How Private Fund Sponsors Promote Decarbonisation and Climate Transition Plans

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In this In Depth, we discuss how private fund sponsors promote decarbonisation in their investments, as well as portfolio companies' adoption of climate transition plans, with reference to the key industry frameworks and EU and international rules on corporate sustainability reporting. This accompanies our previous In Depth on how private fund sponsors invest in the climate transition.

Decarbonisation, Climate Transition and Alignment to Net Zero

The terms decarbonisation, climate transition and alignment to net zero are sometimes used synonymously but have slightly different meanings. Decarbonisation is the reduction or elimination of carbon dioxide and other greenhouse gas ("GHG") emissions. Climate transition is the transition by business and society to a low-carbon and sustainable economy. A decarbonisation plan deals with how a company reduces its GHG emissions, whilst a climate transition plan covers wider topics, such as how the company will adapt to climate impacts, changes to the company's business model and social aspects, such as impacts on communities.

Alignment to net zero means ensuring a company reaches the state in which the total amount of carbon dioxide emissions produced is equal to the total amount removed from the atmosphere, by natural or technological means. If a company adopts a net zero target, it must reduce and, to a more limited extent, remove or offset, its emissions in a manner consistent with reaching net zero emissions—if aligned to the Paris Climate Agreement, by no later than 2050.

A target to reduce GHG emissions that is consistent with the aim to keep global warming to no more than 1.5 °C above pre-industrial levels requires companies to define short- to medium-term reductions in emissions, typically in line with annual emission reduction rates for their sector, taking into account that sector's current emissions and its opportunities and constraints on decarbonisation. The Science Based Targets initiative (the "SBTi"), a global partnership that enables companies and financial institutions to set science-based emissions reduction targets in line with the latest

climate science to combat the climate crisis, has produced a standardised Net Zero Corporate Standard for companies to set reduction targets and a standard for financial institutions, discussed below. Targets are said to be science-based if they match emissions reductions in line with the latest global climate models for emissions reduction. SBTi Services Limited, an independent subsidiary of the SBTi, is responsible for checking and validating individual companies' reduction plans. To address the inconsistent and unclear use of the term "net zero", the SBTi has developed standards, tools and guidance to assist companies in setting net zero targets. The SBTi is currently revising its Net Zero Corporate Standard ("V2"), which is intended to be used from 2027, and released a Consultation Draft in March 2025.

The 2016 Paris Climate Agreement requires countries to set increasingly ambitious contributions to net zero targets every five years and submit national climate action plans. The United Nations' Intergovernmental Panel on Climate Change informs governments about climate change, with its reports regarded as one of the most reliable sources of information. For instance, the United Kingdom's contribution to the Paris Agreement is reflected in its Climate Change Act 2008, as revised, which requires the relevant government minister to ensure that the net UK carbon account for 2050 is at least 100% lower than a 1990 baseline and to set "carbon budgets" (net UK emissions of GHG) for five-year periods. The UK government can, of course, change or repeal the Climate Change Act, and there is a power in the Act for the minister to change the targets, depending on changes to international law or policy. The European Climate Law[1] requires EU institutions and Member States to take necessary measures to achieve climate neutrality by 2050 and to reduce net GHG emissions by at least 55% by 2030. The European Commission can request corrections or updates to states' National Energy and Climate Plans (NECPs) if they are not adequate and can ultimately take action against Member States to enforce the Climate Law. However, the law refers to the importance of both solidarity between Member States and the European Union and of collective progress made by all Member States. To date, many EU state commitments are regarded as insufficient.

Asset Manager Transition Plans

Asset managers and other financial institutions adopt a climate transition plan by reference to their financed GHG emissions, which are emissions linked to their investments under management—or, in the case of banks, their borrowers. The SBTi has recently published its Financial Institutions Net-Zero Standard, a voluntary framework with recommendations for financial institutions to follow when setting a

[1] Regulation (EU) 2021/1119 of the European Parliament and of the Council.

transition plan. The SBTi has validated the targets set by more than 165 institutions to date. The SBTi's framework requires managers to set a policy on activities in the fossil fuel sector; adopt an engagement plan to address de-forestation; if there is a significant deforestation exposure, set targets for operational and Scope 3 emissions, particularly financed emissions; and publicly report on these targets annually.

