Private equity's contribution to achieving net zero

Why should PE firms set net-zero targets

IICI Member Roadmap

Executive Summary

Appendix

A Case for Net Zero in Private Equity

Produced in partnership with Indefi

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A gainst a background of geopolitical hostilities, a global pandemic, market volatility and raw material scarcities, there is a danger that a call to action on climate change will get lost in the noise of global events. However the climate issue is not going away. in fact, the opposite. According to the latest IPCC report, 3.3 billion people are already directly impacted by climate change, and GHG emissions are continuing to rise.

The situation is urgent and the time for resolute and effective climate action is now.

Finance plays a key role in the global economy and society, and thus is instrumental in the mission to preserve our planet’s future. Private Equity (PE) firms stand at the unique intersection of:

- capital deployment capacity
- influence on business strategies of investee companies
- comparatively longer-term holding periods
- agile portfolio companies that have the potential to shape their respective markets

PE firms can play a role in funding and supporting the transition to climate transformation among their portfolio companies.

Since the inception of Initiative Climat International (ICI), we have already seen concrete actions from committed PE investors. ICI also advocates for more collaboration amongst PE firms and sharing of learnings.

We are committed to supporting private equity firms to take effective climate action in the near term and ultimately to adopt a net-zero strategy.

This document is designed to support PE firms through a three-fold approach:

- Explain in simple terms what net zero means for the private equity industry
- Convince on rationale and urgency
- Chart a course by providing concrete guidance through a net-zero PE roadmap

We congratulate the PE investors who have already shown leadership by making net-zero commitments and encourage others to assess the merits of doing so.

This guidance is aimed at private equity CEOs, managing partners and their ESG practitioners. Its objectives are to explain the concept of net zero and encourage ambition from the most senior levels of private equity. This is based on three drivers:

- Net zero is a demanding approach, which requires a comprehensive knowledge of external and internal factors influencing companies’ activities, and relies on strategic decisions
- Achieving net zero is a continuous and iterative process
- The net-zero trajectory is a leadership concern, directly implicating C-level executives in PE firms

ICI intends to release further guidance on the application of net zero to private equity; our objective is to support ICI members to adopt a net-zero strategy and to encourage a consistent approach towards net zero within private equity.
ACKNOWLEDGEMENTS

This guide does not substitute existing literature or technical guidance for a comprehensive understanding of climate action instruments for private equity (see Appendix A). The ICI intends to release further publications on net zero to provide its members with guidance and training.

The ICI Net Zero Working Group was established to provide guidance on net zero and science-based commitments for the benefit of ICI signatories. In partnership with consultancy firm Indefi, we have developed this guidance as the first in a series of publications intended to support the development of net-zero strategies within private equity.

About the Initiative Climat International
The Initiative Climat International (ICI) is a global, practitioner-led community of private equity firms and investors that seek to better understand and manage the risks associated with climate change. The ICI was originally launched as the IC20 (Initiative Climat 2020) in 2015 by a group of French private equity firms to contribute to achieving the Paris Agreement’s objectives. The ICI has since expanded internationally and now counts more than 232 firms representing over US$3.2 trillion in AUM, as of October 2022. Please see the full list of ICI members at the end of this document (Appendix C).

ICI’s members share a commitment to reduce carbon emissions of private equity-backed companies and secure sustainable investment performance by recognising and incorporating the materiality of climate risk. In practice, this implies a commitment to effectively analyse and manage climate-related financial risk and greenhouse gas (GHG) emissions in their private equity portfolios, in line with the recommendations of the Financial Stability Board’s Taskforce for Climate-related Financial Disclosure (TCFD). Members commit to sharing knowledge, experience and best practice, working together to develop resources that will help standardise practices across the industry. The ICI is supported by the Principles for Responsible Investment, is a Supporting Partner of The Investor Agenda, and is open to all private markets firms and investors to join.

About INDEFI
Indefi is a leading strategy advisor for the global investment management business. Established in 2007, Indefi helps asset managers shape their business strategies and build a sustainable competitive advantage. The firm’s expertise spans public and private markets, including infrastructure, private credit and equity, and real estate. A PRI signatory, INDEFI also advises asset managers in developing and implementing differentiated ESG and Sustainability strategies. For more information, please visit www.indefi.com.

Indefi authors:
Emmanuel Parmentier • Clemence Laurencel with the support of Imène Mahrazi

ICI Net Zero Working Group:
Alvar De Wolff, Bregal Investments (Co-Chair) • Josepha Montana, Turenne Capital (Co-Chair) • Serge Younes, Investindustrial (Co-Chair)

Adam Black, Coller Capital • Adinah Shackleton, Permira • Albina Stukalkina, IK Partners • Alexandre Murillo, Eurazeo • Allegra Day, Cinven • Anna Karin Portunato, Argos • Caroline Lofgren, Hg • Chloe Sanders, CVC • Christoph Lueneburger, Towerbrook • Edward Brenninkmeijer, Bregal • Eimear Palmer, Pantheon (formerly ICG) • Ellen De Kraij, Apax • Eva Vogt, EMK Capital • Graeme Aruds, Triton Partners • Ivo Dimov, ICG • Jennifer Flood, Investindustrial • Jennifer Signori, Neuberger Berman • Jessica Peters, Argos • Josie Davis, Coller Capital • Jovana Stopic, IK Partners • Leopoldine Meauze, Bregal • Nathalie Medawar, Astorg • Nicolas Theis, Bregal • Nandini Hampole, Bregal • Nomsa Fulbrook-Bhembe, Permira • Manique Narberg, Permira • Rebecca Svensson, FSN Capital • Simon Guichard, Argos • Thomas Carlier, Investindustrial (formerly PAI Partners) • Viviana Occhionorelli, Astorg.

