced that mandatory climate-related disclosures will be phased in for Australian corporates. Mandatory disclosures will improve the quality and comparability of corporate climate-related reporting thereby enhancing investors' ability to fulfil their fiduciary duty to manage the long-term savings of their beneficiaries. The Australian Government has identified credible and ambitious transition planning and disclosure as a key priority in its draft Sustainable Finance Strategy.

Refer to the Disclosures chapter for more information on Investor Climate Transition Plans.

Pre-declaring votes on the appointment or re-appointment of a director, or approval of an annual report, remuneration report, climate transition plan, or any other routine vote prior to a company's Annual General Meeting (AGM), improves investor accountability and transparency to its clients and beneficiaries.

Additionally, filing resolutions and pre-declaring voting intentions can initiate further dialogue with investee companies, and constitute key stewardship tools that investors can use to enhance the effectiveness of their corporate engagement efforts.

Summary: Looking Forward into 2024

Of the investors surveyed, a majority are participating in collaborative engagements and just under half of investors surveyed have integrated climate into their proxy voting guidelines. Companies developing robust climate transition plans is a key engagement priority for investors, driving asks of companies related to specific climate levers, climate risk governance and alignment of capital with decarbonisation goals.

Although a meaningful number of investors are now voting on climate resolutions and against directors at companies that are not responding appropriately to engagement, only a small number of investors are pre-declaring their voting intentions.

In summary, Australian investors' corporate engagement activities are lagging behind international peers, particularly European investors, with respect to setting engagement targets and disclosing engagement progress and forthcoming company expectations.

Key drivers for investors to further enhance corporate engagement stewardship practices include:

- Ensuring active stewardship goals support portfolio decarbonisation and are aligned with climate commitments and Paris Climate Agreement goals,
- Aligning investor expectations with the growing need for big emitters to translate decarbonisation strategies and commitments into action,
- Ensuring investee companies are advocating for policy conditions that will allow them to decarbonise further and quickly enough,
- Ensuring national standards and regulations guide companies on how to adequately plan for a just transition, with suitable provisions for the impact of decarbonisation on their workers and communities,
- Ensuring the financial costs of physical climate risk are understood by investors and built into engagement objectives.

IGCC will continue to support its members' corporate engagement activities by:

- Providing support and building investors' capacity on stewardship strategies, including escalation frameworks, resolution filing and voting disclosure,
- Building physical risk into corporate engagement objectives,
- Supporting the development and regional testing of sector-specific net zero standards for corporate climate transition plans,
- Providing analysis to support more nuanced and targeted engagement on executive remuneration and allocation of capital in line with company decarbonisation strategies and commitments,
- Facilitating investor input on the design of national regulations and standards to guide corporate just transition planning,
- Supporting investor engagement on 'positive' lobbying, with a particular focus on Australian policy alignment with a 1.5C warming outcome.

07: Practice Area 3: Policy & Advocacy

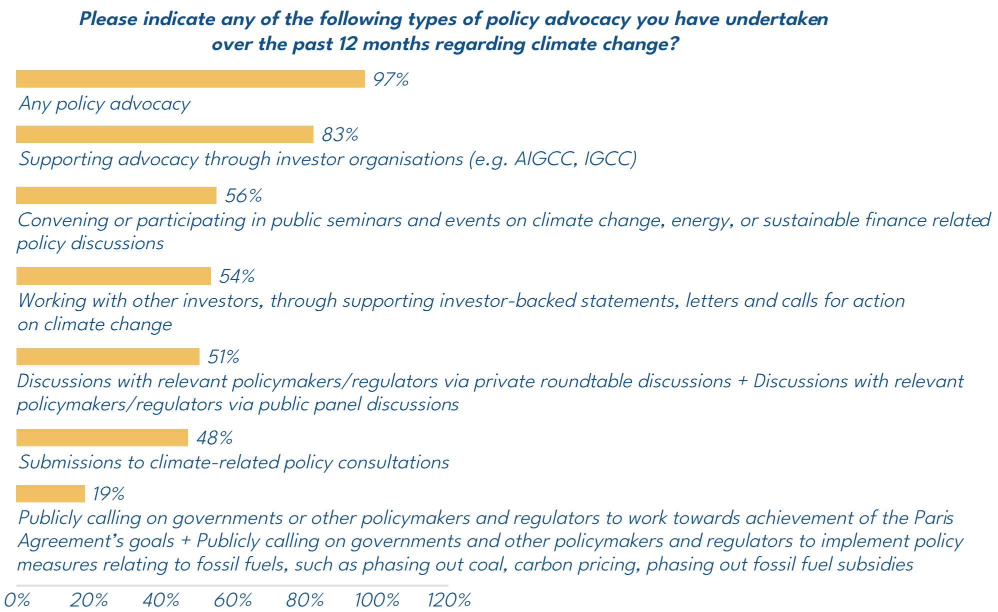
Public policy and managing investments have a two-way relationship. The data in this year's survey provides insights into both directions of that relationship: policy settings' influence on investors' capital allocation, and investors' engagement with policymakers.

The past 18 months have seen a remarkable amount of policy-making on climate and finance. Namely, Australia has legislated its 2030 emissions target, reformed the safeguard mechanism, thereby introducing an effective price on emissions for approximately 30% of the economy, and is starting to plan the economy wide decarbonisation through sector by sector plans.

Given the implications that these policy-settings will have on a wide range of businesses in Australia, and consequently portfolio returns, an important part of investors' overall fiduciary duties will be to closely monitor and engage with new policy developments, to ensure their needs are part of the process.

In recent years, the Australian government has increasingly collaborated with investors on national priorities, such as maximising Australia's opportunity to become a renewable energy superpower in the net zero transformation, and collaborating on public-private partnerships to fund adaptation and resilience. For example, the Treasurer's Investor Roundtable invited some of the country's largest investors and energy and climate leaders to build initiatives that pave the way for Australia's net zero transition.

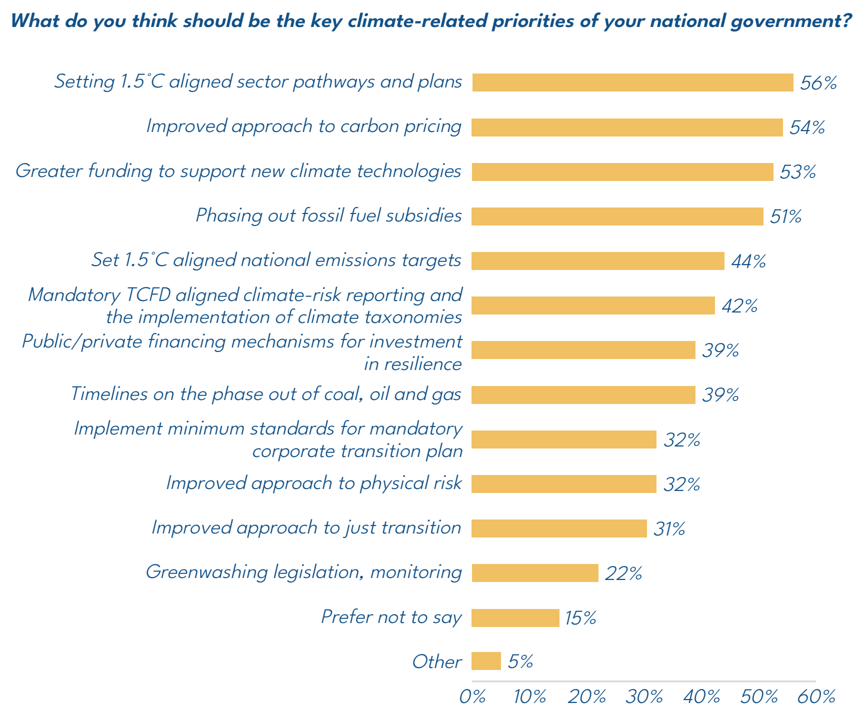
Public Policy Engagement by Investors



97% of respondents have undertaken some form of climate-finance related policy advocacy. This strikingly high figure includes investors who are members of organisations like IGCC, which conducts regular engagement with policymakers on behalf of investors. This would seem to meet the goal of The Australian Prudential Regulation Authority (APRA) asking for cost-effective policy engagement activities including those undertaken "by way of a collective approach".

