

# PARIS ALIGNED INVESTMENT INITIATIVE

## Net Zero Investment Framework for the Private Debt Industry

Produced by



Supported by



Investor  
Group on  
Climate  
Change



## Disclaimer

All written materials, communications, surveys and initiatives undertaken by PAII are designed solely to support investors in understanding risks and opportunities associated with climate change and take action to address them. PAII and its signatories are committed to complying with all laws and regulations that apply to them, including antitrust and other regulatory laws and regulations and the restrictions on information exchange and other collaborative engagement that said laws and regulations impose. These materials serve as a guidance only and must not be used by competing companies to reach anticompetitive agreements. Whilst PAII, as a voluntary initiative, encourages investors to adopt the guidance to assist them in meeting their own voluntary net zero commitments, the choice to adopt guidance, best practice tools or tactics prepared by PAII is always at the ultimate discretion of individual investors based on their own strategies, agendas, starting points and regulatory considerations from which and with which, they make their own unilateral internal decisions regarding the ways and means with which they will set and reach net zero targets.

The information contained in this guidance is general in nature. It does not comprise, constitute or provide personal, specific or individual recommendations or advice, of any kind. In particular, it does not comprise, constitute or provide, nor should it be relied upon as, legal, investment or financial advice, an invitation, a solicitation, an inducement or a recommendation, to buy or sell any security or other financial, credit or lending product, to engage in any investment strategy or activity, nor an offer of any financial service. The guidance is made available with the understanding and expectation that each user will, with due care and diligence, conduct its own investigations and evaluations, and seek its own professional advice.

PAII's materials and services to members do not include financial, legal or investment advice.

## Acknowledgements

The development of this Net Zero Investment Framework for Private Debt has been led by Misa Andriamihaja at IIGCC with significant support from Peter Ellsworth at Ceres.

We are grateful to the IIGCC Private Markets working group members, all the members (participants and observers) of the Private Debt Industry Focus Group including Cassandra Fahy and Niamh Whooley from Pemberton; Lindee Wong from Tikehau Capital; Nathan Brown from Arcmont Asset Management; Sonia Rocher from Blackrock Private Debt and Fabio Ranghino from Ambienta for steering and/or contributing to the development of this Net Zero Investment Framework for Private Debt.

We would also like to thank the Hymans Robertson team led by Penny Cochrane, William Brammar, Mhairi Gooch and Tashemia Glen; who provided facilitation, research and drafting support to the group; and members of all PAII Network Partners (IIGCC, Ceres, AIGCC, IGCC) and members of initiative Climat International (iCI) who provided valuable feedback.

## Table of Contents

Executive summary.....	4
1. Background.....	11
2. Introduction to the Framework.....	12
3. Overview of the Guidance .....	14
3.1. Asset Classes Covered by this Guidance.....	14
3.2. Target types and metrics .....	17
3.3. Influence bands approach .....	18
3.4. Reporting against the Guidance .....	18
4. Implementation guide for GPs and LPs.....	20
4.1. General Partners.....	20
4.1.1. Role of General Partners.....	20
4.1.2. Private Debt Portfolio Coverage Targets for GPs.....	20
4.1.2.1. PC Alignment Criteria and Milestones .....	20
4.1.2.2. Thresholds for Portfolio Coverage Targets.....	23
4.1.3. Private Debt Engagement Threshold Targets for GPs.....	25
4.1.4. GP reporting .....	29
4.2. Limited Partners .....	29
4.2.1. The role of Limited Partners.....	29
4.2.2. Portfolio Coverage Targets for LPs .....	30
4.2.3. Private Debt Engagement Threshold Targets for LPs .....	30
4.2.4. LP reporting .....	32
Appendix.....	33
1) Approaches for transitioning a portfolio and increasing alignment with net zero .....	33
Limited Partners .....	33
General Partners .....	33
2) Worked examples using portfolio company alignment criteria .....	34

# Executive summary

## Introduction

The Net Zero Investment Framework (NZIF) aims to provide a consistent foundation for asset owners and managers to align their individual 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 individual circumstances, mandates 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 debt guidance establishes a consistent industry-wide approach to measuring progress toward net zero with an emphasis on real economy decarbonisation of borrowers of capital from the private debt market.

The guidance establishes a cohesive framework for pursuing net zero across the private debt industry



Figure 1: Roles across the private debt market

Decarbonisation at the borrower level, expressed through the implementation of their individual science-based targets and decarbonisation strategies, is a key driver to the real-economy 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 of the underlying assets.

This Guidance can be adopted by any investor active across private debt, be that in direct corporate lending, venture debt, and other segments of the market including private structured credit. 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 offers a detailed implementation guide.

This Guidance has been developed with inputs from a diverse group of participants in the private debt industry. It takes the view that, given the unique characteristics of private debt investments, distinct actions are required to set and deliver decarbonisation goals for this asset class. As such, the broader concepts of NZIF have been adapted specifically for private debt investments to capture the different normative practices, legal structures and regulation which define this industry. To ensure a consistent approach across private markets, the Guidance leverages the existing Private Equity (PE) NZIF component as the starting point to design a framework suitable for private debt investors.

The aim of this Guidance is to promote clarity and enable action in assessing and disclosing climate-related risks within private debt investments, much like the advent of the Taskforce on Climate-related Financial Disclosures (TCFD) did in public markets. The integration of climate change risks and opportunities into investment practice has advanced

much more slowly in the private markets than in the public ones, and this Guidance provides an avenue to progress these practices in private debt investment. It also provides ways to standardise target-setting, engagement and reporting between Limited Partners (LPs), General Partners (GPs) and Portfolio Companies (PCs) to support progress towards net zero at scale in the private debt industry. For the avoidance of doubt, the Guidance refers to borrowers of private debt as Portfolio Companies. Private debt asset managers are referenced throughout the Guidance as GPs. LPs are investors or asset owners investing in a fund provided by a GP. All investors who lend directly should follow the Guidance set out for GPs.

Public markets have broader coverage 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 Debt Guidance

The existence of nuances in private debt (and in most cases PE) have led to new concepts being developed or reiterated as part of this Guidance, which for those using NZIF more broadly, should only be used in relation to private debt investments. Where there are multiple guidance documents available for investment types that do not specifically relate to trading companies e.g., Infrastructure or Real Estate debt funds, then the specific asset class guidance should be followed as a principle where possible. These new concepts are outlined in Figure 2.

This private debt guidance establishes a consistent industry-wide approach to measuring progress toward net zero with an emphasis on real economy decarbonisation of borrowers of capital from the private debt market.

Over time, as industry norms and regulations 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 debt industry and as playing an important role in shaping the future net zero economy.