During this process, the ICI Net Zero Working Group and Indefi engaged with the following representatives of key industry bodies and advisors:
• Peter Dunbar and Jack Baldson, UN PRI
• Peter Ellsworth and Kelly Odion from Ceres
• Raphaëlle Lahaye, CDP
• Howard Shih, WRI, on behalf of SBTi
• Tim Clare and Myles Tatlock, Anthesis

The Working Group would like to thank these representatives as well as the numerous ICI members and members of the ICI SteerCo who have reviewed this document, with particular thanks to Elizabeth Seeger, International Sustainability Standards Board (formerly KKR), Lee Coker, DigitalBridge and Natasha Buckley, HarbourVest Partners.

The design of this guidance document was kindly sponsored by Investindustrial.

Published November 2022.
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Private equity’s contribution to achieving net zero

Why should PE firms set net-zero targets

Executive Summary

Appendix
EXECUTIVE SUMMARY

What is Net Zero?
Net zero reflects a common commitment to tackle climate change in line with a maximum temperature rise of 1.5°C above pre-industrial levels as defined by the IPCC. The IPCC was created to provide policymakers with scientific assessments on climate change, its implications and potential future risks. This requires financial system actors to support action to reduce emissions that drive global heating and to finance the transition to zero-emissions energy systems.

Referring to the world as a whole, the IPCC defines net zero as when anthropogenic GHG emissions are balanced by anthropogenic removals over a specified period. The common ambition is to achieve net zero at global level by 2050 or earlier.

If this goal is not achieved, there is an expectation that investors and humanity in general will see worsening climate impacts and an economically destructive and disorderly transition towards reduced emissions and greater climate stability beyond the 2050 target date.

How to reach net zero at global level?
Net zero will be achieved primarily by reducing GHG emissions. Effective transition will require strong policy, public and private partnerships and international cooperation. Emissions that cannot feasibly be reduced could be addressed through carbon capture solutions (natural or technological). The Oxford Principles for Net Zero Aligned Carbon Offsetting (the “Oxford Offsetting Principles”) provide guidelines to ensure offsetting helps achieve a net-zero society.
Indeed, carbon offsetting, if performed effectively, can contribute to net-zero strategies. Companies of all sizes and sectors bear responsibility for climate change and the breach of planetary boundaries. They can now be part of the solution, if they act swiftly and with intention.

The net zero target can only be achieved at global level with consistent action over the long term. No individual firm or country can meet this challenge on its own. The financial services industry will play a critical role in supporting corporate decarbonisation goals and scaling innovative climate solutions.

Combining financial means and an ability to take action and influence businesses practices, private equity firms are uniquely positioned to trigger effective and timely change.

A net-zero trajectory entails challenging strategic, financial and executive decisions for which private equity firms are particularly well equipped. This is due to their status as responsible shareholders and thanks to their relationships with portfolio companies and Limited Partners (LPs), which increasingly have their own net zero objectives.

As a PE leader, setting net-zero targets is a decisive and ambitious action, supported by rational business drivers that include:
- evidence-based scientific consensus;
- regulatory developments;
- public opinion and consumer trends;
- first mover advantage;
- increasing cost of inaction;
- competitive pressure;
- financial upside from an orderly transition;
- PE investor (LP) preferences and capital allocations in the mid-long term.

The PRI has commissioned forecasting work aiming to prepare institutional investors for a rapid acceleration of policy responses to climate change, and its associated risks and opportunities. See the PRI Inevitable Policy Response.

There is strong support for net zero across the financial sector, but the number of private equity firms making public commitments remains low. From surveying iCI members, this does not reflect a lack of ambition but rather confusion over application to private equity, relevance to investment strategies, and what public commitments may require in terms of resource and reporting.

So how can private equity investors get started?
This guide introduces iCI’s new signatory roadmap. It builds on existing recommendations and encourages iCI members to commit to aligning with a net-zero trajectory and contributing to a low carbon economy.

The iCI will follow up with further guidance on the application of net zero.

1 IPCC, SR 15, Summary for policy makers
2 Race to Zero Lexicon
3 As per the UNFCC Conference of the Parties (COP)
4 unpri.org/sustainability-issues/climate-change/inevitable-policy-response
Section 1

Private equity’s contribution to achieving net zero
SECTION 1: PRIVATE EQUITY’S CONTRIBUTION TO ACHIEVING NET ZERO

In a nutshell

- Net zero reflects the common commitment to tackle climate change in line with a maximum temperature rise of 1.5°C above pre-industrial levels as defined by the IPCC.
- Referring to the world as a whole, the IPCC defines net zero as when anthropogenic emissions of GHG that cause global warming are balanced by anthropogenic removals over a specified period. The common ambition is to achieve net zero at global level by 2050 or earlier.
- Companies of all sizes and sectors bear responsibility over the past century for climate change and the breaching of planetary boundaries; together with limited government policy and consumer responsibility. They can now be part of the solution, if they act swiftly and with intention.
- Combining financial means, agency and opportunities, private equity firms are uniquely positioned to trigger effective and timely change, particularly across the SME sector.

Laying the foundations:
climate change is a complex topic with some key dynamics to keep in mind

This guide does not seek to summarise everything business leaders need to know on climate change. Instead, the analysis highlights key dynamics to consider when discussing net zero and associated action plans. Please refer to the IPCC’s latest report for a more comprehensive description of the scientific consensus.

In the investment context, climate change actions are discussed with a focus on GHG emissions. However, before delving into carbon reduction strategies and emissions reduction pathways, additional context is required.

Climate change is one of the major challenges facing humankind, but is not the only one.

Earth operates under a certain set of conditions for life to thrive. The conditions may vary slightly within limits, called planetary boundaries. Out of a total of nine planetary boundaries within which humanity can continue to develop and thrive, four have been breached: biodiversity loss, land-system change, altered biogeochemical cycles, and climate change. Transgressing these boundaries increases the risk of large-scale, abrupt or irreversible climatic changes, with effects ranging from large economic system collapse to proliferation of diseases and deterioration of human wellbeing.

