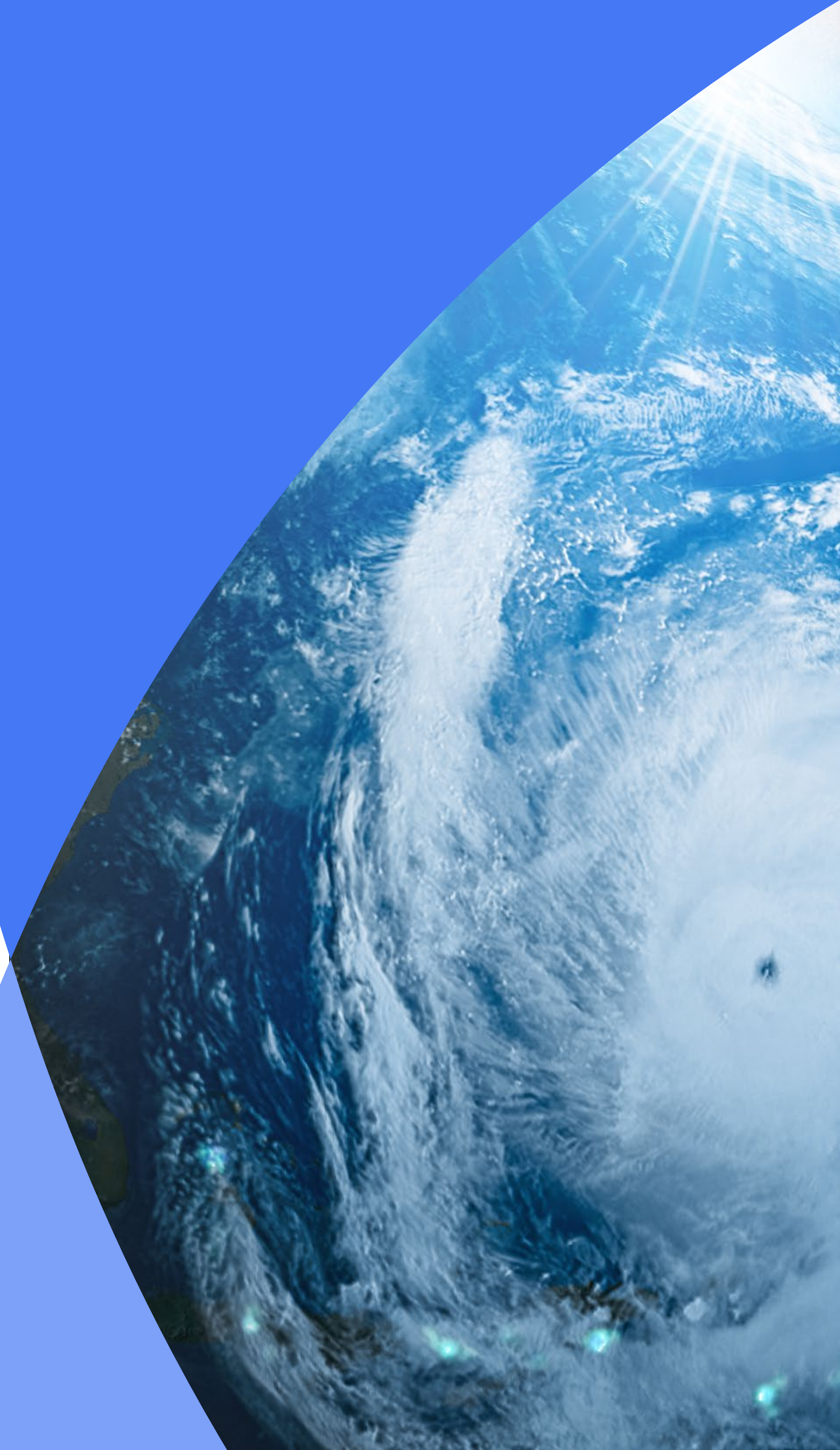
PARIS ALIGNED INVESTMENT INITIATIVE

Net Zero Investment Framework Component for the Private Equity Industry



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Executive summary

Introduction

The Net Zero Investment Framework (NZIF) aims to provide a consistent foundation for asset owners and managers to align portfolios with net zero emissions by 2050 or sooner. While the framework provides recommendations and approaches to alignment with net zero that a broad range of investors can use, it also recognises that investors will set their own specific strategies and undertake actions according to their circumstances and legal requirements. Investors using NZIF are therefore asked to do so on an 'implement or explain' basis to take account of these differing contexts and the need for unilateral decision making. Jurisdiction, regulation, and best practice will determine the approach that can be taken by a particular investor.

This private equity guidance establishes a consistent industry-wide approach to measuring progress toward net zero with an emphasis on real economy decarbonisation of portfolio companies.

Decarbonisation at the PC level, expressed through PC targets and science-based decarbonisation strategies, is a key driver to the real-world emissions reduction required to meet the Paris Agreement's goals. While asset allocation may play a significant role in an investor's net zero strategy, the primary focus of this Guidance is decarbonisation goals.

This Guidance is intended to be adopted by any private equity investor active in buyout, growth, and associated strategies. This introduction explains the methodology and nuances which differentiate NZIF in private markets. Sections 1 – 3 then provide a background and overview of the Guidance, before Section 4 onwards offers a detailed implementation guide.

The guidance establishes a cohesive framework for pursuing net zero in the PE industry

About this Guidance

This Guidance has been developed with inputs from leading industry participants in the private equity industry. It takes the view that, given the distinctive characteristics of private equity investments, distinct actions are required to meet their own specific decarbonisation goals. As such, the broader concepts of NZIF have been adapted specifically for private equity investments due to the different normative practices, legal structures and regulation which define the industry.

The aim of this Guidance is to enable action in private equity investments, much like the advent of the Taskforce on Climate-related Financial Disclosures (TCFD) did in public markets. Advances similar to those in public markets are yet to be seen in private markets, and this Guidance provides an avenue to progress the integration of climate change risks and opportunities into private equity investment. It also provides ways to standardise target-setting, engagement and reporting between LPs, GPs and PCs to support progress towards net zero at scale in the private equity industry.

Public markets have stricter rules and regulations around disclosure of material information when compared to private markets. Over the last 20 years, risks and opportunities related to climate change have been integrated into investor requests for disclosure of information in those public markets.

In many jurisdictions, publicly listed entities and participants are now required to disclose climate-related risks and opportunities. Private markets participants may aim to integrate similar practices over time.

New concepts specific to this Private Equity Guidance

The above outlined PE-specific nuances have led to new concepts being developed as part of this Guidance, which for those using NZIF more broadly, should only be used in relation to private equity investments. Where there are multiple pieces of guidance for investment types that do not specifically relate to trading companies e.g., Infrastructure or Real Estate PE funds, then the specific asset class guidance should be followed as a principle where possible.

These new concepts are outlined here.

Over time, as industry norms and regulation evolve in both private and public markets, certain concepts may converge. Concepts like public markets focused NZIF criteria and Climate Action 100+ indicators may one day become more relevant to private markets, but until then the below guidance is seen as "best practice" for the private equity industry and its important role in shaping the future net zero economy.

New concept	Related NZIF concept	Divergence	Reasoning
PE Portfolio Coverage Target: 'Managed in alignment with net zero'	Portfolio Coverage Target: 'Alignment Criteria'	Less granular information flowing to LPs, aggregated to the overall concept of 'Managed in alignment…' depending on the stage of the investment.	Due to the specific entry and exit points of PE investments, their maturity level, and the need to adapt these concepts for the private markets sphere, a more binary check over time is appropriate.
PE Portfolio Coverage Target: 'Milestones'	Portfolio Coverage Target: five-year goal	Milestones of 2030, 2040 and 2050 are included as opposed to five years from 'baseline'.	Included to reflect the 'phase in' of PCs and funds being managed in alignment with net zero to better reflect the transition for PCs and PE firms.
PE Portfolio Decarbonisation Reference Target: 'Time Relevance'	Portfolio Decarbonisation Reference Target: <10-year target	These targets have been adjusted to 'time relevant' as opposed to <10 years.	Due to the generally closed-ended nature of a private equity fund, targets may be more appropriately set in sync with the lifecycle of the fund.
PE Portfolio Coverage Target & PE Engagement Threshold Target: Influence Bands	Portfolio Coverage Target & Engagement Threshold Target: Materiality	These targets relate to different actors in the value chain and how they engage with each other. These targets are 100% with the threshold based on the stage within the PE lifecycle.	GPs are generally the only actors engaging with PCs and have differing levels of influence depending on the investment type and amount of equity and governance they hold. LPs will also have varying levels of influence depending on how and when they invest.

