Insight Investment response to GFANZ Net-zero Transition Plan framework for financial institutions consultation

Selected highlights

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Insight INVESTMENT

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The Glasgow Financial Alliance for Net Zero (GFANZ) developed a draft framework for financial institutions to catalyse action and specify concrete steps and holistic business strategy changes as part of the transition to a net-zero future[1]. This framework was opened for public consultation until 27 July 2022 via an online portal.

In this document, we provide highlights of Insight's responses to questions within the consultation, alongside some text to explain the context of the questions and answers.

Key themes in Insight's response to the consultation

Our answers in response to the consultation questions cover several topics. We would highlight three key themes:

- **A need to cater for asset classes beyond equities:** We believe it would be useful for the guidance to reflect the diverse range of financial institutions and outputs that GFANZ covers, to minimise the risk that all institutions are judged on the same criteria despite the different challenges they face.
- **A need to reflect that net-zero goals and methodologies vary across different asset classes and markets:** There are gaps in net-zero methodologies for certain types of asset class. We believe the guidance should refer to differing levels of sophistication and accuracy in terms of calculating carbon emissions across different types of financial institution.
- **A need to clarify how legal obligations affect the implementation of net-zero goals:** To focus on UK pension schemes (the majority of Insight's client base), uncertainty over pension scheme trustees' legal obligations creates challenges to investment in support of non-financial objectives, including environmental goals. In our experience, the lack of clarity is leading some pension schemes to opt for a more cautious approach regarding non-financial objectives. Guidance is therefore required for asset managers in the instance that transitioning existing products and services to net-zero aligned products and services goes against fiduciary duty.

Please feel free to contact us if you would like to discuss this response or any of the issues raised within it.

Selected questions and answers

Part A - Introduction

Context: This section focuses on 10 components that help financial institutions deliver on their net-zero targets, and the recommendations set out for each. The components are as follows:

- Objectives and priorities
- Products and services
- Activities and decision- making
- Policies and conditions
- Engagement - Clients and portfolio companies
- Engagement - Industry
- Engagement - Government and public sector
- Metrics and targets
- Roles, responsibilities, and remuneration
- Skills and culture

[1] Recommendations and guidance: Financial Institution Net-zero Transition Plans, June 2022, GFANZ.

13 You told us the ten components CONTAIN MINOR GAPS / CONTAIN MAJOR GAPS. Please explain what you think is missing and why that is important.

The guidance provides a good overall summary with useful examples of good practice. We highlighted that the 10 components contain minor gaps as the guidance does not cater to asset managers which invest in asset classes other than equities. Derivatives are a key example, as derivative instruments do not have carbon accounting methodologies in place due to their complexity. It would be useful for the guidance to reflect the diverse range of financial institutions and outputs that GFANZ covers. We recognise that this framework is not intended to provide the same level of detail that the sector-specific alliances (such as NZAM) provide, but we believe it would be useful if this specific challenge was articulated in the guidance to minimise the risk that all institutions are judged on the same criteria despite the different challenges they face.

Furthermore, while the recommendations provide a good overview of net-zero target setting, we believe they lack specificity and granularity on methodologies for doing so. This impacts the usefulness of the guidance.

Part B – Recommendations and guidance

Context: This section focuses on recommendations and guidance provided by GFANZ for each of the 10 components outlined in Part A.

Objectives and priorities

48 You said that the guidance for this component [the Objectives and priorities component] MISSES KEY CONSIDERATIONS NEEDED TO IMPLEMENT THE RECOMMENDATION / PROVIDES MORE INFORMATION THAN IS NEEDED TO IMPLEMENT THE RECOMMENDATION. Please tell us why you gave that answer.

Our net-zero target does not cover all of our assets under management (AUM) as we face difficulties in setting a target covering all of our assets in certain jurisdictions and for some asset classes due to issues associated with data availability and methodology development. For example, asset classes such as asset-backed securities have nascent approaches to net-zero alignment which are not sufficiently evolved, in our view, or there is not enough data to disclose to an adequate standard. For derivatives, it is unclear how to assess net-zero alignment as there is no 'ownership' of the underlying. Methodologies would need to be established before any target-setting could be deemed appropriate.

The guidance for this section within the GFANZ recommendations does not take into consideration the gaps in methodologies for certain types of asset class, which may mean that the expectations of external stakeholders are unrealistic as they may expect a certain level of homogeneity in transition plans between different financial institutions. The guidance should therefore refer to differing levels of sophistication and accuracy in terms of calculating carbon emissions across different types of financial institution.

