



DECARBONISATION METHODOLOGIES FOR PRIVATE EQUITY:

USING THE PRIVATE MARKETS DECARBONISATION
ROADMAP AND THE NET ZERO INVESTMENT
FRAMEWORK COMPONENT FOR PRIVATE EQUITY

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CONTEXT

Decarbonisation is an increasingly important topic in Private Equity, and Private Markets more broadly, as regulators, investors and the public are putting pressure on the industry to factor decarbonisation into investment and management decisions. These pressures are compelling Private Market participants, including Private Equity firms (General Partners or GPs), and the Limited Partners (LPs) that invest in them, to act. Over the last few years, a diverse landscape of decarbonisation commitments, memberships, methodologies, and reporting platforms have emerged for GPs. With so many choices, navigating this landscape can be daunting at best, and paralyzing at worst.

This guide seeks to help GPs determine which decarbonisation methodology may be best suited to their circumstances by highlighting the similarities and differences between the **Private Markets Decarbonisation Roadmap (PMDR)** and the **Net Zero Investment Framework's (NZIF)** Component for Private Equity. The guide is not exhaustive in its comparison and GPs are encouraged to conduct their own investigations and evaluations, and seek their own professional advice. Readers should refer to the individual documents for further detail.

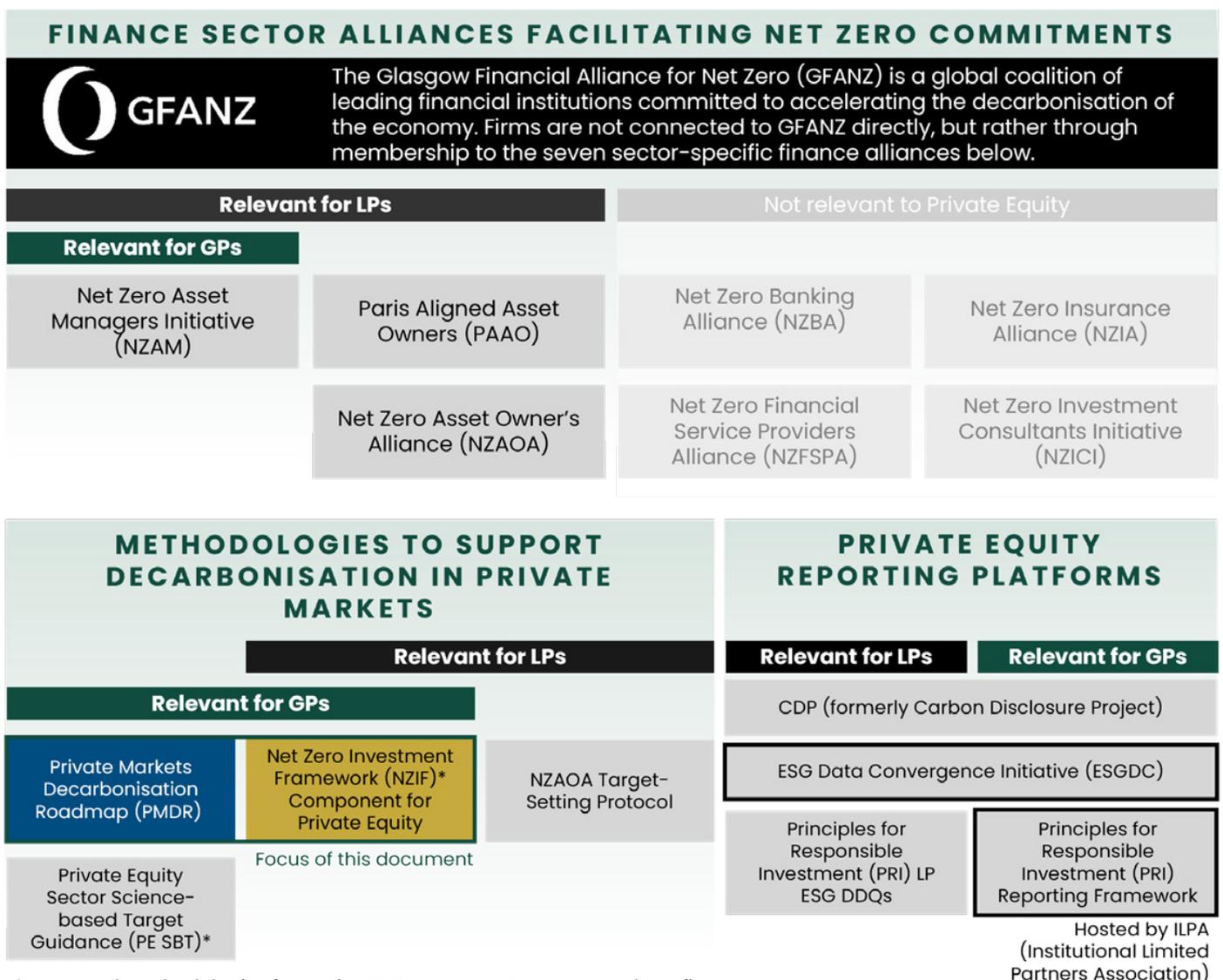
PMDR AND NZIF FOR PE KEY FACTS

	PMDR	NZIF for PE
Core purpose	A decarbonisation communication methodology	A net zero strategy methodology, including decarbonisation target setting and engagement
Target audience	GPs	GPs & LPs
Target funds	Private Markets (including Private Equity)	Private Equity
Sponsors	The Initiative Climat International (iCI) and Sustainable Markets Initiative's Private Equity Task Force	Paris Aligned Investment Initiative (PAII) a coalition including: The Institutional Investors Group on Climate Change (IIGCC), Ceres, Asia Investor Group on Climate Change (AIGCC), and Investor Group on Climate Change (IGCC)
Latest publication date	November 2023	May 2023
Latest version	Private Markets Decarbonisation Roadmap - PMDR Guidance and Supporting Tool	Net Zero Investment Framework Component for Private Equity

OVERVIEW OF DECARBONISATION ALLIANCES, METHODOLOGIES AND REPORTING PLATFORMS

The PMDR and the NZIF for Private Equity both sit within a broader landscape of decarbonisation alliances, methodologies and reporting platforms that support GPs in everything from making a firm-level commitment to net zero, to reporting private equity-backed portfolio company (PortCo) emissions. Some of these tools are relevant for only GPs, while others are applicable to LPs as well.

