COMMENT: CONSULTATION PAPER CP22/20 – SUSTAINABILITY DISCLOSURE REQUIREMENTS AND INVESTMENT LABELS

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SDR and labels policy

Financial Conduct Authority

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To whom it may concern,

The team at Climate & Company is honoured to hereby provide technical inputs on a subset of the questions that were part of the CP22/20: Sustainability Disclosure Requirements (SDR) and investment labels. The experts at Climate & Company who drafted this response collectively have several decades of experience working with carbon/climate finance and environmental reporting. More specifically, Climate & Company conducted two studies for the European Commission to test the applicability of draft EU Ecolabel criteria to 101 equity funds.[1]

According to a survey conducted by the Climate Bonds Initiative (CBI), (retail) investors have an interest in investing in the transition and shift capital into more climate friendly investments. However, the willingness to incorporate these preferences into investment strategies also increases information costs for them – in particular for complex topics, such as transition finance. A meaningful way to reduce these information costs and steer financial flows toward sustainable activities is through (eco)labels for financial products, as they reduce the complexity of the underlying information. Evidence shows that sustainable investment labels increase the inflows compared to their less sustainable counterparts.[2]

While we support the introduction of sustainable investment labels, especially with a focus on economic activities in transition, and hope to see a swift adoption and implementation, we would like to provide several recommendations for improvement.

This response builds on research originating from the ClimLabels project, financed by the German Ministry of Education and Research (BMBF). The project analyses transition labels in climate finance. Our technical input therefore focuses on the "Sustainable Improvers" label, its qualifying criteria (in particular Question 9), and how (retail) investment can support Paris-aligned transition pathways and the decarbonisation of high-emitting sectors. To date, most efforts to align financial flows with the trajectory towards lower greenhouse gas emissions and the goals of the Paris Agreement, have focused on "dark green" sectors and economic activities. But there is also the urgent need to create and finance transition pathways of currently high-emitting sectors, if low-carbon technologies are available.

[1] In 2020, Climate & Company applied EU Ecolabel draft criteria v2 to 101 equity funds marketed as green, concluding that 3-7 funds would comply with the criteria. The study was one of the front-runners regarding EU Taxonomy application at financial portfolio level and provided valuable insights how a EU Taxonomy evaluation can be done. In a second analysis, C&C supported the EU's Joint Research Centre in further developing the criteria. Parts of the analysis can be found in the technical report v4.

[2] Becker, M. G., Martin, F., Walter, A. (2022). The power of ESG transparency: sustainability labels on mutual funds and individual investors. *Finance Research letters*, 47, Part B, 102708 (link).

Our response

Q6b. Sustainable Improvers: the extent to which investor stewardship should be a key feature; and whether you consider the distinction between Sustainable Improvers and Sustainable Impact be sufficiently clear?

Stewardship is an important mechanism for investors to contribute to the sustainability transformation. However, the success of stakeholder engagement cannot be taken for granted – the proportion of successful requests lies between 18% and 60%[3]. Therefore, we suggest considering additional criteria.

Furthermore, the impact of the secondary channel for the "Sustainable Improvers" label, influencing asset prices and the cost of capital, can also be discussed. As scientific evidence shows, there can also be an opposite effect on the costs of capital due to the anticipated climate risk.[4]

Suggestion: Although engagement is a powerful mechanism and, as also emphasized by the Nordic Swan Ecolabel, the inclusion in the label criteria can incentivise fund managers to enhance their engagement to foster the sustainability transition. We believe that the success of the engagement process can be increased by

1) reducing the investable universe by excluding companies with a high impact on the environment with no externally-verified ambition or willingness to transform their business model. Without limiting the investable universe, there is a credibility threat to the "Sustainable Improvers" label since the eligible funds might consist of assets without readiness to transition and without alignment to the goals of the Paris Agreement.
2) adding more specific criteria to guide the engagement process.

Our suggestions under Question 9 provide concrete ideas on how to implement our proposed enhancements.

Q8: Do you agree with our proposed qualifying criteria? If not, what alternatives do you suggest and why? In your response, please consider

- whether the criteria strike the right balance between principles and prescription
- the different components to the criteria (including the implementing guidance in Appendix 2)
- whether they sufficiently delineate the different label categories, and;
- whether terms such as 'assets' are understood in this context?