Companies and governments can now be part of the solution, if they act swiftly and with intention.

---

5 IPCC, SR15, Summary for policy makers
6 Race to Zero Lexicon
7 AR6 Climate Change 2021: The Physical Science Basis
8 Stockholm Resilience Centre [https://www.stockholmresilience.org/research/planetary-boundaries.html]
9 UNFCCC
Net zero: an imperative transformation to effectively reduce GHG emissions

The IPCC Working Group’s latest report shows that the world will probably reach or exceed 1.5°C of warming within the next two decades (see graph below)⁶. The forecasts under a high-emissions scenario (more or less equivalent to business as usual), lead to a 4.4°C increase by 2100 — with catastrophic consequences. Given the lagged effects (time between action taken and observed results), the window for decisive action is narrowing, with action needed in the coming years rather than decades.

Global warming relative to 1850-1900 (°C)

**A CASE FOR NET ZERO IN PRIVATE EQUITY**

### Section 1

Leaders at all levels (policy makers, corporates and investors) are responding to scientists’ call to action and have defined a global objective: Achieve net-zero global emissions by 2050 or sooner.

Net zero reflects a shared commitment to tackle climate change in line with a maximum temperature rise of 1.5°C above pre-industrial levels as defined by the IPCC. The term ‘net zero’ refers to the ambition to reduce GHG emissions that cause global warming to net zero. This balance must be achieved by the middle of the century to meet the 2°C or 1.5°C objectives and stabilise temperatures. It can be achieved by:
- minimising emissions released in the atmosphere;
- removing emissions by expanding carbon sinks.

Scientists stress the need to focus on reducing emissions as a primary way to move towards the net-zero target. Net zero requires significant abatement of GHG emissions across all sectors. Beyond carbon capture solutions, many investors are incorporating emissions offset instruments into their net-zero strategies, while seeking to ensure the integrity of these instruments. For sectors where emission cuts are unlikely to be reduced to zero on the timescale required to meet the Paris Agreement temperature targets (e.g., cement, aviation), the residual emissions will need to be offset by sectors such as land use and power, which have the potential to deploy GHG removal technologies.

- Criticism that using offset measures is a decoy to cover climate inaction is more acute by the day, and public pressure / NGOs are becoming vocal on what is considered by many as a ‘licence to pollute’.
- As per the Oxford Principles, carbon offsetting can contribute to net-zero strategies, especially in hard-to-decarbonise sectors such as aviation and agriculture, but only when companies have first prioritised emissions reductions (first principle)⁷

**Global warming relative to 1850-1900 (°C)**

**Estimated anthropogenic warming to date and likely range**

- Faster CO2 reductions (blue in b,c,d) result in a higher probability of limiting warming to 1.5°C
- No reduction of net non-CO2 radiative forcing (purple in a) results in a lower probability of limiting warming to 1.5°C

**Observed global temperature change and modelled responses to stylised anthropogenic emission and forcing pathways (IPCC’s Special Report on Global Warming of 1.5°C)**


⁷ The Oxford Principles for Net zero Aligned Carbon Offsetting
Why focus on private equity firms?

Almost 90% of global emissions and GDP are currently covered by net-zero commitments. As of November 2023, this includes 450 financial institutions from 45 countries. However, the number of private equity firms committing to net zero has remained low: 12 PE firms had validated SBTi targets as of November 2022, and a similar number of firms were members of the Net Zero Asset Managers Initiative. Private equity typically invests in companies at a critical point in their lifecycle, and can play a key role in helping companies to reduce their emissions as part of a sustainable growth strategy.

Companies of all sizes and sectors bear responsibility for climate change and the breach of planetary boundaries. They can now be part of the solution, if they act swiftly and with intention.

The private equity market saw its size tripled from $2 trillion to over $6 trillion in the past decade. Harnessing financial means, agency and opportunities, it is uniquely positioned to trigger effective and timely change. This requires leadership, capacity and accountability from the most senior levels of private equity firms.

Companies that commit to net-zero trajectories are more likely to attract higher valuations at exit or at least will provide a hedge against a climate valuation cut. The portfolio company will likely have better exit feasibility since the potential buyer group will have increasingly made climate commitments. In addition, most asset owners (e.g., family offices, pension funds) are set up to operate over decades and wish to engage in long-term relationships with GPs.

SECTION 1B: INVESTORS ARE ALREADY TAKING ACTION

The net-zero timeframe to obtain tangible results is 10 years or less, twice the investment period of a typical fund. This means that net-zero inaction may harm a GP's ability to raise money for the next vehicle, and most likely for the following one. It then becomes a question of the durability of the GP itself and a conversation to start with stakeholders. A portfolio company that has contributed to net zero (or is clearly on a science-based path towards net zero) is likely to attract a higher valuation at exit, or at least will provide a hedge against a climate valuation cut.

Various investors initiatives have flourished

Many initiatives encourage net-zero commitments in the financial industry. ICI seeks to work with and enhance some of the following initiatives (non-exhaustive – further details can be found in appendix):

- Principles for Responsible Investing Initiative hosting ICI
- Ceres Partner to ICI North America network
- CDP Worldwide ICI Partner
- Science-Based Target initiative Private equity guidance published in partnership with ICI
- Sustainable Markets Initiative Private Equity CEO Taskforce (PESMIT)
- Glasgow Financial Alliance for Net Zero (GFANZ)
- The Net Zero Asset Managers Initiative (NZAM)
- UN-convened Net Zero Asset Owner Alliance (NZAO)
- Paris Aligned Investment Initiative (PAII)

Despite these initiatives, net zero is a relatively new concept and different parties are defining the terms for corporates and financial sector actors.
Section 2

A deeper dive on why PE firms should set net-zero targets
SECTION 2: A DEEPER DIVE ON WHY PE FIRMS SHOULD SET NET-ZERO TARGETS

In a nutshell

This section describes why PE investors should act, answers their most common concerns at GP level and describes how to drive action with companies.