New concept	Related NZIF concept	Divergence	Reasoning	As per PE Guidance
<b>Private Debt Portfolio Coverage Target: 'Managed in alignment with net zero'</b>	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 maturity level of private debt investments and the need to adapt these concepts for the private markets sphere, a more binary check over time is appropriate.	Yes
<b>Private Debt Portfolio Coverage Target: 'Milestones'</b>	Portfolio Coverage Target: 5-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.	Yes
<b>Private Debt Portfolio Coverage Target &amp; Private Debt Engagement Threshold Target: Influence Bands</b>	Private Debt Portfolio Coverage Target & private debt 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%.	GPs are generally the only actors engaging with PCs and have differing levels of influence depending on their positioning within the deal. LPs will also have varying levels of influence with GPs depending on how and when they invest.	Yes
<b>Private Debt Portfolio Coverage Target: Grace Period</b>	N/A	N/A	Given the challenges that private debt GPs face with collecting data and information from PCs around net zero targets and for the purposes of this Guidance only, a <b>12 month 'grace period' after deal close</b> has been introduced to give GPs more time to collect the relevant information for reporting against the NZIF and engage with PCs to improve transparency, get PC's expression of intent to progressing along PC criteria and potentially finalising deal terms such as ESG margin ratchets.	Specific to Private Debt

Figure 2: New concepts for private debt

## Target Types

There are two types of targets that can be set to support the net zero transition of the private debt industry, Private Debt Portfolio Coverage and Private Debt Engagement Threshold targets. Subject always to the fact that the NZIF is a voluntary framework and investors make their own unilateral decisions based on their individual strategies, agendas and mandates, these two targets are the recommended starting points for both LPs and GPs. It is worth noting that LPs using the NZIF likely will already have or are considering establishing a Portfolio Decarbonization Reference Target and an Allocation to climate solutions investments and these portfolio level objectives span all asset classes. Consequently, and very much like for Private Equity; while GPs are encouraged to set the same objectives in the future; they will remain entirely optional / on a voluntary basis only.

## Private Debt Portfolio Coverage Targets

There are two types of targets that can be set to Portfolio coverage targets seek to increase the percentage of underlying PCs that are “managed in alignment with net zero<sup>1</sup>”. GPs and LPs set portfolio coverage targets that cover all private debt investments for the milestone years of 2030 and 2040. By 2050, 100% of private debt 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 their own investment decisions and GP selection. The fund-level targets also 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.

For the avoidance of doubt these targets will only apply to funds launched after the publication of this Guidance, however GPs and LPs are encouraged to manage as many of their existing assets in alignment with net zero as possible.

Target Type	Description	Metrics
<b>Private Debt Portfolio Coverage Target</b>	A % of invested capital or financed emissions to be managed in alignment with net zero by 2030 and an increased percentage by 2040; achieve 100% net zero by 2050.	GPs: Invested Capital and/or Financed Emissions  LPs: Committed Capital and/or Financed Emissions
<b>Private Debt Engagement Threshold Target</b>	Complete the specified engagement actions for all (100%) private debt investments in scope.	GPs: Invested Capital and/or Financed Emissions

Figure 3: Target types for private debt

<sup>1</sup> See figure 4, 13, 14.

## Managed in alignment with net zero.

### To be considered “managed in alignment with net zero”, portfolio companies are asked to:

- Express an intent to progress one step further on the ‘managed in alignment scale\*’, from their current alignment status and achieving this by exit of the loan.
- Achieve “net zero” status by 2050\*\*

\*See Figure 14 for further details.

### For each PC GPs are asked to:

- Assess each PCs current alignment status preferably pre-deal close or within the defined grace period after deal close. Get an expression of intent from and support the PC to move one step further along the alignment criteria (outlined later in this paper, reference Figure 14)\*\*
- This step should then be achieved before exit.
- In addition, Figures 17 and 18 outline recommended engagement actions with PCs and private equity sponsors (if applicable)

\*\*for positions projected to remain in portfolios by 2050

\*\*\* Whilst this guidance only requires PCs to move one step further along the alignment scale, efforts to make multiple steps are strongly encouraged and will become more important from 2040 onwards when we anticipate that achieving the initial steps should become easier and faster; and the majority of the companies will already be well advanced (aligning or aligned) along the alignment scale with a clear path to net zero by 2050.

Figure 4: Key expectations for portfolio companies and GPs

## Private Debt Engagement Threshold Targets

Active engagement to drive uptake of net zero practices in the private debt industry is one of the most important actions in this Guidance. The adoption of net zero practices in private debt should be seen as a risk mitigation tool. A PC that is managed in alignment with net zero should have a more sustainable enterprise value over the longer term (notwithstanding other factors), which should improve a company's ability to repay debt at loan maturity. It is important for GPs to engage with PCs and for LPs to engage the GPs with whom they invest. This is particularly important as most private debt GPs will have a more limited influence of PCs compared to private equity owners or shareholders. In addition, potential influence in private debt is likely to be concentrated around the deal negotiation period and the earlier days of a loan in contrast to PE influence which can be stronger and lasts throughout the holding period. Furthermore, given the prevalence of sponsored deals in private debt (where there is a PE GP who owns the PC), there should also be a sustained effort to also engage with PE sponsors on specific PC issues. With this in mind, this Guidance introduces the concept of a **"three-way engagement process between lenders (GPs), PCs, and PE sponsors** (Figure 5).

Relevant engagement actions are defined by the corresponding Influence Band (Figure 6). GPs and LPs should build net zero engagement into their standard operating procedures and complete relevant activities for 100% of investments. For GPs, this would translate into engagement attempts reaching 100% of PCs. For LPs this translates into engagement with 100% of existing and new GP commitments.

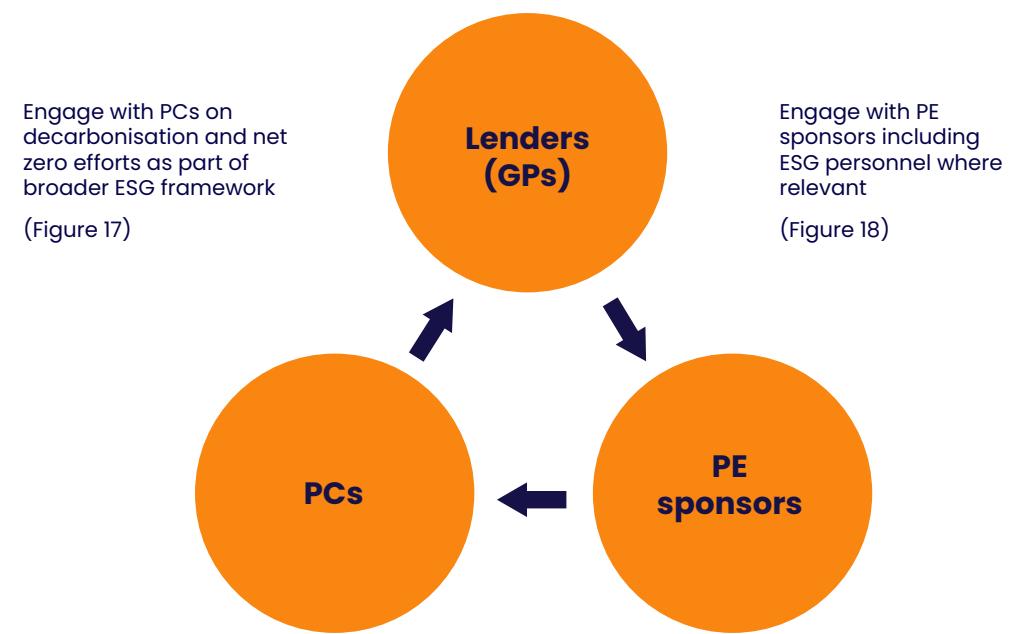


Figure 5: Relationship between GPs, PE sponsors and PCs

**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. These bands outline the relative influence of various types of private debt investors. Whilst the influence bands take a similar structure to the Private Equity influence bands detailed in the PE guidance, we do not anticipate private debt investors have the same influence as a PE investor in the equivalent band from the PE framework. This Guidance acknowledges that direct private debt investors have less influence than direct PE investors and targets have been adjusted accordingly. In addition, for this Guidance, a new band has been created to reflect the reduced access to underlying companies, obligors or collateral which is more common in structured credit.

