

FSC Guidance Note

No. 44

Climate Risk Disclosure in Investment Management

3 August 2022

WARNING:

In September 2024, Parliament passed significant reforms to climate-related financial disclosure laws (see the *Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Act 2024*).

This Guidance Note was last updated prior to these reforms. A review of contents is currently under consideration.

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Climate Risk Disclosure in Investment Management

Date of this version: 3 August 2022

Application of this Guidance Note: This Guidance Note is relevant to FSC investment management members seeking to assess their investment portfolios for emissions, achieve and disclose net zero in their investment portfolios, disclose climate friendly features, and report on climate risk to their portfolios and business.

Main Purpose of this Guidance Note: The main purpose of this Guidance Note is to provide a set of common baseline expectations for the investment management industry's approach to claiming net-zero, disclosing climate friendly investment features, and climate change risk reporting.

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Section 1. Title

This Guidance Note may be cited as FSC Guidance Note No 44 Climate Risk Disclosure in Investment Management (Guidance Note 44).

Section 2. Background

In Australia, regulators have increasing expectations that companies, including financial services institutions, will identify, manage and report on climate risks and opportunities. For example, APRA's CPG 229 Climate Change Financial Risks, aims to provide guidance for regulated entities to incorporate climate change risks & opportunities into their existing prudential obligations for risk management and governance. The Australian Securities & Investment Commission (ASIC)'s review into ESG fund labelling and claims indicates the growing importance of robust reporting and product labelling. ASIC has warned that greenwashing exposes funds to liability.¹ Following its review into ESG fund labelling and claims, ASIC released INFO 271 'How to avoid greenwashing when offering or promoting sustainability-related products', which provides guidance on avoiding misleading and deceptive conduct and fulfilling disclosure obligations.

Internationally, the COP26 summit in Glasgow emphasised the critical role that private finance plays in the world's decarbonisation as well as the resulting opportunities and risks to portfolio value. The Net Zero Financing Roadmap², announced at COP 26, highlighted that private financial participants are crucial in delivering the \$30 trillion required in this decade to finance global decarbonisation. Therefore, reporting on progress towards net zero portfolios will be important in enabling the attraction and deployment of capital. This will, however, not be without regulatory scrutiny. As well as ASIC's review, overseas the United States' Securities and Exchange Commission (SEC) has also turned its attention to ESG fund claims by retail investment funds and advisers.

Net zero targets are also proliferating in the financial services sector, led by investor groups such as the Net Zero Asset Managers Initiative.³ Based on information from the Race to Zero Coalition,⁴ which rallies organisations to commit to net zero emissions, over 50% of the world's GDP is currently committed to net zero emissions by 2050, including Australia's major trading partners such as the European Union, United Kingdom, United States and New Zealand.

Section 3. Statement of Purpose

This Guidance Note develops a set of common considerations for the investment management industry on the following topics:

- approach to assessment of emissions in portfolios, setting net-zero targets and aligning portfolios to net zero targets;
- appropriate product labelling and avoidance of greenwashing; and
- application of Taskforce on Climate Related Financial Disclosures (TCFD) reporting to asset managers.

The guidance provides practical steps to assist funds to act in accordance with leading practice.

This Guidance Note provides up to date guidance from international resources as of June 2022. However, given the rapidly evolving nature of the climate risk disclosure space, the guidance and information herein and in the appendices are subject to change. While the FSC will review this Guidance Note at regular intervals, entities are responsible for keeping abreast of the latest developments.

Section 4. Effective Date

This Guidance Note is effective as of 3 August 2022.

[1 ASIC Greenwashing](#)

[2 Net Zero Financing Roadmap](#)

[3 Net Zero Asset Managers Initiative](#)

[4 Race to Zero](#)

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Section 5. Application of the Guidance Note

This Guidance Note is applicable to fund managers who voluntarily report or who are required to report their Climate Risk (including at group level disclosure), or who launch products making climate related claims, as providers of financial services to external stakeholders.

Adoption of this Guidance is voluntary.

Section 6. Review of the Guidance Note

The Guidance Note will be reviewed on or before end of August 2023.

Section 7. Definitions

ACSI	Australian Council of Superannuation Investors
APRA	Australian Prudential Regulation Authority
ASFI	Australian Sustainable Finance Initiative
ASIC	Australian Securities & Investments Commission
CA100+	Climate Action 100
Climate Risk	Potential risks that may arise from climate change or from efforts to mitigate climate change, their related impacts, and their economic and financial consequences
Emissions	Refers to greenhouse gas emissions being carbon dioxide (CO ₂), methane (CH ₄), nitrous oxide (N ₂ O), and the so-called F-gases (hydrofluorocarbons and perfluorocarbons) and sulphur hexafluoride (SF ₆)
ESG	Environment, Social & Governance
Financed emissions	Refers to financial activity, i.e., an investment or loan which makes an industrial activity possible and therefore is associated with the activity's emissions
IEA	International Energy Agency
IGCC	Investor Group on Climate Change
IPCC	Intergovernmental Panel on Climate Change
Negative Screening	The exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria
Net zero	Refers to the state when anthropogenic emissions of greenhouse gases into the atmosphere are balanced by anthropogenic removals over a specified period
NGFS	Network for Greening the Financial System
PACTA	Paris Agreement Capital Transition Assessment
RIAA	Responsible Investment Association of Australasia
Portfolio Emissions	Total emissions of each portfolio company (proportional to the amount of stock held in the portfolio)

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Positive Screening	Intentionally tilting a proportion of an investment portfolio towards positive solutions, or targeting companies or industries assessed to have better ESG performance relative to benchmarks or peers
SBTi	Science Based Targets Initiative
SFAP	Sustainable Finance Action Plan
SFDR	Sustainable Finance Disclosure Regulation
TCFD	Task Force on Climate-Related Financial Disclosures
UN PRI	United Nations Principles for Responsible Investment
WACI	Weighted Average Carbon Intensity

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Section 8.1 Net Zero Aligned Portfolios Guidance

Key considerations for setting net zero targets and assessing portfolio alignment

Fund managers making net zero commitments should be able to demonstrate their pathway to meeting the commitment. This section provides key considerations to help fund managers provide robust transparency around meeting net zero commitments.

8.1.1 Review industry frameworks

- Industry frameworks exist to help asset managers in the process of aligning portfolios with net zero, such as the Paris Aligned Investment Initiative, Science Based Targets initiative (SBTi) and Net Zero Asset Managers Initiative. However, there should be due consideration given to understanding the requirements or obligations of the chosen initiative or framework.
- Consider the following common key requirements when reviewing an initiative or framework:
 - target setting requirements;
 - scope of emissions disclosure requirements;
 - emissions calculation and target setting methodology; and
 - other disclosure requirements (e.g., percentage share of portfolio that is invested in fossil fuel companies).
- Asset managers should be aware of changing and emerging regulations such as the European Sustainable Finance Disclosure Regulation (SFDR), the EU Taxonomy Regulation and mandatory Task Force on Climate-related Financial Disclosures (TCFD) reporting in some jurisdictions and the impact this may also have on net zero commitments.

8.1.2 Assessing portfolio emissions

- The methodology used to assess portfolio emissions should be publicly disclosed.
- Access to emissions data is crucial to the assessment of portfolio emissions. This can typically be accessed or obtained through a combination of; licensing from third party data providers, public disclosures of investee companies and direct engagement with assets.
- Understand the types of emissions associated with an asset or portfolio company, e.g., Scope 1, 2 and/or 3. See *Appendix 1.4.2 for Scope 1, 2 and 3 definitions*.
- Understand that data limitations may result in emissions estimations being used for various emissions scopes, especially scope 3. These data gaps are closing but will still need to be considered when setting targets. Data limitations include the availability of emissions data from certain sources. This is most prevalent with an investee company's scope 3 emissions where value chain emissions may not be calculated or have a reliable method to calculate emissions.
- Asset managers should assess portfolios for alignment to net zero on an ongoing basis and select an appropriate methodology for assessment.
- Whilst greenhouse gas (GHG) emissions are typically reported annually and are based on the prior year activities of the asset or company, it might be necessary for asset managers to assess portfolio emissions on a more frequent basis depending on the portfolio turnover rate and the fund manager's assessment of data quality and coverage.
- Methodologies may be based on asset class specifics or sector specifics and can be backwards looking, or forwards looking.
- Backward-looking assessments typically involves carbon foot printing using TCFD aligned carbon metrics such as Weighted Average Carbon Intensity (WACI) and Financed Emissions.
- Be aware that there are limitations in the use of most carbon metrics for multi asset class portfolios. WACI has been the most used in the past for equity and debt. As a result, complimentary emissions metrics are

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emerging and now advised, such as Financed Emissions. The Partnership for Carbon Accounting Financials (PCAF) now outlines detailed emissions calculations methodologies for financed emissions.

- Forward-looking assessments can include analysis such as climate scenario analysis. Be aware there is currently no prescriptive scenario specifically for asset managers. Common scenarios include those published by organisations such as the International Energy Agency (IEA), Intergovernmental Panel on Climate Change (IPCC) and Network for Greening the Financial System (NGFS).
- If disclosing other complimentary emissions metrics, ensure these are relevant for your asset class.
- Industry specific target setting guidance, e.g., Science Based Targets initiative (SBTi), may influence the metrics and types of emissions to be assessed.
- It is necessary to seek to ensure that disclosures relating to the assessment of portfolio emissions and emissions reduction strategies, made by both the fund and the underlying portfolio company or asset are as accurate as possible. It is important to inquire as to whether companies/assets in your portfolio have had their emissions data assured or audited.

8.1.3 Setting portfolio emissions targets

- As mentioned above, there should be transparency in methodology used. Internal and external stakeholder reporting should describe the approach used for portfolio emissions assessment when setting and reporting against net zero targets. This includes the extent to which estimations have been used in setting a baseline.
- Portfolio net zero targets should be inclusive of Scope 1,2 and 3 emissions of investments where deemed required and/or appropriate.
- The targets set may also be influenced by both regulatory requirements and/or from obligations set by target setting frameworks. E.g., Net Zero Asset Owner Alliance recommendations.
- Targets should be set across total portfolios, including multi-asset class, only to the extent possible, noting that certain asset classes have inherent restrictions limiting alignment. For example, sovereign bond portfolios where no national government commitments exist with regards to net zero targets, and therefore, the ability to set a portfolio target based on those sovereign bonds is limited.
- Target setting used purely as a marketing technique might open the asset manager to scrutiny and liability for greenwashing.
- Target setting criteria of leading industry frameworks is outlined in Appendix 1, section 1.4.4. A common theme is to set both interim (e.g., 5 to 10 year) targets and long-term targets (e.g., 2040-2050).
- The implications on organisational wide strategy and governance processes should be considered when setting net-zero targets. E.g., resourcing capacity, timeline for implementation; internal risk & controls processes.

8.1.4 Investment approaches to align with net-zero

- Where portfolio emissions targets are being set, they should specifically consider the overall investment strategy of the portfolio to ensure there are no conflicts between targets and the overall investment objectives. The priority remains the client's best interests.
- ESG integration is the primary process of ensuring a systematic approach to the incorporation of climate risk and net zero alignment considerations are factored into investment decision making. This involves ensuring the price paid for an asset is valued appropriately given the perceived impact (risk/opportunity) of climate change and net zero strategy.
- Beyond ESG integration, there are three main approaches emerging as investors begin to align portfolios with net zero. These mainly involve the use of:
 - Quantitative data to set metrics and targets;
 - Stewardship activities combining outcomes-based engagement, voting escalation and policy advocacy to encourage corporate decarbonisation; and

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- Positive climate allocations to provide investment capital and finance to support the transition to a low carbon economy.
- Asset managers can leverage net zero aligned frameworks such as the Paris Aligned Investment Initiative (PAII) and the United Nations Principles of Responsible Investment (UN PRI), which can assist with information on implementation of a range of different alignment practices for different asset classes.
- These globally recognised methodologies and frameworks focus on the achievement of real decarbonisation, rather than merely reducing portfolio emissions via divestment. While fund managers may choose as part of their strategy to divest high emitters, or implement a negative screen of certain sectors, this affects the ability to engage with a company or asset on the topic of decarbonising their operations or products and services.
- A negative screen can affect company engagement on the topic of decarbonising their products & services (eg. being unable to exercise voting rights). However, portfolio exclusion (and the prospect of potential future inclusion) can also support more productive engagement given the potential impact on a company's share price, ability to access capital, cost of capital and reputation.
- Fund managers may choose to remove exposure to high emitters such as thermal coal or fossil fuel via a negative screen or add exposure to low emitters via a positive screen in order to manipulate the emissions exposure of the portfolio and align with net zero. Where negative or positive screens are implemented, consideration should be made to portfolio construction impacts on style, sector, size, country, market and asset class exposures.
- Negative or positive screens are implemented based on revenue thresholds, or activity thresholds. For example, removing exposure to any company or asset that generates more than a certain percentage of revenue from the high emission activity or industry, like fossil fuels. *Refer to Appendix 1.5, Table 8 for more detail regarding positive and negative screens.*
- From a fixed income (debt) perspective, fund managers can further increase portfolio allocation to green and climate-aligned bonds, to increase portfolio alignment with net zero. Investors should be careful of greenwashing with regards to the specific climate credentials of the company and bond. Careful assessment of the use of proceeds of the bond raising by the company should be carried out by investors. *Refer to Appendix 1.5, Table 8 for more detail regarding positive and negative screens.*
- In many cases, companies that are part of the global climate problem are instrumental in the solution and staying invested offers opportunities to influence corporate behaviour. It is important to consider that there may be circumstances where an investment in high emitting companies is warranted due to an overall contribution towards low carbon solutions. For example, companies involved in refining of rare earth and critical metals that are essential in the production of solar photovoltaics (PV) and wind power.
- Asset managers can also invest in companies that contribute to specific climate change thematic solutions. For example, renewable energy technology, waste/water management, energy efficiency, sustainable agriculture etc.
- Investors may consider the development of a dedicated fossil fuel policy to provide transparency to clients on their engagement, voting and escalation practices in relation to achieving a net zero transition for high emitting sectors.
- Industry best practice and standards do not include the use of offsets as a replacement for reducing value chain emissions in line with their science-based targets. This can be considered as part of ESG integration approach and stewardship activities when engaging with assets or companies on their own net zero alignment.

8.1.5 Stewardship

Asset managers should be aware that exposure to climate risk is deeper and broader than purely just exposure to carbon emissions. Every company in every sector and industry should be preparing for climate change. All companies, across all sectors can be engaged on climate change (not just material emitters).