As a PE leader, setting net-zero targets is a rational choice which require decisive business decision based on the below:

• evidence-based scientific consensus;
• regulatory developments;
• public opinion and consumer trends;
• first mover advantage;
• increasing cost of inaction;
• competitive pressure;
• financial upsides from an orderly transition;
• PE investor (LPs) preferences and capital allocations in the mid-long term.

A commitment to net zero is a business decision and may have significant implications on strategies, governance, resource use, financing and profit allocation, innovation, company culture and management, both at GP and portfolio companies and in the short and long terms. Ultimately climate risk is an investment risk and may have significant impact on valuations.

2. A WHY SHOULD PRIVATE EQUITY INVESTORS ACT?

01 PURPOSE
To actively engage
as a responsible investor and contribute
to the global fight against climate change

02 VALUE CREATION
To support
business leaders and seize the opportunities
arising from a green revolution

03 REGULATION
To comply
with commitments made by countries, cities and local communities on long term targets as per the Paris Agreement and upcoming regulations

04 REPUTATION
To meet expectations
of LPs civil society, and protect investor reputation among stakeholders by adopting a “doing our best” approach
Executive Summary

A CASE FOR NET ZERO IN PRIVATE EQUITY

SECTION 2A: WHY SHOULD PRIVATE EQUITY INVESTORS ACT?

Positive factors to inspire PE leaders to take resolute and immediate action:

01 PURPOSE

Actively engage as a responsible investor

Taking the first step may seem a distraction from business priorities or even from investment mandates. However, investors cannot afford to keep on questioning the reality or the magnitude of the threat climate change poses. The most prominent scientific research is definitive on: • the responsibility of human activities on climate change; • the entangled effects of climate change with biodiversity loss and other planetary factors; and • the difference between “adaptive” and “maladaptive” measures.

LPs and GPs that have adopted a “responsible investment strategy” and integrated environmental, social and governance factors into their investment strategies (ESG) are already ideally positioned, with an investment thesis that naturally aligns with a net-zero commitment. Stakeholders, employees and customers in all organisations want to establish a sense of purpose. The associated benefits are more and more tangible: higher market share, customer satisfaction, employee retention and trust.

Private equity firms would benefit from a clear commitment to drive positive change and spearhead the climate movement.

02 VALUE CREATION

Support business leaders and seize opportunities

The World Economic Forum’s (WEF) Global Risks Report 2022 ranks climate crisis as the top global risk for the third year in a row. The business opportunity that comes with the low-carbon energy transition is clear:

• Create greener, more sustainable jobs
• Drive the innovation required to address climate change and climate adaptation
• Deliver enduring economic growth
• Build a more resilient society

Companies lagging are likely to face pressure from regulators, shareholders, customers, NGOs and other stakeholders:

i. Companies with a well-articulated long-term strategy and a clear plan to address the transition to net zero will stand out by inspiring confidence that they can navigate the global transition.

ii. Companies that do not quickly prepare themselves risk seeing their businesses and valuations suffer. Stakeholders may question the capacity of these companies to adapt their business models, strategies and operations in a timely and cost-effective manner, leading to growing concerns on their valuations in the mid-long term.

At the heart of any private equity firm is the mandate to deliver superior risk-adjusted returns. To this end, the case for net zero is strong in that it can help deliver improved financial performance through the following levers:

i. Measurement and reporting: Reliable measurement of GHG emissions allows the company and the GP to understand the primary areas of emissions and will influence the ability of an organisation to make the right strategic and operational choices in the short and long terms.

ii. Risk management: Understanding physical and transitional climate risks and opportunities is a tangible example of good governance translated into strategic decisions. Addressing climate risks may also mitigate other operational or financial risks. For instance, insurance companies increasingly rely on climate modeling to estimate potential liabilities from climate-related events by 2030 and 2050. There are consequences in terms of insurance premiums, climate mitigation costs and fund allocations.

iii. Carbon pricing: External and internal carbon pricing is moving beyond carbon-intensive industries. Some carbon markets have recently seen significant price increases. Both voluntary and regulated emissions are becoming more substantial as a percentage of operating costs, and while some industries have been able to transfer a percentage of operating costs, and while some industries have been able to transfer these costs to the end consumer, this is unlikely to continue going forward.

iv. Lower cost of capital: Asset owners will increasingly be wary of capital allocations, taking into account their indirect GHG emissions across all their investments—listed and unlisted. In this respect, strategic management of climate risks/opportunities and GHG emissions may be an opportunity to attract ESG-type ratchets, linking ESG/carbon outcomes to the cost of debt. These ratchets can be in the form of both bonuses and malus, based on achieving or missing ESG or carbon related targets (e.g., European green bonds, sustainability-linked loans).

v. Valuation: The effect on future valuations of carbon intensive portfolios seems obvious in the mid-to-long term. A poorly performing company already pays an “ESG tax”, with corrective investments deducted from valuations. For instance, brown discounting is becoming more and more noticeable in today’s European real estate industry, where green-labelled buildings tend to achieve higher financial returns. However, the financial premium for reducing GHG emissions and climate risks is yet to be widely proven, at least in a timeframe compatible with IRR optimization (impact of transformative capex on cash flows).

vi. Improved LP engagement and fundraising potential: As a consequence of growing asset owner concern over climate risks, GPs committing to net zero may have access to a larger pool of asset owners, and experience more stable investor relationships over the long term. Most GPs have a diversified mix of institutional investors (different profiles, commercial needs, stakeholder pressures, and geographically-based requirements). As such, it is important for GPs to understand the variables and commitments beyond return profiles that drive investor decisions.

