

U.N.-Convened Net-Zero Asset Owner Alliance (NZAOA)

Live Version 2.0 of Methodological Principles

November 2020

This document outlines the “Methodological Principles” as required by members in the Net Zero Asset Owner Alliance (NZAOA) with regard to setting emission targets to achieve net-zero investment portfolios by 2050. It is not an offer of commercial contract. The Methodological Principles outline asset owner needs with the view to informing a wide variety of data and service providers, NGOs, and public, as to the needs and insights of the AOA membership on forward-looking metrics. The initial draft of the Methodological Principles was issued to the public on April 2020 was enhanced by provider, NGOs and general public reactions. The present document is a live version containing the current status of the Methodological Principles of the NZAOA.

Context – A collective carbon neutrality target

The [Net-Zero Asset Owner Alliance](#) is an international group of institutional investors with a commitment to “transitioning our investment portfolios to net-zero GHG emissions by 2050 consistent with a maximum temperature rise of 1.5°C above pre-industrial temperatures, taking into account the best available scientific knowledge including the findings of the IPCC, and regularly reporting on progress, including establishing intermediate targets every five years in line with Paris Agreement Article 4.9.

Members will seek to reach this commitment, especially through advocating for, and engaging on, corporate and industry action, as well as public policies, for a low-carbon transition of economic sectors in line with science and under consideration of associated social impacts.

This commitment is made in the expectation that governments will follow through on their own commitments to ensure the objectives of the Paris Agreement are met.”

[Download the Collective Commitment Document](#)

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Development of the Methodological Principles

In order for the NZAOA to monitor progress and report against its 1.5°C target and feed ambition into the COP26 process in close coordination with the UN Special Envoy for Climate Action and Finance, the NZAOA has expressed a need to develop robust Paris Alignment methodologies. While various solutions providing an “implied temperature rise” metric already exist, more convergence is urgently needed. The NZAOA is not designed to develop such solutions. Instead, the April 2020 “Call for Comment” defines the core methodology principles required and is launched in order to generate adequate methodology developments that will better suit our needs.

Methodological Principles were enhanced by provider, NGO and general public reactions to the Call for Comment issued April 2020. No compensation was provided to respondents, and the exchange does not constitute or indicate a current or future offer of business. Calls for Comment (and related evidence) allow interested parties including data and service providers, non-governmental organizations, academia, and the general public, to express their views, and support NZAOA efforts to advance the state-of-play with respect to Net-Zero (Paris-aligned) Portfolio Target Setting by increasing methodology and data robustness, strength and transparency, and related efforts to measure members portfolio interactions with emissions.

The content received has been used to inform various efforts of the NZAOA, such as target setting guidance, reporting, methodological uses, and public facing progress reports. Additional information to justify or support comments made is also welcomed. At the time of publication NZAOA indicated that all input received would be kept confidential and internal, unless consent is given by the respondent.

The NZAOA shared this call for comment directly with all data/service providers and NGOs which were believed to be interested in commenting, it will also be posted publicly on the NZAOA website www.unepfi.org/net-zero-alliance. See Annex I for those who received a direct invite to comment, if your organization wishes to be included in future communication please email [the contacts at the end of this document](#), for communication on all future issuances. See Annex II for those who reacted to the Call for Comment.

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Methodological Principles

The methodologies required to achieve the NZAOA commitment should be based on the following principles (underlined features are “must haves”):

Core principles

1. Impact.

- a) The quantification of the alignment of a company’s activities against the pathway commensurate with net-zero emissions by 2050 or a 1.5°C temperature rise is key for asset owners' beneficiaries and asset managers’ clients in understanding climate-related risks associated with individual funds, products, and investment strategies.
- b) The methodology must provide investors / users with a quantified view of the impact of their investments on climate change.
 - i. This is generally described as an “inside-out / impact” approach, which differs from more traditional “outside-in / VaR / risk” approaches. However, NZAOA members, as long-term institutional investors, act in the belief that ultimately those two approaches necessarily converge: investment strategies that degrade ecosystems will harm long-term investment returns.
- c) The quantified view will ideally take the form of a given temperature or may provide the degree of alignment with a given temperature outcome.
- d) It should also clarify the extent to which the assessment relies on modeled emissions projections for the underlying company versus stated policies from the company.

