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NZAOA Issues Target Setting Protocol Third Edition

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By Sara Bussiere
Special Counsel | Global Litigation

Last month, the Net-Zero Asset Owner Alliance (NZAOA), an alliance of asset managers committed to transitioning their investment portfolios to net-zero greenhouse gas emissions by 2050, released the third edition of its **Target Setting Protocol**, which identifies and describes NZAOA's approach to target setting and reporting. The first two editions focused on the years 2020-2025, and 2030, respectively. The recently published third edition **updates** the prior protocols to account for "the latest science, expands methodological coverage across asset classes, provides further details for some of the Alliance's four target types, and adds chapters on carbon removals and just transition."

The NZAOA utilizes a four-part target setting approach:

- Engagement targets, which "help track member engagement activities with companies and asset managers, while also guiding member efforts to engage with the broader investment and real economy sectors through position papers."
- Sector targets, which "help link portfolio-level reductions to the carbon efficiency requirements of a given sector and therefore, real world outcomes."
- Sub-portfolio emission targets, which "cover the asset classes where credible methodologies and sufficient data coverage exist as of the date of the target's publication."
- Financing transition targets, which encompass efforts to support "financing the transition and the increase of climate solution investments, for example, in emerging economies but also by promoting net-zero aligned benchmarks."

The protocol recommends that members set targets on all four parts, but requires members to set targets for at least three (and engagement targets are mandatory). The protocol further provides that:

> “Targets shall be set on the members’ own Scope 3 emissions related to investments (sometimes referred to as ‘portfolio emissions’ or ‘financed emissions’). In addition to setting Scope 3 emissions targets, Alliance members should set net-zero targets on their own Scope 1 and 2 emissions. Members shall set targets on Scope 1 and 2 emissions for their underlying holdings and should do so on Scope 3 of underlying holdings for ‘priority sectors’ as soon as possible, as detailed in the chapter on sector level targets. At the portfolio level, Alliance members should track portfolio company Scope 3 emissions, but are not yet expected to set targets until interpretation of these emissions in a portfolio context becomes clearer and data becomes more reliable.”

The **third edition protocol** “introduces overarching principles for target setting in private assets, a reporting framework for sovereign debt accounting in line with the latest guidance by the Partnership for Carbon Accounting and Financials (PCAF); and carbon accounting and target setting for direct commercial real estate mortgage loans.” Updates include:

- A recommendation that members set targets to reduce emissions between 22-32% by 2025 and between 40-60% by 2030 based on the latest assessment report of the Intergovernmental Panel for Climate Change (IPCC).
- With respect to sovereign debt, a recommendation that members track and report carbon data to the NZAOA by 2024.
- A requirement that members not use carbon removals for their sub-portfolio or sector targets at any time before 2030 to promote accountability toward decarbonization efforts on a wider scale.
- Develop tools via **ASCOR** (the UN-led Assessing Sovereign Climate-related Opportunities and Risks project) to assess sovereign exposure to climate risk and transition with the goal of having members include sovereign debt in sub-portfolio target setting.

Taking the Temperature: The protocol provides helpful guidance to asset managers who are either voluntarily reporting emissions information or are mandated to do so. Either way, the protocol addresses target-setting and reporting at management, portfolio, and financing levels. Importantly, the NZAOA relies on scientific data to support the requirements and recommendations contained in the protocol.

The protocol also contains two noteworthy “disclaimers.” The protocol observes that asset managers must be cognizant of their fiduciary duties to investors in dealing with climate-related concerns: “Asset owners have fiduciary duties that require them to act in the interests of beneficiaries, clients, and members, to act prudently, and to exercise care, skill, and caution in pursuing an overall investment strategy,” and therefore, NAZOA recommends that its members “use science-based ranges, targets, and methodologies in their strategic planning to meet their net-zero commitments,” which the protocol provides, to the extent available.

The protocol also includes an “Antitrust and regulatory disclaimer,” stating:

> **“The Alliance and its members are committed to comply with all laws and regulations that apply to them. This includes, amongst others, antitrust and other regulatory laws and regulations and the restrictions on information exchange and other collaborative**

engagement they impose. Further, each member is responsible for setting their own individual targets. Progress reports shared with the Alliance Secretariat are not shared between members. Any information shared with members is done so on an anonymized basis, and no transaction level information is shared."

The protocol's reference to applicable anti-trust laws was perhaps prompted by recent criticisms regarding climate organizations and their members. It remains to be seen how far such challenges go, and whether regulatory antitrust relief for such climate-focused collaborations will gain steam, as was recently suggested by the head of the UK's Competition Markets Authority.