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*As per the IPCC, maladaptation refers to actions that may lead to increased risk of adverse climate-related outcomes (e.g., increased GHG emissions, increased vulnerability to climate change, more inequitable outcomes, now or in the future). Most often, maladaptation is an unintended consequence.

**SECTION 2A: WHY SHOULD PRIVATE EQUITY INVESTORS ACT?**

Expenses and investments will be required. However, the cost of inaction gets higher by the day. Climate action will protect company valuations when taken early:

- During the holding period, climate action may reduce the cost of energy or provide opportunities for increasing sales of low-carbon products.
- At exit, whether through an IPO, sponsor or strategic buyer, the buyer will come under even more pressure to meet GHG emissions commitments. As such, will the buyer pay full value for a company which, by the middle of this decade, has not shown substantial progress on these issues? Most likely the buyer will discount the business accordingly. Designing and executing a clear plan will put the portfolio company in a better position to negotiate climate consequences with future buyer. Moreover, PE firms are usually in a strong position to convince their clients of the validity of their climate action. ICI acknowledges this topic potentially implies the need to discuss the investment mandate, as business conditions are changing fast. LPs and asset owners are increasingly making their own commitments (to tackle climate change, biodiversity, etc). Facilitate adaptation measures, preserve natural assets, etc.

A GP has sufficient influence and time to enact meaningful action on climate change at portfolio company level:

- Private equity’s traditional growth and buyout funds generally invest with a goal to exit within a ten-year fund lifecycle, resulting in an average target holding period of three to seven years.
- With the emergence of longer-term funds, also referred to as patient capital, the holding periods of portfolio companies are potentially even longer.
- These timelines align with setting science-based targets and laying adequate foundations for long-term net-zero ambitions.

As shareholders, GPs have a key role to play:

- whenever they influence strategy and appoint/engage with management teams;
- whenever they prioritise capital flows towards the most climate-resilient companies;
- whenever they shape investment theses and capital flows in favour of solution-providing companies (to tackle climate change, facilitate adaptation measures, preserve biodiversity, etc).

**Regulations**

Comply with international actions

Since the signing of the Paris Agreement, countries have been forced into action, spurred on by their nationally determined contributions (NDC). In 2019, the United Kingdom became the first major economy to legislate for net zero, changing the long-term target in the Climate Change Act of 2008 to net zero by 2050. As of January 2022, the Energy and Climate Intelligence Unit’s ‘Net Zero Tracker’ shows that fourteen other countries had passed net-zero legislation. Additional climate-related disclosure standards are being implemented in the EU (Taxonomy, SFDR, CSRD), the UK (TCFD) and the US (New Climate Disclosure Requirements).

As with many social or environmental topics in recent decades, business acumen and cautious governance encourage PE firms to adopt corrective actions before stricter regulation comes into force. Rationales include:

- cost effectiveness;
- branding and trust (first-mover advantage, goodwill, social climate inside the company and with stakeholders); and
- the benefit of choosing the most meaningful path given the company’s strategy, and not one imposed from outside.

**Repuation**

Meet expectations of LPs and civil society

Whilst the benefits of intangible assets, such as reputation or branding, may be hard to quantify, the damage to business and loss of value from negative press or damaging business practices is irrefutable.

For businesses, failure to act comes with unique reputational and substantial financial risks. Reputational risk does not only affect those involved in fossil fuel production or deforestation. Any business with a public profile should expect to be held accountable for its impact on the environment. Financial actors, including private equity, should heed these warnings and take action to support their portfolio companies. In Reptra’s 2020 Global Trends in Reputation study, businesses leaders cited climate change as a top-five priority. With consumers increasingly looking to support businesses that prioritise climate change, companies cannot afford to ignore their concerns. Doing so would mean putting their reputations, brands and bottom lines in jeopardy.

Civil society, whether private citizens or NGOs, is putting increasing pressure on governments and businesses to take responsibility for climate issues and to act. Direct shareholder engagement and public demonstrations have been potent forces to improve companies’ disclosures. Furthermore, investors are becoming more aware of the inherent risks of poor ESG management (human rights issues in the supply chain, damage to real assets caused by climate change) as well as the potential long-term benefits of a low-carbon economy. As such, they demand transparency on the management of ESG issues to make better-informed decisions.

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\(^1\) See World Economic Forum guide Winning the race to net zero

\(^2\) Nationally Determined Contribution as per the Paris Agreement

\(^3\) https://ec.europa.eu/nature/trackr

\(^4\)https://www.riprstk.com/blog/2020-global-trends-in-reputation/
## SECTION 2: A DEEPER DIVE ON WHY PE FIRMS SHOULD SET NET-ZERO TARGETS

### 2.8 DRIVING ACTION WITH PORTFOLIO COMPANIES

This section stems from our discussions with our industry peers and is intended to provide grounds for candid conversations.

### 01 GROWTH COMPATIBILITY

“How can I build a GHG emission reduction strategy that is compatible with production growth and external acquisitions?”

**02 FEASIBILITY**

“How can I assess and influence my Scope 3 emissions?”

**03 IMPACT**

“Is climate change relevant to my company?”

“How can I assess and influence my Scope 3 emissions?”

**04 COSTS & RESOURCE RESTRAINTS**

“What is the cost of addressing climate issues?”

“Does my company have the capacity to make this a top priority?”

**05 INFLUENCE**

“As private equity firm, how do we get the leverage to achieve net-zero outcomes?”

---

**01 GROWTH COMPATIBILITY**

“How can I build a GHG emission reduction strategy that is compatible with production growth and external acquisitions?”

