Room151 & Net Zero Investor Roundtable

LGPS: MAKING PROGRESS ON PARIS-ALIGNED INVESTING

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Investment professionals across the globe are currently contemplating their net-zero journeys. Those representing the Local Government Pension Scheme (LGPS) are no exception and are grappling with issues from setting targets to developing engagement strategies, sourcing data and educating members on the complexities involved.

Room151 and its sister title, **Net Zero Investor**, therefore decided to convene a roundtable of LGPS investment professionals and asset managers to discuss these issues and check in on progress on Paris alignment.

Sponsored by Amundi and Insight Investment, the roundtable took place at the London Stock Exchange as part of Room151's LGPS Investment Forum.

Room151/Net Zero Investor

ATTENDEES

Claire Bews
senior credit portfolio manager
Insight Investment

Graham Cook
CIO
Environment Agency Pension Fund

Steven Fawn
head of global credit
Amundi

George Graham
director
South Yorkshire Pensions Authority

Sherilee Mace
director
Insight Investment

Ross Matsentides
institutional sales manager, UK
Amundi

Mike O'Donnell (roundtable chair)
CEO
London CIV

Anthony Parnell
treasury and investments manager
Carmarthenshire County Council/ Wales Pension Partnership

Jo Ray
head of pensions
Lincolnshire County Council

Bola Tobun
head of pension investment and treasury
London Borough of Enfield

ROOM151 & NET ZERO INVESTOR ROUNDTABLE:

LGPS: making progress on Paris-aligned investing

Room151 and **Net Zero Investor** brought together a group of Local Government Pension Scheme investment professionals and asset managers to discuss their net-zero journeys

Paris-aligned investing is a key component of a credible net-zero roadmap. With a variety of strategies and offerings in the market, there is no shortage of opportunities available to those in the Local Government Pension Scheme (LGPS).

Mike O'Donnell

However, questions remain regarding the specifics. What does a good engagement framework look like? How do you benchmark your investments? What are the best ways to achieve carbon reduction? Which asset classes are best suited for a Paris-aligned strategy? And what is the right balance between engagement and divestment?

The roundtable covered these issues and much more. It took place at Room151's LGPS Investment Forum, and was chaired by Mike O'Donnell, CEO of London CIV. The debate began with the two sponsors of the event, Amundi and Insight Investment, putting the LGPS's journey to net zero into a historical perspective.

Steven Fawn: I've been in the asset management industry for 23 years and managing fixed-income portfolios for the last 12. And we've been seeing an increasing demand for responsible investment over the last few years. Be that an ESG tilt or some kind

"As a pool, we haven't set a net-zero target because all eight funds [in Wales] haven't. We need those individual funds to set their targets/ambitions first, before we can go on that journey"

Anthony Parnell, treasury and pension investments manager, Carmarthenshire County Council/Wales Pension Partnership

of climate tilt. Net zero is the topic of the day and also it coincides with the fact that Amundi, being part of the Net Zero Asset Managers initiative, is launching our own global corporate credit fund. We're also in the process of arranging to launch some "buy and maintain" net-zero funds over the next six months or so.

Claire Bews: I've been in the asset management industry for about 20 odd years as well. There's certainly been a very big move in the last few years towards responsible investment and, more recently, Paris-alignment of portfolios.

You need to think about where your portfolio is right now before you can improve it. We look at three metrics to help understand current positioning. The first is forward-looking carbon emissions. The second involves breaking down portfolios into five categories from the Institutional Investors Group on Climate Change [IIGCC]: net zero already, achieving net zero, aligned, aligning, committed and not aligned. And a third measure is the implied temperature rise.

Using these three different metrics, we can paint a picture of current portfolio alignment with the Paris Agreement, and use those to set targets.

Mike O'Donnell [to all attendees]: Where is your organisation on the net-zero journey in terms of setting targets and the roadmap?

Anthony Parnell: The Wales Pension Partnership is made up of eight LGPS funds in Wales, and fewer than half of them have set net-zero targets yet. As a pool, we haven't set a net-zero target because all eight funds haven't but we will be working on it. We feel that we need those individual funds to set their targets/ambitions first, before we can go on that journey. Having said that, we have a sustainable equity sub fund we're launching in February/March 2022, and that has a 2040 target. And so, when we open sub funds, they are going to have individual net-zero targets.

