

## **Investment Association's written evidence to the Environmental Audit Committee's inquiry into the financial sector and the UK's net zero transition**

### **About the Investment Association**

1. The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage over £9.4 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond.

### **Executive summary**

2. The investment management industry's purpose is to meet its clients' investment objectives while delivering long-term financial returns. These clients are individual retail savers and institutions like pension funds, insurers, charities and governments. Investment objectives are typically financial, for instance having enough money to live on in retirement, and require the consideration of financially material risks in the investment process. Climate change is one of the greatest systemic risks that we are now facing – our efforts to address climate risk are therefore among the most important actions the industry can take to act in the best interests of our clients.
3. The Glasgow Financial Alliance for Net Zero (GFANZ) is one of several initiatives which was launched to allow the financial sector to support the UN Race to Zero, an initiative to provide cities, regions, businesses and investors with a means to support the net zero commitments which had been made by national Paris Agreement signatories.
4. In the case of the investment management industry, the launch of GFANZ followed the creation of two other Race to Zero-aligned initiatives, the Net Zero Asset Managers initiative (NZAM) and the Net-Zero Asset Owners Alliance. GFANZ serves as a convening group to ensure coordination and cohesion between industry-led initiatives. Race to Zero supporters, including those in the financial sector, recognise that they have a part to play in the transition, but leadership must continue to come from the national governments who initiated, and are party to, the Paris Agreement.
5. The work programme of GFANZ emphasises the role of the financial sector as a vital cog with the potential to help drive ambition, innovation and understanding of the transition to net zero across the whole economy. Beyond building commitment across the financial sector, the core GFANZ workstreams include working with the wider economy to define net zero sectoral pathways, clearly defining financial sector expectations on wider-economy transition strategies, and defining best practice for transition strategies in the financial sector.
6. The IA is proud to support members signing up to the NZAM initiative and was named as the first official supporting partner organisation to NZAM in July 2021. To date, investment managers with more than £7trn of assets under management in the UK have made this net zero commitment. Central to the initiative is a commitment to work in partnership with asset owner

clients on decarbonisation goals, setting an interim target for the proportion of assets to be managed in line with the attainment of net zero emissions by 2050 or sooner, and a process to review interim targets at least every five years, with a view to increasing the proportion of assets which are managed in line with a net zero ambition.

7. The investment management industry is naturally inclined towards providing the long-term, patient capital that is necessary for transition. Our focus is on understanding the risks and opportunities that face investments across the range of asset classes in which we invest. We are clear that a truly economy-wide transition to net zero will require a transition within most, if not all, companies in which we currently invest. It is important not to erect new barriers to the continued provision of capital to those companies by creating new standards and policies which incentivise divestment at the expense of transition activities.
8. While many IA members committed to net zero are working to develop their own fossil fuel policies, NZAM requires signatories to develop robust and science-based policies for fossil fuel phase-out and the need for a just transition. Investors' policies will be guided by the IEA net zero scenario which also needs to inform Government energy policies.
9. The British Energy Security Strategy describes the UK's transition to net zero as "fundamental to energy security". This adds to the case for the Government to provide detailed net zero transition plans for sectors across the economy. It also highlights why it is essential that we plan for a future in which renewable sources of energy can help to provide power which is secure and sustainable. The focus on energy supply measures in the strategy, while necessary, highlights the relative lack of detail on energy efficiency measures which will make an essential contribution to the UK's transition to net zero emissions.
10. It is essential that investment managers clearly and comprehensively explain to clients how they assess climate-related risk and what impact that assessment is having on investment decisions. Commitments to initiatives such as NZAM, and the workstreams in development by GFANZ, are helping to accelerate understanding of climate-related and transition risk and how best to address it, but there is also a role for governments and regulators in setting a clear approach to greening the financial system. No single initiative can shoulder the burden of achieving transition to net zero alone. It is right that Governments continue to show leadership and that the financial sector continues to pursue innovation and transparency so it can play its part.

### **Accelerating the transition from fossil fuels and securing energy supplies**

11. The Environmental Audit Committee recently held a call for evidence into accelerating the transition from fossil fuels and securing energy supplies, to which the Investment Association responded. While mindful of the guidance that submissions should not have been published anywhere already, the topics considered in that inquiry are of relevance to this latest call for evidence. For the convenience of the committee, its staff and other stakeholders reading this submission we have reproduced salient points from the IA's previous evidence below (paragraphs 12-21). The complete evidence was published by the committee on 6 June 2022, with the reference [ATFF0039](#).