Usually, reduction opportunities lie in accessible and/or cost-effective actions (e.g., energy audits, smart meters, more efficient machinery/equipment). By implementing these solutions, companies will both reduce their energy and associated costs, as well as their GHG emissions intensity. Furthermore, by moving to more onsite energy solutions, a business locks-in a secure supply of energy at a stable price.

It is important to look outside the company and understand:

1. What is the competition doing?
2. What are the consumer trends (if B2C)?
3. What type of commitments are customers making (if B2B)?
4. How will not acting impact the company’s reputation?

Managing for net zero encourages a company to rethink its business models and to innovate. This can lead to new business opportunities. It is not a matter of reducing production but thinking about how production can operate going forward.

Setting a net-zero strategy should not prevent a company from conducting external acquisitions, including of less mature companies. On the contrary, acquiring a less advanced competitor is an opportunity to accelerate the transition of the acquired company. Baseline and CO2 trajectories should be updated to reflect the new perimeter.

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**02 FEASIBILITY**

“How can I assess and influence my Scope 3 emissions?”

Scope 3 usually represents more than 80% of a company’s GHG emissions and the GHG Protocol states that companies must account for those emissions. Monitoring Scope 3 emissions also means better understanding and influencing the supply chain, bringing risk management benefits and future-proofing the business model. Starter questions can be:

1. Who are the suppliers?
2. Who are the most material suppliers based on carbon footprints and/or spend?
3. What are the suppliers doing and how are they managing risks?
4. Is the business unknowingly exposed to social or environmental risks in the supply chain?
5. How are the final products used and what is the footprint associated with that use?

Despite the fact that Scope 3 emissions may seem out of the control of the company, businesses are now starting to be held accountable for these emissions. In fact, in a recent landmark case, a court in The Hague ordered Royal Dutch Shell to cut its GHG emissions and ruled that the company is responsible for the emissions of its customers and suppliers. SME businesses that may not have enough influence on their suppliers to drive change are encouraged to adopt a collaborative approach with their peers in the sector.

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Executive Summary

Companies are already starting to realise some benefits from tackling climate issues and growing the top line? Companies should provide investors with comfort that operational climate issues are being measured, managed and mitigated beyond any product or service impact. If the claim is backed by sufficient evidence, the concern may become an investment opportunity.

Is there any benefit from tackling climate change now?

Companies are already starting to realise some of the early benefits from tackling climate issues through advantageous financing opportunities such as green bonds or ESG-linked financing facilities, and through reduced insurance premiums.

Can I consider that our [Product or Service] more than offsets our impact on the climate?

This kind of statement may be considered a form of greenwashing and potentially a harmful communication claim. Is there an opportunity being missed to bolster climate credentials and grow the top line? Companies should provide investors with comfort that operational climate issues are being measured, managed and mitigated beyond any product or service impact. If the claim is backed by sufficient evidence, the concern may become an investment opportunity.

Does my company have the capacity to make this a top priority?

Except perhaps for companies struggling for their survival in the next 12–24 months, it is hard to imagine that climate issues would not be a top priority. From an energy price surge to public opinion and customer demands, climate pressure comes in many shapes and forms, possibly as a “climate-razor” to make choices for the future.

To open the discussion on priorities in an informed way:

- What is the competition doing?
- What are the consumer trends (if B2C)? What type of commitments are customers making (if B2B)?
- What is happening in the regulatory space? How will this impact the business now or in the near future?
- How will not acting immediately on this impact the company’s strategy / reputation / future cash flows / business operations / employee morale / branding?

In terms of having the capacity to lead this initiative internally:

- Does the business have a strategy that is widely shared within the organisation? If yes, does this strategy consider climate risks?
- What parts of the business will be affected in the short and mid-term? What would teams need to execute a climate-ambitious plan?
- How do other operators in the sector / area organise their responses?
- Would a partnership, a shared set of resources or a common knowledge and operational hub be possible?
- The starting point of a net-zero strategy is a carbon footprint assessment, which can easily be conducted internally or outsourced at a reasonable cost, even for small companies.

As a private equity firm, how do we get the leverage to achieve net-zero outcomes?

The private equity model is well adapted to contributing to net-zero outcomes, given the GP-portfolio company relationship. For majority deals, a GP can work with the portfolio company to create a clear path to net zero. Even in the absence of control, the nature of the relationship should at least allow for a dialogue and for more concrete steps.

While certain mandates do provide more visibility over assets, or more influence to effect change, we find all private equity sub-asset classes (e.g., VC) are under growing pressure to adopt a formal position. All investment strategies have a role in ‘integrating ESG into their investment processes’, albeit commensurate with the limitations inherent to a particular mandate. In addition, regulators are not very discerning about types of investment strategy and tend to view the asset management industry collectively.
Section 3

iCI Member Roadmap
SECTION 3: iCI MEMBER ROADMAP

In a nutshell
iCI has developed a net-zero roadmap for its members, aligning with the recommendations of standard setters. This provides clear milestones for GPs and makes two clear points:
- Portfolio company engagement is a core component to a private equity net-zero strategy
- A net-zero strategy requires continual reinforcement

Introducing a new signatory roadmap
iCI’s members share a commitment to reduce carbon emissions of private equity-backed companies and secure sustainable investment performance by recognising and incorporating the materiality of climate risk.

The iCI aims to help GPs understand and act on climate-related issues by enabling active collaboration, bringing together members at different levels of experience and pooling their expertise. Members commit to sharing knowledge, experience and best practice, working together to develop resources that will help standardise practices across the industry.

iCI members are at different starting points, but in joining the iCI all members commit to accelerate their efforts and produce more effective outcomes.

In line with private equity investor net-zero ambitions, and through consensus, the iCI has developed its roadmap for members to chart actionable milestones in a net-zero strategy.

To summarise the ethos behind the roadmap, iCI has chosen two spatial directions:

Ascending:
Phase 1: COMMIT AND LEARN
The iCI allows for progress by providing resources and practice sharing, with a general push for deeper, more transformational action.