Products and services

52 You said that the guidance for this component [the Products and services component] MISSES KEY CONSIDERATIONS NEEDED TO IMPLEMENT THE RECOMMENDATION / PROVIDES MORE INFORMATION THAN IS NEEDED TO IMPLEMENT THE RECOMMENDATION. Please tell us why you gave that answer.

Our client base is predominantly pension schemes where there is strict regulation regarding our fiduciary duty as an asset manager. Uncertainty over pension scheme trustees' legal obligations creates challenges to investment in support of non-financial objectives, including environmental goals.

Defined benefit pension schemes account for c.£2.2 trillion of assets under management in the UK. Trustees for these schemes are legally required to act in the best interests of pension scheme members. This generally encompasses a duty to act in the best financial interests of the members by considering "financial factors" when making investments (including those that have a climate related/environmental goals). Despite extensive work on the topic in recent years and various guidance notes from industry bodies, a lack of clarity still remains as to what extent 'non-financial factors' can be taken into account as part of the investment process in relation to investments with climate or environmental goals.

This is leading UK pension schemes to adopt a variety of approaches. Our clients include pension schemes with trustees who believe tackling climate change is in the best interests of their members and have supported the inclusion of green gilts within their portfolios, with some schemes having publicly committed to the UN-convened Net-Zero Asset Owner Alliance. We also have pension scheme clients with trustees who consider that their fiduciary and/or legal duties may fetter their ability to enter into certain investments (including those that support environmental or climate-related goals, such as green gilts) because of a belief that non-financial factors should be subordinate to financial factors.

In our experience, the lack of clarity is leading some pension schemes to opt for a more cautious approach regarding non-financial objectives. Clarifying how pension scheme trustees' obligations apply regarding such goals and having clarity on the extent to which financial and non-financial factors can be incorporated within the investment decision-making process could remove this barrier, allowing for a larger proportion of UK schemes' assets under management to be invested in support of such targets.

Guidance is required for asset managers in the instance that transitioning existing products and services to net-zero aligned products and services goes against fiduciary duty. Furthermore, the majority of our products and services are segregated mandates as opposed to pooled funds meaning our discretion is limited, guidance is required for segregated mandates that we manage on behalf of our clients which explains how we can achieve the transition of products and services to be aligned with net zero without our clients asking us, or if it goes against their preferences. Does every individual product and service need to be net-zero aligned, or can the suite of products and services offered be aligned to net zero as aggregated at entity level – e.g. some will be negative emissions and balance out those that don't reach net zero and still have positive emissions. The guidance for the transitioning and creation of new net-zero aligned products and services needs to fit with the current, and future, regulatory requirement for sustainable products.

Education is spoken about and we agree that improving climate literacy of all the players in the industry is important but guidance is required regarding the expectation of escalation processes if educating clients does not work. If education fails or clients are unresponsive to transitioning their products, clear guidance for the expectations of the escalation process for asset managers is required and to clearly outline how this fits into the financial objectives asset managers as businesses should be achieving. The ability for asset managers whose client base is predominantly institutional investors there are limitations in the ability to educate broader society and effectively demonstrate it.

Activities and decision-making

56 You said that the guidance for this component [the Activities and decision-making component] MISSES KEY CONSIDERATIONS NEEDED TO IMPLEMENT THE RECOMMENDATION / PROVIDES MORE INFORMATION THAN IS NEEDED TO IMPLEMENT THE RECOMMENDATION. Please tell us why you gave that answer.

We believe the guidance needs to be broadened to incorporate different asset classes. As more taxonomies are released, additional guidance may be required if these taxonomies are not aligned with each other.

The role of climate change in broader ESG and sustainable activities and decision-making process for asset managers should be clarified. Where climate change is not seen as material to a sector, or other ESG issues are understood to be more material and/or relevant, the guidance should explain how an asset manager might prioritise climate change. For example, if physical risk is the most material climate risk for a company, is the net-zero commitment less important than adaptation requirements for that business?

70 Do you have any other feedback on the ambition, relevance, or importance of this component to net-zero transition planning?

Engagement is a key mechanism to create real-world outcomes which help to support the transition to net zero. While the guidance is sufficient to implement this recommendation, there should be a recognition that not all elements are equally relevant to all asset managers. For example, the guidance mentions that asset managers should participate in proxy voting regarding portfolio companies' net-zero strategies, board candidates or shareholder proposals. As an asset manager focused primarily on risk management and fixed income solutions, a very small proportion of our assets under management is invested in equities. The guidance for this section should include an understanding that the engagement approaches of fixed income investors will differ from those of equity investors, meaning certain elements are not applicable to the former.