Key Standards and Guidance

The key standards and guidance that private equity sponsors should have regard to are as follows.

Calculating and Reporting Emissions

The 2001 Greenhouse Gas Protocol (the "GHG Protocol") is the most widely adopted basis for companies to calculate and report their emissions.

The Partnership for Carbon Accounting Financials provides the standard framework for banks, asset managers and insurers to measure and report financed emissions, which are emissions linked to their loans and investments.

Target Setting

In terms of target setting, the SBTi promotes best practices in emissions reduction and net-zero targets in line with climate science and provides technical assistance and expert resources, including external validation, to companies that set science-based targets.

The SBTi's Private Equity Sector Science-Based Target Guidance is a guide for private equity firms to set targets for their portfolio to reduce carbon emissions. It recommends private equity firms use "portfolio coverage" targets, a measure of the proportion of portfolio companies that have adopted science-based emissions reduction targets by a certain date. For the portfolio coverage target, the portfolio company should follow SBTi criteria to set Scope 1 and 2 GHG emissions targets and Scope 3 GHG emissions targets where Scope 3 emissions are substantial. The guide also covers "sectoral decarbonisation approach" targets, which are targets for a pathway to keep the global temperature increase to no more than 1.5 °C above pre-industrial levels, and "portfolio temperature rating" targets, which are commitments to reduce portfolio companies' "temperature scores" (which are a conversion of the companies' current emissions and

climate targets into an implied temperature range) to no more than 1.5 and 2 °C scenarios.

Reporting

The Taskforce for Climate-related Financial Disclosures (the "TCFD") originally published the key framework for companies, including asset managers, to report on their policy on climate change and emissions and climate-related financial risks and opportunities. The International Sustainability Standards Board (the "ISSB") has incorporated TCFD standards into its climate-related reporting standards, replacing the TCFD framework.[2] The ISSB's IFRS S2 requires companies to make climate-related disclosures which include information on transition planning towards a low-carbon or climate-resilient economy.

The IFRS has published a guidance document on how companies should disclose information on their climate-related transitions when applying IFRS S2. The Guidance states that IFRS S2 does not require a company to have or publish a transition plan. However, a company should disclose its strategic goals on responding to transition and physical climate-related risks or opportunities, including any planned changes to its business model. Under the Guidance, a company should disclose information on assumptions it uses in developing its plans, including about existing or future subsidies for green research and development. It should also disclose information on external factors on which its plan depends, such as a particular workforce, ecosystems such as the availability of clean water or an emission removal technology which is necessary for the company to meet its GHG reduction targets.

The IFRS' Guidance builds on materials published by the UK Transition Plan Taskforce (the "TPT"). The TPT provides guidance on creating a robust climate transition plan. The IFRS assumed responsibility for the TPT's disclosure materials when the TPT disbanded in 2024, and the TPT's materials are designed to be consistent with IFRS S2. Building on the TPT materials, the UK government has stated that it will require UK-regulated financial institutions and FTSE 100 companies to implement transition plans which align with the Paris Agreement's 1.5 °C target and published a consultation on this in June 2025. When in place, the United Kingdom may implement this requirement on a "comply or explain" basis, allowing companies to opt out if they explain why they do not have a transition plan.

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[2] Note that the TCFD disbanded in 2023, recognising that it was most efficient for the ISSB to take over its work on climate-related reporting.