Circular:
Phase 2: ENGAGE
The climate challenge will last decades. There will be unexpected effects, so initially-clear targets will need to be revisited, reshaped or abandoned. GPs should not expect a linear or static roadmap.

Section 1
Why should PE firms set net-zero targets

Section 3
Appendix
SECTION 3: ICI MEMBER ROADMAP

A new roadmap to move towards a net-zero trajectory

PHASE 1: COMMIT AND LEARN

ONBOARDING

01

Align climate awareness within the asset management firm

Join the ICI International and commit to concerted action on climate change
Educate and train investment teams on net-zero
- Raise awareness on net-zero concepts and the management of risks and opportunities with climate change
- Leverage the resources developed by the ICI to raise climate awareness through training

DEFINE STRATEGY

02

Implement appropriate governance of climate issues

Define a climate strategy at the asset management company level, referring to the global goal of reaching net zero in 2050 or before
Define governance on climate-related issues, as per SBTi guidance for private equity
- Board oversight on climate action
- Define responsibilities at management level

ASSESS RISK

03

Identify how climate considerations can affect portfolio holdings

Assess risks of climate change at portfolio level
- Conduct materiality analysis on portfolio companies to identify climate risks and opportunities exposure both in the short term and medium-long term (net zero 2050 scenario)
- Define key climate performance indicators for each portfolio company (e.g. energy consumption)
- Identify portfolio companies with the highest exposure and conduct in-depth analyses

Measure GHG emissions
- Support portfolio companies to measure Scope 1, 2 and 3 emissions
- Measure carbon footprint of the asset management company

Refer to the ICI standard on GHG accounting and reporting for the private equity sector for detailed guidance on how emissions are calculated and disclosed, as per SBTi guidelines.
SECTION 3: ICI MEMBER ROADMAP

Support portfolio companies in their trajectory towards net zero and contribution to a low-carbon economy. Progressively raise ambitions.

PHASE 2: ENGAGE

4.1 Set Targets
- Set targets on emissions reduction with portfolio companies to contribute to net zero
  - Set near-term science-based targets in line with a 1.5°C / net zero 2050 scenario and validate them with a third party
  - Set targets at asset management company and fund level

4.2 Measure Progress
- Support the achievement of climate portfolio company action plans and measure progress on climate-related topics (climate risks and opportunities, emissions reduction)
  - Define action plans to take action on short-, medium- or long-term climate risks or opportunities (physical and transitional)
  - Track the progress of emissions reduction plans and associated KPIs
  - Discuss with portfolio companies potential offsetting of their emissions that cannot be reduced

4.3 Disclose Outcomes
- Communicate externally on targets and results via recognised disclosure frameworks
  - At firm level: Disclose carbon footprint reduction and progress towards targets
  - At portfolio level: Disclose the share (%) of AuM having defined a roadmap towards net zero, validated by an external party
  - At portfolio level: Disclose the amount invested in thermal coal and fossil fuels

4.4 Raise Ambitions
- Raise ambitions by periodically reviewing targets and enhancing commitments at portfolio level
  - Update methodologies and targets on a regular basis, in line with the progress of scientific knowledge (moving targets)
Appendix
### List of climate initiatives led by investors (non-exhaustive)

For further details on climate initiatives, refer to the iCI guidance on GHG Accounting and Reporting for the Private Equity sector.