- Asset managers should create a stewardship policy that guides the process of assessing and reporting portfolio emissions. For Australian asset managers, *FSC Standard 23: Principles of Internal Governance and Asset Stewardship* provides best practice guidance. It is mandatory for FSC members. There are

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several international best practice guides and standards, such as CA100+, ACSI, PRI, IGCC and Ceres which can be leveraged to implement and track engagement objectives.

- Implement an engagement policy and procedure that guides the asset manager through engagement with investees and encourages them to align net-zero.
- Understand the changing climate disclosure landscape, such as TCFD recommendations, and implement into engagement strategies across all asset classes.
- Consideration is needed for resourcing and implementing stewardship and engagement activities.
- An escalation strategy should be implemented to address any concerns that are repeatedly raised by stakeholders.
- As touched on above, as part of engagement, it is necessary to seek to ensure that disclosures relating to the assessment of portfolio emissions and emissions reduction strategies, made by both the fund and the underlying portfolio company or asset are as accurate as possible. Asset managers should seek to ensure that underlying portfolio companies and assets have had emissions data assured or audited.

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Section 8.2 Fund Labelling Guidance

Key considerations for appropriate fund labelling to address climate risk

This section outlines the key considerations for investment managers when labelling their funds to address climate risk concerns based on international best practice. ASIC INFO 271 *How to avoid greenwashing when offering or promoting sustainability-related products* provides important information for funds on how to avoid greenwashing and meet the legal obligations of disclosure and avoiding misleading and deceptive conduct when communicating about sustainability related products.

ASIC INFO 271 defines greenwashing as the practice of misrepresenting the extent to which a financial product or investment strategy is environmentally friendly, sustainable, or ethical.

Any disclosure associated with fund products should be outlined and fully explained in legal product/service documentation such as the Product Disclosure Statement for retail investors or Information Memorandums/Pitch books or equivalent documentation that supports the product for wholesale or institutional investors. More detail and background for each of these guidance points can be found in *Appendix 2: Labelling of Fund Products that Claim to Address Climate Risk Concerns*.

8.2.1 Disclose the fund's objective

- The general, financial, and specific carbon or environmental objectives sought should be clearly described in the documents given to investors. For example, if a new fund is being designed with the intention of investing in companies that will support the transition to the Low Carbon economy the fund should disclose this objective. A representation that a fund has specific climate risk objectives should also demonstrate that the climate related factors are substantial or significant.
- Outline any financial objectives (medium-term extra-performance, risk reduction, or profitability/risk arbitrage, etc.) or objectives of any other type (ethical, etc.) linked to the consideration of environmental objectives. Clearly describe what these objectives are and how they are defined.
- Determine the definition of activities within the scope of the fund's objective. For example, determine the definitions of activities within the scope of the energy and ecological transition. This might include wind, solar, geothermal, hydraulic, energy efficiency and low carbon footprint of industrial buildings and processes, the circular economy, clean transport, agriculture and forestry, infrastructure for adapting to climate change etc.
- When determining the list of activities that fall within the fund's objective, align these with international frameworks and standards, such as the EU Taxonomy, OECD, ASEAN Taxonomy and Eurostat.

8.2.2 Disclose the fund's investment approaches

- Investment managers should disclose the fund's formalised responsible investment strategy and approaches it will utilise to meet the funds' net zero objective if it has one. These need to be consistently applied, auditable, and fit to meet the funds ESG and investment objectives. The responsible investment strategy should include the recognised forms of responsible investment approaches as outlined by the Global Sustainable Investment Alliance (GSIA) and Responsible Investment Association Australasia (RIAA). See Appendix 6 for further discussion of the seven RI strategies. These approaches should be considered alongside the existing investment approaches such as risk minimisation, control of active sector weights and style exposures.
- The manager should disclose the ESG investment approach and criteria for inclusion in the portfolio. The proportion of the portfolio which each ESG investment approach applies to should also be disclosed. I.e., if the portfolio has a net zero commitment, the manager may only wish to apply the ESG thematic approach to 75% of the portfolio, and the exclusionary screen to 100% of the portfolio, if so, this should be disclosed.
- If the fund has investment screening criteria, the criteria should be clearly disclosed as well as the extent to which the screen applies to the portfolio as a proportion of the portfolio, and any qualifications to the screen such as exceptions, limitations and thresholds.
- For a net zero fund, confirm that the investment process considers environmental, social and governance factors while also maintaining decarbonisation as the primary responsible investment objective, ESG

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should still be considered holistically. For example, sector exclusions, company screening and portfolio tilts would benefit from being accompanied by a negative screen to ensure robustness of claiming a net zero and/or sustainable label.

- Ensure fund labelling is aligned and consistent with the responsible investment strategy and responsible investment approaches.
- Disclose the approach the investment team will follow when constructing the fund to ensure that underlying assets and companies are selected in line with the net zero investment objective.
 - For example, what benchmarks and frameworks will be used to assess products?
 - Determine the documentation that will be required to confirm the portion of revenue generated from energy transition activities for an existing or prospective investment.
 - Or determine the tools and ratings that will be required to assess the real asset for inclusion in the portfolio, such as GRESB or Green Star ratings.

8.2.3 Choosing a label

- Ensure that funds are labelled accurately, and that the meanings of labels used are clearly defined. For example, if a fund is labelled “Climate Friendly fund” or “net zero” comprising of companies with strong transition plans and climate attributes yet also includes companies which do not take into consideration ESG issues in any capacity, this could be a greenwashing issue, particularly if the other companies included do not fit the defined investment criteria.
- Consideration of benchmarks and sector benchmarks. For example, if a fund is labelled “best of sector” but only screens out 20% of the worst performing ESG companies, then the “best of sector” label is not the most accurate description for the fund.
- Refer to the European Fund labels to discern whether a fund can realistically claim a label of being a climate fund. Luxembourg Finance Labelling Agency (LuxFLAG) Climate Finance labelled funds are required to have 75% of the fund invested in “green companies” which are defined as companies which derive 50% of their revenue from eco-activities. Green activities have also been defined within the label’s taxonomy. For example, using LuxFLAG as a guide if only 20% of a fund meets the net zero fund investment criteria, it would be unreasonable to label the fund as a net zero fund.⁵
- Funds can utilise existing taxonomies to discern whether a company’s activity is classified as “green” and develop a net zero portfolio comprised of companies meeting this classification.
- Consideration should also be given to using the term “impact” as a label for a fund. Unless the impact can be directly measured, quantified, and reported, referring to a fund as an impact fund can expose the investment manager to greenwashing risk.

8.2.4 Ongoing assessment and engagement disclosure

- Disclose how the underlying assets in the fund are assessed on an ongoing basis to ensure that the fund remains aligned with its net zero objective and is avoiding significant harm in the first instance.
- Net zero funds are expected to engage with companies and play an active role in encouraging decarbonisation through their voting policies and interactions with management teams. This is considered extremely important for net zero and climate funds due to their ability to influence the increasing pace of decarbonisation.
- For funds looking to manage climate risk and be aligned with net zero, the voting and engagement policies should be disclosed with explicit reference as to how the fund engages investee companies on climate risk and emissions. The fund could also disclose how it intends to vote as well as voting outcomes.
- Company engagement and voting should be documented, disclosed, and become a systematic part of the responsible investment process.

⁵ [Novethic Overview of European Sustainable Finance Labels](#)

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- Similarly, for funds of funds structures, consistent and rigorous ongoing engagement with underlying asset managers to ensure they are meeting their stated investment objective and process is recommended to ensure that funds ESG credentials are closely aligned with labelling.

8.2.5 Reporting

- To ensure transparency, regular reporting to key stakeholders whether through periodic reporting or reporting to the board of directors is recommended. Fund reporting can be both qualitative and quantitative.
- Funds should report to investors on the achievement of their objectives, by calculating measurable impact indicators as well as providing qualitative reporting such as that required by TCFD.⁶ Quantitative reporting for funds addressing climate risk and decarbonisation can occur through the selection of performance metrics such as portfolio weighted Scope 1, 2 and 3 emissions, weighted average carbon intensity, CO₂ tons of carbon avoided, or MWh of renewable energy generated.
- Funds can utilise the EU Low Carbon Benchmarks to provide rigour around decarbonisation funds, providing transparency as to the extent to which the fund is aligned to the Paris Agreement, thereby providing non-financial portfolio information to investors.⁷ It should be noted that the utilisation of low carbon benchmarks doesn't provide fund transparency, rather the underlying climate science models and pathway projections underlying the benchmarks provide the transparency.
- Managers can employ a scoring methodology (as shown in Appendix 5) to report on the rigour with which the fund activities are aligned with requirements of EU climate fund labelling.
- Funds may consider disclosure of holdings to investors on a 90 day lagged basis, so investors are able to assess holdings and ensure that they are in line with the stated investment approach.
- If a fund is labelled "Impact" there are also further requirements for reporting and demonstrating that the fund is an impact fund. Key features of an impact fund that should be disclosed include the following:
 - There is an intent to solve/address a problem (e.g., reduction in carbon emissions).
 - The impact is measured. For example, the reduction in carbon emissions can be measured and disclosed.
 - That the impact is additional, this means that the reduction would not have occurred in the absence of the investment.
- If these key features of the fund can be disclosed, then the fund can be considered an impact fund.⁸

8.2.6 Verification

- Independent verification of the claims made about net zero financial product is best practice for instilling trust in investors about the material accuracy of these claims. The more significant a claim is, the greater the risk of greenwashing associated with that claim, and therefore assurance can help to mitigate the risk through external verification. Verification could come in the form of certification from RIAA: See *Appendix 2.5.4 for more on the certification process*.
- While the SFDR disclosures are supervised by national competent authorities, the assessment of the materiality, quality, and depth of ESG integration in the investment process and of the many ways sustainability can be operationalised, can pose specific challenges, and require dedicated expertise and costly data access.
- An investment manager can seek to obtain a limited assurance over the compliance of the product's investment policies with the criteria listed in the label of the fund.

⁶ [TCFD Recommendations](#)

⁷ [EU Paris Aligned Benchmarks](#)

⁸ [RIAA Benchmarking Impact Report 2020](#)

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Section 8.3 TCFD Guidance for Asset Managers

This section provides an overview of the key guidance points for asset managers implementing TCFD reporting. The TCFD is now widely accepted as the premier standard, globally, for integrating climate related financial disclosures into reporting and is becoming mandatory in some jurisdictions such as the UK and New Zealand. More detail for each of these guidance points, including relevant background and context, can be found in Appendix 3: Applying Task Force on Climate-Related Disclosures (TCFD).

8.3.1 The TCFD

There are 11 TCFD recommended disclosures:

Governance:

1. Describe the board's oversight of climate-related risks and opportunities.
2. Describe management's role in assessing and managing climate-related risks and opportunities.

Strategy:

3. Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term.
4. Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.
5. Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.

Risk Management:

6. Describe the organisation's processes for identifying and assessing climate-related risks.
7. Describe the organisation's processes for managing climate-related risks.
8. Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.

Metrics and Targets:

9. Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.
10. Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
11. Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.

8.3.2 TCFD reporting in Australia

- APRA's CPG 229 Climate Change Financial Risks does not create a separate set of obligations for entities but sets out expectations and examples of better practice to assist entities in managing climate-related risks and opportunities as part of their existing risk management (SPS220) and governance (SPS510) obligations. The guide draws on the structure of the TCFD recommendations by outlining governance, risk management, scenario analysis and disclosure as key aspects of managing climate change financial risks.
- ASIC INFO 271 encourages fund managers to voluntarily disclose under the TCFD framework.
- Per recommendation 7.4 of the ASX Corporate Governance Council's Principles (4th edition) entities are encouraged to both consider whether they have material exposure to climate change risk by reference to the TCFD recommendations and, if they do, make disclosures recommended by the TCFD.
- The following steps may be taken by entities to implement TCFD recommendations:

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1. Secure the support of your board of directors and executive team leadership.
2. Integrate climate change into key governance processes, enhancing board-level oversight through audit and risk committees.
3. Bring together sustainability, governance, finance, and compliance to agree on roles.
4. Look specifically at the financial impacts of climate risk and how it relates to revenues, expenditures, assets, liabilities, and financial impact.
5. Assess your business against at least two scenarios.
6. Adapt existing enterprise-level and other risk management processes to take account of climate risk.
7. Solicit feedback from engaged investors about what information they need to know about climate-related risks and opportunities.
8. Look at existing tools you may already use to help you collect and report climate-related financial information such as CDP Questionnaire (aligned to the TCFD since 2018), and the SASB Standards.
9. Plan to use the same quality assurance and compliance approaches for climate-related financial information as for finance, management, and governance disclosures.
10. Prepare the information you report as if it were going to be assured, even if you decide not to do so right now.
11. Look at the existing structure of your annual report and think about how you can incorporate the recommendations into your discussion of risks, management's discussion and analysis, and the governance section.

8.3.3 TCFD reporting for asset managers

- Asset managers' clients, as owners of the underlying assets, bear the major portion of the potential transition and physical risks to which their investments are exposed, and TCFD sector specific guidance for asset managers addresses considerations when reporting to clients.
- Per UN PRI practical guidance for asset owners, the following action steps are recommended:
 1. Review governance arrangements to ensure there is effective board level oversight and internal management processes are in place to effectively manage the climate-related risks and opportunities.
 2. Begin the process of analysing portfolio resilience to climate-related scenarios, including a 2 degree or less outcome.
 3. Assess the potential financial materiality of climate-related risks on the investment portfolio and evaluate the actions that need to be taken to mitigate these risks, as well as capturing new opportunities.
 4. Measure GHG emissions where data is available or can be reasonably estimated, for each fund or investment strategy.
 5. Engage with companies and external fund managers, to encourage greater transparency and alignment with the TCFD recommendations.
 6. Publicly disclose all the above actions and outcomes in annual reports and the climate risk in PRI's reporting framework.
- For assessing external fund managers, the guidance recommends requesting the following information:
 1. Intention to disclose: Whether they support the TCFD recommendations and if they intend to report in line with the key pillars of the framework.
 2. Governance: The oversight and management arrangements of climate-related risks and opportunities, and how this has changed (or will change in the future) considering the TCFD recommendations.
 3. Strategy: The strategy for identifying the risks and opportunities related to climate change, and how these are delineated over the short, medium, and long term.

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4. Risk management: The process for assessing and integrating climate-related investment risks (physical and transition) into investment decisions.
5. Metrics and targets: The utilisation of climate-related metrics as part of the investment process.