Target types

There are four types of targets that can be set to support the net zero transition of the private equity industry. Subject always to the fact that the NZIF is a voluntary framework and investors make their own unilateral decisions, PE Portfolio Coverage and PE Engagement Threshold targets are the expected starting point, both for LPs and GPs. Where relevant, investors could look to include all targets over time.

PE Portfolio Coverage Targets

Portfolio coverage targets seek to increase the percent of underlying PCs that are "managed in alignment with net zero." GPs and LPs set portfolio coverage targets that cover all private equity investments for the milestone years of 2030 and 2040. By 2050, 100% of PE investments should be achieving net zero.

GPs should also establish and communicate portfolio coverage targets for each fund ahead of launch. Stated fund-level targets enable LPs to consider net zero in investment decisions and support GPs in pursuing their firm-level 2030/2040/2050 milestone targets.

Appropriate target ambition will vary based on the specific investment strategies of the organisation. Those with a higher ability to influence net zero alignment among PCs can establish more ambitious targets. The influence band framework included in this Guidance can inform appropriately ambitious targets.

Target Type	Description	Metrics
PE Portfolio Coverage Target	A % of invested capital or financed emissions to be managed in alignment with net zero by 2030 and an increased % by 2040; achieve 100% net zero by 2050.	GPs: Invested Capital and/or Financed Emissions LPs: Committed Capital and/or Financed Emissions
PE Engagement Threshold Target	Complete the specified engagement actions for all (100%) applicable PE investments.	GPs: Invested Capital and/or Financed Emissions LPs: Committed Capital and/or Financed Emissions
PE Allocation to Climate Solutions Target	Increase investment in climate solutions. *This target is optional for GPs.*	Invested Capital
PE Portfolio Decarbonisation Reference Target	A time-relevant absolute or intensity CO2e emissions reduction target set covering scope 1 and 2 emissions (with scope 3 emissions phased in where possible), aligning with relevant fair share of global and regional decarbonisation pathways. *This target is optional for GPs and LPs.*	Financed Emissions

PE Engagement Threshold Targets

Active engagement to drive uptake of net zero practices in the private equity industry is one of the most important actions in this Guidance. It is important for LPs to engage the GPs with whom they invest, and for GPs to engage with co-owners of PCs in instances where the GP's ownership stake can appoint 50% or less of the PC's voting board seats[1].

Relevant engagement actions are defined by the corresponding Influence Band. GPs and LPs should build net zero engagement into their standard operating procedures and complete relevant activities for 100% of investments[2].

Managed in alignment with net zero

To be considered "managed in alignment with net zero," portfolio companies are expected to:

- Achieve "committed to aligning" to net zero within one year of deal close by establishing an ambition to pursue further action and supporting governance.
- Achieve "aligning" status by establishing foundational emissions management practices within two years of the deal close.
    - These practices include establishing net zero ambition, governance structures, emissions measurement and disclosure practices, and setting a 5- to 10-year Paris-aligned emissions reduction target.
- Achieve "aligned" status by establishing a climate strategy and meet or exceed a Paris-aligned emissions target (by exit for fund vintages through 2029; after 4 years for later fund vintages).
- Achieve "net zero" status by 2050.

Influence Bands reflect varying influence levels of GPs and LPs in encouraging PCs to decarbonise. An organisation should consider its expected exposure across influence bands when determining appropriate Portfolio Coverage Targets. Appropriate engagement actions under Engagement Threshold Targets are also determined by influence band.

Asset classes	Band	Criteria	Influence Level
DIRECT • GP buyout fund • GP growth fund • GP continuation fund	**1a**	> 50% board votes (usually the majority shareholder)	Strong (with PCs)
	1b	≤ 50% board votes (usually a significant minority shareholder)	Moderate (with PCs)
	1c	No board votes	Limited (with PCs)
INDIRECT • LP investments in buyout, growth or continuation funds • LP co-investment • GP fund of funds • LP-led secondaries	**2a**	Big ticket investors* and/or first close investors	Strong (with GPs)
	2b	Investment made during fundraise not included in 2a; co-investment	Moderate (with GPs)
	2c	Investment made through secondaries market	Limited (with GPs)

*Substantial capital commitments to a fund (typically 5 to 10% of the fund size).

1 An engagement target for GPs to engage with PCs is not included as it would be redundant with actions that need to be taken to achieve the portfolio coverage target.
2 Band 1a investments do not have engagement actions.

PE Allocation to Climate Solutions Target

GPs and LPs can set targets to increase the amount of invested capital allocated towards climate solutions for the milestone years of 2030, 2040, and 2050. Climate solutions is considered an optional target for GPs because for some managers, these investments will fall outside their core competencies.

There are no established thresholds for climate solutions—LPs and GPs are encouraged to invest additional capital toward these important investments while fulfilling their mandate and fiduciary duty.

Forthcoming guidance from IIGCC will define climate solutions for private markets.

PE Portfolio Decarbonisation Reference Target

This is an optional target for both LPs and GPs. It will be most relevant for diversified asset managers/owners that wish to integrate private equity investments into an existing decarbonisation reference target.

GPs and LPs are encouraged to set a time-relevant absolute or intensity CO2e emissions reduction target covering Scope 1 and 2 emissions (with Scope 3 emissions phased in where possible), aligning with relevant fair share of global and regional decarbonisation pathways.

Reporting

Relevant data for measuring progress against targets should flow from PC to GP to LP. Reporting should take place no less than annually, coinciding with annual reporting cycles.

GPs and LPs should report progress towards established net zero targets. Public reporting is encouraged, but it is of higher priority for GPs to report to their LPs, and LPs to report to their customers.

In addition, GPs are expected to share relevant underlying PC-level data for all PCs in the fund in which an LP is invested to enable the LP to calculate their own net zero progress. This fund-level reporting should include the following information for each PC in the fund:

- Binary "Yes/No" assessment for each PC on their status of being "managed in alignment with net zero"
- Scope 1 & 2 emissions (total PC emissions and financed emissions following Partnership for Carbon Accounting Financial guidelines for the full fund's investment)
- Scope 3 emissions (total PC emissions and financed emissions following PCAF guidelines for the full fund's investment)
- Total invested capital in the PC by the fund
- Net asset value of the PC

Overall, this Guidance aims to provide clear recommendations to the private equity industry on prioritising real world decarbonisation through their investments. The sections that follow explore the nuances of each type of target, distinctions between GPs and LPs, and unique recommendations for associated investment strategies.

1 Background

The Paris Aligned Investment Initiative (PAII) was launched in May 2019 with the aim of exploring how investors can align their portfolios to the objectives of the Paris Agreement. The PAII is a forum for investors which aims to:

- Develop definitions of key concepts and terms to clarify best practice pathways relevant to Paris-alignment to build understanding and consensus around these concepts.
- Analyse potential methods that can be used to assess alignment of different asset classes with Paris-aligned goals.
- Assess approaches for transitioning portfolios and provide practical options for investors to transition and assess alignment to the Paris goals.

The PAII published the Net Zero Investment Framework (NZIF) implementation guide (NZIF 1.0) in March 2021 and established a global partnership with four investor networks: the Asian Investor Group on Climate Change (AIGCC), Ceres, the Institutional Investor Group on Climate Change (IIGCC), and the Investor Group on Climate Change (IGCC). NZIF 1.0 covered four asset classes: listed equity, corporate fixed income, sovereign bonds, and real estate. In 2021, IIGCC established an internal private equity (PE) working group to establish additional components of NZIF relevant to PE, and in late 2022, convened a PE industry focus group comprised of a diverse set of practitioners to develop market solutions to the issues raised during the initial public consultations.

This document presents the components of a Net Zero Investment Framework (NZIF) for private equity (PE).

2 Introduction to the Framework

Figure 1: NZIF aims to establish a consistent basis for asset owners and asset managers to measure and manage portfolios towards the goal of achieving global net zero emissions by 2050 or sooner. While the framework provides recommendations and approaches to alignment with net zero that a broad range of investors can use, it also recognises that investors will set their own specific strategies and undertake actions according to their circumstances and legal requirements. Investors using NZIF are therefore asked to do so on an 'implement or explain' basis to take account of these differing contexts and the need for unilateral decision making. Jurisdiction, regulation, and best practice will determine the approach that can be taken by a particular investor.

The PE components for NZIF are intended to be relevant to both Limited Partners (LP) and General Partners (GP). This Guidance aims to find a balance between establishing recommended consistent best practices, measures, and metrics and allowing for flexibility, to ensure the responsible stewardship required for a sector that has an important role in shaping fast growing, real economy actors.

To determine these components, the PAII has assessed all currently available methodologies and approaches for measuring or undertaking alignment to net zero including the original components in NZIF 1.0, the Net Zero Asset Owner's Alliance's (NZAOA) Target Setting Protocol and the Science Based Targets Initiative's (SBTi) Private Equity Sector Guidance. The Guidance presented in this document intends to build upon these existing methodologies and ensure that targets set using each methodology are complementary. The NZIF Guidance for Private Equity incorporates similar concepts to those in these frameworks such as engagement targets and investments in climate solutions. Similarly, the criteria of this Guidance draw upon the core TCFD pillars including metrics and targets, risk management, strategy, and governance.