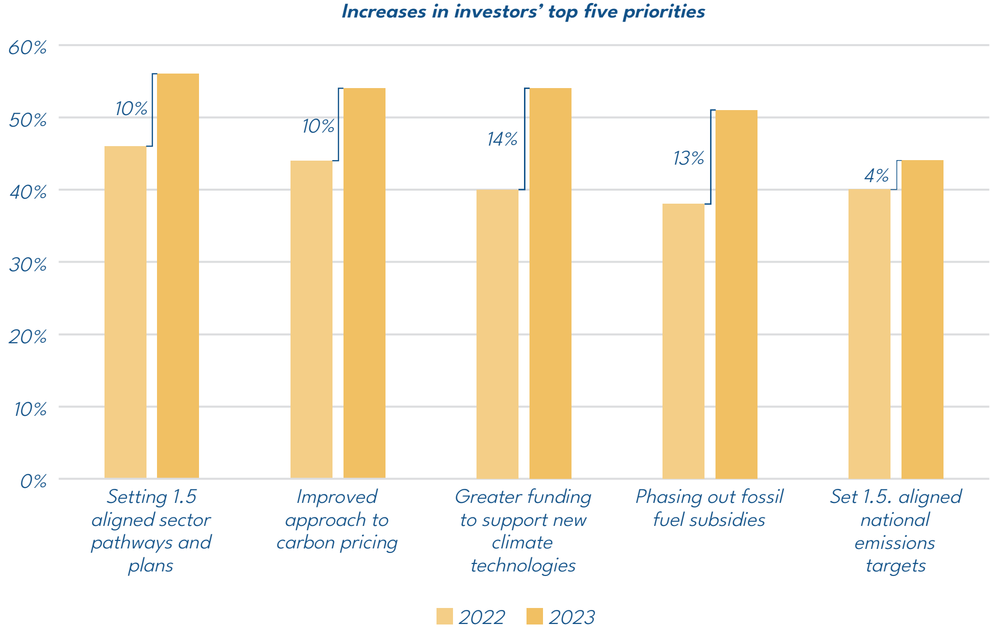
An increasing number of investors also conduct direct engagement with policy makers and/or regulators, and/or participate in public events on relevant topics.

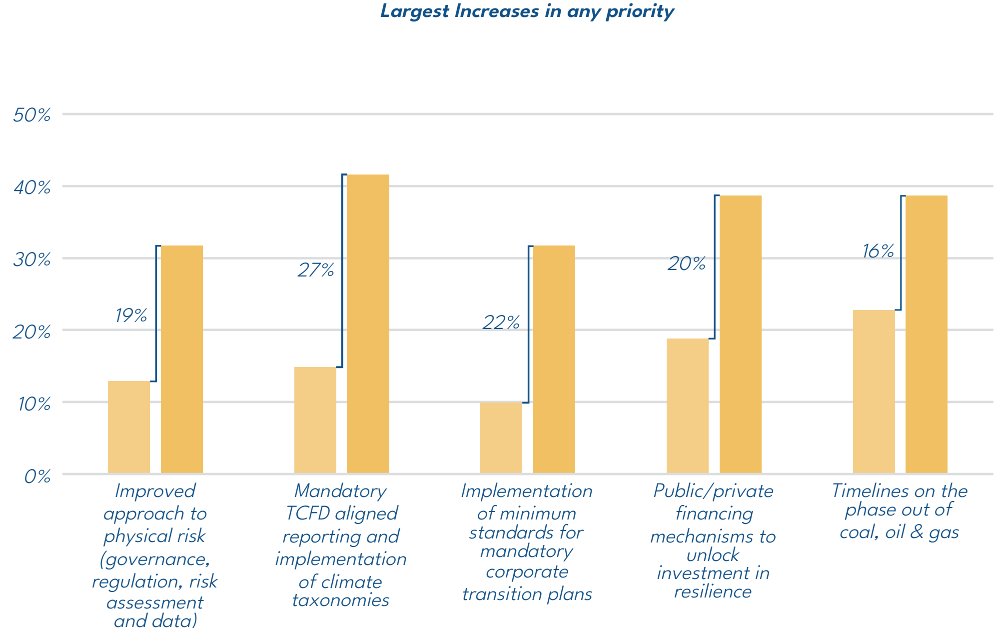
Investor Views on Policy Priorities for Government



The top priority, setting 1.5˚ aligned sector plans, will also affect the next three priorities: carbon pricing, funding for new climate technologies, and phasing out of fossil fuel subsidies. IGCC expects these will be addressed via the government's sector plans.

Year on Year Changes



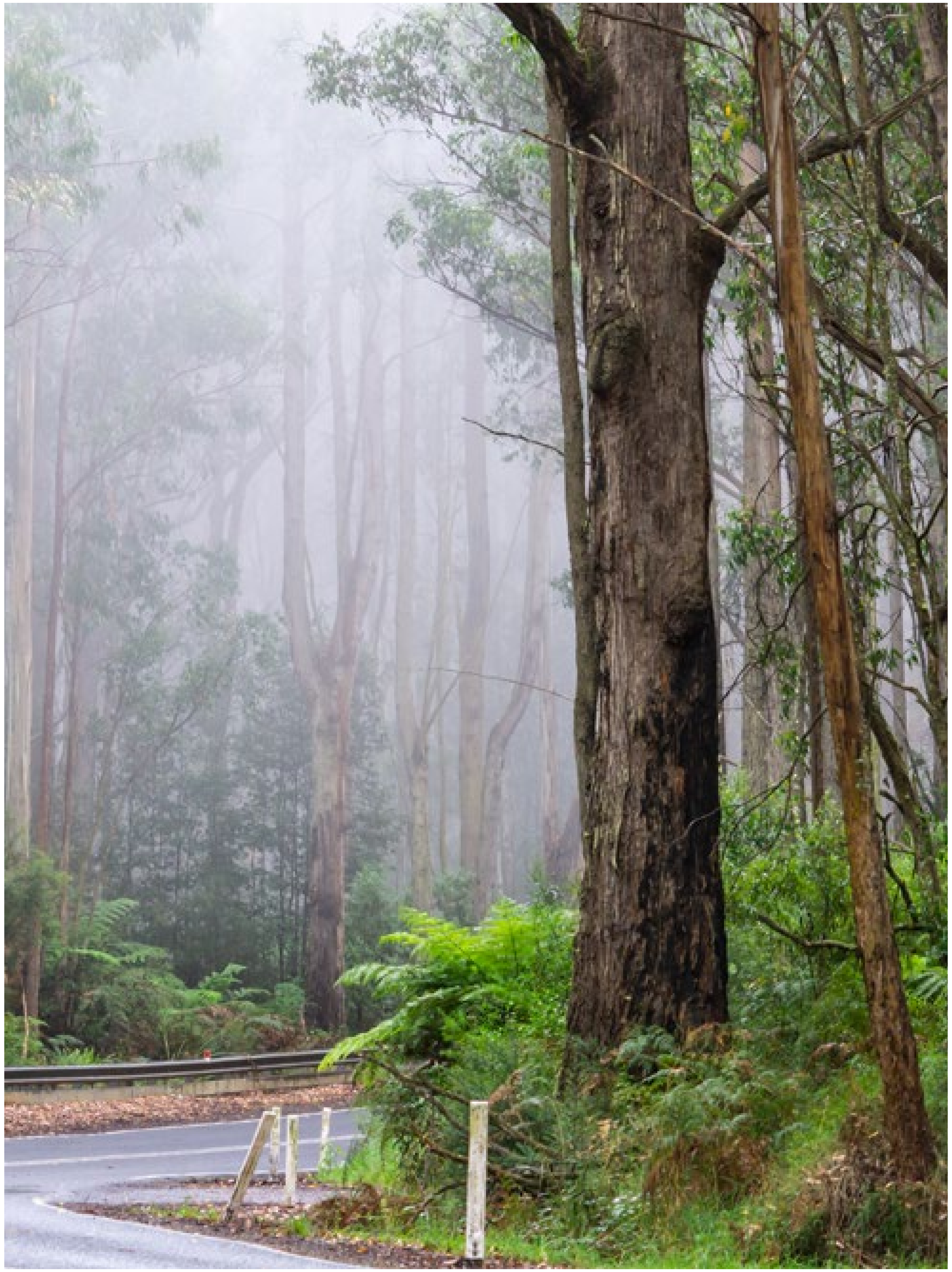


This year's State of Net Zero survey recorded notable year on year increases in *all* the climate-related areas that investors note should be government priorities.