In the European Union, the Platform on Sustainable Finance, which advises the European Commission (the "Platform"), released a report in January 2025 on transition plans. The report does not set any legal requirements for companies but includes useful guidance in producing a transition plan, including by reference to the European Union's current sustainable finance framework. The report recommends that companies incorporate four core elements into their transition plans. The first is setting science-based targets aligned with the Paris Agreement. This includes setting time-bound targets covering Scope 1, 2 and 3 GHG emissions, such as GHG emissions reduction targets for 2030 and in five-year steps to 2050. Companies should distinguish between gross and net emission-reduction targets in their plans, so they should set and disclose corporate emission-reduction targets separately from any planned carbon removals, carbon credits or offsetting, reflecting the European Union's view that carbon removals should be limited to "hard-to-abate" sectors for preventing emissions. The second element is key actions to achieve these targets and ways to mitigate physical climate risks. Companies should analyse the resources they depend on, for example raw materials, to achieve the climate transition and how they intend to address related risks, such as by diversifying their suppliers. The third element is financial planning, where companies should disclose the funding in place to support their plans, including any CapEx spent on activities aligned with the EU Taxonomy Regulation. This section includes helpful guidance on links between financial statements and climate matters, such as reduced value of "lock-in" assets. The fourth element is governance, where companies disclose who oversees the transition plan and how it will be implemented and information such as the company's internal auditing process to assess whether the company's sustainability information is reliable.

The Platform states that climate transition plans should be feasible and economically viable given available technology. The Platform promotes wider environmental considerations when addressing climate change, such as the benefits of restoring eco-systems, and having regard to the "do no significant harm" criteria in the EU Taxonomy for some activities. Climate change drives biodiversity loss, and land use, in particular "carbon sink" forests, impacts the rate of global warming. Climate change also has social impacts, such as the effect of physical impacts of climate change on employee working conditions. The Platform envisages a template for companies to use for their transition plans.

Guidance on Decarbonisation

The Private Markets Decarbonisation Roadmap provides private fund sponsors with guidance on how to disclose their assets' progress towards decarbonisation across different asset classes. This includes reporting on the "maturity" of the assets' progress

towards decarbonisation and the feasibility for introducing decarbonisation for different types of assets, depending on factors such as the manager's influence over investee strategy, including board level seats, duration of ownership and whether the company is in a sector with a known pathway to net zero.

Climate-Related Transition Plans

In EU terms, a climate-related transition plan, as defined in the European Sustainability Reporting Standards (the "ESRS") produced under the Corporate Sustainability Reporting Directive, outlines the targets actions and resources required to enable a company to transition toward a lower-carbon economy, aiming to limit global warming to no more than 1.5 °C and reach climate neutrality, including reducing GHG emissions and related initiatives. The ISSB's IFRS are designed for an international audience and contain a broader definition, namely an aspect of an entity's overall strategy that lays out the entity's targets, actions or resources for its transition towards a lower-carbon economy, including actions such as reducing its greenhouse gas emissions. Neither the ESRS nor IFRS require an entity to adopt a transition plan, although under the ESRS companies are expected to explain whether, and, if so, when, they will adopt a transition plan. By contrast, the Corporate Sustainability Due Diligence Directive requires EU and non-EU companies in scope to adopt and put into effect on a "best efforts" basis a climate transition plan—an obligation that has attracted debate and is currently under review as part of the European Union's Omnibus process, which may result in removal of the requirement. The UK government is currently consulting on whether to oblige UK-regulated financial institutions and large listed companies to adopt climate transition plans.

In principle, all companies may adopt a climate transition plan. However, some sectors with particularly high emissions, such as fossil fuel exploration, face extremely high challenges to reduce their emissions, in particular the emissions associated with the product they sell, to net zero.

Emissions Removals and Offsets

Emissions that are not eliminated may be removed by man-made methods, such as by carbon capture or by establishing natural carbon sinks such as forestation or soil types. Carbon capture is taking CO2 from industrial processes before it enters the atmosphere and storing it underground or converting it into products. Natural carbon sinks absorb CO2 through biological processes. Carbon offsetting is the practice of a company (or individual) compensating for its emissions by financing reductions or removals

elsewhere through the purchase of a "carbon credit" issued by an internationally recognised registry, with each credit representing one tonne of CO2e avoided or removed from the atmosphere. Under the ESRS, companies must report gross GHG emission reduction targets, without reference to either GHG removals or carbon credits, with additional reporting requirements for companies that make public claims of GHG neutrality with the use of credits. Under the IFRS, companies that disclose targets net of offsets, including carbon credits, are also required to disclose gross targets. Offsetting emissions is generally regarded as a last resort, as it does not involve lasting changes to the infrastructure that generates emissions.