In developing this Guidance for the PE industry, NZIF continued to follow the five principles that have guided all NZIF framework development to date (**figure 1**).

This Guidance provides an ambitious and scientifically robust framework that LPs and GPs may choose to use when setting targets in pursuit of net zero by 2050. The PAII recognises that achieving full emissions disclosure for all portfolio companies may take time, as many GPs are still building the systems and capabilities to support their portfolio companies to complete regular, and accurate GHG inventories. The PAII recommends that maturation of measurement capabilities is prioritised by GPs in the short-term as a requisite first step to achieving the full ambition of the net zero commitment as quickly as possible.

This Guidance broadly aligns with PE SBTi Guidance, as implementation of SBTi fulfills some components of NZIF. However, this target-setting methodology allows PE firms to set net zero targets to 2050, provides guidance for a wider range of commitments, and applies to LPs in addition to GPs with links to the broader concepts within NZIF.

Where GPs or LPs have multi asset class portfolios, the PE components set out below are designed to be integrated with the broader recommendations of the NZIF 1.0. This document does not reproduce content that would be repetitive with overarching guidance and should therefore be read in conjunction with NZIF 1.0.

The PAII also notes that if policy and corporate action do not transition in parallel towards the net zero goal, it will be challenging for investors to achieve a portfolio of assets that has net zero emissions in 2050. NZIF guidance is therefore based on the expectation that governments and policy makers will deliver on, and even exceed, commitments made in the Paris Agreement.

Figure 1: Guiding principles for developing the Framework

The PAII followed 5 key principles to guide its work, and to assess methodologies and test conclusions.

Impact

The primary objective is achieving emissions reductions in the real economy. While different investors have varying scopes for undertaking action, the Framework should encourage investors to maximise their efforts to achieve the greatest impact possible.

Rigour

Alignment should be based on sound evidence and data, and be consistent with the best available science on meeting the temperature goals of the Paris Agreement.

Practicality

The methods and approaches should be feasible for a range of investors to implement, build on existing work, and be compatible with existing processes or requirements of investors.

Accessibility

Definitions, methodologies and strategies should be clear and easily applied, using publicly available information and assessments where possible.

Accountability

Definitions, methodologies and strategies should allow clients, beneficiaries and other stakeholders to assess whether investors and assets are aligned with the goals of the Paris Agreement.

3 Overview of the Guidance

The Guidance seeks to establish a consistent industry-wide approach to measuring net zero commitments in the private equity industry (to include both LPs and GPs), underpinned by the real economy decarbonisation of PCs. Rather than focusing only on encouraging LPs and GPs to decarbonise their portfolios by re-allocating capital towards industries that are less carbon intensive, NZIF strives to incentivise engagement and decarbonisation at asset level, consistent with climate science across industries that will be necessary for a successful transition.

Incorporating the actions of LPs, GPs, and PCs into a single set of guidance unlocks greater engagement and influence, as LPs can encourage GPs to adopt the methodology, who, in turn, seek to inspire real economy decarbonisation among their PCs. This cohesive approach also allows for a streamlining of data and reporting, as PCs report to GPs, who can then provide LPs with the information they require; all while using the same tools and metrics.

3.1 Asset classes covered by this Guidance

This Guidance focuses on buyout and growth equity investments, including related strategies such as co-investments, fund of funds, and secondaries. Other private markets asset classes have been excluded because specific guidance exists (real estate, infrastructure) or are in development by PAII and IIGCC (private credit, venture capital).

3.2 Target types and metrics

This Guidance identifies four types of targets that organisations can choose to set to further their net zero ambition. The below targets complement one another, promoting net zero adoption, driving carbon reduction, and encouraging investment in climate solutions. NZIF is a voluntary framework, none of the targets are “mandatory.”

Figure 2: Commitments across the PE industry

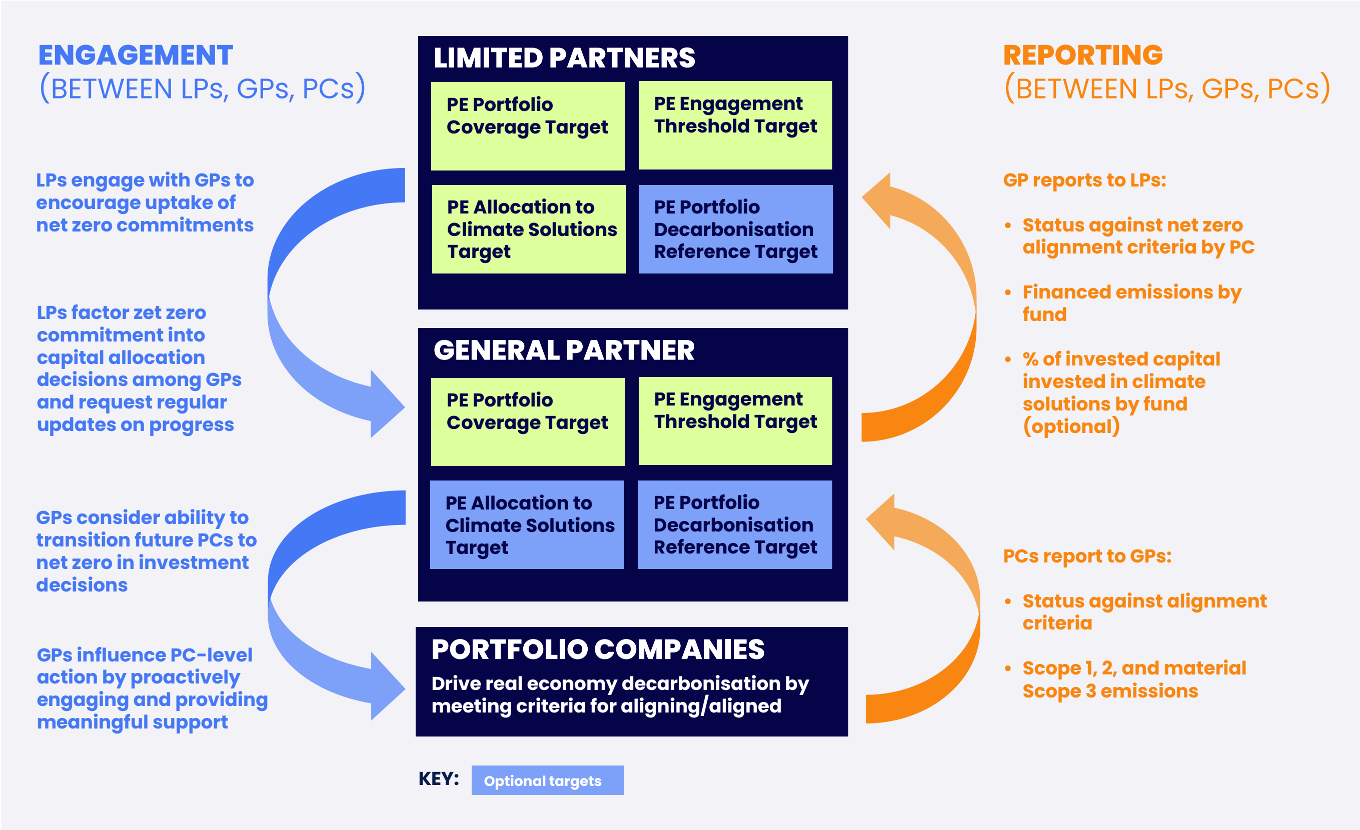


Figure 3: Overview of GP and LP targets

Target type	Description	Metrics	Details
PE Portfolio Coverage Target	A % of invested capital or financed emissions to be managed in alignment with net zero by 2030 and an increased % by 2040; achieve 100% net zero by 2050. GPs can also set this target for each fund.	GPs: Invested capital and/or financed emissions* LPs: Committed capital and/or financed emissions*	Portfolio coverage targets are broadly applicable to both GPs and LPs across PE investment types and are designed to influence the real economy decarbonisation of PCs toward a net zero future. While financed emissions most accurately reflects real climate impacts, incomplete emissions data in the short term makes a financial metric (invested/committed capital) a more practical option. While one metric is selected to set formal targets, GPs are expected to report annual progress to LPs using both invested capital and financed emissions.
PE Engagement Threshold Target	Complete the specified engagement actions for all (100%) applicable PE investments.	GPs: Invested capital and/or financed emissions LPs: Committed capital and/or financed emissions	The engagement threshold target is an important tool to drive uptake of net zero commitments within the PE industry. LPs are expected to engage all GPs they invest in. GP engagement targets are focused on investments where the GP doesn't have a majority of board votes. For these investments GPs are expected to engage the peer investment managers and other owners of these PCs.
PE Allocation to Climate Solutions Target	Increase investment in climate solutions. *This target is optional for GPs.*	% of invested capital	It is critical for the finance industry to invest in climate solutions that will enable a net zero future. However, this guidance recognises that investing in climate solutions does not universally align with the core competencies and strategies of all GPs, which is why it has been left as a supporting goal for GPs. Clear definitions on climate solutions will be the subject of follow-up guidance from IIGCC.
PE Portfolio Decarbonisation Reference Target	The GP/LP commits to a time-relevant absolute or intensity CO_2e emissions reduction target be set covering scope 1 and 2 emissions (with scope 3 emissions phased in where possible), aligning with relevant fair share of global and regional decarbonisation pathways. *This target is optional for GPs and LPs.*	Financed emissions	Investors may set a reference target for overall emissions reduction for private equity investments (where possible relative to a baseline). This target may be expressed in absolute or intensity terms (CO_2e/$mn invested). This target should include scope 1 and 2 emissions, with scope 3 reported separately in line with phase-in.