8.3.4 Scenario Analysis

- The TCFD recommends taking into consideration different climate-related scenarios, a process for identifying and assessing the potential implications of a range of plausible future states under conditions of uncertainty.
- There are several external scenarios which may be leveraged to undertake scenario analysis, which differ in their key characteristics, usage, and limitations. Entities should identify the appropriate climate scenarios for their business, as well as the sectors of the economy that should be described in detail. This information is then leveraged to identify climate-related risks and opportunities which may impact both operations and the supply chain. Scenarios enable an assessment of the likelihood of risks materialising and how material these risks, or opportunities may be to your business. These risks and opportunities should be captured within standard risk assessment processes and procedures.

8.3.5 Stewardship

- The TCFD recommends that asset owners engage with the entities that they invest in and encourage adoption of the TCFD recommendations. The FSC recognises this as an important step in the global effort of increasing alignment towards net zero within the financial sector. The FSC's *Standard 23: Principles of Internal Governance and Asset Stewardship* requires the disclosure of an asset manager's approach to direct stewardship engagement where relevant.
- Shareholder engagement, proxy voting directions and resolutions are increasingly focused on processes for forward-looking stress testing and disclosure. The IGCC acknowledges the importance of investors routinely engaging directly with major emitting companies about their climate change disclosure and response through a range of practices, organisations, and initiatives e.g., Climate Action 100+.

8.3.6 Industry guidance supporting climate disclosures

- The IFRS Foundation launched the International Sustainability Standards Board (ISSB) at COP26, a sister organisation to the IASB which will be responsible for developing global IFRS Sustainability Disclosure Standards. The intention is to deliver a comprehensive global baseline of sustainability-related disclosure standards, the first being the publication of prototype climate and general disclosure requirements. *For more information, please refer to Appendix 3.7.*
- The climate-related disclosures prototype published is structured around the four TCFD pillars of governance, strategy, risk management, and metrics and targets. The recommended objective of the prototype is to require an entity to disclose information about its exposure to climate-related risks and opportunities, it contains approximately 60 disclosure requirements.

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Appendix 1. Net Zero Aligned Portfolios

This section provides detail to support the key guidance points in Guidance section 8.1.

1.1 Background

The Paris Aligned Investment Initiative defines a net zero investment strategy as one that will decarbonise the investment portfolio consistent with the goal of reaching net zero emissions by 2050¹; and will increase investment into climate change solutions needed to meet that goal.

Net zero commitments in the financial sector are increasing. However, there is currently a lack of standardisation to evaluate and validate these pledges. There is an opportunity for financial institutions to drive the decarbonisation of the real economy needed to stabilise temperatures at 1.5°C above pre-industrial levels.

1.2 Key Challenges

The overarching challenge for asset managers and other financial institutions, is to meet the ever-increasing expectation and ambition level of multiple stakeholders such as, regulators, industry, and investors to align with net-zero. This requires dedicated strategic commitment from asset managers, along with adequate governance and risk systems to ensure alignment of investment portfolios can be appropriately assessed, monitored, and reported on. Once asset managers have chosen to align a portfolio with net zero emissions, there remains the challenge associated with restructuring the portfolio to align with net zero and also collaborating with portfolio companies to promote emissions reductions and therefore alignment with net zero emissions.

Setting portfolio wide targets can also create conflict if there is not adequate guidance across all asset classes, and it can cause confusion to have so many industry initiatives to understand before setting an appropriate target. For example, mature methodologies exist for some asset classes, typically listed equities and real estate, whereas other assets classes, such as sovereign bonds, have less rigorous standards and methodologies. This is also the case for carbon metrics, with most only being relevant for equity portfolios.

There is a specific challenge posed through availability of accurate, timely and quality data and tools. The use of company specific emissions data will provide more accurate analysis of net zero aligned portfolios, including using climate scenarios. Whilst there has been both an increase in the amount of Scope 1 & 2 emissions data availability as well as accuracy, there remains a problem in terms of Scope 3 emissions. This has the impact of making it more challenging and reluctant for asset managers to set meaningful targets.

An interrelated challenge here is the ability to engage and influence companies and assets to disclose accurate data. Robust stewardship programs should be implemented, which in turn creates resourcing challenges for asset managers.

Asset managers should remain alert to the challenge of changing regulations, such as mandatory TCFD reporting emerging globally, albeit not yet in force in Australia. These legal obligations may have broader implications for the organisation and should be very carefully considered. There is a risk that asset managers do not undertake an appropriate analysis, and therefore do not fulfil legal reporting obligations. These general challenges are not necessarily isolated to assessing and setting net-zero targets.

The last key challenge also linked to fulfilling reporting obligations, is greenwashing. This is considered in more detail in section 10, but asset managers should be cognisant of making accurate statements with regards to having net-zero aligned portfolios.

1.3 Current Industry Expectations

Whilst there are currently no Australian mandatory requirements obligating Australian asset managers to assess and set net-zero targets, there is increasing pressure from multiple stakeholders for asset managers to align investment portfolios with net zero. There are also several globally recognised frameworks available which can be leveraged to voluntarily assess and set targets such as the TCFD. Section 8.3 contains specific detail on applying the TCFD. There is also EU regulation emerging, such as the SFDR, which do impose climate related obligations on investment product issuers in the EU and Australian asset managers should be aware of these. Table 1 provides a summary of some of the current industry frameworks and regulations.

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Table 1 1 – Summary of the major frameworks and regulation pertaining to alignment with net zero

Initiative	Requirement
Net Zero Asset Managers Initiative ⁹	<p>Disclose the following within 12 months of signing on to the initiative:</p> <ol style="list-style-type: none"> 1. The initial percentage of their portfolio that will be managed in line with net-zero. 2. Their 'fair-share' interim targets for the assets under management (AUM) that will be managed in line with net-zero, and target date. 3. The methodology used in target setting (see section 1.4.4 for more information). <p>Asset Managers must also:</p> <ol style="list-style-type: none"> 1. Review targets at least every 5 years. 2. Report on TCFD recommendations (see section 8.3 on Applying TCFD recommendations).
TCFD ¹⁰	<p><i>Specific detail on applying the TCFD recommendations is outlined in Appendix 3 of this guidance.</i></p> <ol style="list-style-type: none"> 1. The TCFD is currently strictly limited to recommendations. However, international regulation is being introduced that requires companies (corporate and financial institutions) to report climate-related risks and opportunities, in line with the TCFD¹¹.
SFDR ¹²	<p><i>Appendix 2 of this guide will outline further information regarding the requirements of SFDR in a Fund Labelling context.</i></p> <p>Major requirements of the SFDR are:</p> <ol style="list-style-type: none"> 1. Disclosure of Scope 1 & 2 emissions, and as of January 2024, scope 3 emissions. 2. Disclosure of a company's percentage share of investment in fossil fuels, and the share of non-renewable energy consumption and non-renewable energy production of investee companies from non-renewable energy sources compared to renewable energy sources. 3. Disclosure of a sustainability risk policy. 4. Disclosure of a principal adverse impact statement. 5. Disclosure of a remuneration policy.
Paris Aligned Investment Initiative (PAII) ¹³	The PAII is an implementation guide and does not impose any obligations.
Science Based Targets Initiative (SBTi) ¹⁴	<p>The SBTi states that there are three methods for a financial institution to reach net zero¹⁵:</p> <ol style="list-style-type: none"> 1. Financed emissions: reduction of financed emissions aligned with 1.5°C pathways. 2. Portfolio alignment: alignment of all relevant financing activities such that each individual asset achieves a state of net zero consistent with the SBTi Corporate Net zero Standard. 3. Contribution to the net zero economy: based on financial institutions financing both decarbonisation activities and explicitly reallocating financing activities to climate solutions at a rate that is consistent with the 1.5°C pathway.

⁹ [Net Zero Asset Managers Initiative Progress Report](#)

¹⁰ [TCFD 2021 Status Report](#)

¹¹ [UK to enshrine mandatory climate disclosures for largest companies in law - GOV.UK \(www.gov.uk\)](#)

¹² [Sustainable Finance Disclosure Regulation](#)

¹³ [Paris Aligned Investment Initiative](#)

¹⁴ [SBTi Financial Institutions](#)

¹⁵ [SBTi Foundations for Net-Zero Target Setting in the Financial Sector](#)

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Initiative	Requirement
	<p>The SBTi:</p> <ol style="list-style-type: none"> 1. Financial institutions must set a target that covers institution wide Scope 1 and Scope 2 emissions, and Scope 3 investment and lending activities. 2. Scope 1 and 2 targets must cover all relevant GHGs as required per the GHG Protocol Corporate Standard. 3. Targets must cover a minimum of 5 years and a maximum of 15 years from the date the targets are submitted to the SBTi. 4. At a minimum, Scope 1 and Scope 2 targets will be consistent with the level of decarbonisation required to keep global increases in temperatures to well-below 2°C. 5. All financial institutions shall set targets on their investment and lending activities as required, irrespective of the share of quantified Scope 3 portfolio emissions as compared to the total Scope 1+2+3 emissions of the financial institution. 6. Regarding the use of carbon offsetting as part of net-zero claims, the SBTi states that companies are not able to purchase carbon credits as a replacement for reducing value chain emissions in line with their science-based targets". <p>Frameworks such as the Net Zero Asset Managers Initiative allow the use of offsets where there are no technologically and/or financially viable alternatives to eliminate emissions. In circumstances where emissions reduction is not possible, offsets have legitimacy as carbon projects can lead to co-benefits such as improved health outcomes and biodiversity protection.</p>
Transition Pathway Initiative – TPI Sectoral Decarbonisation Pathways ¹⁶	<p>The TPI provides a framework for assessing climate targets in 10 high emitting sectors. The TPI provides climate scenario benchmark pathways for each sector that are derived from IEA scenarios.</p> <p>Energy:</p> <ol style="list-style-type: none"> 1. 1.5 degrees scenario. 2. Below 2 degrees scenario. 3. National Pledges scenario. <p>Transport:</p> <ol style="list-style-type: none"> 1. 2 degrees (highly efficient). 2. 2 degrees (avoid shift, improve). 3. Paris Pledges scenario. <p>Industrials and Materials:</p> <p>(Cement, Diversified mining, and Steel).</p> <ol style="list-style-type: none"> 1. 1.5 degrees scenario. 2. Below 2 degrees scenario. 3. National Pledges scenario. <p>(Aluminium & Pulp, and paper)</p> <ol style="list-style-type: none"> 1. Below 2 degrees scenario. 2. 2 degrees scenario. 3. Paris Pledges scenario.

¹⁶ [Transition Pathway Initiative - TPI Sectoral Decarbonisation Pathways](#)

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Initiative	Requirement
GFANZ ¹⁷	<p>The Portfolio Alignment Team (PAT) developed technical guidance and recommendations on portfolio alignment with net zero emissions. The PAT recommendations are referenced by the GFANZ, and the key recommendations are as follows:</p> <ol style="list-style-type: none"> 1. Benchmarks should be based on single scenarios. 2. The use of a 1.5 degrees scenario to benchmark financial activities and following SBTI standards on scenario choice as minimum criteria. 3. Inclusion of Scope 1,2, and 3 emissions. 4. Following the PCAF accounting standard for quantifying or estimating counterparty emissions (see Appendix 1.4.2 below).

Note: A key point to note is that both the TCFD and SFDR do not require companies to have their emissions aligned with net zero emissions, merely that the various emissions types are disclosed.

1.4 Setting Net-Zero Targets

There are several key considerations and implications to setting a net-zero target for portfolios, regardless of asset class. These being:

- Assessing, understanding, and reporting the emissions profile of portfolios.
- Understanding best practice components of a target such as what framework to leverage.
- Understanding the types of investment strategies available to align to net zero.
- Awareness of the types of collaborative engagement initiatives that can be leveraged to promote improved climate disclosures.
- Understanding the legal obligations which result from climate related products (see section 8.2 and Appendix 2 for more information on ‘greenwashing’).
- Awareness of investment mandate considerations that may be imposed upon asset manager by clients such as Asset Owners.

The aforementioned considerations, particularly around assessing, understanding, and reporting the emissions profile of portfolios and understanding best practice components of targets and investment strategies available, are useful in assisting with baseline expectations for ‘net zero’ emissions. The following sections will provide more detailed guidance around considerations for setting baseline expectations around net zero portfolio emissions.

1.4.1 Portfolio Emissions Assessment & Reporting

Whilst multiple considerations have been identified, the starting point is to understand the emissions profile of the portfolio and to do that it is necessary to understand the types of emissions which can be measured.

Asset manager’s clients, such as Superannuation Funds, may require reporting and assessment of portfolio emissions and to meet their own targets and transparency obligations. The obligation to report on these points may be requested in investment mandates, especially where mandates are managed in accordance with climate specific indices or other investment constraints. Careful and diligent legal negotiation and review will be required to ensure asset managers understand the commitments and are able to meet all requirements.

1.4.2 Types of GHG emissions

The GHG Protocol Corporate Accounting and Reporting Standard (Protocol) defines Scope 1, scope 2 and scope 3 emissions as:ⁱⁱ

¹⁷ GFANZ-Progress-Report

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Table 2 – GHG Protocol Corporate Accounting and Reporting Standard definitions of Scope 1, 2 and 3 emissions

Scope	Definition
Scope 1	Emissions that occur from sources owned or controlled by the reporting company e.g., emissions from the process of combustion in owned or controlled boilers, furnaces, vehicles, etc.
Scope 2	Indirect emissions from the generation of purchased or acquired electricity, steam, heating, or cooling consumed by the reporting company. Scope 2 emissions occur at the facility where the electricity, steam, heating, or cooling is generated.
Scope 3	All other indirect emissions (excluding Scope 2) that occur in the value chain of the reporting company. Scope 3 is broken down into upstream emissions that occur in the supply chain and downstream emissions that occur because of using the companies good or services. Altogether, there are 15 categories of Scope 3 emissions, with category 15 (Investments) being the most relevant.

Asset managers should also understand which of these emissions should be reported for each asset class. Guidance can be taken from PCAF Reporting Standard for financial institutions.

Table 3 – Asset class emissions reporting requirements. Adapted from the PCAF

Asset Class	PCAF reporting guidance
Listed equity and corporate bonds	Financial institutions shall report borrowers and investees absolute Scope 1 and scope 2 emissions across all sectors. For sectors where Scope 3 emissions reporting is required, the company shall separately disclose the absolute scope 3 emissions. By 2026 all sectors will be required.
Business loans and unlisted equity	Shall report borrowers and investees absolute Scope 1 and Scope 2 emissions across all sectors. Shall include Scope 3 emissions for the oil, gas, and mining sectors from 2021 onwards.
Commercial real estate	Shall report absolute Scope 1 and Scope 2 related to the energy use of financed buildings during their operation.