This year saw large increases in the number of investors calling for policy support in managing physical risk, and for public-private financing mechanisms for resilience. This may be explained by increasing instances of damage and disruption from extreme weather on physical assets and supply chains, resulting in higher insurance costs and negative impacts on the broader economy.

One respondent noted that the mechanisms and role of government were an important aspect of policy settings:

> *"The US model to promote and incentivise bottom up activity looks likely to be more successful than a heavy handed rules-based approach."*



Advocating for Sector Pathways: The Story So Far

Investor members of IGCC highlighted to government throughout 2023 that pathways and targets for the decarbonisation of key sectors in the economy will be instrumental in guiding investment for an orderly and just transition.

Such pathways are critical to unlocking finance for climate solutions and can support investor engagement with companies. Access to capital is an emerging risk for many sectors that are struggling to transition to net zero.

Actionable sector transition plans, which can underpin stable and long-term policies, will also help investors to avoid investment in potentially stranded assets, and support investors to confidently allocate capital.

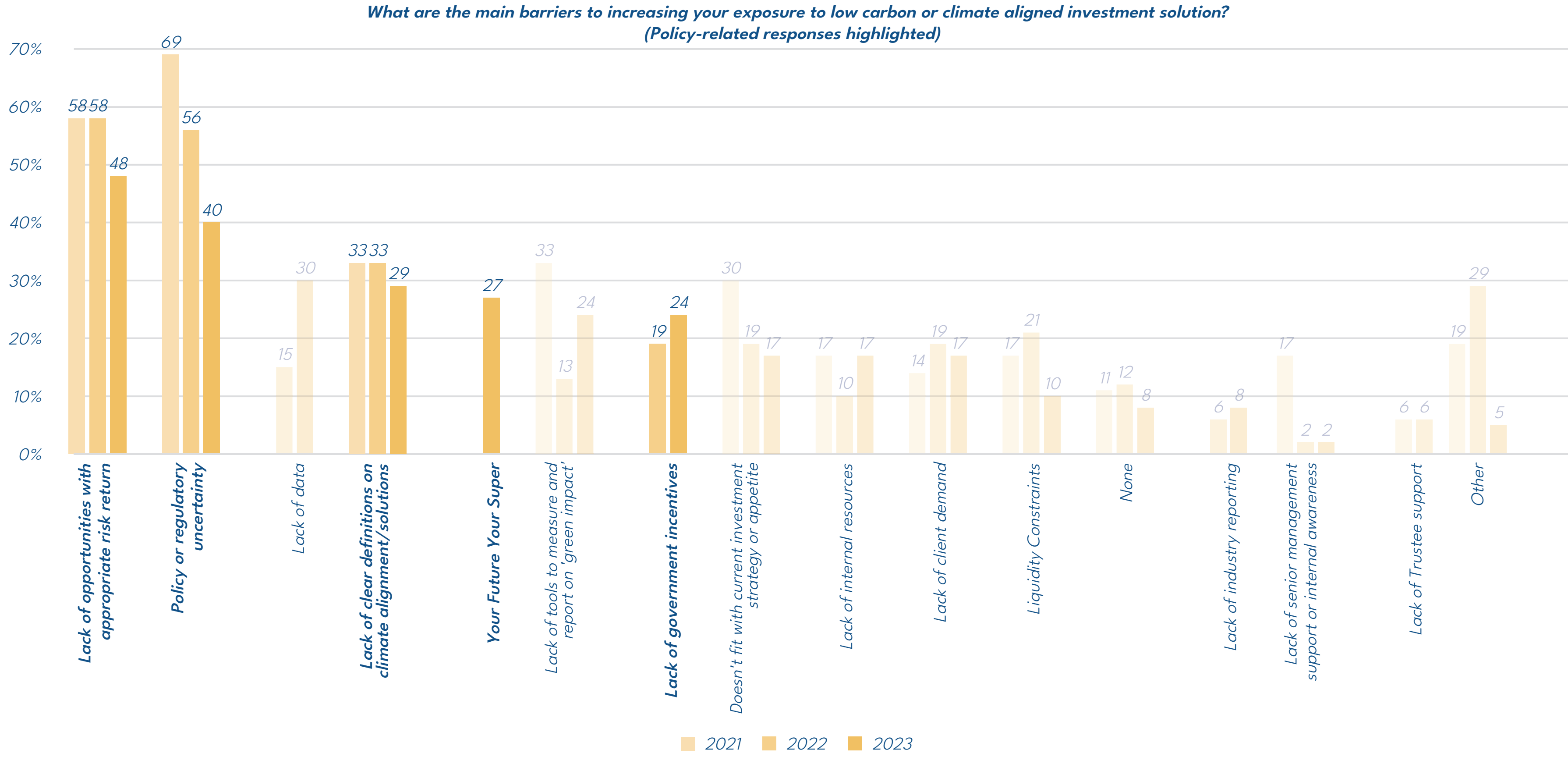
In July 2023, the Australian Government announced it would develop those 'sector plans' citing IGCC and investors as the driver behind this decision.

With IGCC, investors continued to meet with senior policy makers, providing feedback on the Climate Change Authority's (CCA) issues paper on Australia's emissions reduction targets, and focussing on areas most material to long-term investment returns. IGCC also worked with key investors to produce Decarbonisation Investment Solutions for Sectors, which articulated investor needs for sector plans to unlock private sector capital.

In December 2023, the Australian Treasurer, Jim Chalmers, hosted a roundtable with IGCC, many of its members and other finance industry representatives. The development of sector pathways was one of the main agenda items, and participants agreed a set of principles that can support investment in decarbonisation.

The government has signalled that they expect ongoing feedback from the finance sector as policymakers work through the details of plans and continue to adjust them over time. Helping facilitate this process is one of IGCC's highest policy priorities.

Policy Settings and Capital Allocation in Australian Climate Solutions



Policy settings are one important factor amongst many that influence whether investors allocate capital to climate solutions in each market. Each year the State of Net Zero survey asks investors to nominate the most important barriers to allocating capital to climate solutions in Australia. Public policy has a significant influence over many of the barriers.

For the first time, fewer than half of our respondents nominated "unattractive risk/return" and/or "policy uncertainty" as barriers to climate solutions investment in Australia, indicating that we may be likely to see more action on this front in coming years.

Since the inception of the survey policy and regulatory uncertainty on climate change policy in Australia has been a key barrier to investment in Australia. As investors are seeking returns over multiple decades, super funds and investment managers need long term policy visibility and stability to invest with confidence in Australia.

In 2021, 7 out of 10 investors cited policy and regulatory uncertainty as a key barrier in investment. In 2023, this decreased to 4 out of 10 investors citing policy as a barrier, a 30-point drop in two years. This improvement in market sentiment is driven by the significant policy progress governments have made over the last two years.

Two other key obstacles reflected concerns that investors have about the access to quality information on this topic, principally around access to frameworks and data. The data also suggests that the Your Future Your Super (YFYS) regulations may be acting as a brake on investors applying their climate practices outside a relatively constrained set of asset classes and benchmarks.

Nevertheless, the data shows that while there have been improvements in policy certainty, the availability of appropriate local investments remains a consistent concern for respondents.

Several qualitative responses to the Survey noted that the USA's inflation reduction act (IRA) has made that market a very attractive destination for global capital investment in any asset class, but especially for capital allocated to climate solutions.

The urgency of a fast and fair policy response to climate change has been reinforced by other economies, from giants like the USA, South Korea, Japan and Europe to peers like Canada, that have enacted substantial financial incentives and a variety of other supportive policies to drive investment in new green industries. Global capital, including Australian investors, are following these policies.