* For simplicity, the Guidance defaults to invested capital for GPs and committed capital for LPs throughout the rest of this document unless discussing aspects unique to the use of financed emissions.

The private equity portfolio coverage target and private equity engagement threshold target are the central targets for this methodology. The portfolio decarbonisation reference target acts as an accountability mechanism to ensure investors' engagement with investees and actions to support alignment at the asset level are yielding the necessary portfolio level emissions reductions required to remain in line with a science-based 1.5°C carbon budget. Climate solutions targets have been included for investors with multi-asset portfolios where increasing allocation to climate solutions is a viable strategy.

3.3 Influence Bands approach

GPs and LPs experience varying levels of influence in their ability to encourage underlying PCs to decarbonise. A GP that can appoint a majority of voting seats on the PC's board can exert influence on a company's management, while a GP that can only appoint a minority of voting seats on the board or no voting seats may face more difficulty in positively influencing the direction of the company. Similarly, an LP who invests while the fund is still being launched has a greater ability to influence GP actions than one that enters the fund through the secondaries market.

To account for these dynamics, both the private equity portfolio coverage and private equity engagement threshold targets use influence bands to establish objectives that are ambitious yet reflective of the practical circumstances that each investment type faces.

There are six influence bands in total that can be broadly grouped into two categories: 1) direct influence; and 2) indirect influence.

The three direct influence bands apply to investments made directly into a PC and are most frequently relevant to GPs. They are distinguished by the number of voting seats on the board appointed by the organisation, which impact the level of influence it has on the PC. The three indirect influence bands apply to investments where a GP sits between the organisation and the portfolio company. The relative size of the investment made in a fund distinguishes bands 2a and 2b. Band 2c applies to all investments made after a fund has closed (e.g., LP-led secondaries). Secondaries buyers acquire positions in older vintage funds and have a significantly diminished ability to influence action.

Expectations for the speed at which net zero alignment can be achieved vary across influence bands, and a GP's or LP's exposure to different bands will inform appropriate portfolio coverage targets, as described in **Section 4.1.2.1 and 4.1.2.2**. Each influence band also includes tailored engagement actions that are designed around the influence levers available, given the band's dynamics (see **figures 4** and **5**).

Figure 4: Table of Influence Bands

Asset classes	Band	Criteria	Influence Level
DIRECT • GP buyout fund • GP growth fund • GP continuation fund	**1a**	> 50% of board voting seat appointments (usually the majority shareholder)	Strong (with PCs)
	1b	≤ 50% of board voting seat appointments (usually a significant minority shareholder)	Moderate (with PCs)
	1c	No board votes	Limited (with PCs)
INDIRECT • LP investments in buyout, growth or continuation funds • LP co-investment • GP fund of funds • LP-led secondaries	**2a**	Big ticket investors* and/or first close investors	Strong (with GPs)
	2b	Investment made during fundraise not included in 2a; co-investment	Moderate (with GPs)
	2c	Investment made through secondaries market	Limited (with GPs)

*Substantial capital commitments to a fund (typically 5 to 10% of the fund size).

4 Implementation support for GPs and LPs

4.1 General Partners

4.1.1 Role of General Partners

Typically, GPs manage funds that invest directly in equity stakes of PCs. In most situations they obtain the right to appoint board members proportionate to their equity stake and can thereby influence a PC's actions, bearing in mind that PCs are independently managed companies owned by the funds. As a result of this position, most GPs pursuing net zero may want to consider focusing their efforts on motivating and supporting PCs on net zero actions; helping them to measure GHG emissions, set Paris-aligned targets, and develop and execute decarbonisation strategies. GPs are strongly encouraged to proactively engage directly with their PCs on these actions.

Fund of funds are different from traditional GP funds in several important ways. Guidance specific to these investments can be found in the fund of funds callout box.

Details on each of the four target types that GPs can set are presented in the sections that follow.

4.1.2 PE Portfolio Coverage Targets for GPs

Net zero portfolio coverage targets are the foundation of a GP's net zero commitment. These targets are a commitment to manage a portion of invested capital in alignment with net zero (as defined below). The influence bands inform the target thresholds that GPs should seek to achieve by 2030, 2040, and 2050.

4.1.2.1 PC alignment criteria and milestones

Under portfolio coverage targets, PCs aim to meet alignment criteria, which are broken into four levels: 1) Committed to aligning; 2) aligning; 3) aligned; and 4) net zero. The top half of **figure 5** presents the PC alignment criteria. To achieve "committed to aligning," "aligning," or "aligned," a PC should meet **all** criteria marked for that level.

Figure 5: Table of PE portfolio company alignment criteria and milestones

<table>
<tr><th>Category</th><th>Criteria</th><th>Committed to Aligning</th><th>Aligning</th><th>Aligned</th><th>Net Zero</th></tr>
<tr><td>Ambition</td><td>Long-term goal for the company to be net zero emissions by 2050 or sooner.</td><td>X**</td><td>X</td><td>X</td><td rowspan="6">Company with emissions intensity required by the sector and regional pathway for 2050 and whose ongoing investment plan or business model will maintain this performance.</td></tr>
<tr><td>Governance</td><td>Board oversight for climate risk and execution of climate strategy. Climate risk management and strategy are discussed by the Board at least once a year.</td><td>X</td><td>X</td><td>X</td></tr>
<tr><td>Disclosure</td><td>Annual disclosure to investors of scope 1, 2, and material scope 3* absolute GHG emissions. Public disclosure is best practice but not an expectation.</td><td></td><td>X</td><td>X</td></tr>
<tr><td>Targets</td><td>5– to 10-year Paris-aligned GHG emissions reduction target (Scope 1, 2, and material Scope 3*)</td><td></td><td>X</td><td>X</td></tr>
<tr><td>Emissions Performance</td><td>Cumulative YoY reduction meets or exceeds the linear annual reduction established as the target for Scope 1, 2, and material Scope 3* emissions.</td><td></td><td></td><td>X</td></tr>
<tr><td>Climate Strategy</td><td>A proportionate plan is established that sets out the measures to deliver the target.
For high impact sectors, the strategy should be quantified and include capex and opex required to achieve targets.</td><td></td><td></td><td>X</td></tr>
<tr><td rowspan="3">PCs that meet the portfolio alignment criteria listed above within the milestones established to the right are considered “managed in alignment with net zero” and the capital invested in them will count towards coverage targets established by GPs.</td><th>Fund vintage alignment milestones</th><th>Committed to Aligning</th><th>Aligning</th><th>Aligned</th><th>Net Zero</th></tr>
<tr><td>Funds launched through 2029</td><td>1 year after deal close</td><td>2 years after deal close</td><td>By exit</td><td>Not required</td></tr>
<tr><td>Funds launched from 2030 to 2050</td><td>1 year after deal close</td><td>2 years after deal close</td><td>4 years after deal close</td><td>No later than 2050</td></tr>
</table>

* Material Scope 3 as defined by leading guidance such as SBTi.

** For the Committed to Aligning milestone the board should acknowledge the importance for the company to take action toward a net zero future and encourage the company to begin exploring pursuit of Aligning and Aligned criteria.

PCs that meet the committed to aligning/aligning/aligned/net zero criteria described in the top of figure 5 within the milestones presented in the bottom are considered "managed in alignment with net zero", and will count towards the portfolio coverage targets established by the GP (as well as LP calculations of invested capital managed in alignment with net zero). A PC that misses a milestone will be considered "not aligned" until it can achieve the required criteria. It is important to note that timelines and measurement of net zero action are focused on the fund cycle, as investors can only be influential while the company is within their portfolio.