Using emissions metrics and carbon foot-printing help asset managers to understand and compare how exposed one investment or portfolio is to another or a benchmark, as well as the overall emissions exposure of the portfolio in absolute terms.

The TCFD originally outlined a series of potential carbon metrics to use, with Weighted Average Carbon Intensity being the most preferred across the asset management industry due to its application for listed equity and debt portfolios. However, in 2021, the TCFD released updated cross-sector metrics, displayed in Figure 1, which also now includes Financed Emissions.

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Figure 1 – Key TCFD Guidance on Metrics¹⁸

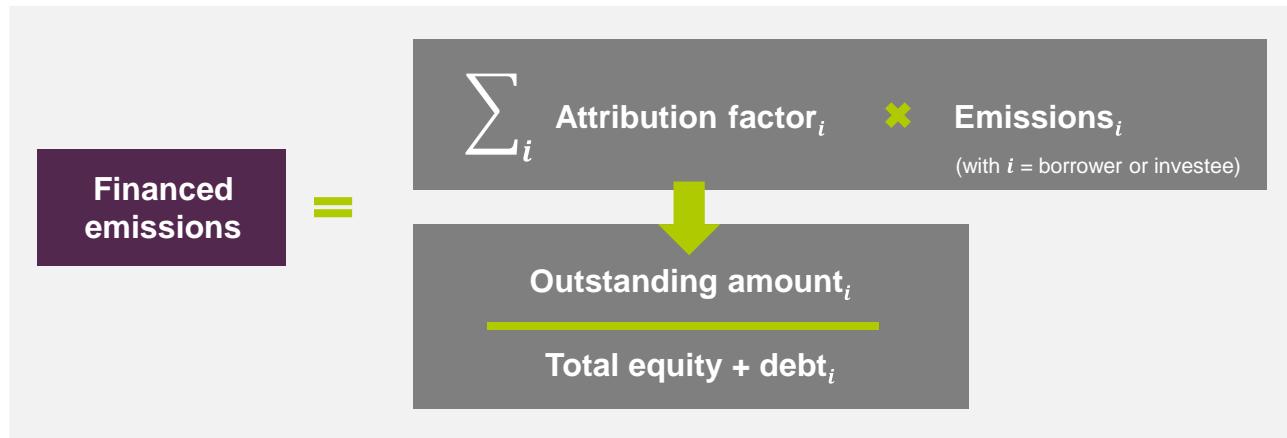
Metric Category	Example Unit of Measure	Example Metrics
GHG Emissions Absolute Scope 1, Scope 2, and Scope 3; emissions intensity	MT of CO ₂ e	<ul style="list-style-type: none"> Absolute Scope 1, Scope 2, and Scope 3 GHG emissions Financed emissions by asset class Weighted average carbon intensity GHG emissions per MWh of electricity produced Gross global Scope 1 GHG emissions covered under emissions-limiting regulations

Financed Emissions are now emerging as the preferred emissions metric in the asset management industry. PCAF released the Global GHG Accounting and Reporting Standard for the Financial Industry (Standard)¹⁹ which provides detailed methodologies and calculations to be used for Financed Emissions.

The Standard notes that Financed Emissions apply the same general attribution principles across all asset classes, which is the main advantage. The attribution factor is calculated by determining the share of the outstanding amount of loans and investments of a financial institution over the total equity and debt of the company, project, etc. that the financial institution is invested in. The use of this common denominator, including both equity and debt funding, is important because:

- It ensures the use of one common denominator across all asset classes.
- It does not differentiate between equity and debt as both contribute to total finance of the borrower or investee (and indirectly their emissions) and are, therefore, deemed equally important.
- It ensures 100% attribution of emissions over equity and debt providers and avoids double counting of emissions between equity and debt providers. This is specifically important for financial institutions that hold both equity and debt positions within the same companies or projects.

Figure 2 – PCAF Standard approach to calculating Financed Emissions



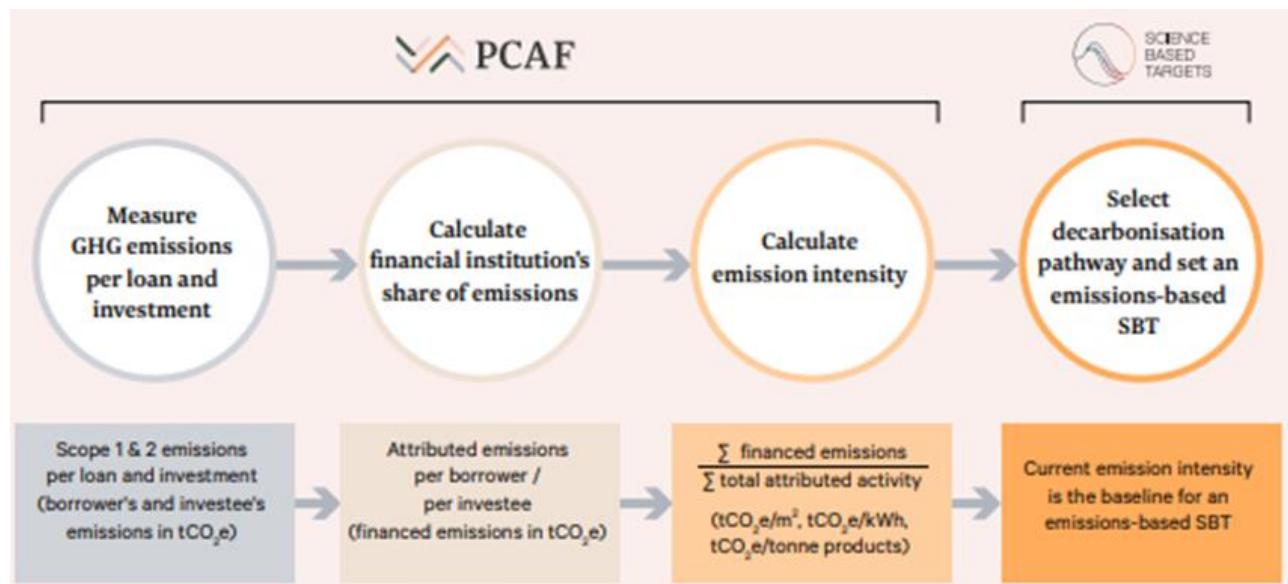
PCAF Financed emissions methods are also aligned with SBTi's framework for setting science-based emission reduction targets as displayed in Figure 3 and discussed in the next section.

¹⁸ P141021-2.pdf (fsb.org)

¹⁹ The Global GHG Accounting and Reporting Standard for the Financial Industry (carbonaccountingfinancials.com)

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Figure 3 – highlights the role played by emissions metrics in target setting methods.



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1.4.3 Assessing Net Zero alignment

It is necessary to assess the net-zero alignment of each portfolio. The Paris Aligned Investment Initiative can be leveraged for guidance and provides methodologies for assessing alignment to net zero for three different asset classes: Sovereign Bonds, Listed Equity and Corporate Bonds, and Real Estate.

Table 4- Paris Aligned Investment Initiative methodologies for assessing alignment with net zero and their assumptions

Asset Class	Approach	Description	Assumptions/Limitations
Sovereign Bonds	Germanwatch Climate Change Performance Index ²⁰	An independent tool that tracks the climate performance of 60 countries and the EU. This tool allows a company to track the performance of the country from which the sovereign bonds are derived and in turn their performance against net zero alignment.	This tool measures alignment with the 2°C scenario rather than the 1.5°C scenario.
Listed Equity and Corporate Bonds	Climate Action 100+ Company Benchmark ²¹	A framework to assess focus companies based on their publicly disclosed information. This tool provides 10 indicators that each have sub-metrics used to assess a company's alignment with net zero.	This framework does not consider actual emissions inventories, which is a major omission because a company could be aligned with net zero emissions and fail against every indicator in this benchmark. This is because the benchmark revolves around target setting, strategy, TCFD disclosures etc.
	Transition Pathway Initiative carbon performance and management quality indicators ²²	Assesses companies based on carbon performance, how the company performs now and, in the future, compared with the Paris Agreement goals, and management quality, the quality of the company's management of their GHG emissions and of climate-related risks and opportunities. Benchmarks against three climate scenarios: NDCs pledged by countries in the Paris agreement (>2°C); 2°C; Below 2°C.	This tool measures alignment with the below 2°C scenario at a minimum rather than the 1.5°C scenario.

²⁰ German Watch Climate Change Performance Index

²¹ Climate Action 100+ Benchmark

²² Transition Pathway Initiative

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Asset Class	Approach	Description	Assumptions/Limitations
Listed Equity	PACTA ²³	An open-source tool that is used to measure financial portfolio's alignment with various climate scenarios that are consistent with the Paris Agreement. PACTA covers the power, coal mining, oil & gas upstream sectors, auto manufacturing, cement, steel, and aviation sectors within its climate scenario methodology.	Limited scope that only covers certain industries.
Real Estate	The Carbon Risk Real Estate Monitor ²⁴	Enables users to monitor the energy performance of single properties as well as of portfolios and whole companies. The tool requires the user to enter information about the specific property. The output is an analysis of portfolio (or building) emissions vs 1.5°C and 2°C scenarios.	Inputs require assumptions about energy and carbon prices, refrigerant losses, and other inputs.

The TCFD also outlines that complementary analysis should be used, for example, historical emissions metrics, discussed in 8.1.2, and forward-looking analysis such as climate scenarios, discussed in section 8.3 and Appendix 3.6.

1.4.4 Target setting criteria for asset managers portfolios

There are several target setting initiatives and guidance available to investors and specifically asset managers. Three of the most used initiatives are outlined below.

Table 6- Target setting initiatives and guidance for asset managers.

Name	Main Requirements	Source
Paris Aligned Investment Initiative	<ol style="list-style-type: none"> 1. Portfolio level: Set a <10-year CO₂ emissions reduction target and a <10-year target for allocation towards climate solutions 2. Asset level: Set a 5-year coverage goal to increase %AUM invested in material sectors that are aligned with and achieving net zero. An engagement goal that ensures at least 70% of financed emissions in material sectors are assessed as net zero. 3. Target to reduce scope 1 and 2 emissions to align with net zero by 2050 4. Publish TCFD disclosures 	Net Zero Investment Framework Implementation Guide ²⁵

²³ [PACTA Leaflet](#)

²⁴ [CRREM Assessment](#)

²⁵ [Net Zero Investment Framework Implementation Guide](#)

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Name	Main Requirements	Source
Net Zero Asset Managers Initiative	<ol style="list-style-type: none"> 1. Set interim 2030 emissions targets that are consistent with the 50% global reduction in CO2 requirement to achieve the goals of the Paris agreement. 2. Account Scope 1 and 2 portfolio emissions. 3. Provide asset owner clients with a net-zero investing risk assessment. 4. Implement a stewardship and engagement strategy. 5. Publish TCFD disclosures annually. 	Net Zero Asset Managers Progress Report ²⁶ .
SBTi	<ol style="list-style-type: none"> 1. Provides guidance not obligations, however, is a useful framework for setting targets that are aligned with net zero. Enables investors to determine which emissions types and metrics to assess. 2. SBTi intends to produce guidance for 13 sectors with 5 currently being finalised. 	SBTi Financial Sector Science-Based Targets Guidance ²⁷ .
TCFD	<ol style="list-style-type: none"> 1. Provides guidance not obligations. Recommends that organisations should consider the following: 2. Whether the target is absolute, or intensity based. 3. Time frames over which the target is based. 4. Base year from which the target is measured. 5. Key performance indicators for that target. 	TCFD Recommended Disclosures 2021 update ²⁸ .

Table 7- Paris Aligned Investment Framework asset class targets

Asset Class	Target
Sovereign Bonds	<p>Increase average climate performance / asset under management to the maximum extent possible.</p> <p>Increase allocation to verified green bonds, if possible.</p>
Listed Equity and Corporate Fixed Income	<p>Increase % asset under management in net-zero or aligning assets (5-year goal).</p> <p>Increase % assets under management that are climate solutions.</p> <p>At least 70% of financed emissions in material sectors are net zero aligned or aligned to a net zero pathway.</p>
Real Estate	<p>Increase % asset under management that are aligned with net zero.</p> <p>At least 70% of financed emissions in material sectors are net zero aligned or aligned to a net zero pathway.</p>

²⁶ [Net Zero Asset Managers Report](#)

²⁷ [Science Based Targets Financial Sector Guidance](#)

²⁸ [TCFD 2021 Update Recommended Disclosures](#)

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1.5 Investment considerations to align with net-zero

Table 4 below is a summary of the example strategies in the marketplace which have been implemented to align a portfolio with net zero emissions. The information is adapted from the UN PRI²⁹.

Table 8 – Summary of Net zero Alignment Practices from the UN PRI

Asset Class	Alignment Practice	Use-Case
Listed Equity	Negative Screen Overlay – exclusionary process of removing certain companies from the fund based on certain characteristics (fossil fuel production, low ESG rating etc.).	Reduces the amount of portfolio emissions, however, scale of impact on emissions reduction in the real economy is uncertain (eg: effect on access to and cost of capital and signalling effect). Can be broad emissions-based screens, or narrow screens such as only fossil fuel companies.
	Portfolio Tilt – process of underweighting high emitting companies and overweighting low-emitting companies or companies that contribute to climate solutions.	Reduces the amount of portfolio emissions whilst also contributing to emissions reduction/a low-carbon economy.
	Thematic Funds – an approach that strictly focuses on low-carbon sectors and themes such as low emitters, renewable energy/technology/water, or waste efficiency.	A less diversified approach, that suits investors seeking exposure to the low carbon economy and will also contribute to a portfolio emissions reduction.
Unlisted Strategies and Assets	Funds – investing in funds that have an explicit or integrated approach to the low-carbon economy. This may include investment into climate solutions.	Useful for investors that predominantly invest in private markets through direct investments. Can reduce portfolio emissions whilst contributing to climate solutions.
	Fund of Funds investing in fund of funds that have an explicit or integrated approach to the low carbon economy. This may include investment into climate solutions.	Useful for investors that have an existing preference or policy to invest through fund of fund structures and are seeking to invest specifically or broadly into the low-carbon economy.
	Direct Investments – into projects such as renewable energy projects.	Investors seeking a more thematic exposure.
Bonds	Partnerships – investing in partnerships with another company/government/institution to better position the company to transition into the low carbon economy.	Investors with an existing partnerships strategy.
	Purchase of Green and Climate-Aligned bonds – Green bonds are strictly labelled bonds and are used to finance, or re-finance new and/or existing eligible green projects. Climate-aligned bonds are labelled or unlabelled bonds for which the proceeds are intended to finance projects that contribute to the low-carbon economy.	A low-risk option that can enable the investor to invest in specific projects of interest.