In 2019, when we launched our first sub fund, we didn't even consider the net-zero journey. And that's only three and a half years ago. It's surprising what's happened in that length of time, and how accelerated everything has become.

Bola Tobun: We started our journey back in 2019. And the [pensions] committee decided to set a target in line with a council target that we want to be in a net-zero position by 2030. We have started that journey, and have seen a remarkable reduction in carbon exposure to our equity portfolio.

For example, we have changed our passive equity to a low-carbon strategy with our passive manager.

When we carried out a carbon exposure analysis at the end of March this year, the

carbon footprint of our whole equity portfolio, including the active one, had reduced by 87%. Now we are looking at the active fund and our bonds portfolio.

Ross Matsentides: One of the things that's really interesting from our point of view is whether the current carbon intensity of the portfolio is the main metric that you're being judged on or whether it's more of a pathway. From the asset management point of view, often the pathway is seen as relevant as well.

Mike O'Donnell: As a pool, London CIV has set a 2040 net-zero target, and we are doing TCFD [Task Force on Climate-Related Financial Disclosures] reporting already. We are starting to track that, and focus on carbon intensity. But it feels like very early days in terms of the roadmap and the action plan. And how you change the asset class allocations, I suspect, is the key piece of that.

Graham Cook: [Paris alignment] is top of our agenda, and forms a central part of our investment thesis of investing for the future. We weren't the first to the party, but were among the first wave to state our net-zero commitment. It was about 18 months or so ago that we came up with our 2045 target, which for some of our members was disappointing because they'd like it to be 2030, like our main underlying sponsor [the Environment Agency].

We didn't just come up with a date and ambition to be net zero, we came up with an action plan as well and took the time to understand the science and what it meant for our investment approach to be Paris-aligned. It's not just about decarbonising your portfolio


Ross Matsentides

or making your portfolio pretty. It's about decarbonising the whole economy globally.

On that action plan, one of the key things for us was finding benchmarks that reflected our investment strategy. If you want to be a net-zero investor, or Paris-aligned investor, you need a benchmark that's Paris-aligned.

It's really important in terms of getting your manager aligned to have that Paris-aligned benchmark. For all the great things that Brunel Pension Partnership have done for us as a pool, working with FTSE Russell to come up with a truly Paris-aligned benchmark for equities is probably the biggest game changer. It means that we're sending our managers in the right direction, the compass is being set straight. We're not asking them to go one way, and then measuring them against something else.

There has been lots of focus on equity. People think about the ownership advantages of equity for engagement. But debt has a really important role to play too, and denying debt to high emitters that aren't going to change... they're impactful opportunities.

"How do you work within a pool where, while the pool sets a target, you've got some investors in the pool products that we are in who have no target and perhaps are less focused on this than we are?"

George Graham, director, South Yorkshire Pensions Authority

"Our committee are very much of the view that our main objective is to pay pensions. Anything that we do is considered with that objective at the forefront. It's very much not about us going out there to save the world"

Jo Ray, head of pensions, Lincolnshire County Council

George Graham: We have set a 2030 goal, explicitly not a target but a goal. That is quite challenging anyway, but it's also challenging because we want to do it in the right way. It's not about "we'll switch all the money into a low-carbon passive fund". We will continue investing in the way we are and seek to take real emissions out of the economy. It's trying to get it done doing the hard yards.

There are constraints on this in our LGPS world. We're part of a pool that has a 2050 target, so that creates a bit of tension. All our listed assets are invested in pooled products that will be working to a 2050 target. How do I balance those tensions? And how do you work within a pool where, while the pool sets a target, you've got some investors in the pool products that we are in who have no target and perhaps are less focused on this than we are?

It's challenging but we have moved the dial. Border to Coast have launched their climate opportunities fund – the first product that they have launched that has been oversubscribed, which is a good sign.

Jo Ray: At Lincolnshire, we're also in Border to Coast, and probably at the other end of the spectrum to George. We haven't set a target yet. We reviewed our investment beliefs and responsible investment beliefs earlier this year, and we're doing our strategy review at the moment. Following that, we will start looking at what do we want to do about net zero.