Figure 1. Landscape of decarbonisation alliances, methodologies and reporting platforms (non-exhaustive)



METHODOLOGIES TO SUPPORT DECARBONISATION IN PRIVATE EQUITY

Decarbonisation methodologies are designed to support GPs by establishing common practices in disclosure and target setting, encouraging action in line with those targets, and tracking progress. The PMDR and the NZIF for PE are two complementary methodologies applicable to Private Equity. PE SBT Guidance is a target-setting methodology that we reference throughout. A GP could use any of the following methodologies. Each focuses on GP-led actions with some nuances. To choose a methodology, a GP should first understand their primary goal.

There are many other methodologies and frameworks across this landscape not covered in this guide, including Net Zero Asset Owner Alliance’s Target Setting Protocol (NZAOA TSP), ESG Integrated Disclosure Project (IDP), Climate Bonds Standard, and other asset class specific methodologies (e.g., Carbon Risk Real Estate Monitor).

Figure 2. Selection criteria for the PMDR, NZIF for PE, PE SBT Guidance

IF THE PRIMARY GOAL IS...

TO DISCLOSE DECARBONISATION PROGRESS	TO SET TARGETS	TO SET VALIDATED TARGETS
<p>Use the PMDR if...</p> <ul style="list-style-type: none"> Looking to communicate to stakeholders climate actions being taken and decarbonisation progress, but not interesting in making a firm or fund-level climate / net zero commitment Working to embed climate practices in PortCo management Managing a multi-asset class portfolio but looking for a single methodology Looking to highlight investments in Decarbonisation Enablers 	<p>Use the NZIF for PE if...</p> <ul style="list-style-type: none"> Seeking to reflect a high climate ambition and align action with climate science Ready to make firm-level and fund-level commitments to achieve net zero Seeking to use a methodology that promotes alignment with LPs across target setting, engagement and reporting Looking to have actions support the NZIF for PE targets set by LPs They have made an NZAM commitment* They have advanced climate practices in portfolio management (or the desire to ramp up) Looking to set targets for investment in climate solutions 	<p>Use PE SBT if...</p> <ul style="list-style-type: none"> Seeking third-party verification of targets They have made an NZAM commitment* Looking to set a firm-level Scope 1 and 2 operational target They are less interested in showcasing investments in climate solutions