²⁹ [UN PRI | How to Invest in the Low-Carbon Economy](#)

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Asset Class	Alignment Practice	Use-Case
Low-carbon indices	Broad Market Optimised.	Useful for investors that cannot accommodate exclusionary processes but is seeking a reduction in fossil-fuel related exposure.
	Portfolio Tilt.	Useful for investors that wish to consider carbon efficiency and climate solutions whilst being able to accommodate exclusionary processes.
	Fossil-Free.	Useful for investors that can accommodate exclusionary processes.

Paris Aligned Investment Initiative also provides useful guidance on asset class specific investment approaches.

Table 9- Summary of Net zero Alignment Practices from the PAlI

Asset Class	Actions
Sovereign Bonds	<ol style="list-style-type: none"> Shift the portfolio towards higher performing issuers based on specific climate performance indicators. Increase allocation to verified Green Bonds.
Listed Equity/Corporate Fixed Income	<ol style="list-style-type: none"> Positively weight assets towards high performing companies and underweight low performing companies in terms of alignment towards key net zero metrics and climate change solutions. Apply screening criteria to the investment decision making process. Use specialist benchmarks, products or funds focused on alignment and climate change solutions. For passive assets, apply an index that utilises positive weights towards net zero alignment and climate change solutions.
Real Estate	<ol style="list-style-type: none"> Create plans to retrofit buildings to reduce energy use and increase renewable energy use.

1.6 Stewardship considerations

For Australian asset managers the FSC's Asset Stewardship code is a useful reference guide. The following are the key stewardship requirements based on assessing portfolio emissions³⁰:

- Monitoring of a company's performance on climate change (targets, strategy, governance etc.).
- Engagement with the company and the board about target setting approaches, strategies to reduce GHG emissions, governance, capital allocation and climate policy engagement.
- Approach to consideration of ESG factors and how this influences decision making
- Collaborative engagement with other investors including involvement with industry groups and associations.
- Principles used for policy advocacy including participation with industry groups and associations.

³⁰ [FSC Standard 23 Principles of Internal Governance and Asset Stewardship](#)

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- An escalation strategy that allows stakeholders to raise concerns and if a certain threshold is reached through repeated stakeholder engagement, the company must address and act through the escalation strategy. This may also include a voting system between members.

There are several internationally recognised collaborative investor initiatives, who have produced relevant climate related guides which Australian asset managers can utilise to implement stewardship practices. Table 2 outlines a summary of several key initiatives and resources.

Table 10- Summary of global engagement initiatives that provide guidance around stewardship activities

Engagement Initiative	Organisation summary	Resource to be leveraged	Key tasks for asset managers
CA100+	Used to monitor a company's performance on climate change. The framework is used to assess companies emissions target setting, tracking and ESG consideration.	NZB ³¹ .	<ol style="list-style-type: none"> Join and become lead or support investor Assess performance against 10 indicators.
ACSI	Provides guidance to aid the implementation and transparency of stewardship practices of asset owners.	Stewardship code ³² .	<ol style="list-style-type: none"> Have stewardship code and plan. Engage with companies about sustainable value creation. Monitor stewardship activities. Encourage alignment practices.
IGCC	Provides financial institutions with guidance around investment practices that address the risks and opportunities of climate change.	Full disclosure report ³³ .	<ol style="list-style-type: none"> Leverage information on investor expectations to inform decisions.
IIGCC	Provides financial institutions with a guide to align investment portfolios with net-zero emissions by 2050. The guide provides engagement and stewardship targets and strategies that help financial institutions reach net-zero targets.	Paris Aligned Investment Initiative ³⁴ .	<ol style="list-style-type: none"> Set engagement goals ensuring at least 70% of emissions in material sectors are aligned with net zero. Engage with companies to improve performance against net zero criteria. Set engagement policies.

³¹ [Climate Action 100+ Benchmark](#)

³² [ACSI Stewardship code](#)

³³ [IGCC Full Disclosure](#)

³⁴ [PAII](#)

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Engagement Initiative	Organisation summary	Resource to be leveraged	Key tasks for asset managers
AIGCC	An initiative aimed at creating awareness and encouraging action amongst Asian asset owners and financial institutions.	Investor Climate Action Plans: Guidance on using the expectations ladder ³⁵ .	<ol style="list-style-type: none"> 1. Assess current approach to climate risk management. 2. Engage with relevant stakeholders to ensure assets are aligned with net zero. 3. Advocate for climate change policy.
CERES	The CERES Roadmap 2030 provides companies with a 10-year action plan centred around sustainable leadership. There are three components to the roadmap: Critical Impact Actions; Business integration Actions and Systems Change Actions.	CERES Roadmap 2030 ³⁶ .	<ol style="list-style-type: none"> 1. Engage with stakeholders to inform key strategic decisions. 2. Embed accountability practices.

³⁵ [Investor Agenda Guidance](#)

³⁶ [CERES Roadmap 2030](#)

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Appendix 2. Labelling of Funds that Claim to Address Climate Risk Concerns

This section provides detail to support the key guidance points in section 8.2.

2.1 Background and challenges with fund labelling

Sustainable financial products are marked with an increasingly large list of tags, from green, sustainable, socially responsible to thematic ESG, water, carbon, impact funds, or net zero, collectively referred to as Socially Responsible Investment (SRI) labels. SRI fund labels can be one way to signal to the market that the fund has a dedicated responsible investment strategy³⁷.

European Sustainable Finance Labels (a list of these European labels can be found in Appendix 5), and in particular climate or thematic labels, are aimed at defining minimum requirements for funds while leaving room for the investor's interpretation. These labels are focused on ensuring a well-defined investment process which considers ESG criteria is followed. The criteria for assigning a European Sustainable Finance Label and indeed a net zero fund label is commonly process and transparency oriented. Furthermore, European labels often employ their own taxonomies (some of which are EU Taxonomy aligned) to guide investments towards being environmentally positive. Overall, European fund labelling provides key takeaways which can be applied globally.

In Australia, RIAA certification is the only formal label or standard that fund managers can apply to their portfolios and there is no label which is specifically targeted at net zero or climate thematic funds.

Greenwashing occurs when funds, both institutional and retail funds overrepresent to the market the extent to which their investment practices are sustainable, ethical, or net zero aligned and this can be a fund labelling challenge. This is partly driven by a lack of clarity about appropriate labelling and the absence of a single generally accepted taxonomy regarding what constitutes responsible, ethical, sustainable, or net zero investments.³⁸ This lack of clarity in Australia is driving increasing instances of greenwashing.

Globally, greenwashing by investment managers is coming under increased scrutiny. This issue has been recognised by international regulators as well as the International Organization of Securities Commission (IOSCO)³⁹ of which the Australian Securities and Investments Commission (ASIC) is a member. The International Monetary Fund (IMF) have also urged regulators to step up to prevent greenwashing, and expressed the role that sustainable labels could play in channelling flows to climate thematic funds.⁴⁰ The EU has been the leading force in the action on greenwashing and launched The European Union Sustainable Finance Action Plan in 2018 which aims to direct capital flows into Sustainable Finance and address greenwashing (discussed in detail below)⁴¹.

Domestically, on 14 June 2022, ASIC released INFO 271 'How to avoid greenwashing when offering or promoting sustainability-related products.' This followed ASIC's thematic review into greenwashing in the Australian market where they reviewed the disclosures of selected managed funds. The information sheet focuses on sustainability related products issued by funds and points to existing prohibitions against misleading and deceptive conduct and disclosure obligations and guidance. The information note covers ensuring the sustainability product is true to label, that vague terminology is avoided, that headline claims are not misleading, that investment screening criteria is adequately disclosed, that influence over a benchmark index is disclosed, that how metrics are used is explained, that there are reasonable grounds for stated sustainability targets and that it is explained how the target will be measured and achieved, and that it is easy for investors to locate and access relevant information.

Another challenge for fund managers is the diverging use of sustainable finance taxonomies. For example, European fund labelling standards focused on climate topics often also include a minimum requirement for the percentage of investments in sustainable or 'green' activities. These requirements are based on different taxonomies defining what constitutes 'green'. The diverging taxonomies make it difficult for asset managers to apply multiple fund labels and for investors it complicates the comparison of funds. This will, for a large part, be solved by the EU Taxonomy, that the European Technical Expert Group (TEG) on Sustainable Finance created

³⁷ [Sustainalytics | Sustainable fund labels](#)

³⁸ [ASIC- What is greenwashing and what are the potential threats?](#)

³⁹ [IOSCO Setting regulatory and supervisory expectations for asset managers](#)

⁴⁰ [IMF: Investment Funds Fostering the Transition to a Green Economy](#)

⁴¹ [Sustainable Finance Disclosure Regulation](#)

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and continues to develop to provide a technically robust classification system on what business activities are considered environmentally sustainable.

2.3 Australian Regulatory Requirements

In Australia, other than ASIC INFO 271, regulatory guidance on climate themed or net-zero fund labelling has not yet been issued and there are no specific regulations regarding labelling for funds focused on decarbonisation or other forms of SRI labels. ASIC however has been actively engaging companies and funds in relation to their climate change risk management claims, warning that making misleading or deceptive claims is a prohibition of the Corporations Act (2001). Recent noteworthy intervention from ASIC includes an energy company's initial public offering in 2021, where ASIC sought 'clarification' of a net-zero claim⁴².

Regulatory consultations are emerging at a domestic level such as through the Australian Sustainable Finance Initiative which has made a recommendation as a part of its roadmap to develop a sustainable finance taxonomy in Australia. While details of this potential taxonomy are not yet final it is likely to be aligned with existing taxonomies⁴³.

2.4 European Sustainable Finance labels

In the absence of Australian regulatory requirements or voluntary climate fund labelling standards, this Guidance Note explores European Sustainable Finance labels and their associated requirements to provide recommendations and guidance for Australian investment managers to label their net zero funds appropriately.⁴⁴ A dozen European labels have been created in the last fifteen years by both Government and private sector. See Appendix 5 for an overview of European Green labels, the number of funds using them and associated AUM.

A European label generally has detailed requirements for the investment process and portfolio composition of sustainable financial products. These requirements often go beyond simple disclosure but also restrict potential investments by stating in which activities, companies or sectors a financial product should or should not invest. In this way, a label demands a minimum level of ambition for the product and creates a qualitative distinction within the diverse offer of products that are promoted as sustainable. Most of the European labels require several mandatory strategies (e.g., ESG integration, exclusions, normative screening, etc.) and encourage additional optional strategies (e.g., corporate engagement, shareholder action).

For example, the Greenfin label is a strict label that focusses on financing the energy and ecological transition and is helpful for investment managers looking to design net zero funds. The Greenfin label is linked to a taxonomy of sustainable activities in which the fund must invest a specific percentage of its assets.⁴⁵ Certified funds must exclude fossil and nuclear energies from their investments at a 5% threshold. The funds benefiting from the label must have set up a monitoring mechanism for ESG controversies and the funds must publish reporting and indicators to measure the environmental benefits of the invested assets.

⁴² [ASIC- What is greenwashing and what are the potential threats?](#)

⁴³ [Australian Sustainable Finance Initiative](#)

⁴⁴ [Sustainability Labels EU Legislation Context](#)

⁴⁵ [The Greenfin Label](#)

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Label/standard	ESG analysis coverage requirements
 SRI label	- ESG screening of more than 90% of the portfolio - 20% reduction of the investable universe, or "significantly" better average ESG score than initial universe
 FNG-Siegel	ESG screening of 100% of the portfolio
 LuxFLAG ESG	100% portfolio screening, in compliance with an ESG strategy (e.g. best-in-class)
 Febelfin QS	100% ESG screening, with temporary derogations
 Umweltzeichen	- Mandatory integration of ESG selection criteria - Less than 50% of the total investment universe can be investable
 Nordic Swan Ecolabel	- ESG screening of more than 90% of the portfolio - More than 50% of the fund must be invested in holdings with "strong ESG practices"

Source: Novethik

2.4.1 European Regulatory Requirements for Fund Labelling

The EU's Sustainable Finance Action Plan (SFAP) is a policy objective by the European Union which aims to promote sustainable investment and minimise greenwashing instances within the EU and is applied to any financial market participant, retail and institutional alike⁴⁶.

The SFAP consists of three key policy objectives that will be useful for investment managers to understand when labelling their fund products, these are the EU Sustainable Finance Disclosure Regulation (SFDR), The EU Taxonomy and the EU Low Carbon Benchmarks. For the development of portfolios aiming to address climate risk and decarbonisation, the EU Low Carbon Benchmarks will be a key tool for investment managers.

The EU Low Carbon Benchmarks provide a transparent method of comparing a portfolio's decarbonisation and climate transition credentials against the EU's requirements for funds labelled as addressing climate or decarbonisation. The SFDR and the EU Taxonomy on the other hand are useful for Australian fund managers for understanding the disclosures required for funds which have an SRI label and for a broader range of funds as well.

The SFDR and the EU Taxonomy are foremost disclosure regulations and are not intended to provide substantive distinctions between financial products that only have basic ESG integration and more complex products such as net zero funds. In this context, sustainability fund labels can be a tool that allows investors to distinguish among different shades of sustainability, without requiring them to do a detailed and often complicated analysis themselves.

2.4.2 The EU Sustainable Finance Disclosure Regulation (SFDR)

The Sustainable Finance Disclosure Regulation (SFDR) aims to make the sustainability of investment funds more comparable and therefore more transparent for investors, particularly retail investors.⁴⁷ The regulation requires funds to consider both the impact that sustainability risk has on financial returns, as well as the impact that their investments can have on sustainability factors. This is referred to as double materiality and reflects best practice in responsible investment.

The regulation will require funds to disclose to investors:

- Information regarding the integration of sustainability risk into the investment decision making process.
- Adverse Sustainability Impact: Consideration of the adverse impact supported by the investment and a statement on due diligence policies.

⁴⁶ Robeco- Sustainable Finance Action Plan

⁴⁷ GSIR-20201.pdf (gsi-alliance.org)

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- Remuneration Policies: Information regarding how remuneration policies are consistent with the integration of sustainability risks⁴⁸.

Additional to the above, level 2 SFDR measures are being put into place which will require entities to report their investment's adverse sustainability impact according to predefined metrics such as climate and the environment, human rights, anti-corruption, anti-bribery, social and employee matters. Furthermore, for those entities which claim to have ESG characteristics, funds will have to demonstrate how this is achieved.