The council itself has a 2050 target and the pool has a 2050 target. Without trying to second guess what our committee will agree, I would very much expect us to have that as an aspiration. We won't do "goal", we'll do "aspiration".

But we will rely heavily on our managers. Our committee are very much of the view that our main objective is to pay pensions. Anything that we do is considered with that objective at the forefront. That this is about the opportunities of investing in some of these companies and opportunities, including transition funds. It's also about reducing the risk to the fund. But it's very much not about us going out there to save the world.

Mike O'Donnell What are the steps that take you from where you are to your target, and tying that into strategic asset allocation? What are the key moves that get you from where you are to where you want to be in terms of emissions?

George Graham It would be quite easy to significantly reduce total emissions in our equity portfolio by rebalancing it away from the UK, and away from emerging markets. Those have much higher baseline emissions than the diversified overseas portfolio and, ignoring climate, there might be an investment case for doing that.

We are overexposed to the UK, given the UK scale in the world economy. Do we want to be that overexposed? Do we still believe the emerging market growth story? Do we want to run the level of geopolitical risk that having a big exposure to China gives you?

I don't know the answer to those questions. But I think that's how I would frame the debate. The climate impact is then the second reason. We come back to Jo's point, that our job is to provide pensions.

Graham Cook: For us, net-zero targets do not impact on our asset allocation. It's much more about how do we do it within the asset classes. I don't expect our asset allocation to change materially, a little bit of moving around within asset classes, as things become more possible: so we'd like more sustainable private debt, more sustainable financing. But we're not really moving out of fixed income, and we wouldn't move out of equities.

We've all been aware there's been a reasonable amount of sustainable equity opportunities for many years. But when you look at the debt side, that's been much slower to come along.

It's the same with private markets. I joined the Environment Agency three years ago, and there is a big difference from when I started, to now, where every manager understands they can't sell anything unless they can stick a "sustainable" label on it. There is a lot more available. But how do you sort the wheat from the chaff, the things that look really good, versus the things that will actually make a difference?

Steven Fawn: You could quite easily have a low-carbon portfolio – you could invest in telecoms and healthcare, just to exclude utilities and energy. But I think that's what we all need to do is address the wider issue where you have that impact on the environment as well. We need to really keep investing in companies in hard-to-abate sectors, with the high emissions, and not leave anyone behind because, otherwise, we're never going to get anywhere close to the targets.

George Graham: Do we want to feel good about what we're invested in or do we want to actually improve the environment?

Graham Cook: Some of the problems are that we can measure the here and now in terms of carbon intensity. What's very difficult is looking over the lifecycle of an investment.

“Companies need to be a lot more transparent. They need to give credible targets and be open to engagement with investors to find out what is actually going on ‘under the hood’.”

Steven Fawn, head of global credit, Amundi

For example, if we invest in wind turbines, our portfolio carbon intensity goes up – our sustainable equity portfolio is more carbon-intensive than a standard equity portfolio. But, over the long run, because we're investing in building things that will take carbon out of the system over many years, they make a positive contribution to getting the world – and our portfolio – to net zero, making them a much better investment.

Finding something that can capture the actual direction of travel and how you're making progress, is far more important than where your carbon intensity is right now. But we don't have the metrics to do that reliably yet.

Sherilee Mace: If you have accounted for Scopes 1 and 2 (in your portfolio) what happens when you add in Scope 3? It goes back to what Jo said, do we go too soon? And then actually, the portfolio that you thought was going to be aligned, isn't necessarily aligned in the way you thought it would be, so it’s an important consideration. The more that data comes through, I think that will really help as well.

Steven Fawn: The data side is the elephant in the room. Companies need to be a lot more transparent. They need to give credible targets and be open to engagement with investors to find out what is actually going on “under the hood”.

George Graham: There is a fundamental data problem. The Scheme Advisory Board has to produce an LGPS-wide TCFD report. Let's say London CIV gets its climate data from Bloomberg, and Border to Coast gets its from MSCI. The same company can have a different emissions metric from those two sources. The poor person in Smith Square, who's going to try and add all this together and make sense of it, has got absolutely no chance. It beggars belief that we could be in this position.