To avoid ongoing capital flight, Australia will need globally competitive, proportional, and smartly targeted incentives of our own, designed to suit our economic strengths and values. The "Future Made in Australia" measures, announced in the May 2024 federal budget may assist.

Although investors are still facing obstacles when it comes to growing their investments in climate-aligned or solution investments, when asked directly if the situation has improved or worsened, 41% responded that they have seen some level of improvement over the previous 12 months in various identified policy and non-policy barriers.

Investors provided examples of the ways in which the environment has become more favourable for climate solutions:

> *"Federal government progress on net zero target setting, biodiversity targets, circular economy strategies plus sustainable finance developments are improvement examples, together with public sector department resourcing."*
>
> *"Improved engagement from regulators."*
>
> *"The Australian Government Sustainable Finance Strategy is helping."*

Remaining policy-related headwinds were also cited, however:

> *"[...] the new approvals for fossil fuel expansion, the approach the regulator has taken to greenwashing enforcement, and implementation issues around planning like transmission lines for renewables."*

While there has been an improvement in overall sentiment, 48% of respondents still feel that progress remains stagnant on barriers to climate solutions and aligned investments.

Summary: Looking Forward into 2024

Almost all respondents to the Survey report that they are engaging in some form of policy advocacy on climate change. This is encouraging, given the unique perspective that investors bring to this conversation, particularly a focus on long-term returns, sector- and economy-level reforms, and the importance of real-world outcomes.

This policy advocacy appears to be having an impact, given the significant reduction in the number of investors identifying policy uncertainty as an obstacle to investment in the climate transition.

Looking ahead, the Australian government is making important five-year policy decisions, including on Australia's 2035 emissions target, throughout 2024. IGCC co-ordinates with other industry organisations, PRI and ACSI to reduce duplication of effort on climate-related policy engagement.

IGCC's key policy priorities include:

- Demonstrating investor support for ambitious emission reduction policy, including the national 2035 target and sector plans.
- Bringing investors' perspectives into the strategic planning of the national Net Zero Economy Authority.
- Embedding financial mechanisms to unlock private capital in the forthcoming National Climate Adaptation Plan.

08: Practice Area 4: Disclosure

Investors' disclosure of climate-related information brings their efforts in portfolio management and stewardship into the public domain. It is a vital, external-facing component of investor climate action.

Disclosure helps existing and prospective beneficiaries and clients understand how the investor is managing the risks and opportunities of climate change on investments. It also contributes to the government's and researchers' understanding of the climate-related risks and opportunities across the economy.

Climate risks and opportunities include both transition risks and opportunities (due to the proliferation of climate policies and market dynamic changes related to the decarbonisation of the economy) and physical risks and opportunities from the direct and indirect physical impacts of climate change (resulting from damage to physical assets and disruption to supply chains).

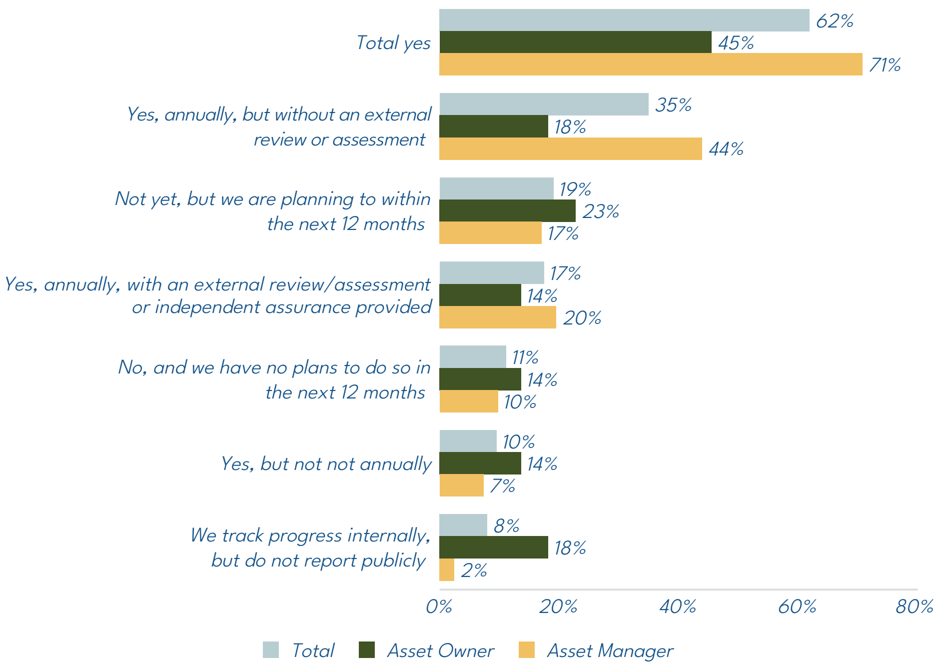
As such, climate disclosures span a range of topics, from publication of commitments and targets, reporting on risk assessment and management processes, and detailing progress and outcomes of the efforts made to work towards targets.

In relation to disclosures, the 2023 survey's key findings are:

- 62% of investors are voluntarily reporting against the recommendations of the TCFD – this is an increase from last year.
- 41% of investors are *publishing* a strategy or transition plan detailing how they plan to achieve net zero climate commitments.
- 67% of investors have assessed at least part of their portfolio for physical risk and resilience (mainly in relation to real estate and infrastructure assets), but only half of this group have implemented any response.
- A very small proportion of investors are analysing their portfolios against plausible scenarios *and* disclosing the results, which is likely to become mandatory, as detailed in the Physical Risk chapter.

TCFD-aligned Reporting

Do you produce TCFD aligned reporting?



The TCFD recommendations promote disclosure of climate-related financial information, particularly that is relevant for investment decision-making. They cover four inter-related areas: governance, risk management, strategy, and metrics and targets.

Companies and financial institutions around the world, including asset owners and asset managers, have been reporting against the recommendations since their inception in 2015.

The TCFD recommendations have recently been incorporated into the International Sustainability Standards Board (ISSB) sustainability disclosures standards (IFRS S1 and S2). The ISSB standards provide a global baseline for standardised climate reporting in capital markets worldwide and will form the basis of Australia's mandatory climate disclosure regime.[11] Australia's legislation, if passed, will apply a mandatory reporting regime to investors including superannuation entities and asset managers.

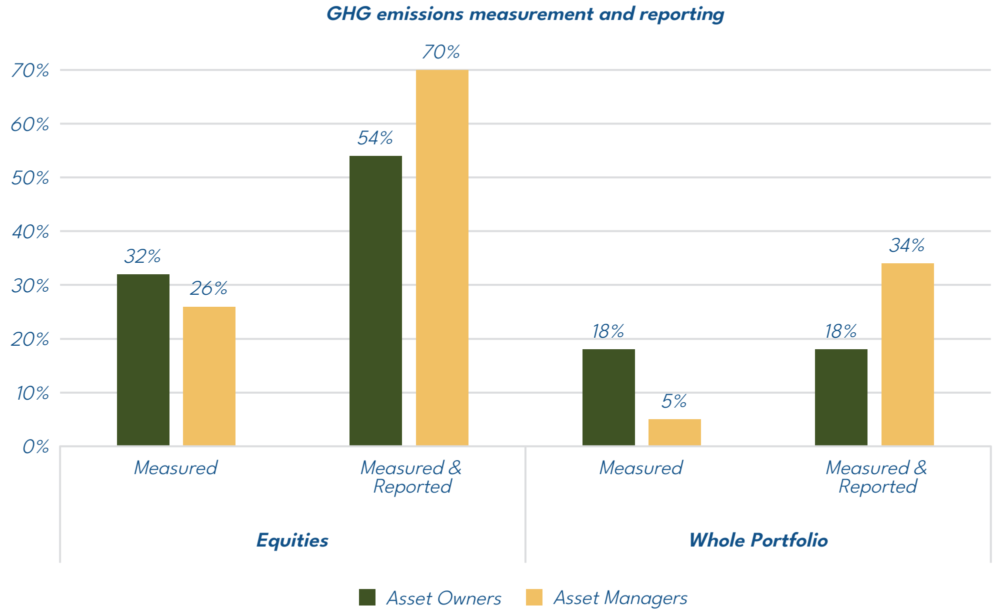
Investors that have been preparing voluntary TCFD reports will be able to draw on this experience to meet their obligations as well as expectations in international markets.