12. The UK's commitment to making Cop26 a success is something of which we should all be proud. Having hosted a fruitful conference in difficult circumstances, it is important that we do not allow momentum to be lost in the remaining months of the UK's presidency. Indeed, we hope and expect that the experience of having held the Cop presidency will have an enduring effect on the UK, embedding a domestic policy approach to the transition to net zero which continues to hold the ambition of being world-leading, and sustaining an understanding of what it takes to be influential in the sphere of climate diplomacy.
13. In May 2021, the International Energy Agency (IEA) published a study of how to transition to a net zero energy system by 2050 while ensuring stable and affordable energy supplies. Under this IEA pathway, there is no need for investment in new fossil fuel supply (no new oil and gas fields, and no new coal mines or mine extensions) but a requirement for the rapid deployment of new technologies to provide clean energy.<sup>1</sup>
14. The time and effort to develop new oil and gas fields would only make a limited and short-term contribution to address supply shortages. Analysis from the Economist Intelligence Unit<sup>2</sup> concluded that the three new gas fields likely to be the subject of exploration would provide limited impact and not contribute to addressing the present situation. They would make a small contribution to UK gas demand and be unlikely to start operating until 2026 and only reach peak output around 2028.
15. While many IA members committed to net zero are working to develop their own fossil fuel policies, the Net Zero Asset Managers initiative requires signatories to develop robust and science-based policies for fossil fuel phase-out and the need for a just transition<sup>3</sup>. Investors' policies will be guided by the IEA net zero scenario which also needs to inform Government energy policies.
16. The British Energy Security Strategy describes the UK's transition to net zero as "fundamental to energy security".<sup>4</sup> This adds to the case for the Government to provide detailed net zero transition plans for sectors across the economy. Ultimately, the Government will be more likely to attract long-term investment if the investment management industry sees a long-term and sustainable approach to energy policy.
17. This situation also highlights why it is essential that we plan for a future in which renewable sources of energy can help to provide power which is secure and sustainable. We must accelerate and expand these plans. The Government should strengthen cooperation with the Green Finance Institute, investors, banks and companies producing energy saving, renewable and energy storage technologies to redouble efforts to help individuals and businesses finance and adopt a wide variety of technologies to support affordability, energy security and climate action.
18. We note the Climate Change Committee's (CCC) initial assessment of the British Energy Security Strategy which, while welcoming the "hugely ambitious" commitments, said that it was

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<sup>1</sup> IEA, 'Net Zero by 2050 A Roadmap for the Global Energy Sector', May 2021, [bit.ly/3EZHg2](https://www.iea.org/reports/net-zero-by-2050).

<sup>2</sup> <https://eciu.net/analysis/briefings/how-to-cut-the-uks-dependency-on-russian-gas-permanently>

<sup>3</sup> Net Zero Asset Managers initiative, 'Network Partners' expectation of signatories with regard to fossil fuel investment policy', December 2021, [bit.ly/3siU4Gf](https://www.netzeroassetmanagers.com/network-partners).

<sup>4</sup> BEIS, 'British Energy Security Strategy', April 2022, [bit.ly/3ErV5AC](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/104441/bes-2022.pdf).

“disappointing not to see more on energy efficiency and on supporting households to make changes that can cut their energy bills now”.<sup>5</sup> We would agree with the CCC that the focus on energy supply measures in the Strategy, while necessary, highlights the relative lack of detail on energy efficiency measures which may make a more immediate contribution to protecting households from high fossil fuel prices.

19. We recognise that cost of living is rising for many people and households. Rising gas and electricity prices will make it more difficult for many to heat their homes and may also place pressure on the ability of some businesses to operate and impact UK economic growth. A comprehensive focus on energy efficiency in buildings and a shift to more low-carbon electricity generation will help to reduce this cost. Any effort to promote energy efficiency and introduce new, low-carbon heating technology in homes and commercial property will depend for its success on that technology being affordable.
20. The IA endorses the ‘balanced pathway’ to net zero in buildings as set out in the statutory Climate Change Committee’s Sixth Carbon Budget and the implied policy scenarios, based on existing Government policy priorities, to reduce emissions in buildings through greater efficiency and new heating technologies.<sup>6</sup> As such, we agree that it is necessary to upgrade the energy efficiency of all buildings over the next 15 years, scale up the market for heat pumps, expand the rollout of low-carbon heat networks in dense areas, and prepare for a potential role for hydrogen in heating.
21. The investment management industry is committed to working with Government to seek ways to support the allocation of new capital to climate solutions in support of these aims. It is also necessary for the Government to provide sufficient detail on transition pathways relating to heat and buildings for investment managers to make investment decisions and properly scrutinise transition plans in relevant sectors.