2. Forward-looking.

- a) The methodology must provide investors / users with a forward-looking metric, at a minimum of 5-year intervals (and on a rolling basis) through to 2050.
- b) As a result, the nature of the metric is expected to require integrating forward-looking data such as sectorial and geographical GHG reduction requirements, CAPEX, green revenues, green share / brown share as well as public corporate commitments to “decarbonize” business mix in the “real economy”, for example in line with technology shifts derived from the EU Taxonomy, per sector.

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- c) Methodologies that are unable to factor such strategic reorientation commitments, especially those with a shorter timeframe, will not be considered compatible with the methodological principles.

3. GHG footprinting.

- a) GHG emissions foot printing must form the basis of this methodology; GHG Protocol Scopes 1 and 2 must be included.
- b) Scope 3 emissions (e.g. “upstream” and “downstream” / product-related emissions) should be covered at least for sectors where these are material.
- i. It should give clarity on how sectors are identified, how materiality is defined, and for the material sectors how Scope 3 is included.
- d) With respect to Scope 2 and 3 emissions, providers should clearly explain and justify how potential double-counting of emissions is identified and treated.¹
- e) With respect to all GHG emissions data used, the sources of that data should be identified as well as how the completeness and accuracy of the underlying data is validated.
- f) The NZAOA expresses a preference for intensity normalized against Enterprise Value (EV)/ Enterprise Value Including Cash (EVIC). This is also the approach pursued by the EU within taxonomy-related developments as well as by the Principles for Carbon Accounting Financials. Additional, alternative approaches welcomed with explanation for use.
- g) Principles 2 and 3, in combination, require that forward-looking metrics are translated into future carbon footprint implications. Assumptions around this translation should be clearly explained.

4. Portfolio “temperature” alignment.

- a) The methodology may produce several KPIs and qualitative insights, but it must deliver a “core” metric expressed in terms of a forward looking carbon KPIs (both relative to production and absolute) as well as temperature KPI, for users to assess considerations around “portfolio alignment” with the Paris Agreement (to one digit precision e.g. 1.5°C).
- b) See also “Coverage” section below for asset class aggregation concerns.

¹ Noting that in certain use cases, double-counting of emissions may have limited to no impact on results. While in other use cases, this could substantially hinder comparability between providers.

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5. Science-based decarbonization & Climate scenarios.

- a) The methodology must be based on IPCC 1.5°C scenarios and seek to promote “real world impact” by encouraging investment decisions that lead a decarbonization of the economy. While the sharing of emissions responsibilities and emissions reductions must be explicit and explained, it is however understood that “real world” impact requirements are currently challenging.
- b) The use of specific climate scenarios (either individual scenarios or combinations of scenarios representing a given consensus), as well as deviations or exclusion of others, must be explicit regarding socio-economic and technological developments as well as climate policies, especially the underlying energy mix and sensitivity to specific technologies such as CCS.
- c) The approach should accommodate not only a single scenario but a set/corridor of scenarios to reduce dependency on individual providers’ and scenarios’ data, assumptions and narratives. In any case, if multiple scenarios are used, their coherence and consistency must be made explicit.
- d) A special attention is given to 1.5 °C IPCC scenarios with limited/no overshoot and no or limited use of CCS/BECCS: the methodology should notably align with IPCC P1 and P2 scenario carbon reduction suggestions.
- e) To improve comparability, scenarios can for example be based on and if possible connected to regulatory stress-testing initiatives, where appropriate.
- f) The underlying scenarios should be regularly reviewed and where new evidence becomes available should be updated to reflect this. Unrealistic or obsolete scenarios must be discarded. The approach should be sufficiently flexible to enable sensitivity analysis to be performed by users with respect to key assumptions and data choices. This flexibility should include accommodating not only a single scenario but a set of scenarios to take account of the uncertainty associated with future developments and to reduce dependency on individual models or data providers.

