Paris Aligned Investment Initiative:
Net Zero Investment Framework:
Private Equity Components

In partnership with Campbell Lutyens
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IIGCC PAII private equity working group co-lead
IIGCC is the European membership body for investor collaboration on climate change.

An investor-led network of over **350 asset owners and managers** across 22 countries, together we represent over €50 trillion in assets.

IIGCC works to support and help define the public policies, investment practices and corporate behaviours that address the long-term risks and opportunities associated with climate change.

With other investor networks we coordinate platforms for investors to make net zero commitments:

- **Net Zero Asset Managers**: 236 asset managers with $57 trillion AUM committed to net zero
- **Paris Aligned Asset Owners**: 53 asset owners with $2.9 trillion AUM committed to net zero
IIGCC established PAII in May 2019 - to define Paris Alignment for investors and explore how investors can align portfolios and actions to the goals of the Paris Agreement.

Four working groups identified best practice methodologies and approaches for measuring alignment, transitioning portfolios, and taking action to drive the transition to net zero.

Produced the Net Zero Investment Framework 1.0 covering 4 asset classes (Sovereign, Listed Equity and Corporate Fixed Income, Real Estate).

Portfolio testing using five investor portfolios to construct aligned portfolios and test performance vs current portfolios.

From 2021, the Paris Aligned Investment Initiative has been delivered by four investor networks.

The networks are supporting investors globally to implement the Net Zero Investment Framework 1.0.

- Asia Investor Group on Climate Change in Asia
- Ceres in North America
- Investor Group on Climate Change in Australasia

More than 150 asset owners and asset managers involved to develop the Framework, with over $33 trillion AUM.
Aims of the Framework

▪ Translate the goals of the Paris Agreement into practical guidance for asset owners and asset managers
▪ Establish a common understanding of effective approaches and methodologies to guide the ambitious action required
▪ Support the decarbonisation of the real economy, help minimise the negative impacts of climate change, and seize investment opportunities
▪ Enable all investors to maximise their efforts and impact to achieve climate goals

How should the Framework be used?

▪ As a basis for a commitment to align to the goals of the Paris Agreement and net zero global emissions by 2050
▪ The recommendations, methodologies and key actions should be used to develop and implement an effective net zero investment strategy
▪ The Framework can be used by asset owners to set their strategies and by asset managers to implement them
An investor’s approach to alignment should be guided by the following five principles

- **Impact**
  - Maximising long-term emissions reductions in the real economy

- **Rigour**
  - Science-based and consistent with achieving Paris goals

- **Practicality**
  - Feasible for a range of investors to implement

- **Accessibility**
  - Approaches and methodologies should be clear and easily applied

- **Accountability**
  - Clients, beneficiaries and stakeholders can assess whether investors are aligned
Overview: Net Zero Investment Framework 1.0

**Governance & Strategy**
- Net zero commitment
- Beliefs, strategy & mandates
- Climate risk assessment
- Monitoring & reporting

**Objectives and Targets**
- Emissions reduction
- Investment in climate solutions

**Strategic Asset Allocation**
- Scenario Analysis
- Portfolio optimisation
- Asset class variants
- Review constraints

**Asset Level Assessment & Targets**
- Alignment & engagement targets
- Asset assessment criteria
- Recommended methodologies

**Implementing Alignment**
- Portfolio Construction
- Engagement & Stewardship
- Selective Divestment
- Direct Management

**Stakeholder & Market Engagement**
- Asset managers or clients
- Data & service providers

**Policy Advocacy**
- Global & national net zero policies
- Disclosure & shareholder rights

**Portfolio / Fund Level**
- Sets direction and portfolio structure for alignment

**Asset Class Level**
- Shifts alignment of assets to meet portfolio goals

**External**
- Influences enabling environment to facilitate alignment
Purpose of a Net Zero Investment Framework for PE

- Develop a common view on “best practice” for GPs and LPs to be considered a ‘net zero’ investor
  - The work acknowledges that private equity integration of climate risk and impact is at an early stage and many investors will need to progress towards this best practice over time.
- Provide a basis for investors to make net zero commitments for PE or incorporate PE into their existing net zero commitments
- Provide a blueprint for investors to develop a net zero investment strategy for PE portfolios or funds.
- Ensure net zero strategies are practical, supporting value creation, and focus on driving emissions reduction in the real economy
- Recommends metrics to measure the alignment of PCs and portfolios, relevant to the objective of achieving net zero GHG emissions by 2050 or sooner
- Recommends targets that should be set and delivered to ensure progress towards net zero portfolio emissions by 2050 or sooner
- Recommends a set of actions for GPs and LPs to manage portfolios to increase their alignment with the net zero goal
Proposed Scope

All portfolio companies classified as Buyout or Growth for Primaries, Secondaries and Fund of Funds should be in scope for net zero alignment measurement and management.