Asset classes	Band	Private debt criteria	Influence level
<b>DIRECT</b>	<b>1a</b>	Sole lender or lead arranger of the debt and/or Holder of 50%+ of the debt tranche and/or Board observer seat and/or Any form of significant equity holding <sup>2</sup> in the deal	Strong with PCs <sup>3</sup>
	<b>1b</b>	Significant minority holder of the debt tranche (have blocking or veto rights). Between 25-50% of the debt tranche	Moderate with PCs
	<b>1c</b>	Small participant of tranche: less than 25%	Limited with PCs
	<b>1d</b>	Any % tranche holding where limited scope to negotiate directly with underlying company / collateral	Highly limited with PCs
<b>INDIRECT</b>	<b>2a</b>	Big ticket investors* and/or first close	Strong with GPs
	<b>2b</b>	Investment made during fund raising, not 2a. Co-investment	Moderate with GPs
	<b>2c</b>	Investment via secondaries	Limited with GPs

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

Figure 6: Table of influence bands for private debt

<sup>2</sup> Significant equity holding is defined as 10% or more

<sup>3</sup> Noted that influence level is relative within private credit

## 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 beneficiaries or regulators where applicable. In addition, GPs are encouraged to share, where permissible, 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”. GPs are encouraged to also report on the alignment status of each PC.
- Scope 1 & 2 emissions (total PC emissions and financed emissions following Partnership for Carbon Accounting Financial guidelines for the full fund’s investment where known—highlight data gaps)
- Scope 3 emissions (total PC emissions and financed emissions following PCAF guidelines for the full fund’s investment where known—highlight data gaps)
- Total invested capital (i.e. the amount deployed) in the PC by the fund, mandate or account
- Net asset value of debt at the PC level

**The Guidance introduces and expands upon several unique concepts which are different from NZIF PE upon which this document is based. In summary:**

- A 12 month ‘grace period’ after deal close has been introduced to give GPs more time to collect the relevant information for reporting against the NZIF and engage with PCs to improve transparency, get PC commitments to progressing along PC criteria and potentially finalising deal terms such as ESG margin ratchets.
- A “three-way” engagement model has also been introduced whereby private debt GPs should consider engaging both with their PCs but also the PE sponsors where applicable.
- Within the influence bands, 1d has been created to expand the Guidance to private debt strategies where there is typically much less influence on the underlying collateral for example certain forms of structured credit or fund financing.
- The Guidance also encourages GPs to negotiate a commitment / expression of intent from, and support PCs to move one step further on the alignment scale throughout the holding period of the asset.

**The Guidance also highlights and recommends:**

- (1) the use and adoption of climate-related ESG margin ratchets or sustainability-linked loans and/or
- (2) the inclusion of clear climate disclosures requests in loan documentations

as best practice tools for GPs to support the real economy decarbonization of portfolio companies.

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

Figure 7: Unique concepts for the private debt Guidance

# 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 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 covered four asset classes: listed equity, corporate fixed income, sovereign bonds, and real estate. The PAII subsequently published NZIF guidance for two additional asset classes: the Private Equity (PE) component to the NZIF and the Infrastructure component to the NZIF.

Following on from the completion of the PE component to the NZIF in May 2023, the IIGCC convened a private debt industry focus group comprised of a diverse set of industry participants to help develop the components of a Net Zero Investment Framework (NZIF) for private debt.



## 2. Introduction to the Framework

NZIF aims to establish a consistent basis for asset owners and asset managers to measure and manage their individual 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 individual circumstances, strategies, mandates 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 private debt components for NZIF are intended to be relevant to both Limited Partners (LP) and General Partners (GP). Direct and indirect investors in private debt that are not GPs or LPs can use the guidance where applicable, using LP guidance for indirect investors and GP guidance for direct investors. 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 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 goals including the original components in NZIF, the Net Zero Asset Owner's Alliance's (NZAOA) Target Setting Protocol and the Private Markets Decarbonisation Roadmap (PMDR). 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 debt incorporates similar concepts to those in these frameworks such as engagement targets. Similarly, the criteria of this Guidance draw upon the core TCFD pillars including governance, strategy risk management and metrics and targets.

In developing this Guidance for the private debt industry, NZIF continued to follow the five principles that have guided all NZIF framework development to date (Figure 8).

This Guidance provides an ambitious and 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 PCs are still building the systems and capabilities to complete regular and accurate GHG inventories. Within PE, 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. Therefore, the "three-way engagement" model is recommended between lenders, PCs, and PE sponsors (where applicable) to encourage consistent sharing of climate / ESG data and to foster discussions across data standardization across private markets. There are currently a number of cross-industry efforts aimed at improving data standardisation and data transparency including the ESG Data Convergence Initiative (EDCI), the ESG Integrated Disclosure Project (ESG IDP), and within the Principles for Responsible Investment (PRI).

This Guidance broadly aligns with guidance from the Science-Based Targets Initiative (SBTi), as implementation of SBTi fulfils some components of NZIF. However, the target-setting methodology set out in this Guidance allows private debt 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 consistency with the broader concepts within NZIF.

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

The PAII also notes that if policy and corporate action do not progress 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.

**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.

Figure 8: Guiding principles for developing the Framework

# 3. Overview of the Guidance

The Guidance seeks to establish a consistent industry-wide approach to setting and delivering on net zero commitments in the private debt industry (including both LPs and GPs), underpinned by the real economy decarbonisation of PCs. A PC that is managed in alignment with net zero should have a more sustainable enterprise value over the longer term (notwithstanding other factors), which should improve a company's ability to repay debt at loan maturity so net zero adoption is a risk mitigant. 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 encourages engagement and decarbonisation at the asset level, consistent with climate science across industries that will be necessary for a successful net zero transition.

Incorporating the ambition and actions of LPs, GPs, and PCs into a single set of guidance can unlock greater engagement and influence, as LPs can encourage GPs to adopt the methodology, who, in turn, seek to encourage real economy decarbonisation among their PCs. This cohesive approach also allows for a streamlining of data collection 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

### 3.1.1 Private debt for the purpose of this Guidance

For the purpose of this Guidance, private debt is defined as 'loans which are privately negotiated by non-bank lenders<sup>4</sup> and are not tradeable on public markets, thus are considered as an illiquid form of debt'. This definition for private debt represents the core focus for this Guidance and impacts the subsequent recommendations and proposals that are presented by this Guidance in its entirety. Therefore, if a sub-asset class does not perfectly fit within this definition, the Guidance may still be applied as flexibility is encouraged but it should be noted that subsequent stages outlined in the Guidance that are necessary for its implementation may not be applicable or suitable, in part or in their entirety.