Sherilee Mace

“You need to look at your portfolios across different asset classes through different lenses. You can't just rely on one piece of data”

Claire Bews, senior credit portfolio manager, Insight Investment

Claire Bews: You need to look at your portfolios across different asset classes through different lenses. You can't just rely on one piece of data, like the emissions data, you've got to think about it in different ways and look at a picture and then use those different metrics.

We have clients who have set us net-zero targets. And we are having open dialogue with them saying, it may well be that by 2030, we're coming to you and saying it's not possible because despite all the engagement that we do with companies, if they don't hit those targets, there's not much as a fund manager you can do. You can engage or all you want, but if, ultimately, the industries don't move and companies don't move ..

Bola Tobun: You have to get more discipline. We're hoping our fund managers will go out engaging with the companies and be able to demonstrate to us, give us evidence of what they're doing. If the company is not going to meet the target, what is it doing, what is the future plan?

Jo Ray: It's also about how we actually manage the message to our membership and to our politicians because there are some industries that absolutely still need to be invested in to be able to move forward. But they're really carbon intensive. The simplest thing is you divest and you've made everyone happy, but it's not made a difference.

George Graham: I think the other part of that is gradually ratcheting up things through the voting policy. So next year's Border to Coast voting policy is tighter and more automatic in terms of votes against for companies that are not at an appropriate place on the transition pathway

In South Yorkshire we have a big steel industry. Converting the steel industry to zero carbon is going to be a hell of a job. The biggest steel producer in the county is marginal at best. But there are 1,500 to 2,000 jobs, depending on that. We need to try to get our activist community to understand that you can't just snap your fingers and it happens. And, actually, we need the capital that is tied up in companies like Shell and BP to be deployed to fund the transition.

Anthony Parnell: From a Wales perspective it is becoming political as well. The LGPS is not devolved to the Welsh government. But we are keen to engage with the Welsh government on how the Wales Pension Partnership is doing in reducing its carbon footprint. So where this wasn’t political before, it has become more so over the last six months.

Mike O’Donnell: What does that look like from the fund managers’ point of view?

Claire Bews: Where we had a ‘buy and maintain’ type of portfolio five years ago, it’s now transformed into something that's got ESG at the heart of it. And we've moved a long way on the engagement front. It used to be seen that, as a debt holder, you didn't have much

power, Now, when we're looking at portfolios, we can see our high emitters, we can see who it is that we should be engaging with. We can see who the "baddies" are, if you like, and who we should be tackling.

Ultimately, your engagement has to have teeth. At every engagement we enter into, we are accepting the fact that maybe at the end, we will have to disinvest. That's a very big change from where we were a few years ago.

Mike O'Donnell: And to what extent do you see that engagement having a real impact?

Claire Bews: Because we're at the early stages of this, we're seeing lots of companies make credible commitments. I think we can point to a number of issuers where, because we've said: "look, if you don't have this, ultimately, we will have to disinvest and they've said: "okay, that's fine. Yes, we're working on it". Where it's going to become harder is when we see them deviate from that. So they set their targets, can they hit them? And that's where the engagement really begins to bite.

Steven Fawn: When you're looking at portfolios now, the extra-financial aspect of a company is as important as the financial aspect. A few years ago, we were just looking at the credit rating, the balance sheets, etc. But looking at the extra-financial side, where you're looking at the ESG, at the carbon side, to avoid the baddies, as Claire says, that's becoming increasingly important across not just climate portfolios, but all our portfolios.

Graham Cook: One of the things that makes this a bit easier, is recognising that we are genuinely long-term investors. The duration of our liabilities is around 22 years. That means when we get to 2045, where we have set our net zero target, I've still got half the liabilities, the pensions, that the fund needs to pay, still to be paid. So it's absolutely right, that my investment horizon is multi-decade.

Jo Ray: And our duration is rolling. We're still getting new members in. That long-term investment horizon that we have, and the short-term political aspirations, is the difficult challenge to balance

George Graham: The 16-year-old apprentice who joins the scheme today and stays in the business will retire if they are lucky when they are 70.