In its current form, the qualifying label criteria leave a lot of room for interpretation[5]. The scientific literature shows that imprecise and unclear regulation is one of the main drivers for greenwashing[6]. Broad and unspecific disclosure requirements provide the opportunity to disclose the "good news" and hide less positive developments[7]. Other research finds that firms' support for voluntary disclosure initiatives (such as the TCFD) is mostly "cheap talk" as they "cherry pick" the disclosed information (i.e., only the non-material

[3] Koelbel, J. F., Heeb, F., Paetzold, F., & Busch, T. (2020). Can sustainable investing save the world? Reviewing the mechanisms of investor impact. Organization & Environment, 33(4), 554-574 (link).

[4] De Angelis, T. Tankov, P. & Zerbib, O. D. (2022). Climate Impact Investing. *Management Science*, 0(0) (link).

[5] For example: Principle 2 "A firm must identify any investment made by a product that a reasonable investor (ie client or consumer) might consider to be in conflict with the sustainability objective, and the investment policy and strategy of the product." Is described very vaguely. A clear exclusion list could give more clarity and improve the principle.

[6] Delmas, M. A., & Burbano, V. C. (2011). The drivers of greenwashing. *California management review*, *54*(1), 64-87 (link).

[7] Christensen, H. B., Hail, L., & Leuz, C. (2019). Adoption of CSR and sustainability reporting standards: Economic analysis and review. *Finance Working Paper*, 623, 1-121 (link).

information), concluding that voluntary reporting should become mandatory (i.e., more prescription than principles)[8].

Suggestion: We suggest increasing the "prescriptive share" to ensure that the labelled products channel the capital towards business models that Planet Earth needs the most. We list some specific suggestions under Question 9 (on Principles 1-5).

Q9. Do you agree with the category-specific criteria for the 'Sustainable improvers' category? Is the role of the firm in promoting positive change appropriately reflected in the criteria?

From our perspective, there is room for improvement for the category-specific criteria of the "Sustainable improvers" to reflect positive change. An explicit headline ambition level, such as direct reference to the Paris Agreement and the UK climate targets, would help to specify the ambition level. To date, greenwashing is a common practice that hinders the transition to a more sustainable economy. According to a recent study, investment funds categorised as sustainable fail to reduce its carbon footprint compared to conventional funds[9]. To increase transparency, prevent greenwashing, and in order to get the most positive impact out of financial products, we encourage the Financial Conduct Authority to change the rather principle-based nature of the qualifying criteria. We list some specific suggestions below.

Principle 1 (Sustainability Objective)

We consider the description of the sustainability objective[10] for "Sustainable Improvers" as insufficiently accurate which poses a risk for greenwashing. The UK has pledged to become net zero by 2050 and to cut emissions by 78% by 2035 compared to 1990 levels. To reach these goals, there is the urgent need to finance credible transition activities of currently high-emitting sectors when technology options are available – and there is no room for financing economic activities that are far ahead from a Paris-aligned pathway. However, the proposed characterisation of the sustainability objective remains unspecific and does not acknowledge the required level of ambition. Going beyond the proposed version, the label "Sustainable Improvers" should credibly indicate which investments are in alignment with the UK climate targets and the Paris Agreement. As also the UK Transition Pathway Taskforce emphasises, the central information of firms in transition is their contribution to reducing the emissions in alignment with the UK Nationally Determined Contributions (NDCs).

Suggestion: We suggest extending the description of the sustainability objective, especially for the "Sustainable Improvers" label, with a clear reference to the Paris Agreement and the UK climate targets[11]. Other (proposed) labels directly refer to policy files and thereby fit well into the existing policy and investing landscape towards more sustainability. The proposed EU Ecolabel for financial products uses the sustainability definition of the EU Taxonomy, for example. The same approach is followed by the Nordic Swan Label, which furthermore refers to the EU Benchmark Regulation. The UK sustainable investment level should also provide a direct link to national and international policies and targets.