Paris-aligned targets and exceptions

Paris-aligned targets should conform with guidance from a credible-third party, such as SBTi, or well accepted sectoral decarbonisation pathways / carbon budget approaches. A target aspiring to less ambitious criteria or goals is accepted in rare instances until 2040, where it has been determined that technology does not exist to achieve net-zero aligned reductions or that pursuing such reductions would threaten the portfolio company's solvency. This can be determined after a thorough evaluation of net zero strategies conducted by a third party with adequate professional qualifications. The resulting target should be sufficiently challenging to ensure the implementation of most viable actions. This exception cannot apply to industries whose primary activity is no longer considered permissible within a credible net zero pathway, irrespective of the percentage of revenue generated by these activities.

Determination of appropriate alignment milestones

The alignment milestones are determined by the year the fund was launched and not the year a particular PC was acquired. For example, if a fund lauched in 2029 closes a deal with a PC in 2030, that PC would have until exit to reach the aligned status, in accordance with pre-2030 requirements.

Cadence of assessment against criteria

At a minimum, GPs should assess each PC's performance against the criteria at each milestone. Completion of criteria for ambition, governance, targets, and climate strategy can be assumed to continue once a company has been assessed to have met the criteria and does not need to be reassessed thereafter (unless the GP has reason to believe these practices have stopped or been materially altered). Disclosure and emissions performance (absolute Scope 1, 2, and material Scope 3 emissions for the prior year reported in $MtCO_2e$) should be assessed at the applicable milestone and then annually thereafter.

GPs only need to report to LPs annually following established reporting cycles and can report alignment status of PCs as of the time of reporting.

PCs acquired within one year of the date at which GPs provide annual reporting to LPs should be excluded from calculations of progress toward targets because they have not had sufficient time to meet the "committed to aligning" criteria. If a PC meets the "committed to aligning" criteria ahead of the 1-year milestone, GPs can opt to include them in their progress calculations and reporting.

Acquisitions and buy-and-build strategies

PCs that complete material acquisitions should update their goals and progress by re-baselining. Acquisitions are expected to be brought into the Scope of the goal within one year. If a material acquisition is completed within one year of the PC being exited, the final assessment against the alignment criteria can exclude the acquisition.

Exits prior to alignment milestones

GPs that exit a PC prior to the date of an alignment milestone can be considered "managed in alignment with net zero" upon exit if they have achieved the alignment milestones up to the point of exit and the GP can demonstrate that the PC was on track to meet the next milestone. For fund vintages through 2029, PCs have until exit to achieve aligned criteria, but do not need to achieve this criterion if they are exited prior to four years from close and are on track to achieve the aligned milestone by the four-year mark.

4.1.2.2 Thresholds for Portfolio Coverage Targets

For GP investments in band 1a, GPs are encouraged to approach or achieve 100% of invested capital managed in "alignment with net zero" by 2030. Investments in bands 1b and 1c, which have less influence, would be expected to achieve a lower threshold target. By 2040, GPs should aim to approach or achieve 100% of invested capital "managed in aligning with net zero" across all three direct investment bands. By 2050 all investments should achieve net zero.

In **figure 6** below, we suggest a 2050 glide path of target thresholds across influence bands that aligns with the guidelines specified above. This can be used by GPs as a starting point for establishing appropriate targets.

Figure 6: Illustrative glide path for PE Portfolio Coverage Target thresholds[3]

Asset classes	Band	% of invested/committed capital managed in alignment with NZ by...		
		2030	2040	2050
DIRECT • GP buyout fund • GP growth fund • GP continuation fund	1a	**80%** Invested cap.	**100%** Invested cap.	**100%** Invested cap.
	1b	**30%** Invested cap.	**80%** Invested cap.	**100%** Invested cap.
	1c	**20%** Invested cap.	**80%** Invested cap.	**100%** Invested cap.
INDIRECT • LP investments in buyout, growth or continuation funds • LP co-investment • GP fund of funds • LP-led secondaries	2a	**44%** Committed cap.	**100%** Committed cap.	**100%** Invested cap.
	2b	**33%** Committed cap.	**90%** Committed cap.	**100%** Invested cap.
	2c	**10%** Committed cap.	**80%** Committed cap.	**100%** Invested cap.

Illustrative glide path thresholds

NZIF Targets

* LPs set their targets using committed capital because it is a metric they have more direct control over, and it more accurately reflects current actions taken. LPs are encouraged to simultaneously report current performance using invested capital., as this reflects how capital is actually deployed at a given time. Because of investment periods and the one-year window to achieve the first milestone, invested capital performance is expected to lag committed capital.

Most funds and portfolios will include investments that span across more than one influence band. In this case, the weighted average of invested capital based on the anticipated distribution across bands should inform the target. For example, based on the glide path established in **figure 6,** a GP expecting to have 80% of invested capital in band 1a and 20% of invested capital in band 1b could set a target to manage 70% of the total invested capital in alignment with net zero by 2030.

Net zero committed GPs can set two types of portfolio coverage targets: fund-level targets and firm-level portfolio milestone targets.

Fund-level targets

For all new funds raised after committing to net zero, the GP establishes a target percentage of the fund's invested capital that will be managed in alignment with net zero. See above for guidance on setting an appropriate target threshold.

The fund-level net zero target should be shared with LPs during fundraising in the fund marketing materials, similar to how funds share forecasted financial returns[4]. This will enable LPs to make asset allocation decisions in furtherance of their own net zero commitments and calculate their net zero committed capital.

Because of legal commitments made to LPs as part of legacy funds, it may be difficult to add a net zero commitment after capital has been committed and deployed. As a result, funds raised prior to the GP making their net zero commitment do not need to be included, though GPs are encouraged to manage as many of their existing assets in alignment with net zero ambitions as possible. Data on net zero alignment of existing funds can be reported to LPs and counted toward the LP's own commitment on a voluntary basis.

3 The exponential nature of the glide path threshold values front loads alignment to help proportionally close the 19-22 GtCO2e emissions gap toward 1.5°C to limit the impacts of global warming as established by the IPCC's AR6 Synthesis Report. This front loading approach is critical to sharply increase investment in GHG reduction, as highlighted by the International Energy Agency findings that an additional 4 trillion USD in investment in clean energy alone is needed to 2030 to close the gap to 1.5°C.

4 Disclaimers on forward-looking statements would likely be necessary.

Firm-level portfolio milestone targets

The second type of portfolio coverage target that GPs can commit to meet are firm-level portfolio milestone targets for 2030, 2040, and 2050 across their full PE portfolio (excluding funds that launched prior to the GP committing to net zero). See above for guidance on setting an appropriate target threshold.

A firm-level portfolio milestone target for 2030, 2040 and 2050 should be assessed as of December 31 of the target year. Progress toward the target should be assessed annually[5].

The high-emitting industry list

Because portfolio companies in certain sectors are likely to represent a disproportionate amount of carbon emissions, PCs that fall into industries deemed to be high emitting (see NZIF 1.0) are asked to be managed in alignment with net zero. If a GP does not meet this expectation, they are invited to report transparently to their LPs with an explanation. Also, because GPs are asked to report the portion of investments managed in alignment with net zero using both invested capital and financed emissions, LPs will see if GPs are failing to prioritise high-emitting investments in their net zero efforts.

Investments in high-emitting industries are expected to set more robust climate strategies (see **figure 5**). In addition, those that fall into bands 1B or 1C are also subject to additional recommended engagement actions (see **figure 7**).

4.1.3 Private Equity Engagement Threshold Targets for GPs

In situations where the GP does not get to appoint a majority of voting seats in a PC's board (bands 1b and 1c), engagement with other investors sitting on the board becomes an important practice to advance net zero efforts. Engagement also helps to drive broader uptake of net zero commitments across the PE ecosystem, making achievement of net zero more feasible for all actors.

GPs are requested to complete the engagement actions specified below in **figure 7** for 100% of investments that are not being managed in alignment with net zero.

5 Communication of the firm-level portfolio milestone target to investors or other stakeholders would likely require forward-looking statement disclaimers.