Mike O'Donnell: I think the long-term perspective is a good note to end on. It's fundamental to tackling this issue. The two things we need to guard against are that some of those short-term imperatives from the politicians need to be managed and the fact that it's long term doesn't mean we can sit on our hands for five years either. We've got to start with an urgency to make progress.

THREE WAYS TO ALIGN FIXED-INCOME PORTFOLIOS TO THE PARIS CLIMATE ACCORD

Claire Bews from Insight Investment discusses three potential approaches to assess Paris alignment and warns that the data should primarily be used to drive engagement and not divestment

Investors are increasingly being asked to report on the alignment of their portfolios with the Paris Climate Accord. Some are also being asked to set targets to improve alignment. As we see it, there are three potential methods for investors to do this.

Before we describe each, it is worth noting:

- There is no single correct method, and this remains a developing area with data improving all the time
- We believe that reporting on all three can give a fuller picture of alignment but recommend targets to be set using only one
- The current data indicates that it's not possible to build net-zero portfolios within a diversified portfolio achieving a market return
- However, using the data to drive engagement should help to more closely align portfolios to the targets set

Method 1: projecting forward

Projecting the greenhouse gas emissions of a client's portfolio out to 2050 and using this snapshot can inform and monitor net-zero carbon targeting. Using data for individual issuers allows the creation of an estimated forward projection of carbon emissions of portfolios.

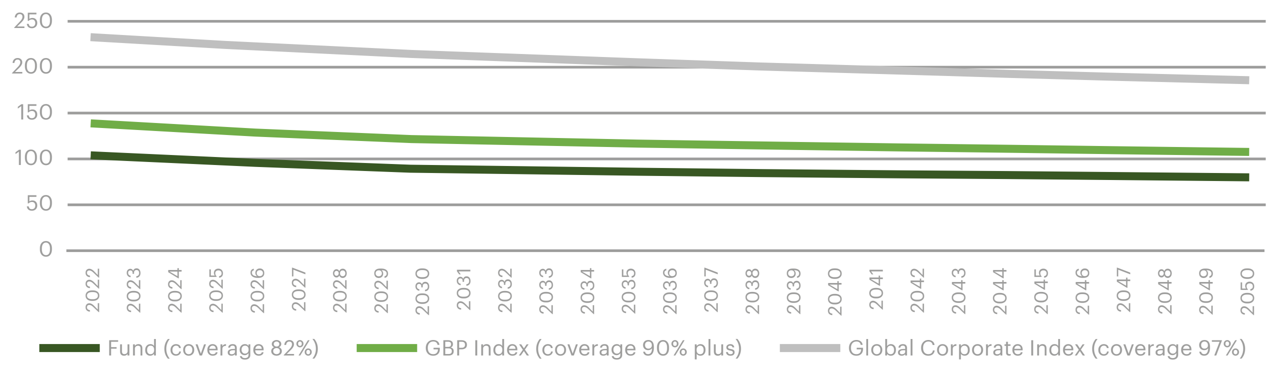
Assumptions can then be made about how the portfolio will develop over time. A high-quality "buy and maintain" portfolio has a constant duration which reinvests proceeds. What we assume is that as bonds mature, they are replaced with bonds from the same issuer. This may, of course, not happen in reality, but if we are invested in an issuer at the moment then we are complicit in its emissions going into the future even if our investment matures in the near term.

Figure 1 highlights the scale of the problem. As things stand, neither the portfolio nor the indices are net zero by 2050. And this is only considering the Scope 1 and Scope 2 weighted average carbon intensity (WACI) – the problem is even bigger when we start to add in scope 3 emissions. However, over time as more issuers make credible carbon reduction targets, we would expect to see these lines steepen and net zero becomes a more achievable target.

Method 2: assigning categories to issuers

The Institutional Investors Group on Climate Change (IIGCC) framework categorises issuers

FIGURE 1: SCOPES 1 AND 2 WACI; LIKE-FOR-LIKE ISSUER REPLACEMENT



into one of five buckets: achieving net zero; aligned to net zero; aligning; committed; and not aligned.

We are using the Science Based Target initiative (SBTi), the Transition Pathway Initiative (TPI) and Climate Action 100+ data in our model to determine which issuers go into which category. We can use these categories to set targets for improvement of alignment over time.

