Introduction
This section establishes net zero objectives over a ten-year period, enabling net zero strategy and target performance assessment. It establishes climate objectives but not the means to achieve these (for this, see sections: ‘Asset Level Assessment & Targets’, ‘Policy Advocacy’, and ‘Stakeholder & Market Engagement’). Together with ‘Governance and Strategy’ and ‘Strategic Asset Allocation’, it forms part of NZIF’s lever of ‘Setting internal direction and portfolio structure for alignment’.

Core action points
NZIF recommends the following actions for investors using the framework and considers them core:

1. Monitor and disclose baseline portfolio scope 1 and 2 financed emissions, with portfolio scope 3 emissions kept separate, and sovereign-related assets disclosed separately.

2. Set and disclose medium term portfolio level reference objectives to inform asset allocation and monitor progress, based on portfolio scope 1 and 2 emissions and disclosing its associated rationale:
   - Portfolio Decarbonisation Reference Objective: <10 year CO₂e emissions reduction objective.
   - Allocation to Climate Solutions Objective: <10 year objective for allocating capital to climate solutions.

3. Disclose the methodology used to calculate portfolio level objectives, including an assessment of the quality of underlying information used.

4. Define the influence of portfolio level objectives over investment decision-making and communicate to investment managers.

5. Set a target to reduce operational scope 1 and scope 2 emissions in line with a suitable global net zero pathway.

6. Disclose the AUM committed to be managed in line with net zero, explaining reasons if this cannot be 100% of AUM.

7. Disclose how targets represent fair share contributions towards global GHG emissions reduction efforts.
Advanced action points
NZIF recommends the following advanced actions specific to ‘Objectives’. These may initially be difficult when beginning to set net zero objectives (when attention is likely to be placed on implementing core action points), but would likely prove beneficial over the long term:

- Assess and disclose the relative strengths and weaknesses of the methodology, metrics, and data used to set portfolio level objectives.
- Disclose performance against targets over time, and any updates or adjustments to objectives that are relevant, on at least an annual basis.
- Assess and disclose factors behind changes in emissions performance via attribution analysis when possible.
- Develop a high level strategy to address scope 3 emissions of investments at portfolio level.
- Develop a policy to define the circumstances and frequency for recalculating baseline financed emissions to ensure the consistency, comparability, and relevance of the reported GHG emissions data over time.
- Disclose reasons for any assets uncommitted to be managed in line with portfolio level objectives, including the process, progress, and timeline for inclusion.
- Assess and disclose financed emissions of uncommitted assets relative to those of committed assets.
- For Sovereign Bonds, incorporate consumption emissions into the design of the Portfolio Decarbonisation Reference Objective on a best effort basis.
Decarbonisation attribution analysis and rebaselining

**Attribution**
A focal principle of NZIF is to reduce real economy emissions. Consequently, it is recommended that investors seek to understand which factors are driving the changes in financed emissions attached to their portfolios. This enables investors to understand if they are ‘financing reduced emissions’ and not merely ‘reducing their financed emissions’. Attribution analysis is a key component of this and can support investors in several ways:22

- Increase investor understanding of portfolio decarbonisation to quantify real economy impact and recognise the achievement of climate goals.
- Inform net zero investment strategies and capital allocation decisions.
- Guide external engagements with underlying assets, external managers, and data vendors.
- Guide internal engagements with fund managers, board members and analysts.
- Inform policy advocacy that promotes real economy and sustainable finance policy measures supporting the net zero transition.
- Prevent greenwashing by ensuring credit is not taken for financed emissions reductions not attributable to changes in the real economy.23
- Enhance transparency and support public reporting with key stakeholders, including clients and trustees.

**Rebaselining**
The PCAF Standard requires a policy defining the circumstances that trigger a recalculation of base year financed emissions to improve consistency, comparability, and relevance of reported GHG emissions data over time, such that underlying progress can be assessed.24

NZIF recommends that baselines reflect a portfolio’s composition and any changes be attributed to allow equivalent comparison. Reasons to rebaseline include:

- Significant changes to data coverage, availability, or quality.
- Significant shifts in sectoral or industry exposure.
- New money or portfolio growth (for absolute targets), requiring attribution for targets.

NZIF recommends that a rebaselining policy be established, either dynamically, periodically, or on an ad hoc basis.
Monitoring portfolio (financed) emissions

Monitoring portfolio-level financed emissions can support portfolio alignment with net zero goals but investors may wish to add context by identifying and monitoring financed emissions associated with climate solutions, transition assets, and/or emerging markets (STEM emissions). These represent avenues for significant real economy emissions reductions but need concerted effort, from both investors and governments.

Identifying emissions associated with climate solutions (such as renewable energy) is important, as these could rise in line with their required global scale up. Emissions associated with manufacturing and installation will be the largest source of lifetime emissions for many of these activities, especially in the short term. However, they will likely have long term emissions performance which is compatible with net zero pathways.