This definition covers private debt to both private and public companies (although it is far more likely that issuers will be private companies). The definition covers all parts of the debt structure (i.e. senior / unitranche / junior tranches) and is mostly applicable to performing private debt.

### 3.1.2 Private debt strategies in scope

The bulk of assets under management in private debt are currently allocated to sub-investment grade direct corporate lending (aka direct lending), but this has not always been the case and we expect the market to continue to evolve. There are a number of other private debt strategies, for which we provide a definition and note that these are in line with the PMDR.

This Guidance broadly aligns with guidance from the Science-Based Targets Initiative (SBTi), as implementation of SBTi fulfils some components of NZIF. However, the target-setting methodology set out in this Guidance allows private debt 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 consistency with the broader concepts within NZIF.

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

The PAII also notes that if policy and corporate action do not progress 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.

<sup>4</sup> GPs who are part of an asset management business within a wider banking group are captured within this Guidance

**Private debt definitions for strategies in scope:**

- **Direct lending** refers to sub-investment grade equivalent corporate debt. It encompasses strategies across the debt capital structure including senior, unitranche, junior and/or mezzanine strategies. Direct lending deals are typically bilateral or with a small number of lenders forming a small club.
- **Venture / growth debt** is direct lending but at a much earlier stage in the borrower's maturity.
- **Opportunistic credit** refers to credit strategies such as capital solutions, rescue financings and special situations.
- **Structured credit** is a broad term capturing many different types of securitisation. The debt is backed by a large underlying pool of loans. In the public markets, the most common structured credit is commonly referred to as Asset Backed Securities, but private structured credit strategies can include a wide range of collateral types. Common private structured credit strategies include some Collateralised Loan Obligations (CLOs), some forms of asset backed lending or regulatory capital release. The CLO market is large and oftentimes tranches of a CLO are publicly listed and traded. Publicly listed and traded CLO tranches should be considered under NZIF fixed income framework whereas non-listed CLO tranches, including CLO equity tranches, should be considered as private debt under this Guidance.
- **Fund financing** is a relatively new sub-asset class within private debt. It includes LP capital call financing and early to late-stage NAV financing, for example where a GP provides loans to existing funds using outstanding capital commitments or fund assets as collateral. This is a growing private debt asset class and in scope where a private debt GP provides fund financing. Fund financing provided by banks remains out of scope.
- **Private placements** are typically corporate debt securities that are illiquid and can be to listed companies. While the securities themselves may be listed, they are typically not tradeable.

Figure 9: Private debt definitions for strategies in scope

### 3.1.3 Private debt strategies not in scope

Other private debt sub-asset classes have been excluded because specific NZIF guidance already exists for them (specifically real estate debt and infrastructure debt).

As indicated above, publicly listed and tradeable tranches of CLOs are excluded from this Guidance as these investments fall under the NZIF framework. Likewise, the underlying collateral of CLOs (broadly syndicated loans) are excluded.

Broadly syndicated loans are loans where the bank is the lead arranger who underwrites the loan, initially finances it and then syndicates to a group of lenders (usually larger than a club of lenders in private debt). They are usually tradeable to some extent although liquidity may be limited.

There can be a degree of overlap between the definitions of syndicated loans and direct corporate lending as mentioned above, but to clarify; the general guidance is if a non-bank lender is originating, underwriting, structuring and executing the loan, this should be considered as a form of private debt and fall under the NZIF private debt framework. On the other hand, if a bank lender originates the loan with the borrower, structures and executes the loan (with the view to further syndicate this), this should be considered as a broadly syndicated loan. Broadly syndicated loans will fall under NZIF fixed income framework. Some syndicated loans have little or no secondary market liquidity, including commercial bank arranged debt syndicates in certain jurisdictions, as well as those offered by Multilateral Development Banks and Development Finance Institutions. These specific cases<sup>5</sup> may be considered private debt and fall under the NZIF private debt framework.

This Guidance also excludes distressed debt strategies because in most instances this involves some sort of restructuring of PCs, which most of the time may lead to a restructuring whereby debt holders become equity owners.

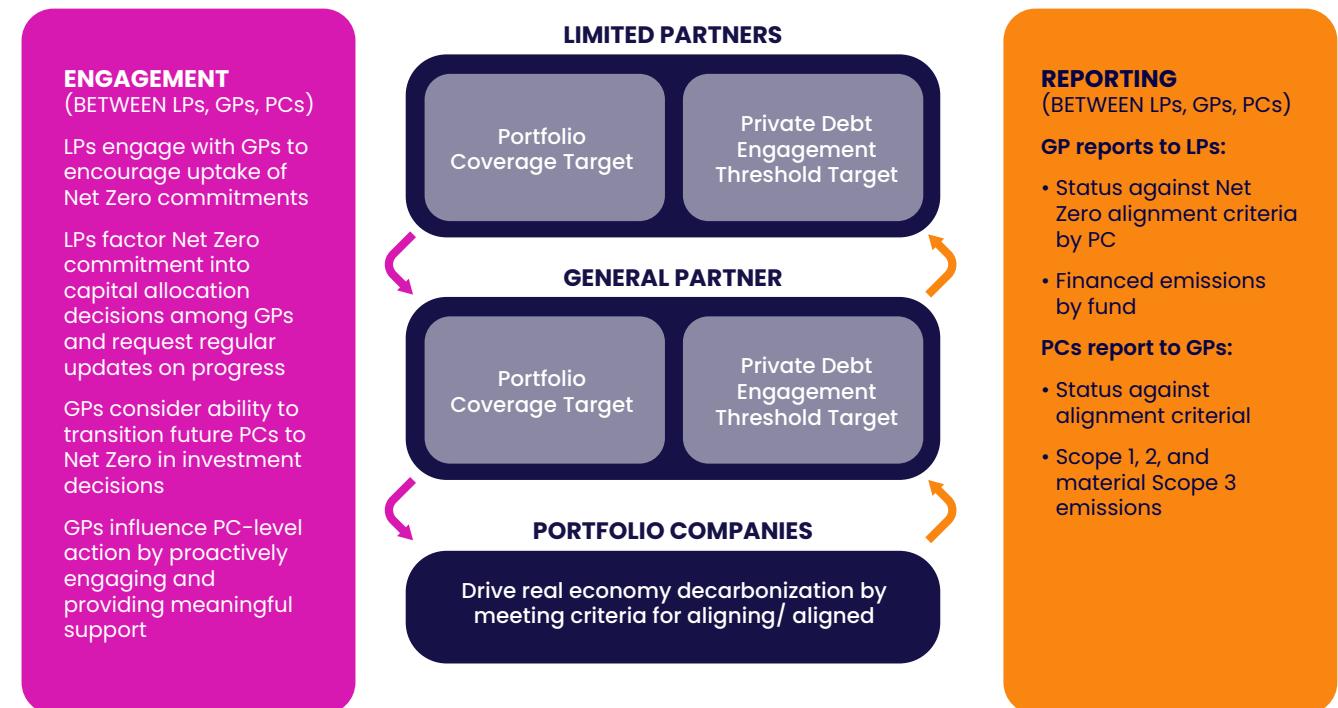


Figure 10: Commitments across the private debt industry

<sup>5</sup> Subject always to assessment and identification at the investors' discretion

### 3.2 Target types and metrics

This Guidance identifies two types of targets that organisations can choose to set to further their net zero ambition (Figure 11). The above targets complement one another, promoting net zero adoption and driving carbon reduction as a key risk mitigant within private debt. NZIF is a voluntary framework, neither of the targets are “mandatory.”