Figure 7: Table of recommended GP engagement actions

Asset classes	Band	Criteria	Required Engagement Actions	Timing
DIRECT • GP buyout fund • GP growth fund • GP continuation fund	**1a**	> 50% board votes	No engagement requirement. Engagement directly with PCs is expected in pursuing alignment targets or portfolio reference targets but is not covered under the Private Equity Engagement Threshold Target.	N/A

	1b	≤ 50% board votes	**Universal**
			• Inform other board members of your firm's net zero commitment.
			• Request that climate risks and opportunities be a regular agenda item for board meetings
			• Request that the PC be managed in alignment with NZ and that as a first step, management is asked to develop a net zero proposal that should be presented to the board of directors for a formal vote. The proposal should include:
			  • Importance of net zero and business benefits for the company
			  • Action plan for implementation
			  • Estimates of cost and impact associated with the plan
			Conditional
			• If, prior to investment, the target company is in a high-emitting industry and co-owners are not in agreement to manage the company in alignment with net zero, the investment's potential mis-alignment with the net zero commitment should be explicitly raised at the investment committee.
				• Within 1 year
				• Within 1 year
				• Within 1 year
				• Prior to investment

	1c	No board votes	**Universal** • Communicate with the largest co-owners/shareholders to share your net zero commitment and express your organization's desire to have the portfolio company managed in alignment with net zero. **Conditional** • If, prior to investment, the target company is in a high-emitting industry and co-owners are not in agreement to manage the company in alignment with net zero, the investment's potential mis-alignment with the net zero commitment should be explicitly raised at the investment committee.	• Within 1 year • Prior to investment

4.1.4 PE allocation to Climate Solutions Target

GPs can set firm-level and fund-level targets to increase investment in climate solutions (% invested capital associated with climate solutions). Please reference forthcoming publications by IIGCC on climate solutions for more detailed guidance on definitions and measurement for private markets.

If these targets are set, GPs should report relevant progress metrics to LPs (see Section 4.1.6 – GP Reporting).

4.1.5 PE Portfolio Decarbonisation Reference Target

GPs may set a time-relevant absolute or intensity CO2e emissions reduction target covering Scope 1 and 2 emissions (with Scope 3 phased in where possible). The target should align with relevant fair share of global and regional decarbonisation pathways.

To the extent possible, GPs should provide evidence of how the target has been determined and a) reflects net zero pathways that will meet absolute emissions reductions required over time, and b) is adjusted to take account of factors that are not related to real economy emissions reductions[6] as relevant.

6 Non-relevant variables such as exchange rate, inflation and interest rate.

4.1.6 GP Reporting

GPs are asked to report net zero-related metrics to LPs no less than annually. The disclosure should be incorporated into existing annual fund reporting cycles. GPs should begin reporting on net zero-related metrics in the reporting cycle that follows the one-year post deal close milestone. This allows GPs to begin to make progress against alignment criteria prior to any reporting requirements. LPs will use the data reported by GPs to calculate their own performance on key metrics.

It is therefore important for GPs to provide sufficient data to LPs. The information to be reported includes the following[7]:

Standard target reporting

- For each PC owned by the fund:
    - Binary "Yes/No" assessment for each PC on their status of being "managed in alignment with net zero" (fund of funds and LPs should assume PCs are not managed in alignment if GPs do not report)
    - Scope 1 & 2 emissions (total PC emissions and financed emissions following PCAF guidelines where known—highlight data gaps)
    - Scope 3 emissions (total PC emissions and financed emissions following PCAF guidelines where known—highlight data gaps)
    - Total invested capital in the PC
    - Net asset value of the PC
- For the fund in which the LP is invested, report progress against net zero commitments made for the fund (i.e., the % of invested capital emissions being managed in alignment with net zero).
- For the fund in which the LP is invested, share qualitative and quantitative updates on engagement actions taken to demonstrate that engagement expectations are being met. Consider sharing outcomes.
- Across all private equity funds established after the GP's net zero commitment, report on progress toward the next firm-level portfolio coverage milestone target (2030, 2040, 2050).
- Across all private equity funds established after the GP's net zero commitment, report on the GP's total financed emissions (highlight data gaps).

Reporting for optional targets

- If an allocation to climate solutions target was set for a fund:
    - For the fund in which the LP is invested, report progress against the target by sharing the % of the fund's invested capital associated with climate solutions.
    - For the fund in which the LP is invested, share which PCs are considered to be investments in climate solutions.
- If a portfolio decarbonisation reference target was set:
    - Emissions reductions achieved in aggregate at the PC level (captured through standard target reporting listed above).
    - Progress towards an absolute or intensity target at the firm's portfolio-level.

Continuation funds

Where the GP establishes a continuation vehicle, often referred to as "continuation fund," in an existing PC or multiple PCs from a legacy fund and where a new Limited Partnership Agreement is being established, these investments would need to be managed as a new GP investment falling into bands 1a, 1b, or 1c.

LPs investments in continuation funds, would be considered new investments and fall under bands 2a or 2b.

7 Subject to restrictions on sharing any competitively sensitive information, to be assessed by the GPs before disclosing.

4.2 Limited Partners

4.2.1 The Role of Limited Partners

While LPs sit two—sometimes three—steps away from the actual operations of PCs, they may have an opportunity to influence the practices of GPs through the commitment of their capital. Because most LPs engage with many GPs, their potential to catalyse and encourage real world decarbonisation is substantial.

In fact, many LPs have already committed to net zero and they are encouraged to lean into appropriate engagement actions that may rapidly shift GP behavior in future funds.

This Guidance establishes four target types that LPs can set, and details on each are presented in the sections that follow.

4.2.2 Portfolio Coverage Targets for LPs

For the milestone years of 2030, 2040, and 2050, LPs should seek to increase the amount of committed capital that GPs plan to manage in alignment with net zero. For example, "45% of PE committed capital will be managed by GPs in alignment with net zero by 2030."

In practice, this means selecting funds and managers that have committed to net zero will support PCs to meet the guidelines and will regularly report metrics on progress. This Guidance also encourages LPs to avoid investments in industries whose primary activity is no longer considered permissible within a credible net zero pathway.

Appropriate ambition is informed by the anticipated distribution of investments across the influence bands. Most LP investments will fall into indirect investment bands 2a, 2b, and 2c. Co-investments made by LPs into specific portfolio companies are also categorised into indirect influence bands. If LPs have direct investment programs, those investments should be considered under bands 1a, 1b, and 1c, and would follow guidance in section 4.1.

By 2050, 100% of committed capital across the indirect bands should be net zero. By this milestone 100% of invested capital should also achieve net zero. In **figure 6** we suggest a potential glide path of 2030 and 2040 milestone targets that could enable a net zero PE investment portfolio by 2050.

The 2030 and 2040 targets are based on committed capital and vary based on influence band. The illustrative glide path presented in **figure 6** can be used by LPs as a starting point for establishing appropriate portfolio coverage targets for the milestone years. IIGCC will aim to monitor evolving market conditions and progress In developing their own targets, LPs should consider the following principles:

- Seek to ramp up investment in funds managed in alignment with net zero as quickly as possible to keep pace with the reductions that climate science says are necessary;
- Balance the need for fast action with an understanding that increased adoption of net zero practices across the private equity industry will be necessary to provide adequate investment options to LPs;
- Consider your organisation's ability to influence your existing GPs to take up net zero commitments;
- Anticipate differences in GP net zero uptake across specific markets/geographies in which your organisation invests; and
- Consider fund duration; If all investments need to be net zero by 2050, commitments made to a 12-year fund in 2038 should plan to be 100% managed in alignment with net zero.

The LP's milestone target and calculation of performance should consider the percent of invested capital that the GP plans to manage in alignment with net zero. Especially in early years, many GPs will set fund-level targets to manage less than 100% of invested capital in alignment with net zero. LPs should apply the GP's fund-level commitment percentage (based on final invested capital) to the capital they are committing to the fund. For example, if an LP commits $100 million to a fund and the fund manager has committed to manage 70% of the funds invested capital in alignment with net zero, then the LP would count $70 million towards their committed capital target.

Calculation of progress toward the LP's targets should include all committed capital that was committed after the LP made a commitment to achieve net zero or this Guidance was released (whichever came later). Committed capital that was committed prior to this point can be omitted.

On an annual basis, LPs should also calculate and disclose[8] the percent of invested capital being managed in alignment with net zero, as this reflects the reality of how investments are actually being managed. These calculations should be based on actual performance reported by GPs and not assumed to be equivalent to a fund's target. As above, investments that were made prior to the LP's net zero commitment or the release of this guidance release can be excluded.

See **Appendix 2) LP Portfolio Coverage Target progress calculation example** for additional guidance on progress calculations.

4.2.3 Private Equity Engagement Threshold Targets for LPs

For LPs to meet their portfolio coverage targets, they will need to be successful at engaging and influencing GPs to adopt net zero practices. As such, LP private equity engagement threshold targets are arguably one of the most important elements of this Guidance.

LPs are asked to complete the recommended engagement actions specified below in **figure 8** for 100% of investments. The intention is that LPs build these practices into their standard operating procedures.

8 Subject to restrictions on sharing any competitively sensitive information, to be assessed by the LP before disclosing.