Principle 2 (Investment Policy)

The current criteria contain cross-cutting references that need to ensure that investments are "in accordance with its investment policy" and that the fund manager "must determine its investible universe and the asset-level selection criteria it applies to meet a target". In addition, the category-specific indicators

[8] Bingler, J. A., Kraus, M., Leippold, M., & Webersinke, N. (2022). Cheap talk and cherry-picking: What climatebert has to say on corporate climate risk disclosures. *Finance Research Letters*, 102776 (link).

[9] Abouarab, R., Mishra, T., & Wolfe, S. (2022). Spotting Portfolio Greenwashing in Sustainable Funds. *Available at SSRN 4258128* (link)

[10] "The sustainability objective must align with requirements in the 'investment policy and strategy' section below ie to invest in assets that have the potential to become more environmentally and/or socially sustainable over time, including in response to active investor stewardship." (see p.41).

[11] We would like to highlight that the biodiversity crisis is of equal importance than the climate crisis. Therefore, we encourage the Financial Conduct Authority to enhance the scope to other environmental dimensions, such as the protection and restauration of biodiversity and ecosystem services. The recently adopted Global Biodiversity Framework (GBF) provides a reference framework for defining national plans and targets.

for the “Sustainable Improvers” label must have the potential to increase their sustainability performance over time. However, what this means and how it is measured remains vague (and up to the fund manager).

Suggestion: To enhance clarity and prevent greenwashing, we suggest limiting the investable universe and exclude certain assets (see also the above rationale). The proposed EU Ecolabel narrows down the investable universe by excluding (see Table 1):

- companies deriving more than 5% of their turnover from the “supply and use of solid, liquid and gaseous fossil fuels for fuel, energy generation in the form of electricity and/or heat, heating and cooling” are excluded unless they tick certain boxes demonstrating their willingness to walk the talk which includes:
  - a turnover of excluded activities of <30%.
  - a strategic plan to reduce GHG emissions to a 1.5 C aligned level including carbon neutrality by 2050. The plan shall also include the phase-out of excluded activities over the next 10 years.
  - zero CapEx[12] (and zero OpEx in maintenance costs) for excluded activities.
  - Scope 1 GHG emissions decrease annually by 7%.

The Nordic Swan Ecolabel takes a similar approach and requires that high-emitting sectors (i.e., aluminium, aviation, automobiles, cement, mining, pulp and paper, shipping, and steel) must fulfil one of the following requirements:

- at least >0.3 according to EU Taxonomy alignment formula (see Table 2).
- at least 75% of CapEx is aligned with EU Taxonomy.
- company has a validated science-based target (or similar accepted framework for transition)
- company is among the best 15% in GHG intensity.
- alternatively, one of the following criteria are met at fund level: 50% alignment of revenues for the part that is eligible to the EU’s climate taxonomy; fund has a legally binding commitment to follow the EU PAB).

Moreover, investment in companies with more than 5% revenue from exploring, drilling, etc. coal, natural gas, crude oil or uranium is not eligible unless 90% of the company´s CapEx goes into renewable energies, 50% of the revenue stems from renewables and there are no revenues generated from fracking or other environmental harmful practices.

Both presented sustainable investment labels thus found a way to restrict the eligible investments universe to sustainable business activities and allows until now unsustainable activities to become eligible if a credible transition pathway is followed. We recommend the Financial Conduct Authority (FCA) to consider developing similar requirements to enhance the validity and integrity of the label and to provide a similar ambitious and precise standard than existing or proposed sustainable investment labels.

Principle 3 (KPIs)

Indicators part of sustainable investment labels often remain qualitative and thereby rather reveal non-binding commitment rather than those having a real impact. Clear and quantitative metrics, such as the proportion of assets with science-based targets, provide more accurate information about the real

[12] CapEx: capital expenditures; OpEx: operational expenditures

contribution.[13] To prevent greenwashing and avoid "cheap talk and cherry picking"[14], the selection of meaningful KPIs and a required mandatory disclosure of them is crucial.

Suggestion: We welcome the proposed Key Performance Indicators (KPIs) as part of ICMA`s registry of illustrative KPIs and recommend incorporating them into the qualifying criteria in particular. In addition, there is the need to define clear thresholds to show credibility to retail investors and ensure an adequate level of ambition. Other label providers define the required KPIs more precisely (see below and Annex). In the following we provide three specific suggestions to incorporate the forward-looking perspective and improve the cross-cutting and category-specific criteria for the Sustainable Improvers label ("transition label").