Include Buyout and Growth for Primaries, Secondaries and Fund of Funds, at least meeting the following portfolio company coverage criteria:

- All portfolio companies classified as Buyout or Growth for Primaries, Secondaries and Fund of Funds should be in scope for net zero alignment measurement and management.
- In the case of the GP having a meaningful influence, >25% fully diluted shares + 1 board seat(s).
- Coverage of >70% of total PCs NAV or emissions are covered, rising to 90% by 2030.
- All high impact sectors TPI classification.
- Venture Capital: Startups included once they meet criteria:
  - >50 persons, and
  - >10mn EUR annual turnover or balance sheet, and
  - In existence for 5 years, and
  - The GP has >15% fully diluted shares and board seat(s).
# Proposed PC net zero alignment indicators

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Net Zero</th>
<th>Aligned</th>
<th>Aligning</th>
<th>Early progress</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1</strong></td>
<td>Ambition: A long term 2050 goal consistent with achieving global net zero GHG emissions by 2050 or sooner</td>
<td></td>
<td>x</td>
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<td><strong>2</strong></td>
<td>Targets:</td>
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<tr>
<td>a.</td>
<td>Short- and medium-term science based GHG emissions reduction target (scope 1, 2 and material scope 3)</td>
<td>x</td>
<td>x</td>
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<td>b.</td>
<td>Immediate emissions reduction target (Scope 1&amp;2) set in line with at least a global net zero decarbonisation pathway</td>
<td></td>
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<td>x</td>
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<tr>
<td><strong>3</strong></td>
<td>Disclosure: Annual disclosure of scope 1, 2 and material scope 3 absolute GHG emissions, and capex or revenues related to climate solutions as defined by the EU Taxonomy mitigation or adaptation criteria, or equivalent assessment</td>
<td>x</td>
<td>x</td>
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<tr>
<td><strong>4</strong></td>
<td>Emissions performance: Current emissions intensity performance (scope 1, 2 and material scope 3) relative to targets provided to GPs and disclosed publicly</td>
<td>x</td>
<td></td>
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<td><strong>5</strong></td>
<td>Climate strategy: A proportionate plan, with clear governance, setting out the measures that will be deployed to deliver GHG targets, assess and manage climate risk, and achieve value creation through climate related opportunities. For high impact sectors this plan should be quantified and include Capex and Opex expenditures (potentially agreed by the GP) to achieve targets.</td>
<td>x</td>
<td></td>
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<tr>
<td><strong>6</strong></td>
<td>Strategy on track to meet exit criteria that a) the company is in a position to be profitable in a net zero future b) the company has the potential to continue to align to relevant net zero decarbonisation pathway over time</td>
<td>x</td>
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<td><strong>7</strong></td>
<td>Governance: A named director on the board with responsibility for climate risk, and other relevant management responsibilities for climate change established; Climate risk management discussed by board at least once a year</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>
Proposed targets

**Portfolio Coverage (asset alignment)**

Target 1a: A year on year alignment target for increasing % of current NAV of assets in scope that is achieving the criteria to be considered i) net zero, or ii) ‘aligned’ or iii) ‘aligning’ to net zero. The year-on-year increase should indicate a target for the following 5 year period, and is expected to demonstrate an increase consistent with reaching 100% net zero, aligned or aligning by 2040.

Target 1b: As a subset of target 1a, for all new assets where the GP has a meaningful influence, criteria should be achieved progressively, reaching 100% of assets ‘aligned’ or ‘net zero’ by 2030, or for acquisitions after 2025 within 5 years of investment.

**Climate Solutions**

Target 2: A relevant goal or target for each fund (GP) or portfolio (LP) taking into account the sectoral profile of the fund or portfolio, to increase investment in climate solutions (% revenues or capex/AUM invested associated to climate solutions as defined by the EU Taxonomy or alternative relevant criteria such as the forthcoming UK taxonomy)

**Fund of Funds**

Target 3: Where investing in fund of funds, the GP or LP shall aim to ensure that as soon as possible and by 2030 at the latest to only invest with firms or fund managers who themselves are setting portfolio coverage targets and undertaking relevant actions set out in the Framework.