The private debt portfolio coverage target and engagement threshold target are the sole targets for this methodology.

Target type	Description	Metrics	Details
<b>Private Debt Portfolio Coverage Target</b>	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	<p>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.</p> <p>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.</p> <p>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.</p>
<b>Private Debt Engagement Threshold Target</b>	Complete the specified engagement actions for all (100%) applicable private debt investments.	GPs: Invested Capital and/ or Financed Emissions	<p>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.</p>

Figure 11: Overview of GP and LP targets

### 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 is the sole lender or lead arranger of the debt within a private debt deal can potentially exert greater influence on a company's management when negotiating deal terms, while a GP that is a minority holder of the debt tranche may face more difficulty in positively influencing the direction of the company through the private debt deal terms. Particularly in competitive private debt deal environments, there can be limited or even no discussion with company management which further impacts the GP's ability to influence deal terms pre-close. Also, certain types of private debt deals, particularly in structured credit for example, offer very limited scope to negotiate with underlying PCs or collateral, making it near impossible for GPs to influence any deal terms with PCs.

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 following the first close or through the secondaries market.

To account for these dynamics, both the private debt portfolio coverage and private debt 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 seven influence bands in total that can be broadly grouped into two categories: 1) direct influence; and 2) indirect influence (Figure 12).

The four direct influence bands apply to investments made directly into a PC and are most frequently relevant to GPs. They are distinguished by the GP's holding % of the debt tranche with typically a higher % holding of the tranche equating to more influence in the deal relative to other lenders. Furthermore, if a

board observer seat or any form of significant equity holding (greater than 10%) is agreed in the deal, the GP likely has more influence versus deals where these are not present. Direct corporate lending and venture or growth debt (direct lending at an earlier stage in a company's maturity), would fall under influence bands 1a to 1c as debt providers to these borrowers have greater ability to influence typically depending on holding proportion of the tranche. To enable the Guidance to apply to a broader remit of private debt strategies, influence band 1d has been created for strategies where the lender is more removed from the underlying companies or collateral as is typical in private structured credit or fund financing.

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.

### 3.4 Reporting against the Guidance

The Guidance can be utilised by private debt investors to support a multitude of goals and ambitions in relation to net zero. For signatories of the Net Zero Asset Manager Initiative (NZAM) signatories, Paris Aligned Asset Owners (PAAO) or GPs supporting an LP's net zero targets, the guidance enables private debt investors to set and report on portfolio coverage and engagement targets. For non-signatories, some or all of the recommendations presented by the Guidance can be used to support overall net zero ambitions as well as being used as a benchmarking tool or a guide for engagement with GPs or portfolio companies.

Asset classes	Band	Private debt criteria	Influence level
<b>DIRECT</b> • GP direct corporate lending • GP venture and/or growth debt	<b>1a</b>	Sole lender or lead arranger of the debt and/or Holder of 50%+ of the debt tranche and/or Board observer seat and/or Any form of significant equity holding <sup>6</sup> in the deal	Strong with PCs <sup>7</sup>
	<b>1b</b>	Significant minority holder of the debt tranche (have blocking or veto rights). Between 25-50% of the debt tranche	Moderate with PCs
	<b>1c</b>	Small participant of tranche: less than 25%	Limited with PCs
• GP private structured credit • GP fund/NAV financing	<b>1d</b>	Any % tranche holding where limited scope to negotiate directly with underlying company / collateral	Highly limited with PCs
<b>INDIRECT</b> • GP continuation funds across these strategies • GP fund of funds • LP investments across private credit (direct & indirect) • LP co-investment • LP-led secondaries	<b>2a</b>	Big ticket investors* and/or first close	Strong with GPs
	<b>2b</b>	Investment made during fund raising, not 2a. Co-investment	Moderate with GPs
	<b>2c</b>	Investment via secondaries	Limited with GPs

\*Big ticket investors defined as committing over 5% of total fund raise

Figure 12: Table of influence bands for private debt

<sup>6</sup> Significant equity holding is defined as 10% or more

<sup>7</sup> Noted that influence level is relative within private debt

# 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 the debt of PCs. In most situations, they have the opportunity to negotiate deal terms and can thereby have some influence over a PC's actions (although in highly competitive deals influence may be more limited). 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 post-close; 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 in the Appendix. Details of the two target types that GPs can set are presented in the sections that follow.

### 4.1.2 Private Debt 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 (beyond unaligned companies who are not committed): 1) committed to aligning; 2) aligning; 3) aligned; and 4) net zero. Figure 13 presents the PC alignment criteria. To achieve "committed to aligning," "aligning," or "aligned," a PC should meet all criteria marked for that level. These are the milestones that need to be achieved to be classed as 'managed in alignment with net zero'.

Ambition as a category is broad, and it is recognised that while there are differences both in practice and in public policy across different jurisdictions; it may be expected that in the earliest stages of a PC's net zero journey, ambition may take the form of an acknowledgement by the PC of the importance of taking decarbonisation action in line with the goals of the Paris Agreement.

PCs that meet the committed to aligning/aligning/aligned/net zero criteria described in Figure 13 within the milestones presented in Figure 14 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 have the most influence while the company is in the deal pipeline or within their portfolio.

Category	Criteria	Committed to aligning	Aligning	Aligned	Net Zero
<b>Ambition</b>	Long-term goal for the company to be net zero emissions by 2050 or sooner.	X <sup>8</sup>			
<b>Governance (HIGH IMPACT SECTORS ONLY)<sup>9</sup></b>	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.	X			
<b>Disclosure</b>	Annual disclosure to investors of scope 1, 2, and material scope 3 absolute GHG emissions. Public disclosure is best practice.		X	X	
<b>Targets</b>	5– to 10-year Paris-aligned GHG emissions reduction target (Scope 1, 2, and material Scope 3)		X	X	
<b>Emissions Performance</b>	Cumulative YoY reduction meets or exceeds the linear annual reduction established as the target for Scope 1, 2, and material Scope 3 emissions.				X
<b>Climate Strategy (HIGH IMPACT SECTORS ONLY)</b>	A proportionate plan is established that sets out the measures to deliver the target. The strategy should be quantified and include capex and opex required to achieve targets.			X	

<sup>8</sup> 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.

<sup>9</sup> Definition of 'High Impact Sectors' as per NZIF.