- Share of assets with science-based emission targets: There are several ways to define an emission target. However, it usually consists of a target date and a measuring unit. Targets are science-based if they are in line with the latest climate science assessment on how to reach the goals of the Paris Agreement[15]. Nevertheless, the academic literature shows that specific characteristics of science-based targets increase their credibility: an absolute emission reduction target is a stronger predictor for emission reductions[16] and externally verified targets correspond with a larger impact than internal targets[17]. The proposed EU Ecolabel and Nordic Swan Ecolabel both include science-based targets as a criterion to include assets from high-emitting sectors (see above). Moreover, the latter of the labels rewards points if 25% or 50% of the portfolio companies have a validated emission target.
- Share of green CapEx: represents the investments into sustainable activities, implying the efforts the company is taking to lower its greenhouse gas emissions or other environmental impacts. The proposed EU Ecolabel relies on this indicator as part of their formular for "portfolio greenness". The Nordic Swan Ecolabel takes the same approach, moreover, a high share of green CapEx might exempt companies from the exclusion list. The definition of "green" or the identification of sustainable economic activities to invest in can be facilitated by using sustainable investment frameworks, often called taxonomies. These create a classification system and thereby a common language. A reference to the forthcoming UK Taxonomy would come with the opportunity to provide clarity and policy coherency.
- Using an index as benchmark to indicate climate alignment: funds can give a binding commitment to follow a specific index and use it as a basis for environmentally focused investments. The European Union has defined minimum criteria for indices labelled as Paris-aligned. The Nordic Swan Ecolabel awards extra points if a fund follows such an approved index. Rather than only proposing the usage of a benchmark, the UK FCA should consider stating precise criteria for the benchmark selection.

To enhance clarity and prevent greenwashing, Principle 3 should be expanded and substantiated. This will then also increase the comparability and usability of the disclosed data.

Principle 5, Stewardship

While we welcome the explicit consideration of engagement activities, which next to capital allocation is one of the key mechanisms of investor impact, we suggest including more specific criteria that should be applied to leverage the full potential of an engagement processes. The success of stakeholder engagement cannot be taken for granted – the proportion of successful requests lies in different studies between 18%

[13] Popescu, I., Hitay, C. & Benetto, E. (2021). Measuring the sustainability of investment funds: A critical review of methods and frameworks in sustainable finance. *Journal of Cleaner Production*, 134, 128016 (link).
[14] Bingler et al. (2022), ibid.
[15] SBTi (2022): Science-based net-zero. Scaling urgent corporate climate action worldwide (link).
[16] Dahlmann, F., Branicki, L. & Brammer, S. (2021). Managing Carbon Aspirations: The Influence of Corporate Climate Change Targets on Environmental Performance. *Journal of Business Ethics*, 158, 1-24 (link).
[17] Freiberg, D., Grewald, J. & Serafeim, G. (2021). Science-based carbon emission targets. *Available at SSRN* (link).

and 60%[18]. New research also reveals widespread lack of action of investor initiatives (which promise active engagement)[19] which underlines the need for stricter engagement guidelines if a real-world impact is desired.

Suggestion: To increase the probability of success of an engagement process, we propose making the stewardship criteria more specific (or at least complemented by clear implementation guidance). Based on an analysis of existing ecolabels for retail financial products (see Annex), we suggest to:

- Distinguish, in the qualifying criteria, between the two primary engagement channels – dialogue and voting. Investors can exercise their power by 1) engaging in a dialogue with portfolio companies (for example at management level); and 2) by exercising their voting rights (for example at the AGM, Annual General Meeting).
- Define a scope for the dialogue with investee companies. We are aware that it is not feasible for fund managers to engage with 100% of their portfolio companies (which would increase fees and would therefore also lower the attractiveness for retail investors due to lower net-of-fee fund performance). We suggest including an ambitious but feasible minimum level. The Nordic Swan Label, for example, provides incentives to engage with at least 10% of the portfolio companies (in numbers).
- Define the scope for exercising voting rights: Similar to the above, we suggest including a minimum threshold for exercising voting rights (and a higher threshold when a proxy voting service is used); the fund manager should make use of voting rights for at least X% of portfolio companies; and for >X% when a proxy voting service is used.
- Include clear guidelines for the engagement process. Existing label providers have included guidance and minimum criteria for the engagement process. The Nordic Swan Label, for example, asks fund managers to A) demonstrate a systematic method for selecting portfolio companies and topics for engagement; B) set time-bound goals for each topic; C) conduct regular assessment of the achievement; and D) describe the resources and tools used. The draft EU Ecolabel asks for a clear objective (based on the six environmental objectives of the EU Taxonomy regulation), a strategy (e.g., how fund managers plan to increase the portfolio companies' green turnover), to disclose their method and monitor the process.

We hope you will find these comments useful, and we wish you the best of luck with your further work on these important proposals. Should the FCA colleagues have any questions or identify any further need for feedback or input, please do not hesitate to reach out to us.

Yours sincerely,

Ingmar Juergens

Ingmar Juergens, CEO of Climate & Company, on behalf of all authors.

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[18] Kölbel et al. (2020), ibid.

[19] Zink, J. (2022). Which investors support the transition towards a low-carbon economy? Exit and Voice in mutual funds. Exit and Voice in Mutual Funds, *Available at SSRN* (link).

ANNEX: EXISTING ECOLABELS FOR FINANCIAL PRODUCTS (AND HOW THEY INCENTIVISE THE TRANSITION)

In the ClimLabels (Transition Labels in Climate Finance) project, we currently analyse the existing landscape of ecolabels for financial retail products and to what extent they have incorporated incentives for fund managers to include companies in transition. This can be done, for example, by including forward-looking indicators such as 'green' capital expenditures (CapEx), GHG reduction metrics or science-based targets into the label criteria. We have analysed the Austrian Ecolabel, the Belgian "Towards Sustanability Label", the French Greenfin Label, the German FNG Label, the Luxflag Labels by the Luxemburg Finance Labelling Agency, the Nordic Swan Ecolabel as well as the draft EU Ecolabel for financial products. Preliminary research has already revealed that the draft EU Ecolabel and the Nordic Swan Ecolabel have done a particular good job about incorporating transition characteristics. They are therefore described in more detail below as a source of inspiration. While not a label per se, also the Swiss Climate Scores provide another good source for inspiration (link). Our final publication will be published on our website soon.

EU Ecolabel for financial products

Brief description**:** The EU Ecolabel for Financial Products emerged from the EU's Action Plan on Sustainable Finance published in 2018 where action point #2 stipulated the extension of the existing EU Ecolabel for consumer products, ranging from shampoo to printing paper, to financial products. This has triggered an extensive stakeholder process including existing data providers, asset managers, label providers and civil society groups. In 2021, the Joint Research Centre of the European Commission published the fourth (and final) version of draft criteria encompassing a broad spectrum of qualifying criteria (ranging from clear green revenue and CapEx thresholds over exclusion criteria to clear engagement prescriptions). There are seven different criteria that must be fulfilled: 1) clear green revenue & green capex thresholds; 2) Exclusion criteria; 3) Social and governance aspects; 4) Engagement; 5) Measures taken to enhance investor impacts; plus, two criteria (6 & 7) that are linked to disclosure and transparency.

Focus on transition: While there is no stand-alone EU "transition label", the transition aspect is an inherent part of the EU Ecolabel Draft Criteria (see below).

Do the evaluation criteria incentivise investing in companies in transition?