+ Reporting on emissions and solutions to enable incorporation of PE into portfolio-wide net zero emissions reduction and solutions targets
Key actions: LPs (selected)

- Incorporate PE exposure into NZ commitments
  - conduct target-setting / carbon portfolio assessments
  - deliver right metrics for asset allocation
  - and appropriate exclusion policies

- Establish carbon footprinting / climate risk mapping of the existing portfolio to prioritise GP engagement
  - institute investment committee sign-off to approve new funds and GP co-invests

- Future-proofing: ensure you build capacity and have internal training programmes in place
Key actions: LPs (selected)

☐ Include screening / exclusion policies in side letter terms
  o ensure assets not aligned with NZ pathways are not acquired
  o as well as overall GP compliance with TCFD recommendations

☐ Disclose carbon performance of assets / fund each year

☐ Adopt the portfolio coverage approach
  o both for measuring alignment and for setting targets to increase alignment through time

☐ Integrate commitments on climate performance / management into fund LPA agreements or side letters and committee consultation processes
Where a GP has not yet made commitments, LPs have the opportunity to engage on best practice and the adoption of KPIs relating to disclosure, target setting and governance

Incorporate climate performance and management into new fund development

Request information from the GP through DDQ or pitch book materials
  - to allow effective monitoring through the LPAC
No specific extra requirements for upsizing an existing investment if the fund’s strategy is Paris-aligned

- Given upsized exposure, LPs may want to independently underwrite NZ assumptions
- Where the portfolio company is not Paris aligned, the LP shouldn’t invest in companies that cannot meet an alignment pathway
  - LPs should seek representation on the board where possible
  - Ensure the LPA has the relevant alignment and reporting criteria
  - Coinvest with a majority shareholder meeting GP selection criteria and consistent with the LP’s own broader targets
  - The LP should seek out opportunities to make a positive allocation to climate solutions
Build capacity to understand, analyse and value climate risk to commercialise opportunities in the context of NZ pathways. Following this:
- Implement TCFD recommendations: scenario analysis and disclosures relating to climate risk
- Deliver climate literacy programmes for investment teams and portfolio company directors
- More broadly, be prepared to resource portfolio company’s Net Zero delivery
- Set a climate strategy for the fund including scenario analysis and disclosures

Develop Net Zero aligned terms for LPs and be open to side letter terms regarding Paris alignment / climate risk management
Key actions: GPs (selected)

- Implement screening and exclusion processes

- Conduct due diligence around climate scenario analysis to inform valuations, identify potential climate solution opportunities and exit strategies

- Include Net Zero / climate risk assessment in investor committee sign-off processes / memos

- Ensure shareholder agreements include terms pertinent to climate

- Consider including climate risk management KPIs in leverage for the deal
Key actions: GPs (selected)

- Support portfolio companies to establish a carbon footprint to set baselines for performance and targets
- Identify key decarbonisation levers as part of developing a portfolio company strategy:
  - include timelines for KPIs (e.g. for 100 day plans) and climate targets for Director remuneration
- Define governance / management responsibilities
- Set science based targets and implement disclosures by portfolio company
  - ideally allowing for the calculation of intensity metrics
The aim is that the portfolio company will be profitable in a Net Zero future.

And have the scope to align fully to Net Zero.

The GP can set out the value-added from climate initiatives undertaken in the holding period.
1. Do you agree with the proposed minimum criteria and thresholds for portfolio companies to be included in scope?

2. If not, what amendments to these thresholds do you propose?

3. Do you agree with the minimum criteria that at least 70% of aggregate portfolio companies’ NAV or emissions are included, rising to 90% by 2030?

4. Are the proposed alignment indicators, thresholds and additional recommendations relevant to assessing and ensuring alignment of portfolio companies to a net zero pathway, and measuring progress towards alignment?

5. Do you consider the proposed targets appropriate for GPs and LPs?

6. Do the recommended actions for GPs and LPs capture the key activities that should be undertaken to manage climate risk/opportunity, increase net zero alignment of portfolio companies and funds/portfolios, and to achieve net zero targets?

7. If you consider any actions listed as not relevant or a lower priority for supporting the transition to net zero, please list which these are and reasons for your assessment?

- Consultation is open until 27 February 2022
- Responses should be submitted online here
- Following the consultation the responses will be reviewed by the PAII network partners and IIGCC private equity working group.
- Relevant updates will be made to the components, and a final version of the Framework components will be published in Q2 2022
Download the PAII private equity guidance [here](#).

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