This year's survey finds that overall, 62% of investors in Australia are producing TCFD aligned reporting. This is a healthy increase from the 53% reported last year.

Interestingly, a higher proportion of asset managers are producing TCFD reports on an annual basis than asset owners – *and* are undertaking external assessment or assurance of their reporting. This may in part be in response to demand from their institutional clients, many of whom have their own climate commitments and want to be sure that their investments are being managed accordingly.

11 At the time of writing the Australian Accountability Standards Board (AASB) was consulting on the Australian standards and the enabling legislation had been tabled in Parliament for debate.

Portfolio GHG Emissions Measurement



To identify exposure to climate risks and opportunities, investors need to measure and identify the sources of greenhouse gas (GHG) emissions in their portfolio. Building on the TCFD recommendations on metrics, the ISSB Standard requires investors to disclose the emissions associated with their investments –otherwise known as 'financed emissions'.

The bulk of investors are measuring their portfolio carbon footprints in asset classes where the information is readily available: public equities being the prime example.[12]

It appears that there are some challenges for some investors when it comes to publishing whole of portfolio GHG measurements, and across the board, a significant proportion of investors keep whatever emissions measurements they do make private.

We have see an increase in the number of investors measuring emissions in private equity, up from 30% in 2022 to 47% in 2023, an asset class that typically faces challenges around data availability and consistency.

Just over a third (25%) of investors have sought third party verification on any published GHG measurements. Of those that have, listed equity and real estate are the asset classes reporting the highest verification activity.

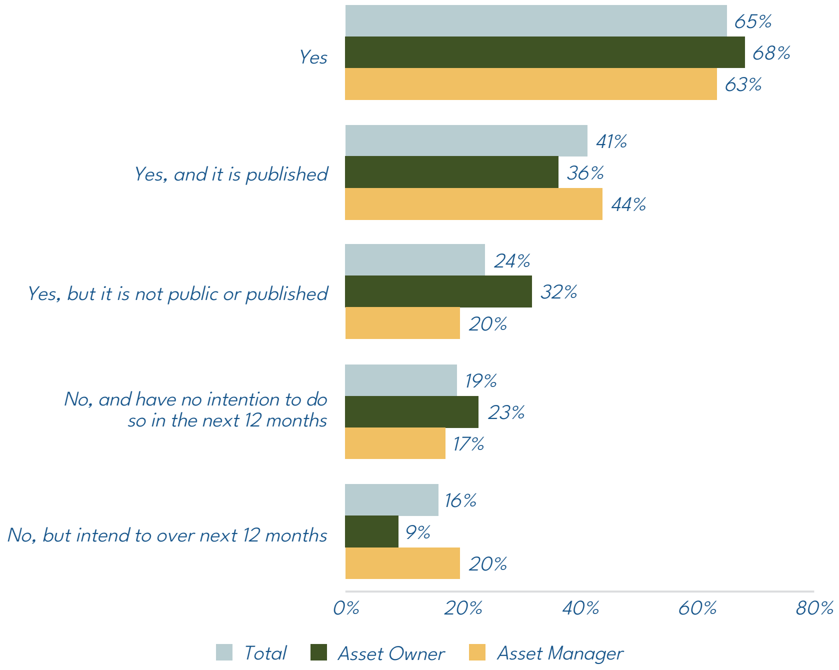
As currently drafted, Australia's proposed standards for climate-related disclosures will require investors with reporting obligations to disclose their financed emissions.

We expect to see improvements in the availability and sophistication of investee company data available to investors with the commencement of Australia's mandatory climate disclosures regime, in turn enabling investors to improve the quality and depth of their financed emissions disclosures.

12 For this section, it is assumed that asset owners will hold assets across all asset classes, but that asset managers may be answering 'not applicable' for some asset classes, if their business specializes in specific asset classes.

Investor Climate Transition Plans

Do you have a strategy/plan for achieving your net zero objectives and targets (e.g. an Investor Climate Action Plan (ICAP) or other climate transition plan)?



A plan gives credibility to targets by setting out the actions an investor intends to take to achieve climate goals and commitments.[13] For stakeholders, a climate transition plan demonstrates how investors are preparing for a net zero future by mitigating and adapting to physical and transition climate risks.

Nearly half of investors surveyed (41%) have published a strategy or plan detailing how they intend to achieve their net zero objectives and targets – this is up by 5% on 2022 results.

The increase in voluntary disclosure of climate transition plans indicates that investors are recognising the importance of setting out how their organisation is planning to pivot their business and assets under management towards a net zero economy. There is still room for improvement however, as our results show that almost one in five investors with an interim 2030 target have not yet published a transition plan.

As part of its draft Sustainable Finance Strategy, the Australian Government has stated that "[s]upporting more transparent, credible and ambitious transition planning and disclosure by Australian firms is a key medium-term priority for the Government."

Entities with a transition plan will need to disclose this under the ISSB-aligned climate disclosure standard. In the draft Sustainable Finance Strategy, the Government indicated that ASIC will "inform the market of its key expectations and supervisory priorities relating to the disclosure of transition-related targets, plans and claims".

Again, those investors who have already been undertaking transition planning and publishing this information will be in good stead to meet future disclosure expectations or requirements.

13 ASIC has made it clear that entities must have "reasonable grounds" for any sustainability targets. ASIC's market guidance states that entities should clearly explain how and when they expect to meet their target and how they will measure progress or milestones, among other matters: ASIC (2022) "INFO 271: How to avoid greenwashing when offering or promoting sustainability related products". Australian Securities & Investments Commission. https://asic.gov.au/regulatory-resources/financial-services/how-to-avoid-greenwashing-when-offering-or-promoting-sustainability-related-products/

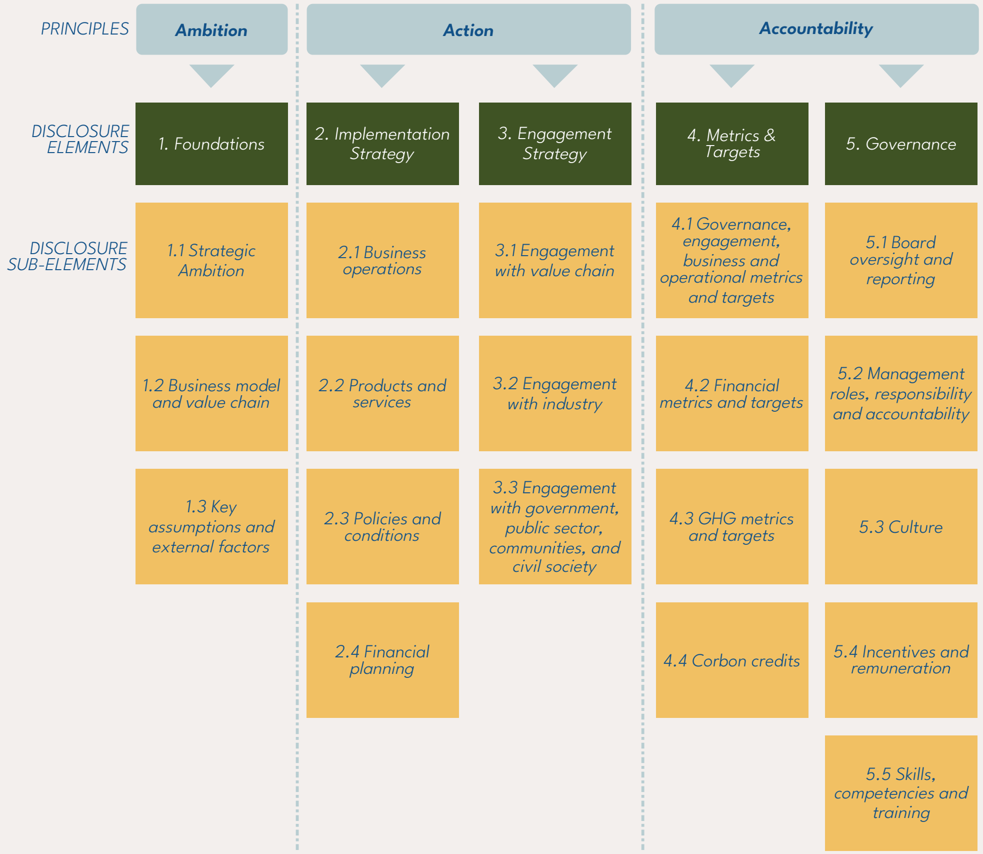
Transition Plans

"Transition plan – An aspect of an entity's overall strategy that lays out the entity's targets, actions or resources for its transition towards a lower-carbon economy, including actions such as reducing its greenhouse gas emissions." – ISSB Standard (IFRS S2)