* Investors can benefit from using the NZIF for PE and PE SBT target-setting methodologies even if they have not made an NZAM commitment

As GPs evolve their climate ambitions and decarbonisation capabilities, they could transition from one methodology to another, or integrate multiple methodologies simultaneously, while maintaining continuity in efforts and building on work already completed.

PMDR AND NZIF FOR PE KEY SIMILARITIES AND DIFFERENCES

Figure 3. The PMDR and the NZIF for PE comparison

			PMDR	NZIF for PE
Core criteria	Stages of decarbonisation maturity covered	Not Started	✓	✗
		Aligning to Net Zero	✓	✓
		Aligned to Net Zero	✓	✓
		Achieved Net Zero	✗	✓
	Private Markets ownership hierarchy addressed	LP Firm	✗	✓
		GP Firm	✗	✓
		Fund	✓ Optional	✓
		PortCo / Asset	✓	✓
	Activities covered	Decarbonisation	✓	✓
		Governance & Commitment	✗	✓
		Measurement & Reporting	✓	✓
		Target-Setting	✓ Optional	✓
	Asset classes covered	Buyout	✓	✓
		Growth	✓	✓
		Venture Capital	✓	✗
		Infrastructure	✓	✗
		Real Estate	✓	✗
		Private Credit	✓	✗
		Secondaries	✓	✓
		Funds of Funds (LPs)	✗	✓
Additional criteria	Recognises assets supporting the net zero transition	✓ Decarbonisation Enablers	✓ Optional for GPs	
	3 rd party verification required	✗	✗	
Alignment with 3rd party tools	Could be used in conjunction with reporting platforms and disclosure initiatives	CDP private markets	✓	✓
		EDCI NZ	✓	✓
		ILPA LP DDQs	✓	✓
		PRI PE	✓	✓
	Supports 3 rd party commitments	NZAM	✗	✓
		NZAOA	✗	✗
		PAAO	✗	✓
		PE SBT	✗	✗

For an elaboration of the acronyms in this Figure, please refer to Figure 1

As outlined in Figure 3, the PMDR and the NZIF for PE are similar and complementary in many regards. However, the three primary distinctions are:

- 1) Their primary goal (a communication methodology vs. a target-setting methodology),
- 2) The stages of decarbonisation maturity they cover and,
- 3) The applicability of the methodology for use by LPs (although they both serve GPs).

The PMDR and the NZIF for PE each employ some unique and important terminology and concepts, which are defined below.

Both the PMDR and NZIF for PE feature classification frameworks that provide GPs with a way to categorise their PortCos based on their decarbonisation progress.

Figure 4 presents a comparison of the PMDR and the NZIF for PE, calling out meaningful differences along a PortCo's decarbonisation journey. Crucially, Figure 4 highlights the fact that the three most substantive steps of the journey – gathering data, setting a transition aligned target and achieving the required emissions reductions – are broadly consistent across the two methodologies.

PMDR terminology

Decarbonisation Enablers: PortCos whose operations support the transition to a low-carbon environment. A subset of GFANZ's Climate Solutions.