Another key element of the SFDR is the development of fund classifications which requires funds to label themselves as Article 9, 8 or 6. These classifications have the following meanings:

- Article 9: also known as 'products targeting sustainable investments', include products targeting bespoke sustainable investments and applies "... where a financial product has sustainable investment as its objective." It applies where an index has been designated as a reference benchmark, net zero portfolios are likely to fall in this category.
- Article 8: also known as 'environmentally and socially promoting', applies "... where a financial product promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices."
- Article 6: Article 6 covers funds that are not Article 8 or 9, however sustainability may still be part of the portfolio manager's process, e.g., by assessing the sustainability risk. Note that this category covers all other products and will, consequently, include everything from funds that report sustainability as not relevant to funds that have good integrations of sustainability – only not as defined by the SFDR (for example, an index fund that excludes the worst companies from an ESG perspective)⁴⁹.

2.4.3 The European Union Taxonomy

The EU Taxonomy Regulation is a new European regulation which works hand in hand with the SFDR, it came into force in July 2020 with further disclosure obligations due to be implemented.⁵⁰ The Taxonomy brings together corporates and investors by identifying economic activities that contribute to a low carbon economy. The Taxonomy classifies companies according to their economic activities so that investors in these companies can transparently report the extent to which their investments are sustainable. Under the taxonomy, corporates will either meet the criteria for the taxonomy or will not meet the criteria. To be considered sustainable under the taxonomy companies' economic activities will need to be in line with all the three below criteria:

- Contributes to one of the 6 designated taxonomy areas including climate change mitigation, climate change adaption, sustainable and protection of water and marine resources, transition to circular economy, pollution prevention and control, protection and restoration of biodiversity and ecosystems.
- After contributing to one of the 6 areas, corporates must also do no harm to the other 5 areas.
- Must comply with minimum safeguards.

If a company is classified as being eligible for the taxonomy, the proportion of the company's revenue which is taxonomy aligned is declared, this information can then be used to calculate the percentage of the fund which is also taxonomy aligned⁵¹.

2.4.4 The European Union Low Carbon Benchmarks

The third aspect of the recent EU Sustainable Finance Action Plan is the EU Low Carbon Benchmarks.⁵² The benchmarks are another method for mitigating greenwashing, enhancing transparency, and providing a strong comparative tool, particularly for funds focused on decarbonisation. The Low Carbon Benchmarks consist of the EU Climate Transition Benchmark and the EU Paris Aligned Benchmark. The two carbon benchmarks both require a 7% per annum reduction in the portfolio's GHG emission intensity however they differ in that:

⁴⁸ [CFA: Global ESG Disclosure Standards](#)

⁴⁹ [Robeco- Sustainable Finance Disclosure Regulation](#)

⁵⁰ [EU taxonomy for sustainable activities | European Commission \(europa.eu\)](#)

⁵¹ [Robeco: EU Taxonomy](#)

⁵² [EU climate benchmarks and benchmarks' ESG disclosures | European Commission \(europa.eu\)](#)

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- EU Climate Transition Benchmark- requires 30% less GHG emissions intensity compared to the market index.
- EU Paris Aligned Benchmark- requires 50% less GHG emissions intensity compared to the market index and has total exclusions from certain high carbon industries.

These benchmarks are designed to reorientate investors away from risk reduction and to place a greater emphasis on opportunity seeking in line with the transition to a low carbon economy. The benchmark tools are an internationally recognised method of ensuring the reduction in emissions intensity, easily communicating this effort with investors, allowing comparability, transparency and avoid greenwashing⁵³.

It would be expected that Article 9 funds will use the EU Paris Aligned Benchmark. As such for Australian funds looking to label themselves as climate focused or decarbonisation funds, using one of the respective Low Carbon Benchmarks could assist in providing transparency and credibility to the fund label.

2.4.5 The European Sustainable Investment Fund Labelling Frameworks Comparison

The European based financial data and analytics provider Qontigo issued a Whitepaper in January 2022⁵⁴ providing a comparison of European fund labelling requirements across 12 European fund labelling regulations including the EU Taxonomy Regulation, SFDR, Low Carbon Benchmarks, Belgium's Towards Sustainability Label, Franc's SRI Label, and the Nordic Swan Ecolabel.

Key takeaways for portfolio construction and labelling processes across the labels are as follows:

- That an exclusion only approach to sustainable investment is no longer sufficient for a portfolio to be considered "sustainable" however is considered essential for sustainable investment funds. This is key for climate focused or net zero funds as it is clear the exclusion only is unlikely to be sufficient to warrant labelling a fund as net-zero/or climate focused.
- ESG integration as a sustainable investment approach is also considered essential however alone is also not considered sufficient to classify as a sustainable investment fund and therefore not considered sufficient for a net zero fund, instead the preferences are for best-in class, thematic and impact ESG integration approaches.
- Engagement is also increasingly being considered as a powerful method for creating real world impact and is considered mandatory or desirable for net zero funds. The paper also argues that engagement is one of the most powerful tools available to financial market participants and that its importance will grow in both active and passive management.

It is suggested that over time, the various European labelling regulations will come further into alignment with the EU Taxonomy, SFDR and EU Low Carbon Benchmarks. In the interim, it is important that funds do not rely on fund labelling as a box ticking exercise and that they should focus on incorporating companies with transition plans and sustainability and decarbonisation targets into their portfolios to ensure that funds are aligned with their net zero claim.

2.5 Other International Guidance for Fund Labelling

This section outlines other best practice guidance from international organisations regarding labelling of funds.

2.5.1 United States Securities and Exchange Commission

The United States' Securities and Exchange Commission (SEC) has also recently turned its attention to ESG fund claims and has issued a Risk Alert targeted largely at retail investment funds and advisers. The Risk Alert was issued following the SEC's review into the ESG claims of investment funds and highlighted key issues regarding the incongruencies between what funds were claiming and the actual investment processes. Furthermore, the Risk Alert outlined the key differences between those funds at risk of greenwashing and those which were demonstrating better practice. The key better practice funds were doing the following:

⁵³ [Morningstar: EU Low Carbon Benchmarks](#)

⁵⁴ [Qontigo Whitepaper Fund Labelling](#)

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- Disclosures are clear, precise, and tailored to the firms' specific approaches to ESG investing and aligned with the firms' actual practices.
- Policies and procedures are publicly available which address ESG investing and cover key aspects of the fund's relevant practices. Including detailed investment policies and procedures which address ESG investing at various stages of the investment process (e.g., research, due diligence, selection, and monitoring).
- Funds consider incorporating compliance personnel, that are knowledgeable about the specific ESG-related processes and practices, into ESG-related processes, to avoid materially misleading claims in their ESG-related marketing ⁵⁵.

2.5.2 United Nations Principles of Responsible Investment

The UN PRI provides the opportunity for fund managers and corporates globally to become signatories to its Principles of Responsible Investment, known as the UN PRI. The UN PRI also sets out the key activities which investment managers should employ to ensure that they are meeting the requirements of being a Responsible Investor. The UN PRI has recently advised in a publication the importance of assurance for responsible investment funds for assessing the responsible investment process and has issued the following guidance:

- the UN PRI recommend that responsible investment funds have their fund labels externally reviewed and assured. This serves to ensure that funds are meeting the criteria of a certain label.
- Seeking this type of third-party assurance should be embedded into the responsible investment process and undertaken yearly to ensure the ongoing alignment with the label.

Undertaking this assurance process can help protect the fund against greenwashing risk as well as provide investors with confidence in the validity of the fund's ESG characteristics.

2.5.3 Chartered Financial Analyst (CFA) Institute

The CFA Institute released guidance in 2021 – The Global ESG Disclosure Standards for Investment Products (the “Standards”) which are ethical standards based on the principles of fair representation and full disclosure. They are designed to communicate information about an investment product’s consideration of ESG issues in its objectives, investment process, or stewardship activities⁵⁶. Key guidance in relation to labelling from the CFA institute is that fund managers often describe responsible investment approaches differently. For example, the definition of ESG integration differs across organisations and to address this, the CFA Institute has provided an overview of ESG investment approaches and the associated definitions. The CFA institute has recommended that when disclosing the ESG investment approach utilised by a fund, the manager should provide a definition and ensure that the definition is aligned with the definitions from international bodies such as the Global Impact Investing Network (GIIN), Global Sustainable Investment Alliance (GSIA) and UN PRI⁵⁷. This can assist with fund labelling to ensure that the investment approach terminology used by the fund is aligned with international terminology and best practice.

2.5.4 The Responsible Investment Association of Australasia (RIAA)

RIAA is the peak body in Australia which runs a ‘Responsible Investment Certification Program’ that provides confidence that a product or service provider is delivering on its responsible investment promise and meeting the Australian and New Zealand Standard for responsible investing ⁵⁸.

RIAA’s RI Certification Symbol signifies that a product or service has implemented an investment style and process that systematically considers environmental, social, governance or ethical considerations, and that the investment process is reliable has been verified by an external party. The product or service meets the strict operational and disclosure practices of Certification Program requirements, the main requirements from RIAA are:

⁵⁵ [SEC Risk Alert Review of ESG Investment](#)

⁵⁶ [CFA Institute ESG Disclosure Standards for Investment Products](#)

⁵⁷ [CFA Institute ESG Disclosure Standards for Investment Products](#)

⁵⁸ [RIAA RI Certification](#)

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- In line with European fund labelling, RIAA suggests that funds should have a primary responsible investment strategy supported by a secondary responsible investment strategy.
- Relying on only one responsible investment strategy could potentially expose the fund to greenwashing risk especially for net zero funds.
- Investment managers and products go through an extensive process to obtain RIAA certification which ensures the consumer that a financial product has legitimate responsible investment qualities and can be labelled as such. The process to become RIAA certified is rigorous and requires funds to meet various ongoing requirements to ensure that they meet the criteria for responsible investment. RIAA recognises that there are many different forms in which responsible investment can take however it enforces minimum requirements for funds⁵⁹.

2.5.4 Association of South East Asian Nations (ASEAN) Taxonomy

The Association of South East Asian Nations (ASEAN) Taxonomy is a taxonomy which was released at the end of 2021. The taxonomy was developed out of a recognition of minimal transparency of information, data quality and standardisation across nations. This was perceived as a barrier and a risk for financing in the region. The taxonomy is intended as the reference point for sustainable projects and activities in ASEAN to help issuers and investors understand the sustainability impact of a project or economic activity. This will result in a more informed and efficient decision-making process. The ASEAN Taxonomy is largely aligned to the EU Taxonomy and shares 3 out of the 6 environmental objectives with the EU Taxonomy including Climate Change Mitigation, Climate Change Adaption and Transition to the Circular Economy and is also aligned with the do no significant harm criteria⁶⁰.

⁵⁹ [RIAA RI Certification](#)

⁶⁰ [ASEAN Taxonomy](#)

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Appendix 3. Applying Task Force on Climate-related Financial Disclosures (TCFD)

This section provides detail to support the key guidance points in section 8.3.

3.1 TCFD Background

The TCFD recommendations, released in 2017, focus specifically on business disclosure of how climate change affects financial performance over varying time horizons. They were developed to enable capital markets to understand and manage climate risk across portfolios.

The TCFD recommendations apply across all sectors and jurisdictions and are suitable for both preparers and users of financial information, including asset owners and managers. The intention is also that asset managers' and owners' beneficiaries receive this information. Disclosures relating to strategy and metrics and targets should be subject to an assessment of materiality. With regards to risks and opportunities, the TCFD recommendations have a strong focus on both the risks and the opportunities of climate change and their financial impact.

In total, the TCFD set out 11 recommended disclosures, split across four key areas, which are outlined in Table 6 below.

Table 6- TCFD recommendations and supporting recommended disclosures

Governance	Strategy	Risk Management	Metrics and targets
Disclose the organisation's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material.	Disclose how the organisation identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
Recommended Disclosures:			
Describe the board's oversight of climate-related risks and opportunities.	Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term.	Describe the organisation's processes for identifying and assessing climate-related risks.	Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.
Describe management's role in assessing and managing climate-related risks and opportunities.	Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.	Describe the organisation's processes for managing climate-related risks.	Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
	Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.	Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.

The TCFD recommends that investment managers follow the standard disclosure guidance for all sectors, with the addition of supplemental guidance for asset managers below.

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Table 7- Supplemental TCFD guidance for asset managers

Strategy	Supplemental Guidance for Asset Managers
Recommended Disclosure b) Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.	Asset managers should describe how climate-related risks and opportunities are factored into relevant products or investment strategies. Asset managers should also describe how each product or investment strategy might be affected by the transition to a low-carbon economy.
Risk Management	Supplemental Guidance for Asset Managers
Recommended Disclosure a) Describe the organisation's processes for identifying and assessing climate-related risks.	Asset managers should describe, where appropriate, engagement activity with investee companies to encourage better disclosure and practices related to climate-related risks to improve data availability and asset managers' ability to assess climate-related risks. Asset managers should also describe how they identify and assess material climate related risks for each product or investment strategy. This might include a description of the resources and tools used in the process.
Recommended Disclosure b) Describe the organisation's processes for managing climate-related risks.	Asset managers should describe how they manage material climate-related risks for each product or investment strategy.
Metrics and Targets	Supplemental Guidance for Asset Managers
Recommended Disclosure a) Disclose the metrics used by the organisation to assess climate related risks and opportunities in line with its strategy and risk management process.	Asset managers should describe metrics used to assess climate-related risks and opportunities in each product or investment strategy. Where relevant, asset managers should also describe how these metrics have changed over time. Where appropriate, asset managers should provide metrics considered in investment decisions and monitoring. Asset managers should describe the extent to which their assets under management, products, and investment strategies, where relevant, are aligned with a well below 2°C scenario, using whichever approach or metrics best suit their organisational context or capabilities. Asset managers should also indicate which asset classes are included.
Recommended Disclosure b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.	Asset managers should disclose GHG emissions for their assets under management and the weighted average carbon intensity (WACI) for each product or investment strategy, where data and methodologies allow. These emissions should be calculated in line with the Global GHG Accounting and Reporting Standard for the Financial Industry developed by the Partnership for Carbon Accounting Financials (PCAF Standard) or a comparable methodology (See Table 2, p. 50). In addition to WACI, asset managers should consider providing other carbon foot printing metrics they believe are useful for decision-making. See Table 3 (p. 52) for additional carbon foot printing and exposure metrics.

Accompanying the recommendations is an Annex which contains implementing guidance and sector specific guidance, which includes sector specific guidance for Asset Managers in section 9.3⁶¹.