By using a wide number of sources, it is possible to have good coverage of over 90% of the GBP index and nearly 97% of the global index. There are no issuers in the global corporate index currently "achieving net zero", with only a small proportion in the "aligned" category. Currently, about 65% of the GBP and the global universe are categorised as "committed" or better. So, we don't believe it is currently possible to build an aligned portfolio or even an aligning portfolio within a diversified portfolio achieving a market return.

What we have been doing is working with clients to incorporate a minimum percentage in issuers who are categorised as "committed" or better, then, as the market evolves, we can look to increase this percentage over time and so improve the alignment of portfolios.

Method 3: issuer implied temperature rise

A third way to analyse alignment of a portfolio with the Paris Climate Accord is using the implied temperature rise data in degrees Celsius for an issuer. This reflects an assessment of the underlying companies projected emissions as measured today, taking into consideration a company's credible climate-related commitments. So, it is forward looking and it is expressed in degrees Celsius. Thus, it is a relatively intuitive way of assessing whether a portfolio is aligned with the Paris goals.

It is worth noting that less than 40% of the issuers in the indices have an implied temperature rise of less than 2 degrees. So, once again, it is therefore very difficult to build a diversified portfolio offering a market type of return with a Paris-aligned implied temperature rise.

Drive engagement, not disinvestment

These approaches are good starting points for assessing portfolios and the three of them together allow investors to paint a picture of the current alignment of portfolios. However, one has to be careful when using this data as a blunt tool to pivot portfolios away from what might be seen as the "worst" climate offenders. For instance, selling bonds with high Scopes 1 and 2 emissions without considering their Scope 3 emissions or selling issuers who are categorised as "not aligned" even while they are developing their net-zero approach.

It is key that this data drives engagement with issuers rather than disinvestment; the latter only an option in the last resort. This data can highlight to managers which issuers to focus engagement on and we would hope and expect that a large improvement in these portfolio metrics could come from engagement with issuers, encouraging them to publish credible Paris-alignment plans and also to deliver them.

Claire Bews is senior credit portfolio manager at Insight Investment.

HOW INVESTORS CAN CONTRIBUTE TO NET-ZERO EFFORTS

Caroline Le Meaux and **Ross Matsentides** from Amundi offer five five ideas for investors on the journey to net zero, covering objectives, metrics, engagement, innovation and strategic asset allocation

Carbon emissions have been increasing slowly despite efforts to bring them down; net zero commitments, however, have skyrocketed. So what does net zero actually mean for investors and what tools and guiding principles are there that can be adopted and adapted to help the transition?

Without a doubt, net zero will be a huge challenge for the investment world: there is no single answer, no single path to net zero, and net-zero methodologies are evolving rapidly. Nevertheless, we can expect some communality between different frameworks. They will need to deliver real-world decarbonisation, to demonstrate their contribution to clients and regulators and to follow guidelines already established by policy-makers.

Given the above, our objective is not to provide a comprehensive "how to reach net zero" manual, but to give investors some guiding principles to prepare and implement a net-zero strategy.

Do no significant harm: exclude the worst issuers

A starting point for investors would be to apply progressively net-zero commitments to all assets and to develop a comprehensive exclusion policy.

Most investors have already set up exclusion policies on polluting activities such as coal mining. Investors should think about enlarging these policies to all corporates whose strategies are detrimental to climate change mitigation.

KEY IDEA 1:
Investors can start by excluding corporates that are detrimental to net zero objectives.

Investing in the transition and engaging with issuers

Given that all sectors and corporates need to transition, a net-zero approach cannot only be about short-term exclusion. Investors can contribute to reaching carbon neutrality through innovative investment solutions and continuous dialogue with issuers to turn beliefs into concrete action.

In terms of implementation, it is currently impossible to build a perfect "net zero today" product, as there are too few projects and corporates that have net-zero carbon emissions as of now. In fact, there are too few corporates that have made credible commitments to ever being net-zero carbon emitters at all.