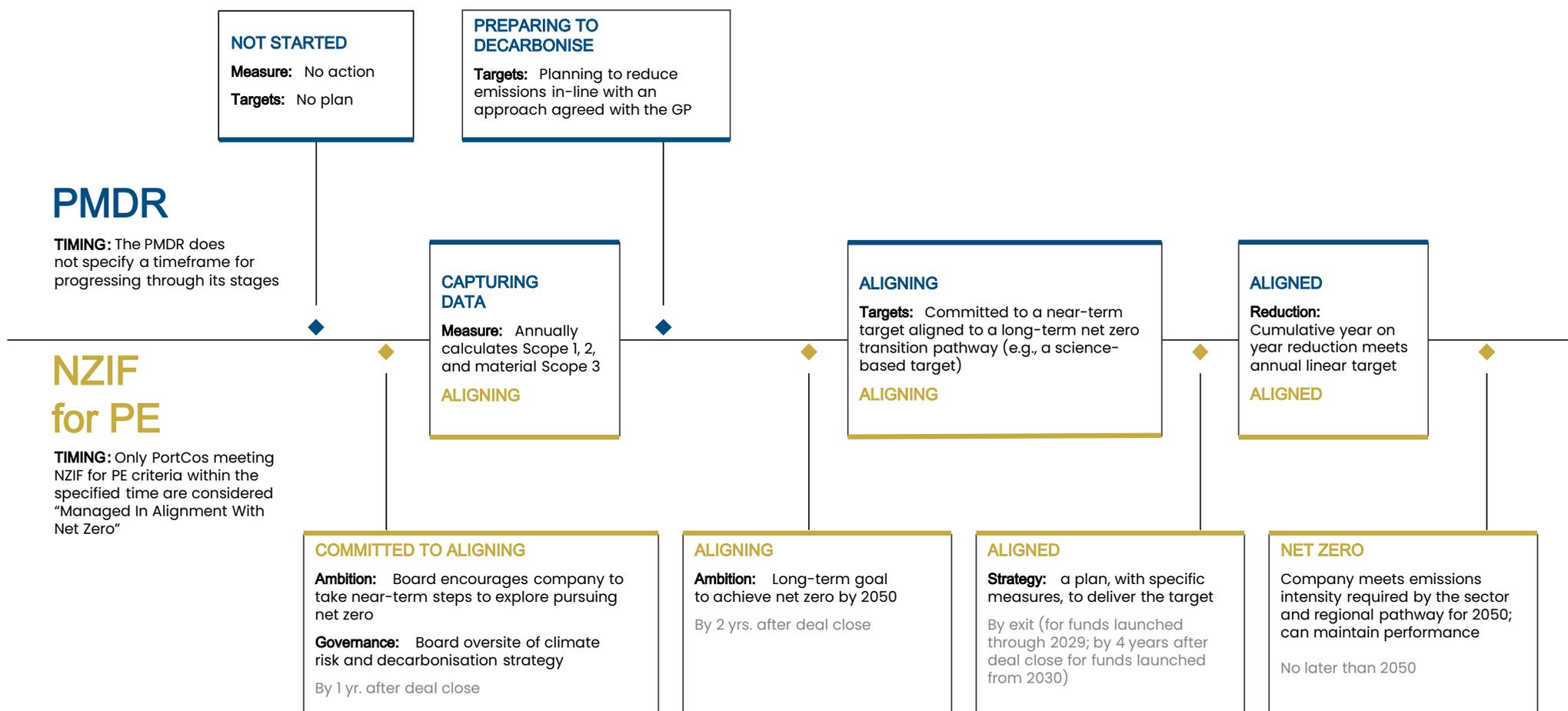
No current pathway to Align: PortCos with no pathway to align to the transition using existing technology.

NZIF for PE terminology

Managed in Alignment with Net Zero: The NZIF for PE methodology establishes key alignment criteria for a PE firm's portfolio companies to accomplish on their journey to net zero. To account for fund cycles and investment periods, NZIF for PE has also established a temporal element to achieving these criteria. If a PortCo achieves the alignment criteria within the timeline defined by the guidance, the PortCo will be considered "Managed in Alignment with Net Zero" and count towards the GP's target.

Figure 4. Deep-dive comparison between the PMDR and the NZIF for PE at PortCo level

Portfolio Company Actions



Both the PMDR and the NZIF for PE emphasise classification at the PortCo level as an approach to disclosing and target setting for decarbonisation. Under the NZIF for PE this classification applies to the Portfolio Coverage Target, though the methodology also includes three other target types that are not represented in the comparison above (Climate Solutions Target, Engagement Threshold Target, and Decarbonisation Reference Target).

Both methodologies also highlight actions that the GP themselves could take to further decarbonise their portfolios, though the PMDR and NZIF for PE differ in their recommendations and expectations. Key differences are highlighted below.