Figure 8: Table of recommended LP engagement activities

Asset classes	Band	Criteria	Required Engagement Actions	Timing

INDIRECT
• LP investments in buyout, growth or continuation funds
• LP co-investment
• GP fund of funds
• LP-led secondaries
	2a and 2b	Investment made during fund raise	**Universal actions after committing to net zero**
			• Send a letter to all the following: the Chairman of the Board, the CEO, Investor Relations, and the ESG leader of every GP in which you invest. The letter should share your commitment to net zero, your expectation of GPs to adopt net zero practices in new funds, and how consideration of net zero could impact your investment decisions going forward. Request that the GP make their own net zero commitment and have Limited Partnership Agreements stipulate a commitment to net zero.
			Universal actions during fund selection
			• Engage with senior leaders of the GP, including Investor Relations, to request the fund include a commitment to net zero within the Limited Partnership Agreement. If that is rejected, propose a side letter with the GP that stipulates a commitment by the GP to manage a portion of the invested capital in line with net zero. The specific percent of invested capital can be negotiated.
			  • LPs can choose to invest with GPs that refuse to align with net zero. But, over time, the proportion of capital that LPs can commit to GPs that don't manage in alignment will diminish rapidly. LPs should make sure this dynamic is clearly understood by GPs that refuse to align.
			Conditional actions during ownership
			• If you have an LPAC seat:
			  • Request that climate-related performance is integrated into LPAC reporting for the fund.
			  • If the GP is not meeting its net zero targets, request net zero performance as an LPAC agenda item.
			• If you don't have an LPAC seat:
			  • Engage with other LPs to discuss and seek to collectively push for net zero commitments at the GP level AND/OR when attending a GP's annual investor day, raise net zero as a concern and share your expectation that the GP will commit future funds.
			  • If the GP is not meeting its net zero targets, hold a meeting with ESG lead and relevant senior leader(s) at the GP to raise your concern and seek assurances the situation will be rectified.
				• Withing 6 months of making your net zero commitment
				• Before making fund selection
				• Within 1 year
				• If targets are not on track to be met
				• Within first 3 years
				• If targets are not on track to be met

	2c	Investment made through secondaries market	**Universal actions after committing to net zero**
			• Send a letter to all the following: the Chairman of the Board, the CEO, Investor Relations, the ESG leader of every GP in which you invest. The letter should share your commitment to net zero, your expectation of GPs to adopt net zero practices in new funds, and how consideration of net zero could impact your investment decisions going forward. Request that the GP make their own net zero commitment and have Limited Partnership Agreements stipulate a commitment to net zero.
			Universal actions during fund selection
			• Engage with senior leaders of the GP, including Investor Relations, to make clear your commitment to net zero, and how consideration of net zero will impact your investment decisions going forward. Request that the GP make their own net zero commitment.
			  • LPs can choose to invest with GPs that refuse to align with net zero. But, over time, the proportion of capital that LPs can commit to GPs that don't manage in alignment will diminish rapidly. LPs should make sure this dynamic is clearly understood by GPs that refuse to align.
			Conditional actions during ownership
			• If you have an LPAC seat you should:
			  • Request that climate-related performance is integrated into LPAC reporting for the fund.
			  • If the GP is not meeting its net zero targets, request net zero performance as an LPAC agenda item.
			• If you don't have an LPAC seat you should:
			  • Engage with other LPs to discuss and seek to collectively push for net zero commitments at the GP level AND/OR when attending a GP's annual investor day, raise net zero as a concern and share your expectation that the GP will commit future funds.
			  • If the GP is not meeting its net zero targets, hold a meeting with ESG lead and relevant senior leader(s) at the GP to raise your concern and seek assurances the situation will be rectified.
				• Withing 6 months of making your net zero commitment
				• Before making fund selection
				• Within 1 year
				• If targets are not on track to be met
				• Within first 3 years
				• If targets are not on track to be met

Beyond the specific actions described above, we encourage LPs to think creatively about how to inspire rapid and broad uptake of net zero practices by GPs.

LP co-investments

Even though co-investments are made in a single PC, they are still considered to fall under the indirect influence bands since the investment is made within the blind pool structure, with the GP taking the lead on engaging directly with the PC. A co-investment should be considered in the same influence band as the initial investment in the fund.

In addition to engagement actions described for bands 2a and 2b, LPs should, subject to relevant regulation and strategy, consider undertaking the following additional engagement actions for their co-investments:

- Screen out co-investment opportunities in high-emitting sectors if the GP does not intend to implement a net zero transition plan or there is no viable pathway to net zero.
- Engage with the GP on the specific PC in which the co-investment was made to request it be managed in alignment with net zero.

4.2.4 PE allocation to Climate Solutions Target

LPs may set an allocation to climate solutions target for milestone years of 2030, 2040, and 2050. There are no required thresholds for climate solutions, but LPs are encouraged to invest additional capital toward these important investments while fulfilling their mandate and fiduciary duty.

Climate solutions can be defined as % invested capital associated with climate solutions. Please reference forthcoming publications by IIGCC on climate solutions for more detailed guidance on definitions and measurement.

4.2.5 PE Portfolio Decarbonisation Reference Target

LPs may set a time-relevant absolute or intensity CO2e emissions reduction target covering Scope 1 and 2 emissions (with Scope 3 phased in where possible). The target should align with relevant fair share of global and regional decarbonisation pathways.

To the extent possible, LPs should provide evidence of how the target has been determined and a) reflects net zero pathways that will meet absolute emissions reductions required over time, and b) is adjusted to take account of factors that are not related to real economy emissions reductions[9] as relevant.

4.2.6 LP Reporting

LPs are asked to monitor their progress toward their targets no less than annually. Under this Guidance, LPs are encouraged to report on their progress to their clients or publicly, as appropriate. The information that should be reported includes the following[10]:

Standard target reporting

- Across all PE investments, report on progress toward the next firm-level milestone portfolio coverage target (2030, 2040, 2050) by sharing the % of committed capital that will be managed in alignment with net zero (based on fund-level commitments).
- Across all PE investments, report on the % of invested capital that has been managed in alignment with net zero for the reporting year (based on data reported from GPs):
  - Performance can additionally be calculated and communicated using financed emissions or net asset value.
- Across all PE investments, share qualitative and quantitative updates on engagement actions taken to demonstrate the private equity engagement threshold target is being met. Consider sharing outcomes.
- Across all PE investments, share financed emissions attributable to the LP's stake (as known; identify gaps).
- Across all PE investments, share the percent invested capital associated with climate solutions.

Reporting for optional targets

- If a portfolio decarbonisation reference target was set:
  - Net emissions reductions achieved across all funds and their underlying PCs.
  - Progress towards an absolute or intensity target at the portfolio-level.

9 Non-relevant variables such as exchange rate, inflation and interest rate.
10 Subject to restrictions on sharing any competitively sensitive information, to be assessed by the GPs before disclosing.

Fund of funds

A fund of funds is a pooled investment fund that invests in buyout or growth funds. Fund of funds occupy a space between asset managers and asset owners.

They are similar to LPs because they invest in funds managed by GPs and, often, they make coinvestments with those GPs. However, Like GPs, fund of funds managers also form general partnership agreements with LPs that invest with them. As a result, this Guidance recommends that fund of funds follow the target-setting guidance for Limited Partners (generally falling into bands 2a or 2b) while following the reporting expectations for direct investment GPs.

Fund of funds should follow target-setting guidance for LPs while taking into account three important exceptions:

1. Set fund-level coverage targets in addition to firm-level portfolio milestone coverage targets, as expected of GPs, though these targets should be based on committed capital;
2. Communicate to prospective LPs a target percentage of the fund's invested capital that will be managed in alignment with net zero for all new funds raised;
3. An allocation to climate solutions target is considered to be optional for fund of funds.

Fund of funds are expected to report following guidance for GPs, though reporting on progress toward portfolio coverage targets should be based on committed capital rather than invested capital. Fund of funds should also pass through PC-level information to their LPs to the extent this information is available[11].