The financial industry has plenty of room for innovation to develop relevant products as access to relevant indicators along with robust related data improves. A net-zero investment strategy should feature several core elements:

1. **Seeking carbon reductions in the real world.** Carbon emissions are the heart of net zero, and should therefore be at the heart of any net-zero investment strategy. A carbon reduction pathway that is on track with the global objective of net zero is a good way to orientate financing toward corporates that decarbonise. However, it should include a reality-check, to make sure that this reduction translates in the real economy and that investors do not simply avoid polluting sectors.

Net zero will be a huge challenge for the investment world: there is no single answer, no single path to net zero, and net-zero methodologies are evolving rapidly

2. **Looking at trends and forward-looking indicators.** The race to net zero is about transitioning and today's carbon emitters are key to solving the net-zero equation by decarbonising their processes and products. Looking at trends can therefore be more relevant in the net-zero context than absolute carbon footprints. Investors and asset managers will need to use new metrics within their investment process to measure the contribution of issuers to the net-zero objective. Some are already available and/or work-in-progress, such as Science-Based Targets (SBTs) and temperature scores. CAPEX plans could also be a good forward-looking indicator.

KEY IDEA 2:
Historical carbon footprints are good, but better if combined with forward-looking metrics, including CAPEX plans.

3. **Incorporating a social dimension.** The massive transformations that a transition to a net-zero world requires will have huge social impacts, on job security and quality, on health and so on. Workers and consumers alike will be impacted. Therefore, an inclusive transition approach is necessary: a green transition cannot be achieved without a socially inclusive approach.

4. **Sending the right signal:** The objective of net-zero emissions is global and will be reached only by mobilising all actors. Investors have a role to play by putting pressure on corporates that lag behind and by accompanying corporates that are leading the charge. Defining a comprehensive and balanced net-zero engagement strategy is not easy but it is crucial.

KEY IDEA 3:
Active engagement with corporates is crucial to turn investment beliefs into concrete action.

Tapping into new geographies and asset classes

Even though capital is abundant nowadays, the net-zero financing challenge remains high as net-zero scenarios rely on the deployment of capital-intensive technologies. Based on the International Energy Agency Net Zero Emissions (NZE) scenario, energy investments would have to rise from an equivalent of 2.5% of global GDP to 4.5% in 2030. Such a scenario requires a huge mobilisation of private capital.

From an asset allocation perspective, it is worth considering where capital is and will be needed in net-zero scenarios. When considering net zero and your strategic asset allocation (SSA), the following points are worth bearing in mind:

1. **Unlocking financing barriers.** There is plenty of room for innovation for strategies designed in a way that alleviates key hurdles to net-zero financing needs. An example would be strategies structured around public-private collaborations that can lower the cost of financing for clean energy developers, while allowing institutional investors to allocate capital beyond their usual boundaries and stay within risk frameworks. Amundi's AP EGO strategy, launched in partnership with the International Financial Corporation, is an example of this sort of innovation.

KEY IDEA 4:
There is plenty of room for innovation when it comes to financing the transition to net zero.

2. **Consider new or unexplored asset classes.** Counting on their own balance sheet, corporates may face limitations in financing their clean energy project pipelines as fast as needed in net-zero scenarios. Off-balance sheet financing can therefore work as a catalyst. Significant investments will need to be made to scale up existing climate innovations, and to develop the innovations of the future. Investors can focus on green impact strategies, green private financing to support innovation and renewable energy infrastructure.

Net-zero Implications for strategic asset allocation

Research on how to integrate net-zero objectives within risk models is a key element that must be tackled. In practice, this is a tricky topic for investors, as ESG approaches are often bottom-up exercises, while SAA is a top-down affair. What is clear, however, is that traditional approaches to modelling SAA should be reassessed to tackle fundamental shifts in the global economy brought about by climate change.

KEY IDEA 5:
Traditional approaches to strategic asset allocation should be reassessed to account for climate risks.

Indeed, while standard approaches to SAA rely on historical quantitative analysis, much of the investment risk around climate change requires the addition of more qualitative and forward-looking inputs. Given the uncertainty around climate policy, investors should think about using scenario analysis to anticipate future trends and pathways resulting from climate change.

Caroline Le Meaux is global head of ESG research, engagement and voting, and **Ross Matsentides** is UK institutional sales manager, for Amundi.