Measuring Emissions

Greenhouse gases comprise carbon dioxide and a range of other gases, including methane, nitrous oxide, sulphur hexa flurorocarbons and perfluorocarbons. Conventionally, when measuring GHG, all emissions are combined into units of carbon dioxide equivalent (CO2e) based on the global warming potential of each type of gas.

The GHG Protocol sets out the three types (Scopes) of GHG emissions:

Scope 1: Emissions from sources owned or controlled by the reporting company, including those produced by the company's facilities, such as generators, boilers or furnaces; by its vehicles; and by industrial processes such as smelting and "fugitive" emissions, such as emissions from refrigerants or methane from waste.

Scope 2: Emissions generated from energy purchased by the company, comprising electricity, heating, steam and cooling, with the company using information about whether the purchased energy is from a renewable source.

Scope 3: Indirect emissions generated in a company's upstream and downstream value chains. Scope 3 comprises 15 different categories, with categories 1 to 14 comprising various types of value chain emissions and category 15 being financed emissions. Categories 1 to 8 are GHG emissions relating to purchased or acquired goods (the upstream value chain), including emissions associated with raw materials and waste generated in production, and categories 9 to 15 are emissions relating to sold goods and services, including those arising from downstream transportation and use of sold products. Companies typically identify one or two key sources of Scope 3 emissions—for retail, purchased goods and services and use of sold products, or for oil and gas companies, use of the products they produce. Category 15 is financed emissions, which for an asset manager are the emissions generated by their investments. The guide GHG

Accounting and Reporting for the PE Sector includes helpful guidance on determining the appropriate Scope 3 category.

For most service-based companies, Scope 1 and 2 emissions sources are relatively simple to identify, as they relate to the company's offices, warehouses and distribution chains. For primary (raw material) and secondary (manufacturing) industries, the emissions sources can be more complex.

In calculating emissions, companies use a range of activity data, such as the quantity of diesel used, kWh of electricity consumed or kilometres of business travel. "Spend" data is a source, although consumption data is regarded as the better source. Emissions data, such as 2.7kg of CO2e per litre of fuel consumed, are used to convert a unit of activity or material production into a carbon footprint, with emissions factors themselves potentially dependent on the country in which the emissions were generated, noting that different countries have different emissions profiles in generating energy. Given practical challenges, determining emissions and emissions factors often involves the use of estimations. In practice, companies focus on identifying their material emission sources.

A company's GHG "inventory" comprises the relevant scope and category of the emission and the total related emissions for the year. A company will need an inventory management plan to support its ongoing data collection and reporting. As well as measuring their overall emissions, companies may measure their emissions intensity, which is emissions relative to factors such as revenue or, in real estate, to area. Intensity figures are helpful to compare the relative emissions of companies within a sector, such as cement production, and are relevant to the technical screening criteria under the EU Taxonomy. As a company grows, its absolute emissions may continue to grow, but the intensity may reduce. The European Union generally requires reporting of absolute targets and related emissions, with intensity data reported separately.

A company will need a baseline year to measure emissions reductions over time and relative to a target, with the baseline year representative of the operations conducted by the business. Where a private-equity-backed business expands through mergers and acquisitions, this requires adjustment to the baseline.

Setting Targets

In setting a target, a company will need to specify the period over which the target applies, the baseline year and any interim targets. If a company sets a target in line with the SBTi guidance, it demonstrates its alignment to the objective of reducing global

warming to no more than 1.5°C above pre-industrial levels by 2050. As well as adopting the long-term target to reduce emissions to net zero by 2050, companies may set short-term (two to five years) and medium-term (five to 10 years) targets.

Under the SBTi, if a company's Scope 3 emissions account for 40% or more of its total Scope 1, 2 and 3 emissions, the company must set a target to reduce the Scope 3 emissions, focussing on the most material categories (such as purchased goods or use of products) rather than each type of emission in all Scope 3 categories. The SBTi has a "streamlined" route for small and medium enterprises, defined as companies with fewer than 500 employees, which only requires companies to commit to specific Scope 1 and 2 emissions reductions, with companies required to measure and reduce Scope 3 emissions but not to adopt a specific reduction target. SMEs will report publicly the Scope 1 and 2 emissions and progress against targets but will not report their Scope 3 emissions. As the data is collected from sources outside the control of the company and frequently relies on estimations, including based on proxy data, the quality of Scope 3 data continues to be debated.