Resources for Investors Developing a Climate Transition Plan

The Investor Agenda's Investor Climate Action Plans (ICAPs) Expectations Ladder offers investors with a useful tool to help determine their progress on climate action in a number of key focus areas relevant to an investors' business. The framework also helps to develop and address the key elements of a robust climate transition plan. Other key resources in this space include:

- The UK Transition Pathway Taskforce (TPT) has released a Disclosure Framework that sets out good practice for robust and credible transition plan disclosures with asset owner and asset manager supplementary guidance.
- The Glasgow Financial Alliance for Net Zero (GFANZ) has also released guidance for Financial Institution Net-zero Transition Plans, developed through a series of industry working group meetings to allow for globally applicability and relevance to a range of sectors.



Summary: Looking Forward in 2024

With Australia's mandatory climate reporting regime likely to be legislated by mid- 2024, climate related disclosures will be an unavoidable area for investors. Investors who have started to build experience in this area will be better prepared to meet their obligations than their counterparts who have not started.

Of particular focus, and as pointed out in the Physical Risk & Resilience chapter, the sector remains in an early stage of reporting exposure to physical climate risks. IGCC has scheduled a masterclass to assist members in this area.

IGCC will also continue to monitor Australia's process of legislating climate disclosures, the development of the Australian standard, and will keep members appropriately informed.

Quantifying Greenhouse Gas Emissions in Aware Super's Private Markets Portfolio

Pathzero

Sponsored Case Study:
Learn how Pathzero helped improve the carbon footprint coverage and accuracy of Aware Super's private markets portfolio

Aware Super, a prominent industry superannuation fund in Australia, recognised the importance of measuring the emissions associated with their private market portfolio. To address this challenge, they partnered with Pathzero, a sustainability technology solution, to assist in creating accurate emissions disclosures.

Background

Measuring emissions in private market portfolios is challenging due to the limited availability of publicly disclosed emissions data from private companies and many private companies having greater resource constraints.

Pathzero's Solution

Pathzero offers a solution that enables asset owners to obtain precise investment-level emissions data directly from their fund managers and investment companies through the Pathzero platform.

Methodology

Pathzero's approach involves facilitating fund managers and investee companies in creating emissions estimates aligned with the Partnership for Carbon Accounting Financials (PCAF) framework. This can be achieved using financial data or by acquiring emissions disclosures directly from companies through Pathzero's platform.

Benefits and Impact

Pathzero's technology will play a pivotal role in enabling Aware Super monitor the implementation of their climate strategy and climate reporting and to support informed decisions regarding the management of risks and opportunities within their portfolio. With accurate emissions data in hand, Aware Super engaged in constructive discussions with fund managers, emphasising their commitment to responsible investing and Aware's net zero commitments.

Client Testimonial

A representative from Aware Super stated, "partnering with Pathzero has contributed towards improving the coverage and accuracy of the carbon footprinting of our private markets portfolio."

Conclusion

The collaborative relationship between Aware Super and Pathzero underscores the significant role of technology in advancing sustainability objectives within institutional asset portfolios. This case study exemplifies the positive impact of innovation in the pursuit of responsible investing.

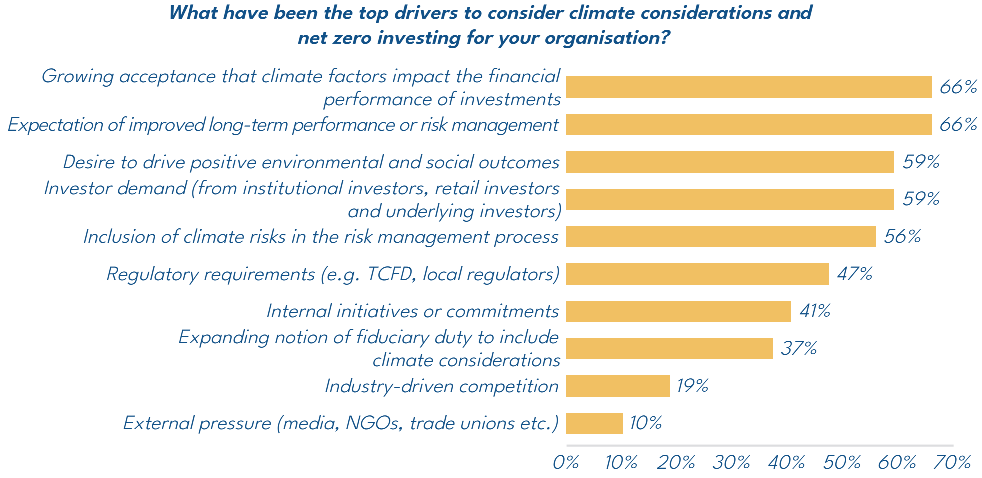
To learn more about Pathzero and its emissions data network for private markets, visit pathzero.com

09: Practice Area 5: Governance

Against the rising backdrop of increased climate risk awareness and mandatory climate-related disclosures, trustees, directors, and senior managers will face more scrutiny on the governance structures and oversight of their sustainability strategies and processes. Governance forms one of the key pillars of the ICAPs Expectations Ladder, and should include policy, accountability, planning and evaluation, skills assessment, and board reporting.

The 2024 State of Net Zero report explores some of the key drivers behind investors' decisions to consider climate and net zero investing. We also look at some of the key governance structures used by investors to implement climate action and examine the way in which climate practice is included in mandates set by investors.

Investor Motivation for Action on Climate



The most common drivers for considering climate in investment management are associated with financial performance and risk management.

Other key drivers include underlying investor demand and a desire to drive positive environmental and social outcomes. This result is supported by the findings of a recent study by RIAA, which found that 88% of Australians expect their super or other investments to be invested responsibly and ethically. Climate change was a key motivator for consumers of financial products, with RIAA reporting that: “76% want commitments on net-zero emissions by 2050”.

Fiduciary Duty: A Gap Between Asset Owners and Managers

While our headline finding was that 37% of investors identified fiduciary duty as a key motivator, when we examined the data more closely, we found more asset owners (52%) than asset managers (29%), noted the expanding notion of fiduciary duty to include climate considerations as a key driver.

This is a notable finding. Alignment between asset owners and asset managers on climate is critical, particularly where investment services are outsourced to managers by asset owners. A recent academic study analysing the alignment between UK asset owner and their asset managers’ voting practices, notes that:

> *“...UK asset owners have been concerned that despite unequivocal warnings from the United Nations and the IPCC of the risks of delayed action on climate change, short-term interests of asset managers may be trumping long-term interests of pension funds.”*