Engagement – Industry

73 You said that the guidance for this component [the Engagement – Industry component] MISSES KEY CONSIDERATIONS NEEDED TO IMPLEMENT THE RECOMMENDATION / PROVIDES MORE INFORMATION THAN IS NEEDED TO IMPLEMENT THE RECOMMENDATION. Please tell us why you gave that answer.

The guidance provides a good overview of formal structures which support cross-industry collaboration, including industry initiatives and working groups. Although this information is useful, we believe a greater emphasis should be placed on the importance of facilitating smaller group collaboration, which explains how players in the financial sector could create structures to encourage and enable this type of engagement. This would be particularly useful for collaboration between fixed income investors and equity investors, where best practices and challenges can be shared.

78 Do you have any other feedback on the ambition, relevance, or importance of this component to net-zero transition planning?

We believe governments have a significant role to play alongside the financial markets to ensure climate change and the transition to net zero are addressed holistically and effectively. This component is therefore key to developing effective transition plans.

Skills and culture

89 You said that the guidance for this component [the Skills and culture component] MISSES KEY CONSIDERATIONS NEEDED TO IMPLEMENT THE RECOMMENDATION / PROVIDES MORE INFORMATION THAN IS NEEDED TO IMPLEMENT THE RECOMMENDATION. Please tell us why you gave that answer.

It would be useful to include recommendations on how to provide and assess climate-related education so it is suitable for all staff.

Part C – Policy examples and areas of further work

Context: This section provides clarity on several concepts, as well as insight into next steps. The consultation requested reactions to Part C, including any thoughts on the areas for future work identified. Insight did not provide any response to this section of the consultation.

Risk disclosures

Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

Associated investment risks

ESG

- **Investment type**: The application and overall influence of ESG approaches may differ, potentially materially, across asset classes, geographies, sectors, specific investments or portfolios due to the nature of the specific securities and instruments available, the wide range of ESG factors which may be applied and ESG industry practices applicable in a particular investable universe.
- **Integration**: The integration of ESG factors refers to the inclusion of ESG risk factors alongside financial risk factors in investment analysis and research to judge the fair value of a particular investment and may also include the monitoring and reporting of such risks within a portfolio. Integrating ESG factors in this way will not typically restrict the potential investable universe, but rather aims to ensure that relevant and material ESG risks are taken into account by analysts and/or portfolio managers in their decision-making, alongside other relevant and material financial risks.
- **Ratings**: The use and influence of our ESG ratings in specific investment strategies will vary, potentially significantly, depending on a number of factors including the nature of the asset class and the structure of the investment mandate involved. For an investment portfolio with a financial objective, and without specific ESG or sustainability objectives, a high or low ESG rating may not automatically lead to a buy or sell decision: the rating will be one factor among others that may help a portfolio manager in evaluating potential investments consistently.
- **Engagement activity**: The applicability of Insight firm level ESG engagement activity and the outcomes of this activity relating to buy, hold and sell decisions made within specific investment strategies will vary, potentially significantly, depending on the nature of the asset class and the structure of the investment mandate involved.
- **Reporting**: The ESG approach shown is indicative and there is no guarantee that the specific approach will be applied across the whole portfolio.
- **Performance/quality**: The influence of ESG criteria on the overall risk and return characteristics of a portfolio is likely to vary over time depending on the investment universe, investment strategy and objective and the influence of ESG factors directly applicable on valuations which will vary over time.
- **Costs**: The costs described will have an impact on the amount of the investment and expected returns.
- **Forward looking commitments and related targets**: Where we are required to provide details of forward-looking targets in line with commitments to external organisations, e.g. Net Zero Asset Managers Initiative, these goals are aspirational and defined to the extent that we are able and in accordance with the third party guidance provided. As such we do not guarantee that we will meet them in whole or in part or that the guidance will not evolve over time. Assumptions will vary, but include whether the investable universe evolves to make suitable investments available to us over time and the approval of our clients to allow us to align their assets with goals in the context of the implications for their investments and issues such as their fiduciary duty to beneficiaries.

Insight applies a wide range of customised ESG criteria to mandates which are tailored to reflect individual client requirements. Individual investor experience will vary depending on the investment strategy, investment objectives and the specific ESG criteria applicable to a Fund or portfolio. Please refer to the investment management agreement or offering documents such as the prospectus, Key Investor Information Document (KIID) or the latest Report and Accounts which can be found at www.insightinvestment.com and where applicable information in the following link for mandates in scope of certain EU sustainability regulations https://www.insightinvestment.com/regulatory-home/sustainability-regulations/; alternatively, speak to your main point of contact in order to obtain details of specific ESG parameters applicable to your investment.

Other disclosures