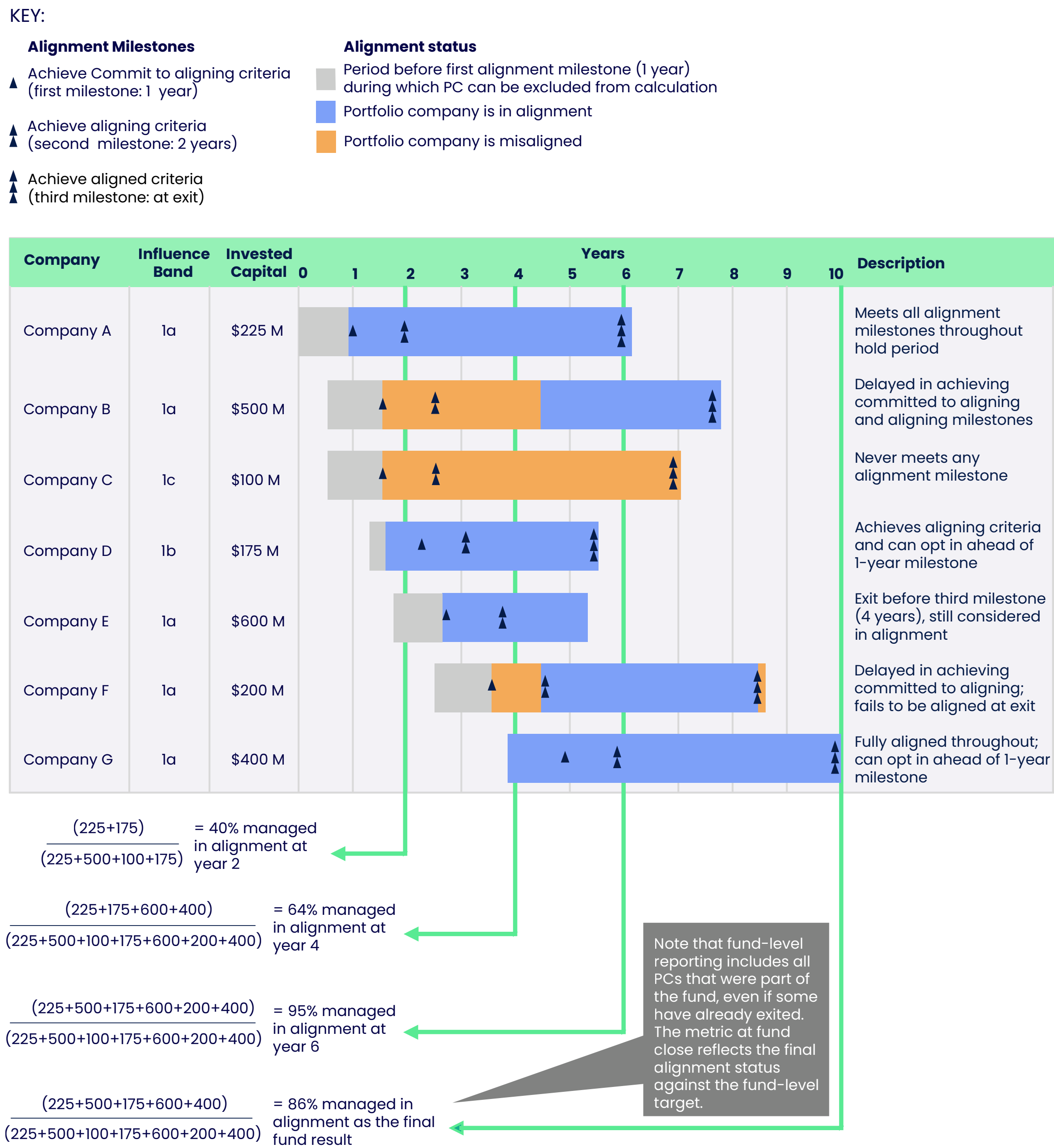
11 Subject to restrictions on sharing any competitively sensitive information, to be assessed by the fund manager before disclosing.

Appendix

1) GP PE Portfolio Coverage Target calculation example

The graphic below depicts an illustrative fund and demonstrates how the GP would calculate the fund's alignment at years two, four, six, and at fund close (assuming fund vintage is prior to 2030). In practice, these calculations would need to be completed annually. On the same date each year, the percent of the portfolio managed in alignment with net zero is calculated as the total invested capital of PCs managed in alignment with net zero divided by the total invested capital of all PCs.

Figure 9: GP progress calculation example



2) LP PE Portfolio Coverage Target progress calculation example

The table below shows an illustrative example of how an LP would calculate performance against its portfolio coverage target. In this example the LP has invested in seven different funds, which are at different stages in deploying capital. Two calculations are illustrated: calculation of committed capital, which represents progress toward the LP's target, and calculation of invested capital, which LPs should calculate annually and share with key stakeholders.

Figure 10: LP target performance calculation example

	Committed capital calculation			Invested capital calculation			
Fund	**Fund-level net zero commitment**	**Committed capital ($ M)**	**Committed capital to be managed in alignment ($ M)**	**PC**	**Managed in alignment**	**Invested Capital by the LP ($ M)**	**LP's Invested Capital in Alignment ($ M)**
Fund 1	80%	75	60	PC A	Yes	15	15
				PC B	Yes	20	20
				PC C	No	9	-
				PC D	Yes	12	12
				PC E	Yes	16	16
Fund 2	0%	82	0	PC F	No	7	-
				PC G	No	10	-
				PC H	No	19	-
				PC I	No	18	-
				PC J	No	13	-
				PC K	No	13	-
Fund 3	70%	80	56	PC L	Yes	12	12
				PC M	No	15	-
				PC N	No	10	-
				PC O	Yes	21	21
Fund 4	50%	86	43	PC P	No	5	-
				PC Q	No	16	
Fund 5	90%	90	81	PC R	Yes	14	14
				PC S	Yes	11	11
				PC T	NA*	17	-
Fund 6	80%	50	40	PC U	Yes	18	18
				PC V	NA*	12	-
Fund 7	50%	64	32	PC W	NA*	14	-
				PC X	NA*	7	-
TOTALS:		**527**	**312**			**274**	**139**

$\frac{\$312}{\$527}$ = 59% of committed capital to be managed in alignment with net zero

$\frac{\$139}{\$274}$ = 51% of invested capital managed in alignment with net zero

*PCs marked as NA reflect companies acquired within the last year which are not required to be included in alignment calculations.

3) Approaches for transitioning a portfolio and increasing alignment with net zero

The following elements set out 'best practice' transition-enabling actions that can be applied by LPs and GPs respectively, and at different stages of the investment cycle, to increase the alignment of their portfolios. The actions listed here are additional to those contained in the body of the Guidance above and are helpful supporting actions to advance progress toward net zero.

Limited Partners

Portfolio assessment and management

- Include PE assets in net zero commitments, climate-risk governance and TCFD reporting. This includes monitoring and reporting on aggregated carbon performance and achievement of milestones/actions of PCs and funds based on requested reporting from GPs.
- Prioritise GP engagement strategies through the climate risk mapping and carbon footprinting of existing PE portfolios e.g. review high emitting sector exposures (by invested capital) where sector data for underlying PCs is available; or establish priorities using estimated carbon footprint data and modelling (where available) to identify the most exposed funds.
- Include net zero and climate risk assessment in investment committee sign-off processes/memos to approve commitments to new funds and GP co-investments.
- Refer to standard frameworks developed by ILPA, the TCFD, BVCA, iCI etc. to increase allocation to GPs who are more mature in their response to climate risk management.
- Introduce an appropriate fossil fuel investment policy e.g., avoid new investment in thermal coal and tar sands (per the NZIF 1.0 recommendation).
- Upskill in-house legal counsel, compliance team, and fund administration teams with training and guidance to represent net zero alignment within side letters and deal terms.
- Collaborate with industry bodies to advance best practice and standards to facilitate Paris-alignment in the PE sector.

GP Selection

LPs may wish to select GPs based on fulfillment of one or more of the following:

- GP compliance with the recommendations of TCFD and Transition Plan Taskforce (TPT) in relation to climate-related financial risk and transition risk.

GP Engagement

- LPs may request information from the GP on climate risk management in pitch book materials. The ILPA Due Diligence Questionnaire (DDQ) 2.011, for example, includes questions that managers should address on climate in fund marketing materials.
- LPs may work alongside other LPs, GPs and industry bodies to advance best practice and standards to facilitate Paris-alignment in the PE sector, such as adoption of Science Based Targets.

Co-investment

- Consider "positive screening" to increase allocation to PCs which represent 'climate solutions', as defined by the climate solutions guidance to be released by IIGCC.

General Partners

Portfolio assessment and management

- Build skills and capacity to better understand the value of climate risk, opportunities and net zero, and commercialise net zero intellectual property.
- Implement TCFD recommendations, including scenario analysis, and disclosures in relation to climate-related financial risk as a firm across the portfolio.
- Develop capacity and resource to support PCs in the delivery of net zero In asset management.
- Enable 'climate-literacy' programs for investment teams and portfolio company board directors.

Pre/During acquisition

- Expand due diligence to include climate risk analysis to inform valuations, exit strategies and identify opportunities to increase investment in climate solutions.
- Include net zero and climate risk assessment in investment committee sign-off processes/ memos.
- Ensure shareholder agreement includes appropriate terms in relation to climate risk governance, performance, management and reporting.
- Consider inclusion of climate risk management KPIs in leverage for the deal. Details can be agreed at a later date in a competitive/ time constrained deal situation.

During holding period

- Frontload decarbonisation strategy development and planning to include as part of 100-day plans and value creation plans.
- Define TCFD aligned governance/management responsibilities for climate change in each PC, including establishing remuneration linkage to delivering on targets/climate strategy as relevant.
- Support PC management with educational/ operational guidance on managing climate performance and implementing a net zero strategy.

At Exit

- Include an updated net zero and climate risk assessment profile of each PC as part of the exit documentation.

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