### **The purpose of the Glasgow Financial Alliance for Net Zero (GFANZ)**

22. The Glasgow Financial Alliance for Net Zero (GFANZ) is one of several initiatives which was launched to allow the financial sector to support the UN Race to Zero. The Race to Zero is an initiative of the Chilean (Cop25) and UK (Cop26) High-Level Climate Champions to provide cities, regions, businesses and investors with a means to support the net zero commitments which had been made by national Paris Agreement signatories. With the end of the Chilean Cop25 Presidency, the Race to Zero is now led jointly by the UK and Egyptian (Cop27) High-Level Climate Champions.
23. In the case of the investment management industry, the launch of GFANZ (in April 2021) followed the creation of two other Race to Zero-aligned initiatives, the Net Zero Asset Managers initiative (in 2020) and the Net-Zero Asset Owners Alliance (in 2019). It was recognised by policymakers and industry that the proliferation of many such initiatives across the financial sector, and representing different parts of the investment chain, needed to be supplemented by

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<sup>5</sup> Climate Change Committee, ‘CCC responds to UK Government’s Energy Security Strategy’, April 2022, [bit.ly/3rCr38i](https://bit.ly/3rCr38i).

<sup>6</sup> Climate Change Committee, ‘Sixth Carbon Budget: Buildings’, December 2020, [bit.ly/3vsFQn8](https://bit.ly/3vsFQn8).

the creation of a convening group to ensure coordination and cohesion between industry-led initiatives.

24. It is worth reflecting that the stated ambition of the Race to Zero is “to build momentum around the shift to a decarbonized economy” and to “send governments a resounding signal that business, cities, regions and investors are united in meeting the Paris goals and creating a more inclusive and resilient economy”. Race to Zero supporters, including those in the financial sector, recognise that they have a part to play in the transition, but leadership must continue to come from the national governments who initiated, and are party to, the Paris Agreement.
25. The work programme of GFANZ emphasises the role of the financial sector as a vital cog with the potential to help drive ambition, innovation and understanding of the transition to net zero across the whole economy. Beyond building commitment across the financial sector, the core GFANZ workstreams include working with the wider economy to define net zero sectoral pathways, clearly defining financial sector expectations on wider-economy transition strategies, and defining best practice for transition strategies in the financial sector. This is essential and complex work and the urgency of the issue means we may only have one opportunity to get it right. We welcome the progress that is being made, most recently in the publication of GFANZ’s consultation on its draft Net-zero Transition Plan (NZTP) framework for the financial sector.

### **The Net Zero Asset Managers initiative**

26. The Net Zero Asset Managers (NZAM) initiative exists as the main ‘chapter’ of GFANZ for investment managers. The IA is proud to support members signing up to the NZAM initiative and was named as the first official supporting partner organisation to NZAM in July 2021. To date, investment managers with more than £7trn of assets under management in the UK have made this net zero commitment. This represents nearly three-quarters of the AUM in the UK. Globally, NZAM has 273 signatories with \$61.3trn in assets under management.
27. The NZAM commitment acknowledges that there is “an urgent need to accelerate the transition towards global net zero emissions,” with investment managers playing their part. Central to the initiative is a commitment to work in partnership with asset owner clients on decarbonisation goals, setting an interim target for the proportion of assets to be managed in line with the attainment of net zero emissions by 2050 or sooner, and a process to review interim targets at least every five years, with a view to increasing the proportion of assets which are managed in line with a net zero ambition.
28. The NZAM commitment was created by, and is managed by, a global network of organisations with a track record of credibility and delivery on climate-related investment. In the UK, two of the leading network partners are the Institutional Investors Group on Climate Change (IIGCC) and CDP (formerly the Carbon Disclosure Project).
29. The scope of the call for evidence and the questions considered by the committee are heavily focused on fossil fuels. This is understandable. As the call for evidence notes, fossil fuel use is the dominant source of the carbon emissions which are causing climate change. In considering the transition to net zero, we must recognise that fossil fuel consumption, as opposed to fossil fuel extraction, is an economy-wide issue.