6. Portfolio management.

- a) The methodology must allow for comparison of single companies in a given sector and decision making with regards to which company is better aligned towards net-zero by 2050 or an implied temperature rise of 1.5°C, as a basis of all investment decisions. This

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requirement effectively rules out methodologies which are based on estimations per sector alone.

- b) Inclusion and reference to temperature alignment plans and policies from companies/assets is critical, and where available should be identified, and referenced.
- c) While initiatives such as SBTi are preferably expressed at sector or asset class level, this metric should be able to be expressed at individual issuer and portfolio levels (including multi-asset class portfolios²) and may also be extended at an asset class level. The metric should make sense at both individual security and portfolio levels, to guide both investments and Asset and Liability Management (ALM) decisions.
- d) This metric must also be able to produce KPIs per sector, comparing these to a sector average or range, notably to guide engagement and ALM decisions, in coordination with the NZAOA's Engagement Track, as well as other relevant organisations such as Climate Action 100+.

Technical assumptions

7. Data sources.

- a) Reported data must be favored over inferred (proxy-based) data, in particular where it is robust (e.g. audited, publicly reported), even though it is understood that a significant amount of GHG emissions measurement are estimates.
- b) Proxies may be used to cover lack of data provided these are transparent and based on robust and dynamic (revised regularly) extrapolation rules.
- c) Companies / emitters should be able to view their own data (GHG emissions, Capex, etc.) and approve or correct it if necessary. When such corrections are made, they must be identifiable by data users.

8. Sector Applicability.

- a) The methodology may look at companies based on sector specific analysis (using market-based sector classifications) or by comparing companies globally based on aggregate emission levels.

² Noting that certain single-asset class approaches may provide exceptional insights and should not be excluded.

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- b) Sector specific analysis could help investors select best-in-class companies while aggregate emissions analysis could inform wider investment strategies, promoting a deviation away from certain “high temperature” sectors altogether.
- c) The methodology may also offer a technology-agnostic/sector-agnostic transition pathway.
- d) Outright divestment assumptions *per se* are not favored, but may be justified for “outdated” technologies, such as thermal coal, that present no clear value-add towards carbon neutrality.

9. Back-testing and Neutrality.

- a) The methodology should provide 3-5 years of back-testing capability, although it is understood that its forward-looking nature (Principle 1) can make back-testing challenging. If back-testing is not available the provider should explain why back-testing cannot be provided.
- b) The methodology should be “neutral” regarding corporate ownership structures (e.g. mergers) and consolidation across asset classes.

10. Coverage.

- a) The asset classes covered must include at least listed equities, publicly-traded corporate debt, sovereign debt, and real estate.
 - i. Sovereign debt “modules” should integrate both the 2015 COP21 NDCs and revised 2020 COP26 NDCs. Solutions for other asset classes are encouraged.
- h) The security coverage must include at least the main listed equity indices.
- c) Covering other asset classes is valued and encouraged. In particular, infrastructure, unlisted (private) corporate debt, private equity, mortgages, and covered bonds.
- d) In addition, it must set out clearly how the temperature KPI can be aggregated across investments in different asset classes, sectors and companies for users to assess the overall “portfolio alignment” with the Paris Agreement.
- e) Methodologies that cover only a small set of carbon intensive sectors will not be considered compatible with the methodological principles, although a variable methodology depth across sectors may be acceptable.

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Usability & platform requirements

11. Target-setting & reporting.

- a) Once finalized, the metric must be readily leverageable by investors (and link to sectoral pathways to net-zero by 2050) to monitor progress against their intermediate (2025, 2030, etc.) and long term NZAOA targets (at a sectoral level or at least portfolio level) and support annual public reporting from NZAOA members.