Table 1 - EU Ecolabel criteria and its focus on transition (Source: EU Ecolabel criteria v4[20])

Engagement	To qualify for the EU Ecolabel UCITS funds and retail AIFs need to comply with Criterion 4 (Engagement). Documenting the Engagement Policy by describing A) the objective (i.e., how engagement with portfolio companies will be based on the environmental objectives of the EU Taxonomy Regulation - see Regulation 2020/852: climate change mitigation, climate change adaptation, water, circular economy, pollution, biodiversity; B) the strategy (e.g., how the investor plans to engage with portfolio companies to increase their green turnover); C) methods (e.g., how to use their influence); and D) monitoring. Prescriptions how to exercise voting rights: • Prioritisation: It is clearly defined which companies should be prioritised (e.g., companies with green turnover < 10%). Fund managers should try to orientate those companies, for example, to align investment strategies to grow green turnover and phasing out activities not complying with EU taxonomy criteria. • Disclosure: Number of resolutions raised; how votes have been casted; the instances in which cases were adopted; among others. Prescriptions on dialogue with investee companies: • Requirements: Fund managers shall regularly engage at management level with at least 10% of their portfolio companies. It is clearly defined which companies shall be prioritised. • Process: The process shall be monitored and include, among others, the goals and targets discussed (for example expanding EU Taxonomy aligned activities or closing non-aligned activities); intermediate steps or milestones; frequency and means of communication.
Green Revenue	Criterion 1 defines the investable universe. Financial products must contain a certain share of environmentally sustainable economic activities. This "portfolio greenness" is (for UCITS funds) defined by the following formula and must be >= 0.5 with PC = portfolio contribution of each company, GT = green turnover, GC = green capex, and T = the absolute turnover of the individual portfolio company. $G = \sum_{n=1}^{0} PC_i \times \frac{GT_i + GC_i}{T_i}$ The "green" share of turnover and capex is here defined by the EU Taxonomy and therefore relates to existing and forthcoming criteria linked to climate change mitigation and adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems.
Green Capex	Green CapEx is an inherent part of the formula in Criterion 1 (see above). The "portfolio greenness" of 50% could (hypothetically) be reached by companies with 100% green capex and 0% green turnover, which expands the investable universe.
Setting (science-based) Targets	Forward-looking (science-based) targets are not explicitly part of the criteria. However, Criterion 2 describes a detailed exclusion list. Companies deriving more than 5% of their turnover from the "supply and use of solid, liquid and gaseous fossil fuels for fuel, energy generation in the form of

[20] European Commission (link)

	electricity and/or heat, heating and cooling” are excluded unless they fulfil the following criteria, demonstrating their willingness to walk the talk: - A turnover of excluded activities of <30%; - A *strategic plan* to reduce GHG emissions to a 1.5 C aligned level including carbon neutrality by 2050. The plan shall also include the phase-out of excluded activities over the next 10 years. - Zero Capex (and zero OpEx in maintenance costs) for excluded activities. - Scope 1 GHG emissions decrease annually by at least 7%.
Track record of GHG emissions	GHG emissions are not explicitly included. However, GHG emissions are an integral part of the EU Taxonomy criteria for climate change and therefore implicitly included.

Nordic Swan Ecolabel

Brief description: Implemented by the Nordic ministries as a consumer label, the label has also been applied to financial products since 2017 currently awarding 75 financial products for environmental excellence. To receive the Nordic Swan Ecolabel, there are a range of obligatory requirements plus a scoring system of which 6 out of 14 possible points need to be reached.

Focus on transition: While there is no stand-alone Nordic Swan “transition label”, the transition aspect is an inherent part of the criteria (see below).

Do the evaluation criteria incentivize investing in companies in transition?

Table 2 - Nordic Swan criteria and its focus on transition (Source: Nordic Swan Ecolabel – Investment Funds – Criteria version 2.1)[21]

Engagement	**Obligatory Criteria (O16): Engagement with non-confirming holdings** O16 describes the process if an “unacceptable” risk occurs (i.e., not complying with international norms, conventions, and sanctions) or if the portfolio company is in breach with the obligatory exclusion criteria. The fund manager must remove the holdings in question from the portfolio or (if there is doubt regarding the non-conformity) start an engagement process. Further points can be collected for “Systematic and targeted engagement” (max 3 points) and “Regular Voting” (max 3 points). **“Systematic and targeted engagement” (max 3 points)** General Guidelines: A fund manager shall demonstrate A) a systematic method for selecting portfolio companies and topics for engagement; B) time-bound goals for each topic; C) regular assessment of the achievement; D) description of resources and tools used. Scope of engagement: 1 point (2 points) if engagement with at least 5% (10%) of the portfolio companies (in numbers). At least 5 (10) holdings are required.