30. The investment management industry is naturally inclined towards providing the long-term, patient capital that is necessary for transition. Investment managers, and others in the financial services industry, will hold different views on how best to achieve the transition to net zero, and the impact that the transition will have on the financial system. Our focus is on understanding the risks and opportunities that face investments across the range of asset classes in which we invest. While the transition to net zero will see new technologies and companies emerge in which there will be opportunities to invest, we are clear that a truly economy-wide transition to net zero will require a transition within most, if not all, companies in which we currently invest. It is important not to erect new barriers to the continued provision of capital to those companies by creating new standards and policies, or encouraging a simplified understanding of the issues, which incentivise divestment at the expense of transition activities.
31. An important element of supporting those companies in their transition will be assessing and engaging with them to understand how they plan to align their business with the transition in the wider economy. This will be supported by the introduction of transition plans, which will place a requirement on companies to outline their strategies, but it will also be essential that Government, and other policymakers, make clear the economy-wide measures they intend to introduce in support of the transition. Without granular policy information, it will not be possible to produce comprehensive sectoral pathways against which to assess company strategies. Only with a detailed understanding of the effects of transition on the whole economy, and the strategies in place to manage it, can investment managers make credible statements on how they plan to increase the proportion of assets which are managed in line with the attainment of net zero emissions.

### **Transparency, disclosure and labelling**

32. While scrutiny from all stakeholders, including policymakers, should be welcomed, ultimately investment managers are accountable to their clients. Investment managers have a fiduciary duty to act in the best interests of their clients. The investment management industry's purpose is to meet their clients' investment objectives while delivering long-term financial returns. These clients are individual retail savers and institutions like pension funds, insurers, charities and governments. Investment objectives are typically financial, for instance having enough money to live on in retirement, and require the consideration of financially material risks in the investment process. Climate change is one of the greatest systemic risks that we are now facing – our efforts to address climate risk are therefore among the most important actions the industry can take to act in the best interests of our clients.
33. It is essential that investment managers clearly and comprehensively explain to clients how they assess climate-related risk and what impact that assessment is having on investment decisions. Commitments to initiatives such as NZAM, and the workstreams in development by GFANZ, are helping to accelerate understanding of climate-related and transition risk and how best to address it, but there is also a role for governments and regulators in setting a clear approach to greening the financial system. In 2021, the UK Government published a roadmap to sustainable investing, 'Greening Finance'. 'Greening Finance' described three phases for greening the financial system with an important role for the UK Government and regulators.

34. 'Greening Finance' aims to address the first phase, which is 'informing investors and consumers', and we will welcome progress on phases two ('acting on the information') and three ('shifting financial flows'). We support the objectives and measures for phase one as set out in the roadmap and have been pleased to support this work through participation in the Transition Plan Taskforce and the FCA's Disclosures and Labels Advisory Group.
35. We recognise that companies, investment managers, asset owners, and policymakers are all on a journey to understanding and managing the impact of climate change. It is essential that efforts are made with urgency to provide transparency and accountability on climate risk across the economy. It is imperative that these proposals provide consistency and comparability and are set at the right level of granularity to enable investment managers and asset owners to meet their own reporting requirements.
36. As the providers of capital to companies and real assets all around the world, investment managers have a keen interest in ensuring global efforts to improve sustainability disclosures are coordinated and aligned. The quality, availability, and comparability of data from investee companies and other assets across different jurisdictions is crucial for investment managers to contribute to a sustainable economy. However, regulatory and regional fragmentation remains a significant challenge. Backing from the highest levels of government is needed to ensure significant progress is made on the international harmonisation of sustainability reporting standards for both issuers and investors. In this regard, we welcome the UK Government's early support for the Taskforce on Climate-Related Financial Disclosures (TCFD) and the current focus on the development of an International Sustainability Standards Board (ISSB).
37. Later this year, the Government will publish an updated Green Finance Strategy. This will be a welcome opportunity to clearly set out how industry-led initiatives like GFANZ interact with international initiatives like TCFD and the ISSB, and the expectations and actions of the UK's policymakers and regulators. No single initiative can shoulder the burden of achieving transition to net zero. It is right that Governments continue to show leadership and that the financial sector continues to pursue innovation and transparency so it can play its part.