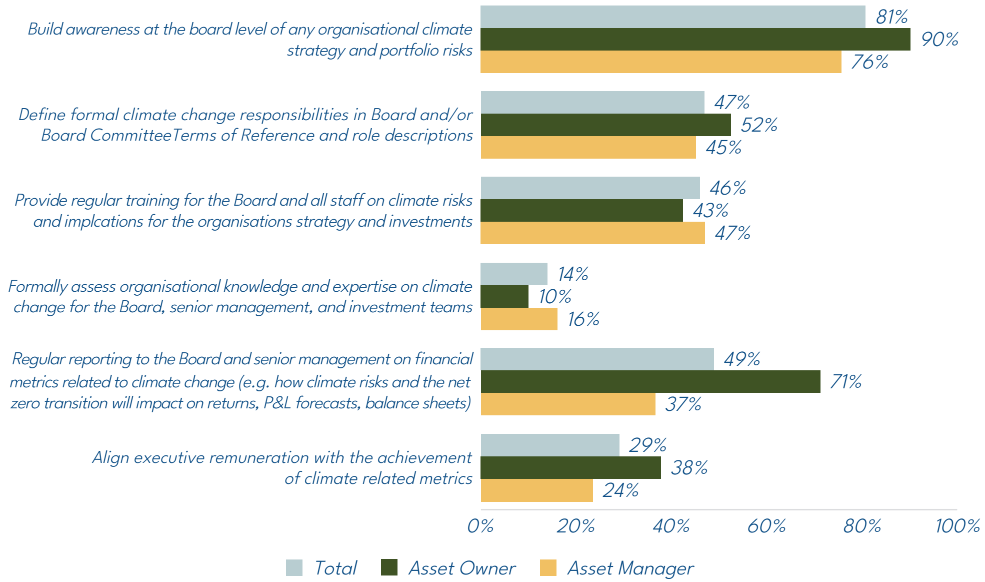
The study’s author, Prof. Andreas G. F. Hoepner, discusses five potential explanations for this misalignment, with one of the key explanations being around the conceptual understanding of fiduciary duty itself:

> *“If an asset manager ... is largely or predominantly incentivised by return or alpha, then the risk aspect is either ignored (return) or limited to classic risk factors such as beta, or size (alpha) with no consideration given to climate change as a systematic risk factor”.*

We will examine the mandate-setting process later in this chapter.

Climate Governance

Regarding your organisational governance structures regarding climate change, which of the following do you generally satisfy?



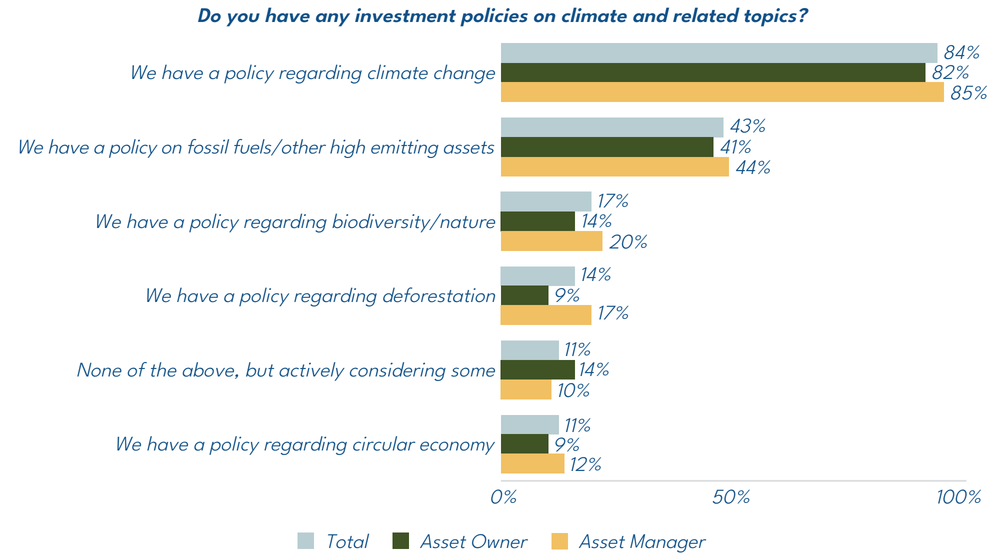
Asset owners are leading in most areas of implementing climate governance structures. .

Almost all investors are building awareness at the board level on organisational climate strategy and portfolio risks (81%) with more asset owners than asset managers doing so (90% vs 76% respectively).

A large proportion (but not the majority) of investors say they have formalised board roles, responsibilities and reporting on climate. Similarly, climate training for the board and all-staff is quite common but not the majority's practice.

Executive remuneration linked to climate related metrics is becoming more common. Overall 29% of investors reported doing to, although it was less common for asset managers. This is an 8-point increase from last years' result of 21%.

Climate Investment Policies



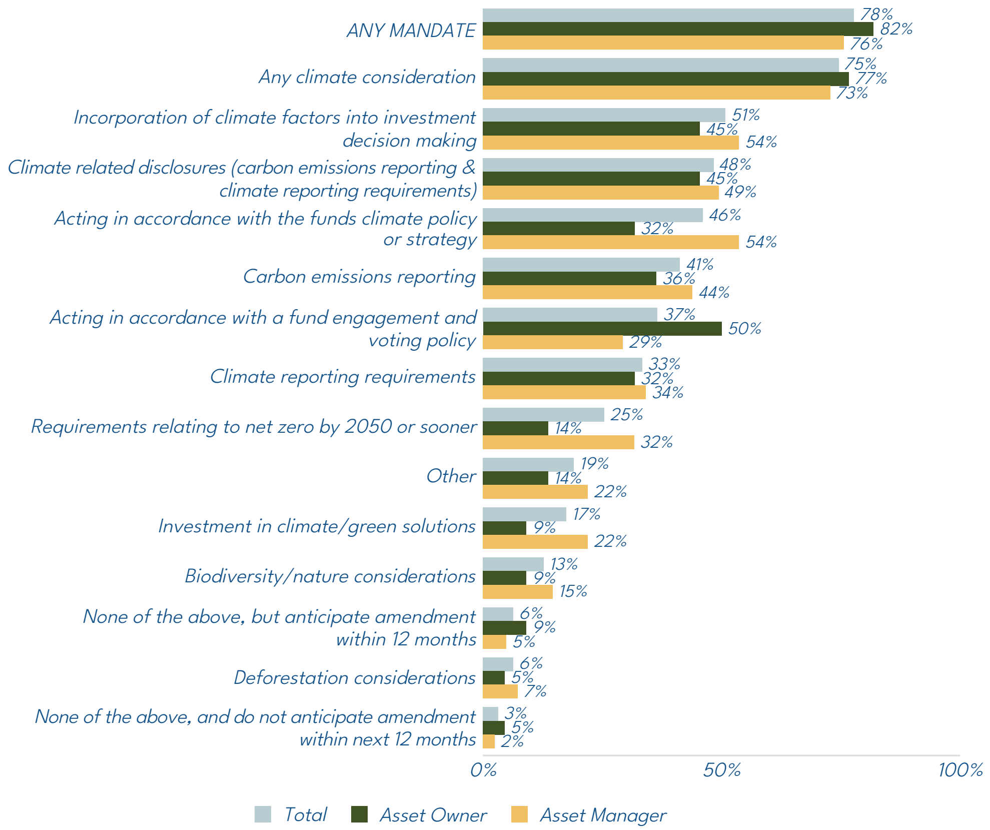
The majority of investors (84%) have set a climate change policy at an organisational level.

However the proportion of investors with formal policies on fossil fuels and other high emitting assets has increased by only one-point increase from our findings in 2022.

The Policy & Advocacy chapter discusses some of the challenges faced by investors in the Australian context that may in part explain the slow adoption of fossil fuel policies by investors.

Climate Requirements in Mandates

Which of the following climate considerations do the mandates (investment management agreements – 'IMAs') you enter into typically include?



More than two thirds of investors surveyed (both asset owners and asset managers) say their mandates include climate considerations.

The top three climate considerations explicitly included in mandates are:

- the incorporation of climate factors into investment decision making;
- acting in accordance with the funds climate policy or strategy; and
- portfolio carbon emissions reporting.

Close to half of all investors reported that mandates include climate disclosures (i.e. carbon emissions reporting (41%) and climate reporting requirements (33%)). The proportion of asset owners requiring carbon emissions reporting has doubled since last year.

On investments in climate/green solutions, there is a very stark gap between asset owners and asset managers – 9% vs 22% respectively – that report their mandates formally include expectations for investment in climate solutions. This is consistent with last years' results. This suggests that climate solutions-focussed mandates are attributable to only a small proportion of asset owners.

Qualitative responses from investors indicate that although asset owners are increasingly considering climate solutions investments, they are using more informal channels such as direct engagement with managers. By way of example, asset owners are asking managers how they define climate solutions. It is possible that these discussions will lead to more formal requirements in mandates in future.