Investors may wish to identify emissions associated with some forms of transition finance. Carbon intensive assets, particularly within high impact material sectors, may be acquired or remain in portfolios to facilitate decarbonisation. This may be the case if investors have real economy emission reductions goals, as high impact material sectors will tend to be the largest sources of portfolio emissions.

Finally, investors may wish to identify emissions associated with emerging market investments. These decarbonise along different net zero pathways relative to developed markets, taking longer to both reach peak emissions and net zero. Identifying financed emissions associated with emerging markets is recommended as part of incorporating fair share principles into net zero strategies.

Monitoring of STEM emissions will only be valuable to stakeholders if these categories are well defined and genuinely denote activities that contribute to achieving global decarbonisation. It is not envisaged that these activities should exclude assets from the alignment criteria in the asset alignment target, which is outlined in the ‘Asset Level Assessment and Targets’ section of this document.

The PAII investor networks are continually working together and with broader stakeholders on the definitions of these categories to provide appropriate methodologies in their calculation.

Absolute emissions reductions metrics

NZIF recognises that to set objectives and evaluate progress, it is useful to employ a ‘dashboard’ range of metrics, each of which provides important insights and serve different purposes. This includes the broad consideration of whether to use absolute- or intensity-based metrics and whether to use production or financial denominators.

Whilst some advocate for absolute metrics as the more direct way to measure performance, this can be problematic for investors, especially as capital flows into and out of portfolios. Investor experience also indicates that a sole focus on absolute emissions and rigid annual reduction requirements may inadvertently lead to:

- Application of undifferentiated pathways across material and high impact material sectors,
- Capital flight from emerging and frontier economies,
- Aversion to financing climate solutions which tend to have upfront emissions (e.g. clean energy),
- Restricting needed transition finance for high impact material sectors,
- Ignoring differing investor profiles, progress, and risk tolerances.

This could paradoxically undermine progress towards achieving the goals of the Paris Agreement. Consequently, a dashboard approach whereby a range of metrics are collectively used and considered is broadly recommended. It is also recognised that due to industry expectations (e.g. due to TCFD or PCAF), the headline figure will tend to be an emissions intensity approach using a financial denominator (either WACI or EVIC); however, it is noted that these metrics themselves have limitations.
The purpose of the Portfolio Decarbonisation Reference Objective is to encapsulate net zero goals over a long to medium time frame. Actual progress can be contrasted against this reference point, facilitating internal accountability, understanding of why changes have occurred, and assessment of the efficacy of net zero strategies in reducing portfolio emissions. It also allows emissions to be monitored at a portfolio level, rather than asset class level.

It is not intended or recommended to be used for portfolio optimisation, investment decision making, or as a target setting tool to reduce financed emissions through year-on-year reductions. Using financed metrics alone may lead to decisions that are misaligned with net zero goals. NZIF adopts an alignment centric approach to target setting, as set out in the ‘Asset Level Assessment and Targets’ section of this document.

No minimum performance expectation for decarbonisation is provided as this depends on various factors (e.g. the methodology used for target setting, as well as asset mix and location). Inclusion of portfolio scope 1 and 2 emissions is considered necessary for comparison with a contextually relevant net zero pathway and consideration of fair share principles.

Key design decisions when making a Portfolio Decarbonisation Reference Objective are 1) to adopt a self-decarbonisation or benchmark relative approach, and 2) to adopt a cumulative emissions or point-in-time reduction approach.

The Portfolio Decarbonisation Reference Objective is directed towards scope 3 category 15 emissions. This is because this is typically most material to their carbon footprint and their ability to reduce real economy emissions. However, those directly owning or managing assets may have elevated operational scope 1 and 2 emissions and so may find utility in setting a Portfolio Decarbonisation Reference Objective on these emissions.

NZIF considers that for corporate assets, its Portfolio Decarbonisation Reference Objective must include portfolio scope 1 and 2 emissions. It is recommended that material portfolio scope 3 emissions be phased into net zero efforts at the portfolio level, as data availability, quality, and consistency allow, as well as where meaningful to net zero goals. However, it is currently recommended that they be monitored separately to portfolio scope 1 and 2 emissions and a separate strategy is created to address these due to measurement, aggregation, and mis-incentivisation challenges (including double counting).

Sovereign Bonds should have their own baseline and decarbonisation objective, as aggregation with other assets may over-reward changes in sovereign alignment versus other assets. It is expected that the baseline reports on production emissions (including and excluding land use, land use change, and forestry (LULUCF)) include consumption emissions on a best effort basis, if desired. It should also take into account fair share principles and use processes, such as normalisation weights, to ensure equitable treatment of annex and non-annex I countries.