Figure 13: Table of private debt portfolio company alignment criteria and milestones

GPs are encouraged to assess each PCs current alignment status and get a commitment from and support the PC to move at least one step further to the right along the alignment criteria.

Whilst this guidance only requires PCs to move one step further along the alignment scale, efforts to make multiple steps are strongly encouraged and will become more important from 2040 onwards when we anticipate that achieving the initial steps should become easier and faster; and the majority of the companies will already be well advanced (aligning or aligned) along the alignment scale with a clear path to net zero by 2050.

In general, the move from “committed to aligning” to “aligning”, may be more demanding than the move from “not aligned” to “committed to aligning”; similarly to what we currently see on the private equity market. Most companies issuing private debt today are “not managed in alignment”, and consequently, it is expected that in the run up to 2030; the industry may see a surge in capital “managed in alignment” by virtue of such companies stating their intent to decarbonise to respond to stakeholder requests (PE Sponsor, lenders, and/or other stakeholders). It is expected that this initial surge may subside over time as the progression along the alignment scale may become more demanding.

For the avoidance of doubt, if a PC is already on “aligning” when invested for funds launched before 2030 then it can be counted from the point of investment with no further required action<sup>10</sup>.

Fund vintage alignment milestones	Committed to Aligning	Aligning	Aligned	Net Zero
Funds launched after guidance published but Before 2030	Expression of intent by PC to move to this category by end of grace period  Achieve ‘Committed to Aligning’ by exit	PC is already ‘Aligning’  Expression of intent by end of grace period to move to ‘Aligned’  Achieve ‘Aligned’ by exit	Not required	Not required
Funds launched between 2030 – 2040	Expression of intent by PC to move to this category by end of grace period  Achieve ‘Committed to Aligning’ by exit	PC is already ‘Committed to Aligning’  Expression of intent by end of grace period to move to ‘Aligning’  Achieve ‘Aligning’ by exit	PC is already ‘Aligning’  Expression of intent by end of grace period to move to ‘Aligned’  Achieve ‘Aligned’ by exit	Not required
Funds launched between 2041 – 2045	Expression of intent by PC to move to this category by end of grace period  Achieve ‘Committed to Aligning’ by exit	PC is already ‘Committed to Aligning’  Expression of intent by end of grace period to move to ‘Aligning’  Achieve ‘Aligning’ by exit	PC is already ‘Aligning’  Expression of intent by end of grace period to move to ‘Aligned’  Achieve ‘Aligned’ by exit	PC commitment to achieve no later than 2050
Funds launched between 2046 – 2050	Achieve ‘Committed to Aligning’ before deal close	Achieve ‘Aligning’ before deal close	Achieve ‘Aligned’ by exit or 2050, whichever is sooner.	All PCs achieve net zero no later than 2050

<sup>10</sup> While no further action is required, the guidance always encourage investors to continue encouraging PCs for further progression to the extent possible.

Figure 14: Fund vintage alignments

## Paris-Aligned target and exceptions

Companies' 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. The criteria for these instances 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 launched in 2029 closes a deal with a PC in 2031, 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. Compliance with criteria for ambition, governance, targets, and climate strategy can be assumed once a portfolio company has been assessed to have

met the criteria and does not need to be reassessed at each milestone 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<sub>2</sub>e) 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.

### 4.1.2.2 Thresholds for Portfolio Coverage Targets

Debt investments still within the grace period at which GPs provide annual reporting to LPs (i.e. those made within one year of the date) should be excluded from calculations of progress toward targets because they may not have had sufficient time to assess the PC's position against the alignment criteria. However, if a PC meets the required criteria ahead of the 1-year milestone, GPs can opt to include them in their progress calculations and reporting.

For GP investments in band 1a, GPs are encouraged to approach or achieve 40% of invested capital managed in "alignment with net zero" by 2030. Investments in bands 1b, 1c and 1d, which have less influence than band 1a, would be expected to achieve a lower threshold target (decreasing by influence level). By 2040, GP's investments in band 1a should aim to approach or achieve 75% of invested capital "managed in alignment with net zero". The other bands are expected to achieve a lower target, but note a material increase versus the 2030 level. By 2050 all investments should achieve net zero.

In Figure 15 below, we suggest a 2050 glidepath 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.

The portfolio coverage targets expressed by the illustrative glide path set out the net zero targets that GPs are encouraged to undertake for capital investment at each milestone. These initial targets reflect a lower starting point relative to PE, given the relatively lower ability to influence PCs faced by the private debt industry. The progress along the glide path will be steeper over time for private debt, relative to private equity, because despite a lower starting point all private debt investments will still need to reach 100% managed in alignment with net zero by 2050. The majority of private debt deals are PE sponsored, which should facilitate and support further progress towards net zero in the private debt market.

Most funds and portfolios will include different investments that are categorised in different influence bands. 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 15, 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 38% 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.

Asset classes	Band	% of invested/committed capital <sup>11</sup> managed in alignment with NZ by...		
		2030	2040	2050
<b>DIRECT</b> <ul style="list-style-type: none"><li>GP direct corporate lending</li><li>GP venture and/or growth debt</li></ul>	<b>1a</b>	<b>40%</b> Invested capital	<b>75%</b> Invested capital	<b>100%</b> Invested capital
	<b>1b</b>	<b>20%</b> Invested capital	<b>50%</b> Invested capital	<b>100%</b> Invested capital.
	<b>1c</b>	<b>10%</b> Invested capital	<b>40%</b> Invested capital	<b>100%</b> Invested capital
<b>DIRECT</b> <ul style="list-style-type: none"><li>GP private structured credit</li><li>GP fund/NAV financing</li></ul>	<b>1d</b>	<b>10%</b> Invested capital	<b>40%</b> Invested capital	<b>100%</b> Invested capital
<b>INDIRECT</b> <ul style="list-style-type: none"><li>GP continuation funds across these strategies</li><li>GP fund of funds</li><li>LP investments across private credit (direct &amp; indirect)</li><li>LP co-investment</li><li>LP-led secondaries</li></ul>	<b>2a</b>	<b>28%</b> Committed capital	<b>75%</b> Committed capital	<b>100%</b> Invested capital
	<b>2b</b>	<b>18%</b> Committed capital	<b>65%</b> Committed capital	<b>100%</b> Invested capital
	<b>2c</b>	<b>10%</b> Committed capital	<b>55%</b> Committed capital	<b>100%</b> Invested capital

<sup>11</sup> Committed capital is forward looking metric

Figure 15: Illustrative glide path for Private Debt Portfolio Coverage 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. 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 consider managing as many of their existing assets in alignment with net zero ambitions where 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.

## 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 private debt 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.

### High-impact sectors

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 impact are asked to be managed in alignment with net zero. If a GP does not meet this, 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-impact investments in their net zero efforts.

For the purpose of this guidance and similarly to the Private Equity component of NZIF, the definition of high impact sectors will follow NZIF guidance.

Investments in high-impact industries are asked to set more robust climate strategies and governance.