PRIOR TO FUND LAUNCH

PMDR establishes metrics and measures which the GP could use to set targets:

- Fund alignment target
- “Alignment Scale” stages progressed by PortCo target
- Decarbonisation Enabler target

GPs could use NZIF for PE guidance to establish targets for the fund and their firm:

- Portfolio coverage target
- Engagement threshold target
- Climate solutions target (optional)
- Decarbonisation reference target (optional)
- The GP is expected to roll up fund-level targets to a firm-level goal

DURING THE INVESTMENT & HOLD PERIODS

PMDR gives GPs the option to:

- **Report to external stakeholders:** Data aggregated and shared at the PortCo and fund level
- **Highlight investments in Decarbonisation Enablers:** Invest in PortCos whose objective it is to reduce emissions

NZIF for PE guidance gives GPs the option to:

- **Report to external stakeholders:** Data aggregated and shared at the PortCo, fund, and firm levels
- **Invest in Climate Solutions:** Increase investment in PortCos considered “climate solutions” (optional)
- **Engage on Net Zero:** Complete relevant engagement actions with partners and co-investors

FUND EXAMPLE

To illustrate the similarities and differences between applying the PMDR and the NZIF for PE, a simplified example of a GP fund, comprising five PortCos, is presented below.

When collecting information needed to classify a PortCo and Fund using the PMDR and NZIF for PE the inputs required are largely the same. To track PortCo performance, both the PMDR and the NZIF for PE request PortCos disclose emissions data, targets they have set, and any plans or ambitions. GPs disclosing under the NZIF for PE should also indicate if governance, ambition, and climate strategy criteria have been met, and should report against fund and firm-level targets.

When classifying PortCos in the example below, similar results are evident, with the distinction at the NZIF for PE “Committed to Aligning” stage, where the PMDR splits this stage into “Capturing Data”, followed by “Preparing to Decarbonise”. The PMDR distinguishes between these two stages by assessing whether a PortCo has a plan to reduce emissions.

Example PortCo description	PMDR	NZIF for PE
<p>ManufacturingCo has been tracking and publicly disclosing Scope 1 and 2 and material Scope 3 emissions for four years. It set Board-approved near-term science-based targets two years ago (which were validated by the PE SBT last year) together with a robust long-term decarbonisation plan. ManufacturingCo has since reduced emissions in line with its Scope 1 and 2 and material Scope 3 linear annual reduction targets. ManufacturingCo was acquired by the fund three years ago.</p>	Aligned	Aligned
<p>FoodCo has been tracking and publicly disclosing its Scope 1 and 2 and material Scope 3 emissions over the last two years. The Board recently approved a near term Paris aligned* target in line with the PE SBT but has yet to materially reduce emissions. FoodCo established clear governance and ambition towards net zero within six months of acquisition. FoodCo was acquired by the fund four years ago.</p>	Aligning	Aligning
<p>TechnologyCo been tracking and disclosing its Scope 1 and 2 emissions for two years and Scope 3 since last year. A net zero ambition and high-level interim emissions reduction targets have been set and approved by the Board, but TechnologyCo does not have a near term science-based target yet. The company develops carbon accounting software. They were acquired by the fund one year ago.</p>	Preparing to Decarbonise	Committed to Aligning
<p>TransportCo has been tracking and disclosing its Scope 1 and 2 emissions for two years and material Scope 3 since last year. A net zero ambition has been approved at the Board level, but no specific reduction targets or decarbonisation plans have been set. TransportCo was acquired by the fund three years ago, and the fund exited the investment six months ago.</p>	Capturing Data	Committed to aligning
<p>BeverageCo has not yet validated a decarbonisation plan and has only been collecting Scope 1 and 2 emissions data. The PortCo was acquired less than a year ago by the fund.</p>	Not Started	Not Assessed