<table>
<thead>
<tr>
<th>Initiative</th>
<th>Purpose</th>
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<tr>
<td><strong>Ceres</strong></td>
<td>Initiative partnered with iCI&lt;br&gt;The non-profit organisation aims to transform the economy to build a just and sustainable future for people and the planet. Founded in 1989 by a group of forward-looking socially responsible investors and environmentalists, the group has steadily grown in prominence and influence. &lt;br&gt;+200 institutional investors&lt;br&gt;+$47 trillion in AuM&lt;br&gt;Ceres is building a zero-emissions economy by driving greater corporate ambition, transparency and accountability for aggressive reductions in greenhouse gas emissions. Ceres Ambition 2030 is designed to meet the urgency of this moment.</td>
</tr>
<tr>
<td><strong>The Principle for Responsible Investment (PRI)</strong></td>
<td>Private equity guidance published in partnership with iCI&lt;br&gt;A UN-supported world’s leading initiative on responsible investment. The PRI has over 4,000 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US $30 trillion in assets under management.&lt;br&gt;The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of ESG issues and to support signatories in integrating those issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.</td>
</tr>
<tr>
<td><strong>The Science-Based Target Initiative (SBTI)</strong></td>
<td>Private equity guidance published in partnership with iCI&lt;br&gt;The initiative founded by the CDP, United Nation Global Compact World Resources Institute (WRI) and World Wide Fund for Nature (WWF) aims to mobilise the private sector to take the lead on urgent climate action.&lt;br&gt;2,634 companies taking action&lt;br&gt;126 with science-based targets&lt;br&gt;SBTI published guidance for the private equity sector, providing clear target-setting requirements on PE direct investments in buyout, growth and venture capital strategies. Also, to ensure PE firms collectively address this most material asset class and accelerate the G4 emissions calculation and target setting practices of private companies.</td>
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<tr>
<td><strong>Climate Action 100+</strong></td>
<td>Climate Action 100+ is an investor-led initiative to ensure the world’s largest corporate greenhouse gas emitters take action on climate change.&lt;br&gt;570 investors&lt;br&gt;+$54 trillion in AuM&lt;br&gt;The Climate Action 100+ Net Zero Company Benchmark assesses the world’s largest corporate greenhouse gas emitters on their progress in the transition to a net-zero future.</td>
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<tr>
<td><strong>The Glasgow Financial Alliance for Net Zero (GFANZ)</strong></td>
<td>Launched in April 2023 by Mark Carney, UN Special Envoy for Climate Action and Finance, the UK’s Finance Advisor for COP26, the COP26 Private Finance Hub in partnership with the UNFCCC Climate Action Champions, the Race to Zero campaign and the COP26 Presidency.&lt;br&gt;+560 members&lt;br&gt;+50 countries&lt;br&gt;Bringing together existing and new net zero finance initiatives in one sector-wide coalition, GFANZ provides a forum to accelerate the transition to a net zero global economy.</td>
</tr>
<tr>
<td><strong>The Partnership for Carbon Accounting Financials (PCAF)</strong></td>
<td>An initiative led by the financial industry to develop a harmonised global standard to measure and disclose the greenhouse gas (GHG) emissions of loans and investments, in order to ultimately enable financial institutions to set science-based targets and align their portfolio with the Paris Agreement.&lt;br&gt;+300 financial institutions&lt;br&gt;PCAF developed the Global GHG Accounting and Reporting Standard for the Financial industry.</td>
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<tr>
<td><strong>The CDP</strong></td>
<td>A CDP is a global non-profit that runs the world’s environmental disclosure system for companies, cities, states and regions. Founded in 2000 and working with more than 680 financial institutions with over $330 trillion in assets, CDP pioneered using capital markets and corporate procurement to motivate companies to disclose their environmental impacts, and to reduce greenhouse gas emissions, safeguard water resources and protect forests. Nearly 20,000 organisations around the world disclosed data through CDP in 2021. Including more than 10,700 companies worth half of global market capitalisation, and over 100 cities, states and regions.&lt;br&gt;Full TCFD aligned, CDP holds the largest environmental database in the world, and CDP scores are widely used to drive investment and procurement decisions towards a zero carbon, sustainable and resilient economy. CDP is a founding member of the Science Based Targets Initiative, We Mean Business Coalition, The Investor Agenda and the Net Zero Asset Managers initiative.</td>
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<tr>
<td><strong>Paris Aligned Investment Initiative (PAII)</strong></td>
<td>The Paris Aligned Investment Initiative is a collaborative investor-led global forum enabling investors to align their portfolios and activities to the goals of the Paris Agreement. It was established by four industry partners and is working in collaboration with PCAF.&lt;br&gt;18 investors&lt;br&gt;$34 trillion in AuM&lt;br&gt;The initiative supports investors to implement commitments, using their net zero investment framework. The Paris Aligned Investment Initiative is now collaborating with the Partnership for Carbon Accounting Financials (PCAF).</td>
</tr>
<tr>
<td><strong>The Institutional Investors Group on Climate Change (IIGCC)</strong></td>
<td>The European membership body for investor collaboration on climate change and the voice of investors taking action for a prosperous, low-carbon future.&lt;br&gt;+300 members, mainly pension funds and asset managers&lt;br&gt;+22 countries&lt;br&gt;+€37 trillion in AuM&lt;br&gt;IIGCC recently released a net-zero investment framework implementation guide. A dedicated private equity component is being finalised and will provide a common set of recommended actions, metrics and methodologies through which investors can maximise their contribution to achieving net-zero global emissions by 2050 or sooner.</td>
</tr>
<tr>
<td><strong>The Net Zero Asset Managers initiative</strong></td>
<td>An international group of asset managers committed to supporting the goal of net-zero GHG emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5°C; and to supporting investment aligned with net-zero emissions by 2050 or sooner.&lt;br&gt;236 signatories including investors&lt;br&gt;$57 trillion AuM&lt;br&gt;The Net Zero Asset Managers initiative is part of the UN Race to Zero initiative, which aims to rally leadership and support from businesses, cities, regions and investors for a healthy, resilient, zero-carbon recovery that prevents future threats, creates decent jobs, and unlocks inclusive, sustainable growth.</td>
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<tr>
<td><strong>UN-convened Net zero Asset Owner Alliance</strong></td>
<td>An international group of institutional investors delivering a bold commitment to transition their investment portfolios to net-zero greenhouse gas emissions by 2050.&lt;br&gt;71 institutional investors&lt;br&gt;$10.4 trillion AuM&lt;br&gt;The initiative shows united investor action to align portfolios with a 1.5°C scenario, addressing article 2.1 of the Paris Agreement.</td>
</tr>
<tr>
<td><strong>Sustainable Markets Initiative Asset Manager &amp; Asset Owner Task Force (PESMT)</strong></td>
<td>At the invitation of His Royal Highness, The Prince of Wales, executives from a number of the world’s largest asset managers and asset owners have come together under the auspices of the Sustainable Markets Initiative’s (SMI) Asset Manager and Asset Owner Task Force (AMAO) to work on meaningful and actionable plans to help accelerate the transition to a sustainable future. The SMI-AMAO offer resources to help institutional investors pursue net zero; including guidance on asset stewardship and allocation, and portfolio construction; as well as recommendations to accelerate transition finance.</td>
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# List of other Net Zero guides for investors and companies (non-exhaustive)

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<td>October 2022</td>
<td>ICI</td>
<td>Guide</td>
<td>TCFD Implementation Considerations for Private Equity</td>
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<td>April 2022</td>
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<td>Foundations for Science-Based Net Zero Target Setting in the Financial Sector</td>
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<td>World Economic Forum</td>
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<td>Winning the race to Net Zero: The CEO Guide to Climate Advantage</td>
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<td>“Net Zero” Debonk /: A field guide for Board and C-suite executives to respond effectively to the climate emergency</td>
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<td>Showing the way to Paris-aligned investing</td>
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<td>ADEME</td>
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<td>February 2021</td>
<td>Net Zero Assot Owner Alliance UN PRI / UNEP FI / WWF Global Optimism</td>
<td>Protocol guidance</td>
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²°Guidance for private equity being finalised