Figure 16: High impact sectors<sup>12</sup>

<sup>12</sup> Within NZIF, high impact sectors are those with representative companies on the Climate Action 100+ focus list; companies in high impact sectors consistent with Transition Pathway Initiative sectors; plus, banks and real estate, as well as agriculture, forestry, and fishing. As such, please refer to the NZIF as for the definition / classifications / and / or additional considerations for high impact sectors.

### 4.1.3 Private Debt Engagement Threshold Targets for GPs

In situations where the GP does not have high levels of influence, engagement with the PC and shareholders alike (and at times other debt holders) becomes an important practice to advance net zero efforts. Engagement also helps to drive broader uptake of net zero commitments across the private debt ecosystem, making achievement of net zero more feasible for all actors. A PC that is managed in alignment with net zero should have a more sustainable enterprise value over the longer term (notwithstanding other factors), which should improve a company's ability to repay debt at loan maturity so net zero adoption is a risk mitigant.

To support GPs in achieving their net zero targets, this Guidance proposes the use of a "three-way" engagement model. Through this model, GPs are encouraged to fulfil their 100% engagement target<sup>13</sup> by engaging with their PCs on net zero and climate-related concerns as well as their PE sponsors where private debt deals are sponsor backed. This enables GPs to broaden the remit of obtaining the relevant information necessary to support the achievement of their net zero targets. The first table in Figure 17 details the required engagement actions to be undertaken by GPs when engaging with PCs. The second table in Figure 18 details the required engagement actions to be undertaken by GPs when engaging with PE sponsors where appropriate.

<sup>13</sup> 100% engagement target refers to the role of GPs in attempting to engage with all underlying portfolio companies. This does not mean that all engagements must be successful, but a reasonable activity in line with the required engagement actions in Figure 17 is encouraged. Reasonable engagement should not constitute a one-way correspondence, but ideally ongoing dialogue and/or meetings with PCs.

Asset classes	Band	Private Debt Criteria	Required Engagement Actions	Timing
<ul style="list-style-type: none"> <li>• GP direct corporate lending</li> <li>• GP venture and/or growth debt</li> </ul>	<b>1a</b>	Sole lender or lead arranger of the debt and/or Holder of 50%+ of the debt tranche and/or Board seat and/or Any form of significant equity holding in the deal <sup>14</sup>	<p>Engage with PC management with decarbonisation and climate risk as key engagement priorities. This could include correspondence, meetings, webinars and/or training. It is important to engage on the PC's ambition, disclosures, targets and emissions performance. Governance and climate strategy should also be engagement priorities for PCs in high impact sectors.</p> <p>Best practice: climate-related ESG margin ratchet loans / sustainability-linked loans and/or language in loan documentation requiring climate disclosure. The climate related KPIs included may vary across loans. For high impact sectors, in addition to meeting all the required alignment criteria, <b>managers should</b> (1) actively use selection as a tool to identify and/or avoid and/or select them; (2) use climate-related ESG margin ratchets and /or covenants in related legal documentation; (3) ensure such investments have a clear path to net zero by exit from 2040.</p>	Post Deal Close/ Grace Period until Exit
	<b>1b</b>	Significant minority holder of the debt tranche (have blocking or veto rights). Between 25-50% of the debt tranche		
	<b>1c</b>	Small participant of tranche – less than 25%		
• GP private structured credit • GP fund/NAV financing	<b>1d</b>	Any % tranche holding where limited scope to negotiate directly with underlying company / collateral	It may not be possible to access underlying PCs As such, GPs are encouraged to engage with the issuer and consider, if possible, the issuer's firm level attributes instead of portfolio companies' characteristics.	Post Deal Close/ Grace Period until Exit

<sup>14</sup> Significant equity holding is defined as 10% or more

Figure 17: Table of recommended GP engagement actions with PCs

Asset classes	Band	Private Debt Criteria	Required Engagement Actions	Timing
<ul style="list-style-type: none"> <li>• GP Direct corporate lending</li> <li>• GP venture and /or growth debt</li> </ul>	<b>1a</b>	Sole lender or lead arranger of the debt and/or	<p>Identify PE sponsors across debt portfolio. Engage with investment leads and/or sponsor's ESG personnel on the PC's ambition, disclosures, targets and emissions performance. Governance and climate strategy should also be engagement priorities for PCs in high impact sectors.</p> <p>Notify all PE sponsors of Net Zero ambition and targets and introduce NZIF PE framework if they are not already committed to that.</p>	Within first 12 months of deal close Within first 12 months of deal close Annually thereafter
		Holder of 50%+ of the debt tranche and/or		
		Board seat and/or		
<ul style="list-style-type: none"> <li>• GP private structured credit</li> <li>• GP fund/NAV financing</li> </ul>	<b>1b</b>	Any form of equity holding in the deal	<p>Provide them with standardised data request for all deals going forward.</p>	
		Between 25-50% of the debt tranche		
		Less than 25%		
<ul style="list-style-type: none"> <li>• GP private structured credit</li> <li>• GP fund/NAV financing</li> </ul>	<b>1d</b>	Any holding	N/A	N/A

Figure 18: Table of recommended GP engagement actions with PE sponsors

### Inclusion of climate disclosures requests in loan documentation.

GPs can encourage support for net zero targets through the inclusion of climate disclosures requests within loan documentation. This helps to increase the availability of data on PCs as well as providing a better indication on a PCs position in the transition to net zero and associated risks and opportunities.

Some examples of language that can be included in loan documentation are as follows:

- Statement confirming (i) commitment towards net zero alignment and (ii) commitment to set targets to align to net zero
- Disclosure of absolute scope 1, scope 2 and material scope 3 greenhouse gas emissions
- 5-year to 10-year Paris-aligned greenhouse gas emissions reduction targets (capturing scope 1, scope 2 and material scope 3) are set and disclosed by the PC
- Cumulative YoY emissions reduction meets or exceeds the linear annual reduction established as the target for Scope 1, 2, and material Scope 3\* emissions

Figure 19: Climate disclosure requests in loan documentation

During the private debt deal process, there are varying degrees of negotiating power at different stages of the deal and the types of deal, e.g. club deals, bilateral deals. In general, as a deal progresses closer to deal closing, the level of negotiating power decreases. However, negotiating power may be minimalised in a competitive deal market which can prevent GPs from negotiation specifically on net zero terms or even the assessment of a PCs current alignment category, which has led to the introduction of the grace period (12 months after deal-close). Thereafter negotiation power tapers significantly unless there is a reason to force shareholders into discussion (e.g. financial covenant stress, add-on capital or a refinancing). Therefore, in the post-deal close and during the grace period, greater focus is placed on engagement efforts by GPs and LPs to support PCs in implementing the agreed commitments during pre-deal close and grace period.

Details on engagement best practice for LPs and GPs can be found in section 4.1.3 for GPs and 4.2.3 for LPs.

Figure 20: The difference between engagement and negotiating power

### ESG margin ratchets and sustainability-linked loans

**ESG Margin Ratchet** – Mechanism which links defined ESG Key Performance Indicators (KPIs) to a reduction in the margin if achieved and/or an increase in the margin if not achieved. Climate-related KPIs can be set to support net zero progress.