-  Managed in Alignment
-  Climate Solutions / Decarb Enablers*

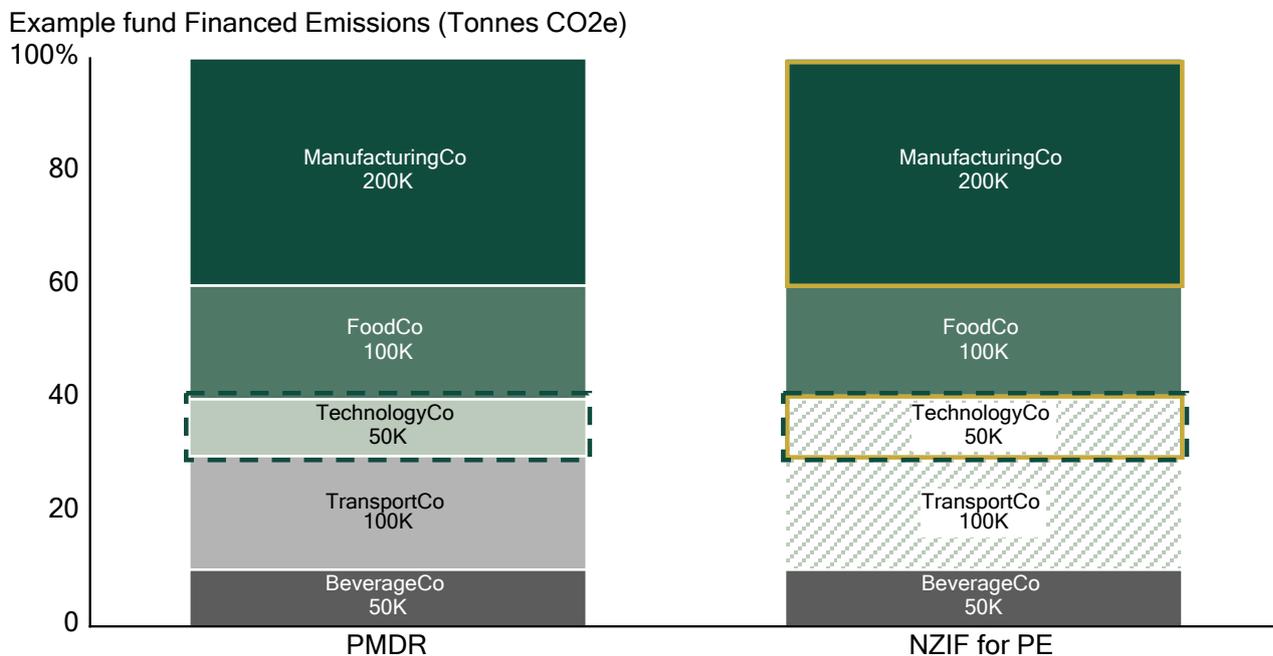
Note that this example includes temporal considerations required for a PortCo to be considered "Managed in Alignment with Net Zero" under the NZIF for PE methodology. If a PortCo achieves the alignment criteria outside of the established timelines, the PortCo would not be considered "Managed in Alignment" and would not count towards GP target progress.

PortCo

*The NZIF for PE to date does not specify a definition for Climate Solutions, however, guidance on this subject is in development by PAII.

The GP fund example does not include elements of engagement threshold targets or decarbonisation reference targets as NZIF for PE defines. Using the PMDR, a GP has the discretion to disclose its decarbonisation performance. Under the NZIF for PE, GPs have an expectation to annually disclose to LPs to ensure accountability and transparency to net zero goals.

Figure 6. Example GP fund classification



% of "Aligning" and "Aligned" 60.0%¹

% Managed in Alignment with Net Zero

55.6%²



- (1) Calculation for the % of "Aligning" and "Aligned" is done by dividing the sum of Financed Emissions from the PortCos that are categorised as "Aligning" and "Aligned" (ManufacturingCo and FoodCo) by the total Financed Emissions of the fund
- (2) Calculation for % Managed in Alignment is done by taking the sum of Financed Emissions from the PortCos that are Managed in Alignment (ManufacturingCo and TechnologyCo) divided by the total Financed Emissions of the fund (excluding any PortCos that were acquired less than a year ago, in this case BeverageCo)

Despite the slightly different categories and terminology used by the PMDR and NZIF for PE, their categorisation of the example PortCos is very similar.

CONCLUSION

Decarbonisation methodologies and guidance for Private Markets – including both the PMDR and the NZIF for PE – will evolve as regulation, ambition levels and accepted practices changes. The risk is that confusion drives paralysis and stops GPs from taking real action on climate. As such, iCI, PRI and PAII will seek to continue working in close collaboration to minimise divergence and offer a clear and unified voice for how private equity can decarbonise.

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