Nature-related Mandates

Whilst nature-related topics (especially biodiversity and deforestation) have been a focus of climate discussions in recent years, this is not translating into mandates, with only an average of 12% of investors surveyed reporting working to these requirements. This finding is supported by the finding in the Investment chapter that investor practice in these areas, such as the assessment and building resilience in portfolios to address biodiversity/nature and deforestation related risks, remains low (see Emerging Areas of Practice). This raises concerns that Australian capital markets may well be under-pricing the implications of biodiversity and nature loss in investment portfolios.

Summary: Looking Forward into 2024

While investors have implemented more governance structures, they have further opportunities to enhance investor accountability, namely the alignment of executive remuneration and incentives with the achievement of climate related metrics. They could also increase skills assessments to ensure the board, senior management and investment teams have the necessary competencies to oversee, assess and manage climate related risks and opportunities.

Further engagement and collaboration between asset owners and asset managers will help to bed down clear market expectations of climate-related stewardship practices, including asset managers reporting the materiality and management of climate risks. Additionally, a deeper conversation around fiduciary duty will help to better understand the extent to which sustainability factors, including environmental, are being considered and integrated into mandates.

Climate change poses material risks to high emitting sectors, including fossil fuel companies. This will be seen in the form of increasing climate policies and intervention by government as well as rising awareness by consumers and changing consumption patterns. Other concerns such as stranded asset risk and reputational and litigation risks will also become increasingly important topics for boards and senior management to consider and manage.

With top-down regulatory requirements and the proliferation of climate policies increasing globally, there has never been a more critical time for boards and senior management to show that they are on top of climate risks. Implementing and disclosing good climate governance structures, accountability measures, and risk management practices is the way to do this.

IGCC will continue to support its members by:
- increasing investors' understanding of the implications that the latest climate policies and disclosure regulations will have on investors,
- developing IGCC's yearly workplan with the objective to progress investor knowledge and practice on climate related risks and opportunities,
- working closely with members and industry to support the translation of climate commitments into climate action by investors.

Demystifying Net Zero

JANA
DEPTH WITH DIFFERENCE

Sponsored Real World Example: JANA Investment Advisers

Advising over 80 Australian and New Zealand institutional investors, JANA provides investment solutions and services across superannuation, government entities, insurance firms, endowment funds (community, charitable and university trusts), long-service leave funds and family offices.

JANA's Sustainability team works with clients across various sustainability themes and regulations, including climate. There is increasing investor interest in integrating climate considerations into the development of high-level investment strategies, taking into account the latest insights and ideas. JANA's clients are focussed on delivering superior long-term investment results for their beneficiaries, at the same time as driving positive change in the lives of everyday people.

For many organisations, net zero investing is a constantly evolving and complex problem to solve. There is an abundance of net zero-related terms, metrics, target dates, frameworks etc. and net zero commitments aren't uniform or easily comparable.

JANA assists our clients in their understanding and integration of 'best practice' on their net zero journeys. It is critical that investors are able to identify and communicate their investment beliefs and ambitions, through action plans that are relevant to each investor's unique starting point, objectives, peers and stakeholders.

There are a number of steps that are crucial to an investor building net zero planning into their high-level governance structures. JANA recently assisted a large financial organisation in the development and rollout of a net zero plan that aligned with their investment and corporate objectives. This work involved guiding the investor through a range of consultations and stakeholder workshops to develop:

- **Evidence and beliefs** to reach a consensus tone from the top;
- A **defined strategy**, including interim target setting across emissions reduction, portfolio alignment, stewardship and climate solutions;
- Clear **organisational enablers** which manage, measure and report on the ongoing net zero impact; and
- A **governance structure**, including guidance on policies, manager mandates and compliance with best practice and legal standards.

It is important that investors can demystify net zero by building out clear, pragmatic and actionable roadmaps, with interim targets and clear milestones, to put them on the right path to meet their public 2050 net zero commitments. This includes the development of a measurable action plan that aligns both strategic organisational and investment goals, while working towards their broader goal of contributing to global net zero emissions.

10: Conclusion

This year's report on the State of Net Zero investment shows that the industry continues to take significant strides in developing and implementing climate action plans.

It also shows just how wide-ranging comprehensive action needs to be. Trustees and investment executives have responsibilities across climate risks and opportunities associated with the Australian and global economic transition to net zero. In addition to mitigating the negative climate impacts of their investments, they must also work to protect their beneficiaries from the climate damage and disruption that is already unavoidable.

Climate risks and opportunties factor in the practice of portfolio management, investment stewardship, government relations, legal departments, and myriad other staff throughout investment firms. These teams work in the context of broad economic, societal and political trends.

The executive summary of this report points to the areas where IGCC sees the greatest opportunities to accelerate the movement of capital into climate solutions, meeting investors fiduciary duties and supporting a thriving Australian economy for decades to come.

The data and analysis informs our work, and we invite investors, business decision-makers, researchers and policy-makers to also use this vital intelligence to inform their work to accelerate our collective progress towards a resilient, net zero economy.

11: Appendix: Methodology

In September 2023, IGCC surveyed institutional investors[14] operating in Australia (superannuation funds, sovereign wealth funds and asset managers) regarding their climate-aligned investment and stewardship practices.

The findings detailed in this report constitute a market level analysis on the current state of climate investment and practice by Australian investors. The analysis also highlights the challenges and barriers faced in the Australian market by investors that impact investment practices. We have organised the to align with the five ICAPs focus areas: **Investment, Corporate Engagement, Policy Advocacy**, and **Disclosure**, with **Governance** also referenced as a cross-cutting theme across all areas. We have also included a chapter focusing on physical risk, given the need for rapid investor action on this theme.

This work was complemented by similar exercises carried in Asia by AIGCC, and in New Zealand by our partners Mindful Money.

Lonergan research provided the platform for data collection and analysis.

The ICAPs Framework

To support investors with the development of climate transition plans, the international initiative Investor Agenda developed the Investor Climate Action Plan (ICAPs) Expectations Ladder & Guidance, providing details of progressive climate actions investors can take today in four interlocking areas: **Investment**, **Corporate Engagement**, **Policy Advocacy**, and **Disclosure**, with **Governance** also referenced as a cross-cutting theme across all areas. Use of the ICAPs can support the goal of maintaining returns as we transition to a net zero emissions economy by 2050 or sooner.

The ICAPs can also be applied by investors seeking to self-assess the progress of their climate investment implementation, and serves as an on-ramp for those investors that are starting out on their climate journey.

Survey features

Respondents

Responses were received from a total of 63 investors comprising of 22 asset owners and 41 asset managers, with a combined global assets under management (AUM) of over AUD$35tn, and over AUD$5tn in Assets managed on behalf of Australian beneficiaries.

Approximately 87% of survey respondents are IGCC members.

Questions

Survey questions were designed to align with the key recommendations in the Net Zero Investment Framework (NZIF), the actions detailed in the Investor Climate Action Plans (ICAPs) Expectations Ladder, and questions from previous surveys conducted by IGCC to allow for ongoing trend analysis.

With each new survey iteration, the inclusion of year-on-year data allows for further trend analysis of the actions taken and key challenges and barriers faced by investors. Some participants also provided further depth to their responses with qualitative commentary.

Results and analysis

This report includes aggregated data and graphs, investor comments, and trend analysis. It is important to note that the results in this report are based solely on the responses provided to the most recent State of Net Zero survey, and the authors have not audited or otherwise verified the self-reported data.

Real world examples

The 2024 State of Net Zero Report is supported by a select group of IGCC's service provider members. These members have provided real world examples that are intended to illustrate how investors are accessing good quality information and applying it in their investment processes to manage climate risks and opportunities.

Where possible, examples are provided in sections of the report where they add colour to the survey's findings. Examples have been only lightly copy-edited for readability. IGCC is happy to introduce readers to case study authors for more details on the content of those case studies.

14 The term 'investors' used throughout the report refers to the collective responses of all asset owners and managers combined. In some instances, we aggregate the data for asset owners and managers; in other instances, it is split out. If IGCC members are interested in more granular response data, please reach out to: secretariat@igcc.org.au, and we would be happy to discuss the potential for further collaboration (while adhering to our commitment to anonymise responses).

Investor Group on Climate Change

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