**Sustainability Linked Loan (SLL)** – A type of loan, which includes an ESG Margin Ratchet mechanism, that is aligned to the Loan Market Association (LMA)'s guidelines, e.g. includes third party audit of KPIs etc.

Although KPIs are set out by private debt investors, the terms must ultimately be agreed by the borrower (which often includes the shareholders, very frequently including private equity investors).

Figure 21: ESG margin ratchets and sustainability-linked loans

## Impact funds

Climate and/or net zero impact funds are highly likely to already be aligned to net zero, given their intentionality in specialising in net zero/climate change mitigation and the need to provide measurable environmental and social outcomes as an impact fund. Therefore, effective engagement methods for this type of fund will need to go further than a traditional private debt fund. The positioning of impact funds on the glidepath and corresponding milestones will inevitably be further along than a traditional private debt fund given their default alignment. Impact fund engagement may include the following engagement actions in addition to those required by band 1a private debt investors:

- Meaningful net zero/climate related KPIs for the PC to comply with

Figure 22: Impact funds

### 4.1.4 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:

#### 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). GPs are encouraged to also report on the alignment status of each PC.
  - Scope 1 & 2 emissions (total PC emissions and financed emissions following PCAF guidelines where known—highlight data gaps)
  - Material Scope 3 emissions (total PC emissions and financed emissions following PCAF guidelines where known—highlight data gaps)
  - Total invested capital (ie the amount deployed) in the PC by the fund, mandate or account
  - Net asset value of debt at PC level
- 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 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 debt 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 debt funds established after the GP’s net zero commitment, report on the GP’s total financed emissions (highlight data gaps).

As noted in section 4.1.2.1, debt investments still within the grace period at which GPs provide annual reporting to LPs (i.e. those made within one year of the date) should be excluded from calculations of progress toward targets because they may not have had sufficient time to assess the PC’s position against the alignment criteria. However, if a PC meets the required criteria ahead of the 1-year milestone, GPs can opt to include them in their progress calculations and reporting.

## 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 economy 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 behaviour in future funds. This Guidance establishes two 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, “40% of private debt committed capital will be managed by GPs in alignment with net zero by 2030”.

In practice, this means that LPs should focus on selecting funds and managers who have committed to net zero and who will implement net zero investment strategies. This will facilitate LP’s investments to meet the requirements outlined by this Guidance. GPs should also regularly report on the progress of the net zero alignment criteria of PCs to LPs. 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 and invested capital across the indirect bands should be net zero. In Figure 15 we suggest a potential glide path of 2030 and 2040 milestone targets that could enable a net zero private debt 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 15 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 debt industry will be necessary to provide adequate investment options to LPs;
- Consider your organisation’s ability to influence 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 10-year fund in 2040 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 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.

#### 4.2.3 Private Debt 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 aligned practices. As such, LP private debt 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 23 for 100% of investments. The intention is that LPs build these practices into their standard operating procedures.

Asset classes	Band	Private Debt Criteria	Required Engagement Actions	Timing
INDIRECT				
<ul style="list-style-type: none"> <li>• GP continuation funds across these strategies</li> <li>• GP fund of funds</li> <li>• LP investments across private credit (direct &amp; indirect)</li> <li>• LP co-investment</li> <li>• LP-led secondaries</li> </ul>	2a	Big ticket investors and/or first close	<p><b>Universal actions after committing to net zero:</b></p> <ul style="list-style-type: none"> <li>• 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<sup>15</sup>.</li> </ul> <p><b>Universal actions during fund selection:</b></p> <ul style="list-style-type: none"> <li>• Engage with senior leaders of the GP, including Investor Relations, to request the fund include a commitment to manage the portfolio in alignment with 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.</li> <li>• 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 with net zero will diminish rapidly. LPs should make sure this dynamic is clearly understood by GPs that choose not to align.</li> </ul> <p><b>Conditional actions:</b></p> <ul style="list-style-type: none"> <li>• If you have an LPAC seat:</li> <li>• Request climate-related performance integrated into LPAC reporting for the fund.</li> <li>• If the GP is not meeting its net zero targets, request net zero performance as an LPAC agenda item.</li> <li>• If you don't have an LPAC seat:</li> <li>• Engage with other LPs to discuss and seek to 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.</li> <li>• 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.</li> </ul>	During fund selection Throughout life of fund
	2b	Investment made during fund raising, not 2a. Co-investment		
	2c	Investment via secondaries		

<sup>15</sup> With the understanding that changes to fund documentation are not easily implemented after a fund's first close

Figure 23: Table of recommended LP engagement activities

## 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-impact sectors if the GP does not intend to implement a net zero transition plan or there is no viable pathway to net zero. The full list of high-impact sectors can be found in Appendix 2.
- 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.

### 4.2.5 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.

#### Standard target reporting

- Across all private debt 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 private debt 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 net asset value.
- Across all private debt investments, share qualitative and quantitative updates on engagement actions taken to demonstrate the private debt engagement threshold target is being met. Consider sharing outcomes.
- Across all private debt investments, share financed emissions attributable to the LP's stake (as known; identify gaps).

## Fund of Funds

A fund of funds is a pooled investment fund that invests in private debt 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 they can also make co-investments 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 asks 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 asked 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. Fund of funds are asked 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.

Figure 24: LP Co-investments

Figure 25: Funds of Funds

## 1. Approaches for transitioning a portfolio and increase 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 private debt 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 private debt portfolios e.g. review high impact 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 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 private debt sector.

#### GP Selection

LPs may wish to select GPs based on fulfilment 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 private debt 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 through asset management.
- Enable 'climate-literacy' programs for investment teams.

#### 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 loan documentation includes appropriate terms in relation to climate risk governance, performance, management and reporting.
- Consider inclusion of climate risk management KPIs in loan documentation. Details can be agreed post-close in a competitive/ time constrained deal situation.

#### During holding period

- Support PC management with educational/ operational guidance on managing climate performance and implementing a net zero strategy.

## 2. Worked examples using portfolio company alignment criteria

Here we have set out three examples of a PCs path through the portfolio company alignment criteria, and how a GP would report at each stage.

Position timeline	Status	Actions	Report in Alignment Y/N
Pre close	Not aligning	N/A	N/A
End of grace period	Not aligning	Expression of intent to 'Committed to aligning'	Y
Between end of grace period and exit	Move from Not aligning to committed to aligning	Actions to move one step further	Y
Exit	Committed to aligning	N/A	Y

Position timeline	Status	Actions	Report in Alignment Y/N
Pre close	Not aligning	N/A	N/A
End of grace period	Not aligning	None	N
Between end of grace period and exit	Move from Not aligning to committed to aligning	Expression of intent to committed to aligning & actions to move one step further	Y
Exit	Committed to aligning	N/A	Y

Position timeline	Status	Actions	Report in Alignment Y/N
Pre close	Not aligning	N/A	N/A
End of grace period	Not aligning	Expression of intent to committed to aligning	Y
Between end of grace period and exit	Not aligning	None	Y
Exit	Not aligning	N/A	N



Produced by



Supported by



Investor  
Group on  
Climate  
Change