12. Transparency, replicability, stability.

- a) The methodology principles must be documented and transparent, meaning the results produced by calculations can be replicated by other investors using the same databases.
- b) In addition, changes over time to the methodology should be carried out in a controlled manner, should be documented and analysis of change conducted to ensure that period to period changes can be properly interpreted.
- c) The methodology and/or organization promoting it should make it possible for companies to validate and where appropriate or correct the data or results.
- d) The NZAOA publicly favors open source platforms, but nonetheless encourages the development of methodologies that may be proposed by commercial enterprises, provided those commercial solutions are in line with the methodology principles described in this document and are documented, transparent and replicable.
- e) More generally it should leverage existing frameworks where applicable, such as the TCFD, SBTi, IIGCC PAII, TPI, PCAF, PACTA, INVECAT, CDP / Tropic, etc. The methodology should be regularly benchmarked against other methodologies.

13. Pluggability.

- a) The methodology should ideally use underlying databases and classification systems that make it “pluggable” into financial data terminals (notably by using standard financial market identifiers such as ISIN and CUSIP codes) to improve usability and enable as widespread users as possible, beyond NZAOA members in due course. NZAOA members do not expect, however, such “pluggability” from the outset.

14. Communications.

- a) The basic principles of this methodology must be simple to explain to non-specialist audiences, while the full underlying methodology may remain complex.

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- b) Whether the methodology has been developed by a public or private organization, it should disclose how the methodology, and where appropriate its implementation, is validated. Any potential conflicts of interest should be clearly disclosed.

Additional Information

Next steps:

NZAOA members are aware the requirements listed above are demanding and do not expect any provider to fulfill all principles at this time. However, NZAOA considers the above as a roadmap to highlight a trajectory over time. Providers are encouraged to continue to update the NZAOA on their progress. No single provider or set of providers will be engaged by the NZAOA. Rather the AOA acts as an information sharing platforms for its members.

As highlighted above, the NZAOA will not advocate for a specific commercial solution, but members will be free to choose individual tools provided these fit the remits outlined in this document.

Main contacts:

With any question or update please contact:

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Annex I

NZAOA attempted to identify all known potentially interested partners. NZAOA shared the original call for comment with the following list of organizations. In an effort to be transparent this list is made available to the public. If you wish your organization to be included in future notifications of a similar nature please complete the survey and include your organizations contact details.

1. 2dii
2. 427
3. Acclimatise
4. Arabesque
5. Asset Owner Disclosure
Project, ShareAction
6. Baringa
7. Beyond Ratings
8. Bloomberg ESG Data
9. Carbone 4
10. Carbon Delta (MSCI)
11. Carbon Tracker
12. CDP
13. Climetrics
14. EcoAct
15. Engaged Tracking
16. ERM
17. Investor Agenda
Founding Partners
18. ISS
19. Oliver Wyman
20. Ortec Finance
21. OS-Climate
22. PWC
23. Quantis
24. Right.XDC
25. SBTi FI
26. SENSES
27. Southpole
28. Sustainalytics
29. TPI
30. Trucost (S&P)
31. Vigeo Eiris (Moody's)
32. Vivid Economics

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Annex II

The following institutions and individuals responded to the April 2020 Call for Comment:

1. 2° Investing Initiative
2. Aviva
3. Baringa
4. Carbon Delta (MSCI)
5. Carbon Tracker Initiative
6. Carbone 4
7. CDP
8. Climate Policy Initiative
9. Entelligent (1)
10. Entelligent (2)
11. Extinction Rebellion UK
12. Guidehouse
13. Independent
14. Individual
15. ISS ESG
16. Mantle314
17. Moody's - Four Twenty-Seven -
Vigeo Eiris
18. N/A
19. Neural Inc.
20. Ortec Finance
21. OS-Climate (with Ortec Finance
(OF), Entelligent)
22. PIK
23. PineBridge Investments
24. PwC
25. PwC UK
26. right. based on science GmbH
27. S&P Trucost
28. ShareAction
29. Social & Environmental Finance
30. Sylvera
31. Trucost, part of S&P Global
32. University of Warwick
33. University of Warwick
34. University of Zurich, Swiss FinTech
Innovation Lab
35. Urgentem
36. WWF

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