Any reductions target will need to be approved at board level, with involvement of board audit and risk committees.

Decarbonisation Plans

Having developed a methodology for counting its GHG emissions and set a related target for reducing Scope 1, 2 and 3 emissions, the company will next need to define its decarbonisation "roadmap" or plan. The decarbonisation plan will of course depend on the company's activities and their location, as climate reduction solutions are invariably assessed on a local scale. Procuring renewable energy and replacing the company's own fossil fuel powered systems, such as diesel-fuelled vehicles and the use of natural gas boilers, with models that run on electricity from renewable sources are fundamental steps. Improving energy efficiency includes use of "smart" building energy controls and controls on industrial processes to reduce energy consumption, as well as building renovation to reduce energy consumption. Separately, decommissioning carbon-intensive assets is key.

As an example, steps that an oil and gas company can take to decarbonise include replacing diesel-based facilities, such as rigs and pumps, with electric-powered alternatives; the use of low-emissions hydrogen in refining processes; the use of carbon capture and removals; and installing infrastructure to produce and transport low-carbon fuels and to generate low-carbon electricity.

The decarbonisation plan will include details on both cost and savings. As well as reduced energy costs, benefits that companies expect to derive from decarbonisation plans include reduced exposure to disruptions in energy supply and fossil fuel price fluctuations; the use of government incentives, such as grants and capital allowances; and reduced waste disposal, with potential to sell waste for recycling.

The company's broader climate transition plan will specify factors outside the company's control, including government subsidies, the development of renewable infrastructure which the company may rely on, technological changes and the physical impacts of climate change—the steps a company must take for climate adaptation. Other relevant factors include the views expressed by the company's customers on its climate strategy, for instance in requests for proposals received by the company, the approach taken by the company's competitors and the company's existing carbon-reporting requirements under law.

Sponsors associate portfolio companies with decarbonisation plans in place as attracting a premium at exit. Contractual commitments in shareholder agreements to report on GHG emissions are common. In practice, the sponsor will hold investee companies to account through its ownership of the company and its nomination of one or more board members and may include contractual commitments to adopt climate transition plans in shareholder documentation.

Reporting of Emissions and Targets

Most companies expect to disclose and report on their climate transition plans, either publicly or to particular stakeholders, such as investors. Under the IFRS and ESRS reporting frameworks, climate reporting means supplying information under the headings of governance, strategy, risk management and metrics and targets. A company will publish details about its climate transition plan under each of these headings, with information on the plan, its relation to the company's business model and the impact of external factors such as government policy and information on capital expenditure. Companies will provide information on emissions, the approach used to measure emissions and the various categories of Scope 3 emissions reported, as well as progress against the reduction targets.

In terms of private fund sponsors reporting to investors, the key data points are likely to be the proportion of the investments—by number and size relative to the portfolio—which have adopted a target and the proportion on track to meet the target. Some, but not all, managers report their financed emissions, which are the relevant proportion of the underlying reporting company's emissions by reference to the proportion of equity

or debt owned by the asset manager's mandate in the underlying company relative to the total value of the company.

External Assurance

The frameworks mentioned above, to which companies adhere on a voluntary basis, do not require companies to obtain external assurance or audit of the climate-related data they report, although they do contain guidance on practices companies can adopt for internal and external assurance. The CSRD requires companies to obtain limited assurance of all information reported under the ESRS, as do similar climate-disclosure laws in the U.S. state of California, although this may be limited to quantitative data under the Omnibus revision of the ESRS. As countries require various categories of companies in their jurisdiction to adopt ISSB reporting as part of their annual report, assurance of the data may be required. Engaging an external consultant to review and advise on collection of GHG data is a common practice.[3]

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Please do not hesitate to contact us with any questions.

[3] ISO 14064-3 is a standard for verifying GHG statements, and ISAE 3410 is an assurance engagement standard for assuring GHG statements.

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