⁶¹ <https://assets.bbhub.io/company/sites/60/2020/10/FINAL-TCFD-Annex-Amended-121517.pdf>

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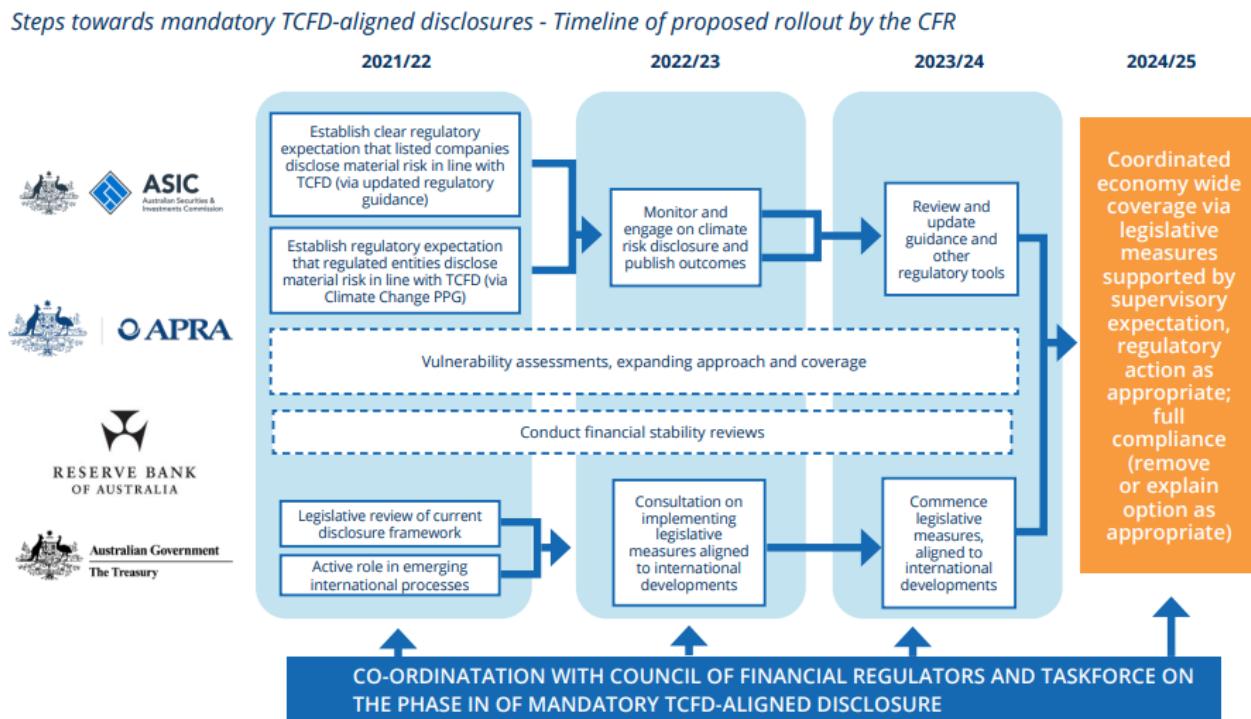
3.2 TCFD Reporting in Australia

In Australia adoption of TCFD reporting is voluntary only, however due to investor and regulatory expectations the number of companies who are now adopting TCFD aligned reporting is increasing year on year. For example, ACSI stated in their report 'Promises, Pathways & Performance - Climate change disclosure in the ASX200' that adoption and disclosure against the TCFD accelerated during 2020, with 80 companies now having adopted the framework. This is seven times the number in the first year of TCFD disclosure (FY17: 11 companies). This was also expected to increase during 2021.

The IGCC has proposed recommended immediate next steps for implementing mandatory TCFD-aligned disclosure in Australia. This includes updating regulatory guidance, and publishing new guidance, including monitoring, and reviewing the outcomes.

The timeline and recommended steps have been summarised by the IGCC⁶²:

Figure 4 – Proposed steps towards mandatory TCFD-aligned disclosures



3.3 Industry Guidance Supporting Climate Disclosures in Australia

Australian Prudential Regulation Authority (APRA) CPG 229

Australian regulators have been increasingly concerned with climate risks remaining unidentified on the balance sheets of regulated entities. They have all strongly signalled that they will be monitoring entities' management of climate change risk.

On 26 November 2021, APRA finalised CPG 229 Climate Change Financial Risks. This does not create a separate set of obligations for entities but sets out expectations and examples of better practice to assist entities in managing climate-related risks and opportunities as part of their existing risk management (SPS220) and governance (SPS510) obligations. The guide strongly draws on the structure of the TCFD recommendations by

⁶² https://igcc.org.au/wp-content/uploads/2021/06/ConfusiontoClarity_APlanforMandatoryTCFDalignedDisclosureinAus.pdf

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outlining governance, risk management, scenario analysis and disclosure as key aspects of managing climate change financial risks. Clearly, in implementing the TCFD recommendations, Australian regulators will also strongly align with APRA's expectations.

Governance Institute's Climate Change Risk Disclosure Practical Guide

Recommendation 7.4 of the ASX Corporate Governance Council's Principles (4th edition) encourages entities for the first time to consider and report upon any material exposure to climate risk. In February 2020, The Governance Institute of Australia released a guide, titled 'Climate change risk disclosure: A practical guide to reporting against ASX Corporate Governance Council's Corporate Governance Principles and Recommendations'⁶³ ('the guide') to assist listed companies to identify and disclose climate change risks in accordance with the TCFD, as per recommendation 7.4. of the ASX Corporate Governance Council's Principles (4th edition).

Recommendation 7.4 encourages entities to both consider whether they have material exposure to climate change risk by reference to the TCFD recommendations and, if they do, make disclosures recommended by the TCFD.

With respect to TCFD reporting, the guide supports the AASB's and the AUSB's joint guidance on the consideration of materiality and disclosure of climate-related risk in financial reporting standards. In their materiality definition and APS 2⁶⁴ entities can no longer treat climate-related risks as a matter of corporate social responsibility and should consider them also in the context of their financial statements.

With respect to TCFD implementation in Australia, the guide refers to the joint guidance released by SASB and the CDSB⁶⁵ which include the following practical steps:

1. Secure the support of your board of directors and executive team leadership.
2. Integrate climate change into key governance processes, enhancing board-level oversight through audit and risk committees.
3. Bring together sustainability, governance, finance, and compliance to agree on roles.
4. Look specifically at the financial impacts of climate risk and how it relates to revenues, expenditures, assets, liabilities, and financial impact.
5. Assess your business against at least two scenarios.
6. Adapt existing enterprise-level and other risk management processes to take account of climate risk.
7. Solicit feedback from engaged investors about what information they need to know about climate-related risks and opportunities.
8. Look at existing tools you may already use to help you collect and report climate-related financial information such as CDP Questionnaire (aligned to the TCFD since 2018), and the SASB Standards.
9. Plan to use the same quality assurance and compliance approaches for climate-related financial information as for finance, management, and governance disclosures.
10. Prepare the information you report as if it were going to be assured, even if you decide not to do so right now.
11. Look at the existing structure of your annual report and think about how you can incorporate the recommendations into your discussion of risks, management's discussion and analysis, and the governance section.

3.4 TCFD Adoption Globally

The below table provides a summary of approaches to implementing TCFD requirements,⁶⁶ for further detail please refer to the IGCC Report 'Confusion to Clarity: A plan for mandatory TCFD-aligned disclosure in Australia'.

⁶³ https://www.governanceinstitute.com.au/media/884632/govinst_climate_change_guide.pdf

⁶⁴ https://www.aasb.gov.au/admin/file/content102/c3/AASBPS2_12-17.pdf

⁶⁵ <https://library.sasb.org/tcfd-implementation-guide/>

⁶⁶ https://igcc.org.au/wp-content/uploads/2021/06/ConfusiontoClarity_APlanforMandatoryTCFDalignedDisclosureinAus.pdf

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Table 8- International approaches to TCFD implementation

Region	Coverage	Regulatory Instrument	Mandatory	Phase
New Zealand	Companies, Finance	Legislative	In part, with comply or explain function	Commence 2023
UK	Companies, Finance	Combination	<u>Yes</u> , and in part	Committed; increased coverage over period 2021 to 2025
Hong Kong	Companies, Finance	Supervisory expectation and regulatory action	Yes	Committed, and no later than 2025
EU	Companies, Finance	Regulatory	Yes	Committed
Switzerland	Companies, Finance	Legislative	Yes	Committed
Canada	Companies, Finance	Recommended	Under consideration	Considering
Singapore	Companies, Finance	Combination	Yes	Expectation Implemented, committed
US	Companies, Finance	Executive Order	Under consideration	Considering

3.5 TCFD reporting for Asset Managers

The TCFD supplemental guidance for asset managers recommends disclosures related to both assets under management and products and investment strategies. For example, asset managers are asked to 'describe how climate-related risks and opportunities are factored into relevant products or investment strategies' and disclose 'GHG emissions for their assets under management'.

Asset managers' clients, as owners of the underlying assets, bear the major portion of the potential transition and physical risks to which their investments are exposed. The relevance of climate-related risks and opportunities to an asset manager and its asset owner clients will depend on several variables, including its investment styles and objectives, the asset classes in which it invests, the investment mandates, as well as other factors. Where an asset manager is a public company, its climate related financial disclosures will be observed by its shareholders, who need to understand enterprise level risks and opportunities, and its clients. Asset managers' clients rely on reporting from asset managers to understand how climate-related risks and opportunities are managed. TCFD guidance for asset managers' addresses considerations when reporting to clients⁶⁷.

3.6 TCFD Implementation

In 2018, the PRI released the 'Implementing the TCFD Recommendations: A Guide for Asset Owners' which outlines the steps for getting started on TCFD reporting as well as sample disclosure. The Guidance is focused on the actions that fund managers should implement, as well as providing guidance as to what funds should be requesting of external funds. This groundwork is summarised in several key action steps that companies can take now to prepare for TCFD aligned reporting.

⁶⁷ [2021-TCFD-Implementing_Guidance.pdf \(bbhub.io\)](https://bbhub.io/2021-TCFD-Implementing_Guidance.pdf)

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Figure 2 – Action steps to lay the groundwork



To summarise, the action steps are as follows:

- Review governance arrangements to ensure there is effective board level oversight and internal management processes are in place to effectively manage the climate-related risks and opportunities.
- Begin the process of analysing portfolio resilience to climate-related scenarios, including a 2 degree or less outcome.
- Assess the potential financial materiality of climate-related risks on the investment portfolio and evaluate the actions that need to be taken to mitigate these risks, as well as capturing new opportunities.
- Measure GHG emissions where data is available or can be reasonably estimated, for each fund or investment strategy.
- Engage with companies and external fund managers, to encourage greater transparency and alignment with the TCFD recommendations.
- Publicly disclose all the above actions and outcomes in annual reports and the climate risk in PRI's reporting framework.

For assessing external fund managers, the guidance recommends requesting the following information:

- **Intention to disclose:** Whether they support the TCFD recommendations and if they intend to report in line with the key pillars of the framework.
- **Governance:** The oversight and management arrangements of climate-related risks and opportunities, and how this has changed (or will change in the future) considering the TCFD recommendations.
- **Strategy:** The strategy for identifying the risks and opportunities related to climate change, and how these are delineated over the short, medium, and long term.
- **Risk management:** The process for assessing and integrating climate-related investment risks (physical and transition) into investment decisions.
- **Metrics and targets:** The utilisation of climate-related metrics as part of the investment process.

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Scenario Analysis

The TCFD recommends taking into consideration different climate-related scenarios, including a 2°C or lower scenario, where such information is material. Scenario analysis is a process for identifying and assessing the potential implications of a range of plausible future states under conditions of uncertainty.

Quantitative and qualitative approaches may be achieved by using existing external scenarios and models (e.g., those provided by third-party providers) or by organisations developing their own, in-house modelling capabilities. Entities should identify the appropriate climate scenarios for their business, as well as the sectors of the economy that should be described in detail. This information is then leveraged to identify climate-related risks and opportunities which may impact both operations and the supply chain. Scenarios enable an assessment of the likelihood of risks materialising and how material these risks, or opportunities may be to your business. These risks and opportunities should be captured within standard risk assessment processes and procedures. Key scenarios commonly leveraged are summarised below:

Table 9- Existing external scenarios and models

Type	Provider	Name	Key characteristic	Usage and limitations
Physical climate scenario	IPCC ⁶⁸	Representative Concentration Pathway (RCP) 8.5	High emissions scenario, 4.5°C of warming.	The RCPs have been developed using Integrated Assessment Models (IAMs) as input to a wide range of climate model simulations to project their consequences for the climate system. ⁶⁹ These projections provide a foundation for emissions mitigation and impact analysis and are based on extensive scientific research in the IPCC Sixth Assessment Report. RCPs are the most widely used existing scenarios to model atmospheric carbon concentrations and global warming outcomes. Noting this, the RCPs only consider physical outcomes and should be used in conjunction with the SSPs to observe possible future outcomes. The implementation of RCPs at a granular level requires detailed analysis by an SME.
		RCP 6	High-to-immediate climate emissions scenario, ~2-3.7°C.	
		RCP 4.5	Immediate climate emissions scenario.	
		RCP 2.6	Limits warming to the Paris Agreements target of 2°C by 2100.	
Socioeconomic Pathways	IPCC	Shared Socioeconomic Pathway (SSP) 1	Sustainability – Low challenges to mitigation and adaptation.	The SSPs examine how global society, demographics and economics might change over the next century. ⁷⁰
		SSP2	Middle of the road – Medium challenges to mitigation and adaptation.	The SSPs were also developed by the IPCC and, when used with the global RCP scenarios, helps entities to better anticipate potential impacts of climate change. The RCP and SSP scenarios were designed to be complementary and informed the IPCC's Sixth Assessment Report, which is widely considered to be the most reputable global report on climate change. The SSP's are not sector specific and only
		SSP3	Regional rivalry – High challenges to mitigation and adaptation.	
		SSP4	Inequality – low challenges to mitigation, high challenges to adaptation.	