[21] Criteria document - version 2.1 (link)

Transparency: An additional point can be earned if the reporting contains an accurate description of goals and status for the company engagements.

"Regular Voting" (max 3 points)

Regular Voting: The fund manager must have a clearly written voting policy. 1 points (2 points) can be earned if fund manager votes at AGMs/EGMs for at least 25% (50%) of portfolio companies. Alternatively, the fund can use a proxy voting service (1 point for 70%, 2 points for 90%).

Voting transparency: An additional point can be earned if the voting records (incl. company-specific voting) are disclosed.

Plus biodiversity critical sectors (agriculture, construction and infrastructure, extractive industries, fishery and aquaculture, food and beverage, forestry and logging, and shipping) can only be included if the fund engages according to P3.

Green Revenue

"EU Taxonomy alignment" (max 6 points)

Green revenues are an integral part of the scoring system (applicants must collect at least 6 points on top of obligatory requirements). Points are awarded according to the share of the portfolio that is fully aligned with the EU Taxonomy. The same formula as from the EU Ecolabel draft criteria is used (see description above) and the following points are awarded:

$$G = \sum_{n=1}^{0} PC_i \times \frac{GT_i + GC_i}{T_i}$$

	1p	2p	3p	4p	5p	6p
Taxonomy	≥ 5%	≥ 10%	≥ 20%	≥ 30%	≥ 40%	≥ 50%

Green Capex

Green CapEx is an integral part of the scoring system (see formula above).

Exemptions from exclusion criteria

Furthermore, green CapEx might exempt companies from the exclusion list related to extracting and refining of fossil fuels; and power generation. The following conditions must be fulfilled: *(see criterion O4 on exclusion criteria)*

- At least 90% of the company's energy sector CapEx† goes towards renewables; AND
- Revenue generated from renewable energy is >50%, among others; AND
- No revenue generated from fracking activities, mining of oil shales, extraction in Arctic region, among others.

Setting (science-based) Targets

Enhanced Analysis and inclusion (max 2p)

Including more holdings with a validated 1.5C Net Zero Science Based Target (or other environmental areas) is incentivised via the scoring system. Fund managers can collect 1 point (2 points) if >=25% (50%) of portfolio companies have a validated target.

Furthermore: SBTs can help to include companies from high-emitting sectors into the portfolio (see below).

Track record of GHG emissions

Reductions of GHG emissions in critical sectors (obligatory requirement)

Portfolio companies operating in high-emitting sectors (i.e., aluminium, aviation, automobiles, cement, mining, pulp and paper, shipping, and steel) must fulfil one of the following requirements:

- At least >0.3 according to the formula above;
- At least 75% of CapEx is aligned with EU Taxonomy;
- Company has a validated SBT (or similar accepted framework for transition)

- Company is among the best 15% in GHG intensity (in a global comparison of its sector)

(Alternatively, one of the following criteria are met at fund level: 50% alignment of revenues for the part that is eligible to the EU's climate taxonomy; fund has a legally binding commitment to follow the EU PAB)

Enhanced Analysis and inclusion (max 2p)

Furthermore, the fund manager can collect one point in the scoring system if the fund has a legally binding commitment to follow an EU Paris-Aligned Benchmark (which is linked to GHG reduction targets).

For any inquiries, please refer to:

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Climate & Company (C&C) is Germany's leading sustainable finance think tank. Founded in 2020, Climate & Company brings together leading senior sustainable finance expert economists from EU institutions, academia and the banking and investment sector. The experienced leadership team is supported by the knowledge, energy, vision and commitment of a growing team of young sustainable finance economists and communication experts from prestigious universities and specialised finance schools. This mix provides the special formula driving the successful expansion of our think tank in less than three years. The entire team is united in a single and pragmatic goal: to help large and small businesses be ready to lead the transition to a greener, more sustainable future; and help policymakers to get the policy right. Over the past two decades, our ground-breaking analysts have helped to shape the EU's current climate and sustainable finance ambitions. We have achieved this by developing the most advanced and up-to-date evidence-based methodologies to gather and interpret business data for sustainable finance solutions and products for the global marketplace. Climate & Company helps bring climate credibility to the global financial system as well as businesses large and small.