⁶⁸ Climate scenario analysis | PRI Web Page | PRI (unpri.org)

⁶⁹ Topic 2: Future changes, risks, and impacts — IPCC

⁷⁰ Explainer: How 'Shared Socioeconomic Pathways' explore future climate change - Carbon Brief

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Type	Provider	Name	Key characteristic	Usage and limitations
		SSP5	Fossil-fuelled development – high challenges to mitigation, low challenges to adaptation.	provide high level commentary on key sectors under future scenarios.
Energy transition scenario	IEA ⁷¹	Net Zero Emissions by 2050	Pathway to achieve net zero emissions by 2050.	The World Energy Outlook uses a scenario approach to examine future energy trends relying on the World Energy Model (an IEA developed simulation model covering energy supply, energy transformation and energy demand). These scenarios are limited to the future of the global energy system, however, are useful when leveraged in conjunction with other scenarios. The scenarios provide insights into announced and current emissions targets, as well as a pathway for the global energy sector to achieve net zero by 2050 (not relying on reductions from outside the energy sector).
		Announced Policies Scenario	Assumes that all climate commitments made globally will be met on time.	
		Stated Policies Scenario	Reflects current policy settings based on a sector-by-sector assessment of the policies in place.	
		Sustainable Development Scenario	Integrated scenario pathway aiming at achieving SDG 7, SDG 3.9, and SDG 13.	
		Net Zero Emissions by 2050	Pathway to achieve net zero emissions by 2050.	
Policy Response Scenario	UN PRI ⁷²	Announced Policies Scenario	Assumes that all climate commitments made globally will be met on time.	
		Inevitable Policy Response (IPR)	Governments will be forced to act more decisively than they have thus far, leaving financial portfolios exposed to significant transition risk.	The IPR scenario assumes governments will be forced to act more decisively than they have so far, leaving investor portfolios exposed to significant risk. Given a forceful policy response to climate change is not priced into today's market, this scenario presents an interesting possible future state and presents possible impacts to the economy, specific sectors, and asset classes. ⁷³ This scenario was developed by the UN PRI, an UN-supported international network of investors. The IPR scenario does not contain the granularity of detail some of the other scenarios do, and does not align specifically with a particular RCP or SSP.
Physical risk and transition risk scenarios	NGFS ⁷⁴	Orderly	Assume climate policies are introduced early and become gradually more stringent. Physical and	The NGFS is a group of 66 central banks and supervisors and 13 observers. The scenarios were developed as a common starting point

⁷¹ Climate scenario analysis | PRI Web Page | PRI (unpri.org)

⁷² What is the Inevitable Policy Response? | Thought leadership | PRI (unpri.org)

⁷³ IPR: Forecast Policy Scenario (FPS) (unpri.org)

⁷⁴ NGFS Scenarios Portal

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Type	Provider	Name	Key characteristic	Usage and limitations
			transition risks are relatively subdued.	for analysing climate risks to the economy and financial system, developed primarily for use by central banks and supervisors, however useful to the broader financial, academic, and corporate communities. These scenarios are still in the process of being developed and are limited to the financial system.
		Disorderly	Higher transition risk due to policies being delayed or divergent across countries and sectors. Carbon prices are typically higher for a given temperature outcome.	
		Hot house world	Some climate policies are implemented in some jurisdictions, but global efforts are insufficient to halve significant global warming. Critical temperature thresholds are exceeded.	
		Too little, too late	It is possible that a late transition would fail to contain physical risks. While no scenarios have been specifically designed for this purpose, this space can be explored by assuming higher physical risk outcomes for the disorderly scenario.	

Stewardship Considerations

The TCFD recommends that asset owners engage with the entities that they invest in and encourage adoption of the TCFD recommendations.

In line with FSC's stewardship code, engaging with an investee about introducing TCFD disclosures is an important step in the global effort of increasing alignment towards net zero within the financial sector. Collaboration between investor and investees about expectations on climate risk reporting is necessary to encourage adoption of TCFD disclosures.

It is important to outline to investees that an absence of robust disclosures can lead to a conclusion that the climate risks are not being adequately managed. Engaging with investees about TCFD disclosures also requires a level of understanding about the specific company/investee.

Producing TCFD disclosures requires a significant time and resource commitment, one that the investee may not have considered or understand. Furthermore, every investee has their own unique circumstance and baseline, it is important when engaging with investees that a balance is achieved in highlighting urgency in advancing TCFD disclosures and recognising the investees capabilities and limitations in reporting on the TCFD. Section 9.3 has more detail on collaborative engagement initiatives which asset managers can leverage and participate in.

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With respect to TCFD specifically, shareholder engagement, proxy voting directions and resolutions are increasingly focused on processes for forward-looking stress testing and disclosure. The IGCC acknowledges the importance of investors routinely engaging directly with major emitting companies about their climate change disclosure and response through a range of practices, organisations, and initiatives. For example, Climate Action 100+ is a global investor-led initiative that is engaging with 167 companies to seek greenhouse gas emissions reductions and climate disclosure, among other asks, including that the company has committed to implementing the TCFD recommendations and the company employs climate-scenarios tests against its strategic and operational resilience.

3.7 Industry Guidance Supporting Climate Disclosures

International Sustainability Standards Board (ISSB) and Draft Climate Prototype

The IFRS Foundation launched the ISSB at COP26, a sister organisation to the International Accounting Standards Board (IASB), which will be responsible for developing global IFRS Sustainability Disclosure Standards (SDS). The intention is for the ISSB to deliver a comprehensive global baseline of sustainability-related disclosure standards that provide investors and other capital market participants with information about companies' sustainability-related risks and opportunities to help them make informed decisions⁷⁵.

The IFRS Foundation published two exposure drafts being:

- Exposure Draft Proposed IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information⁷⁶; and

Exposure Draft Proposed IFRS S2 Climate-related Disclosures⁷⁷.

The Exposure Drafts (ED) were developed by their Technical Readiness Working Group (TRWG). The climate-related disclosures ED is structured around the four TCFD pillars of governance, strategy, risk management, and metrics and targets. The recommended objective of the ED is to require an entity to disclose information about its exposure to climate-related risks and opportunities, it contains approximately 60 disclosure requirements.

Overall, the requirements from the ISSB climate ED are more detailed than the TCFD, therefore an organisation compliant with IFRS would be compliant with TCFD, however compliance with the TCFD may not be sufficient to meet IFRS climate prototype requirements.

Investor Group on Climate Change's (IGCC) TCFD Materials

In their report 'Confusion to clarity: A plan for mandatory TCFD-aligned disclosure in Australia'⁷⁸, the IGCC support effective disclosure as a critical element to managing systemic financial risks associated with climate change, rather than just another box tick requirement for investors and companies.

The IGCC outlines a Roadmap which details the actions Australian financial regulators, and the Federal Government can take to build on existing work and further ensure there is clear and consistent reporting from companies, investors, banks, and insurers that will produce investable disclosure and ensure financial markets can properly price and act on the physical and transitional risks of climate change. These steps have been summarised in Figure 4, with further information located within the report⁷⁹:

⁷⁵ IFRS - International Sustainability Standards Board

⁷⁶ <https://www.ifrs.org/projects/work-plan/general-sustainability-related-disclosures/#published-documents>

⁷⁷ <https://www.ifrs.org/projects/work-plan/climate-related-disclosures/#published-documents>

⁷⁸ https://igcc.org.au/wp-content/uploads/2021/06/ConfusiontoClarity_APlanforMandatoryTCFDalignedDisclosureinAus.pdf

⁷⁹ https://igcc.org.au/wp-content/uploads/2021/06/ConfusiontoClarity_APlanforMandatoryTCFDalignedDisclosureinAus.pdf

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Appendix 4. Additional Key Resources

Australian Sustainable Finance Initiative (ASFI)

The Australian Sustainable Finance Initiative (ASFI) was established in 2019 to set out a roadmap for realigning the Australian finance sector to support greater social, environmental, and economic outcomes for the country.⁸⁰ “Responsible” or “sustainable” finance and a focus on environmental, social and governance (ESG) factors have moved firmly into the mainstream, with the recognition that capital needs to be mobilised for positive outcomes.

The ASFI Roadmap contains four key areas of recommendations:

- Embedding sustainability into leadership;
- Integrating sustainability into practice;
- Enabling resilience for all Australians; and
- Building sustainable finance markets.

These areas are supported by a total of 37 recommendations with actions required at multiple levels for system change (e.g., company, industry, regulatory, community and consumer and economy wide levels). Reporting in line with TCFD recommendations is a core component of the ASFI roadmap, under the ‘integrating sustainability into practice’ domain, an extract of which has been provided below. Specifically, ASFI supports TCFD adoption within recommendations 11, 12 and 13.

Figure 3 – Integrating sustainability into practice

2. Integrating sustainability into practice 	10. Join International Platform on Sustainable Finance 12 & 13. Develop TCFD reporting guidance 14. Play leadership role in development of TNFD	16. Create stress-testing framework and develop guidance 19. Embed sustainability into regulatory guidance and standards 20. Embed sustainability into outsourcing and procurement	9. Establish Taxonomy project 11. Financial institutions report according to TCFD on ‘if not, why not’ basis 12. ASX 300 report according to TCFD on ‘if not, why not’ basis 14. Fund research and develop TNFD guidance 15. Mandate sustainability reporting and align with international developments	16. Undertake scenario analysis and stress testing for climate risk 17. Expand vulnerability assessments 18. Value environmental and social externalities 19. Embed sustainability information into products and services 20. Develop stewardship codes	16. Expand scenario analysis and stress tests to include other sustainability risks 18. Facilitate compilation of national- and state-level data sets
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⁸⁰ Australian Sustainable Finance Initiative

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Appendix 5: Examples of ESG & Green Labels in Europe

French SRI label and Greenfin label, the Austrian Ecolabel ('Umweltzeichen') and the Scandinavian Nordic Swan Ecolabel are government initiatives. Other labels are initiatives from the private sector such as the German FNG label, the Luxembourg LuxFLAG labels or the Belgian Towards Sustainability label.

A label for sustainable financial products is a way to signal to the market that a product satisfies a minimum set of requirements regarding sustainable financial management, the environmental, social and governance criteria used, exclusions of harmful activities and the engagement with investee companies. Australian fund managers can draw upon the requirements of the fund labels to come out of Europe. While they are not prescriptive and broadly cover ESG and sustainability as opposed to being directly climate risk focused, the requirements can be applied to climate related funds looking to ensure that they are employing appropriate labelling practices.

Label	Number of funds	AUM as of 31/03/2019 (€bn, Morningstar & LuxFLAG ² data)
 Label ISR (France)	200	51,30
 FNG-Siegel (Germany, Austria & Switzerland)	65	9,87
 LuxFLAG ESG (Luxembourg)	46	12,77
 Umweltzeichen (Austria)	104	11,6
 Nordic Swan Ecolabel (Nordic countries)	23	8,20
 LuxFLAG Environment (Luxembourg)	7	6,03
 LuxFLAG Climate Finance (Luxembourg)	4	0,61
 Label Greenfin¹ (France)	11	2,55
TOTAL	414	94,03

¹ Unlisted funds are not counted here (18 funds and approximately €4.5bn in AuM).

² The latest LuxFLAG data was used in the absence of available data from Morningstar

Source: Novethik

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Points for:	FNG-Siegel	Umweltzeichen	Nordic Swan
Additional ESG analysis & selectivity of ESG filter	Yes , a selection strategy score assesses and rewards positive & negative screening	Yes , high selectivity rates are rewarded (via 3 thresholds of 50, 33 & 25% of initial investment universe remaining)	Yes , if 100% of the portfolio (in number of issuers) has undergone ESG analysis
Stringency of ESG processes	Yes (qualitative)	Yes (quantitative)	No (assessed in minimum requirements)
Voting policy (equity funds)	Yes , a dialogue strategy grade rewards funds that can show evidence of an active dialogue on sustainability with a large proportion of issuers. A policy on formal engagement processes with issuers is also mandatory.	Yes , the exercise of voting rights in general assemblies is rewarded	Yes , rewards regular voting (at more than 10 or 50% of general assemblies) and the funds able to demonstrate a past track record and future strategy of regularly putting forward shareholder proposals
Engagement and dialogue	Yes , a dialogue strategy grade rewards funds that can show evidence of an active dialogue on sustainability with a large proportion of issuers. A policy on formal engagement processes with issuers is also mandatory.	Yes , an engagement criteria rewards solution-oriented dialogue with portfolio corporations	Yes , points are attributed if the fund manager regularly engages on ESG issues with at least 5/10% of portfolio companies. Another point is awarded if specific resources and objectives are allocated for the engagement and dialogue process
Additional exclusions	No	No	Yes , GMO crops
Environmental focus	No . Thematic funds are treated separately	No . Thematic funds are treated separately	Yes , based on a simplified environmental taxonomy (see page 7)
Additional reporting	Yes , if ESG KPIs at fund level are made public	No	Yes , if one or several of the following are publicly available: detailed engagement list, voting records showing company-specific voting, environmental performance indicators (see on page 8), holding list with ESG brief
Reporting verification (3rd party)	No	No	Yes
Barème de notation	Graded from 0 to 100. "Basic" label between 0 and 24,9%. Stars awarded when grades exceed 25, 50 or 70%	Weighted points sum must exceed 65 % of the maximum amount of points (differentiated by category of products)	Graded from 0 to 16. A minimum score of 6 points must be achieved

Source: Novethic

Source: <https://www.novethic.com/sustainable-finance-trends/detail/overview-of-european-sustainable-finance-labels.html>

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Appendix 6: Responsible Investment Strategies

ESG integration	The systematic and explicit inclusion by investment managers of environmental, social and governance factors into financial analysis.
Corporate engagement & shareholder action	Employing shareholder power to influence corporate behaviour, including through direct corporate engagement (i.e., communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting that is guided by comprehensive ESG guidelines.
Norms-based screening	Screening of investments against minimum standards of business or issuer practice based on international norms such as those issued by the UN, ILO, OECD, and NGOs (e.g., Transparency International).
Negative/exclusionary screening	The exclusion from a fund or portfolio of certain sectors, companies, countries, or other issuers based on activities considered not investable. Exclusion criteria (based on norms and values) can refer, for example, to product categories (e.g., weapons, tobacco), company practices, (e.g., animal testing, violation of human rights, corruption) or controversies.
Best-in-class/positive screening	Investment sectors, companies or projects selected for positive ESG performance relative to industry peers, and that achieve a rating above a defined threshold.
Sustainability themed/thematic investing	Investing in themes or assets specifically contributing to sustainable solutions – environmental and social – (e.g., sustainable agriculture, green buildings, lower carbon tilted portfolio, gender equity, diversity).
Impact investing and community investing	<p>Impact investing Investing to achieve positive, social, and environmental impacts – requires measuring and reporting against these impacts, demonstrating the intentionality of investor and underlying asset/investee, and demonstrating the investor contribution.</p> <p>Community investing Where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to businesses with a clear social or environmental purpose. Some community investing is impact investing, but community investing is broader and considers other forms of investing and targeted lending activities.</p>

Source: <http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf>

