CATEGORIZATION FRAMEWORK

ASSESSING LOW- CARBON TRANSITION

ACT Assessment Categorization

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Abstract

In order to operationalize the transition, a need for categorization of companies has emerged, notably in order to ensure that financial flows are directed consistently to activities and companies transitioning "*towards low greenhouse gas emissions and climate-resilient development*" (Art. 2.1.c of Paris Agreement). As a matter of fact, without consistent categorization, there is a risk that each financial actor makes its own assessment, leading to different if not contradictory outputs on which company is transitioning and which is not. This would result in diffracted signals weakening the orientation of the financial flows and ultimately weakening the transition process itself.

The purpose of this paper is to leverage on the ACT assessment methodologies, that provide an in-depth assessment of strengths and weaknesses of company's transition plans and propose **a categorization framework providing a clear signal on a company's situation**. While this doesn't diminish the value of performing relative assessments, either for a company from one assessment to another or for a company vs. its sector, **this paper ambitions to address the long-term question of "what is a good ACT score?"**.

This abstract provides the essential information regarding the framework itself and its use while the remaining part of the paper provide more in-depth context elements (part 1) the underlying foundations of the proposed approach (part 2) and the recognized limitations (part 3), as it is acknowledged that addressing such a complex question as "which company is transitioning in a credible and robust way?" cannot be addressed easily and needs **a pragmatic simplified approach**.

The categorization framework proposed is the following:

1. Companies transitioning in a credible and robust way;
2. Companies partially satisfactory on one or two of the following aspects:
    a. Companies "committed" that are ambitious enough but have not yet demonstrated the performance;
    b. Companies "performing" that have demonstrated good GHG trajectory at the moment but haven't provide aligned ambitions.
3. Companies **not** transitioning in an enough credible and robust way.

This framework can be useful for either financial institutions, public authorities or any stakeholder interested to get a categorized view on companies in order to implement any transition policy such as:

- financing objectives, or financial products guaranteeing minimum investments in a given category for a financial institution,
- eco-conditional policies for a public authority (fiscal policies, condition to access public markets, label…).

It is specified that, as the ambition of this paper is to leverage solely on the ACT Assessment scoring output, the categories provided in the paper **does not prevent any stakeholder to explore other categories at the edge of the methodology**. For instance, regarding less advanced companies with not enough background

to be assessed yet, provide a specific recognition if they have engaged in an ACT step-by-step process[1], which demonstrate a preliminary commitment in the transition journey. To this extent it is specified that the ACT initiative is currently working on a more detailed recognition on the outputs of an ACT step-by-step process. Furthermore, as ACT is designed primarily on the “transition” purpose, companies that would be considered as already transitioned / compatible with a low-carbon economy might not fit directly in the proposed categorization, although most of the time there is always a part of their activity that could be improved. In order to categorize these companies interested stakeholders might therefore rather explore a “low-carbon” dimension based for instance on taxonomical referential.

The categorization of companies proposed in this paper is based on **thresholds on the global performance score, complemented by safeguards on relevant sub-module performance score levels, on narrative and on trend scores**. The categorization framework is sum-up in the table below:

Category	1. Transitioning in a credible and robust way	2a. Committed	2b. Performing	3. Not transitioning in a credible and robust way[2]
Criteria application	Criteria blocks are cumulative			Criteria blocks are alternative[3]
Global performance score	≥12/20	No threshold.		Global < 12/20 AND Module 1 < 75% AND Modules 2+4 < 60%
Module performance scores	Module 1 ≥ 75% Modules 2+4 ≥ 60% *Where relevant:* Modules 6+7≥ 50%	Module 1 ≥ 75%	Modules 2+4 ≥ 60%	
Narrative score	≥ C global AND ≥ C on consistency and credibility AND reputation			< C global OR <C on consistency and credibility OR reputation
Trend score	= or +			-

While theoretical, a situation might happen where a company is both committed and performing (categories 2a and 2b), while not reaching the “transitioning” level due to particularly poor scoring on other modules.

As recalled, this framework embeds **unavoidable limitations** (threshold effects, residual compensation effects…) that are displayed below in the paper (see part 3).

Furthermore, as the main objective is to get as much as possible consistent concepts at global level the ACT initiative will keep a view on emerging standards in order to adapt if necessary the categorization framework to better suit the way stakeholders will handle the issue in the coming years (for instance by adapting/developing different categories should a consensus emerge to a different maturity scale than the one proposed here).

[1] As a recall, the ACT initiative is divided between (i) ACT Step-by-step, which helps companies building their transition plan and (ii) ACT Assessment, which assesses the already existing - possibly through by an ACT Step-by-Step process - company’s transition plan. The current paper positions the framework solely on ACT Assessment.
[2] By difference, any company that does not fall in 1, 2a or 2b category will fall in the “3. Not transitioning in a credible and robust way” category.
[3] i.e. a narrative rating D OR a trend score “-“ are a sufficient condition to categorize the company in 3.

Contents

1. Introduction

ACT assessment delivers to the assessed company a scoring triplet detailing the strengths and weaknesses of its positioning toward transition through (i) its performance scoring (ii) its narrative scoring and (iii) its trend.

There is however at the moment no specific threshold indicating whether the score obtained is good or not, meaning whether the company is transitioning in a credible and robust way or not. As time goes by, many stakeholders have expressed the need to have **a clear signal** regarding this issue. Identified needs are notably:

- In the context of finance, where several frameworks, develop the concept of transitioning assets and financing transitioning companies (without having an operationalized definition of what it is:
    - the four key transition financing strategies of GFANZ: Climate Solutions, Aligned entities, Aligning entities and Managed phaseout, without operationalized process for assessing notably aligned/aligning entities, see December 2023 GFANZ publication.
    - July 2023 SBTi consultation paper on finance drawing lines toward portfolio alignment on a credible 1.5°C pathway.
    - The CBI that has issued in September 2023 a "consensus mapping" on the way to assess company's transition, encompassing a proposed global categorization framework ranging from commitments to net zero achievement through the recognition of credible transition plan and alignment toward Paris Agreement.
    - the ACT Finance methodology itself that encompasses a feature leveraging on ACT assessment of invested/financed companies.
- In the context of discussions with public authorities where a framework of definition would be useful in order to implement public policies favoring transition.

Thus, beyond the ACT scoring there is a need of categorization, which, based on abovementioned expectations, should not rely solely on a binary approach not transitioning/transitioning but expresses a more progressive maturity scale. The present paper proposes such a framework on the perimeter addressed by the ACT assessment methodologies, meaning companies that needs transition and have already set a transition plan. Companies that are at preliminary steps (not having yet a transition plan) or company that are considered already compatible with a low-carbon economy (typically climate solutions provider) won't be directly tackled in this paper, which does not prevent stakeholders to leverage on the current framework and provide complementary categories recognizing either preliminary steps of transitioning or recognition of a compatibility with a low-carbon economy (relying for instance on a taxonomical referential).

Following parts of the paper will deal with justifications of the framework design and thresholds set (part 2) and acknowledgement of necessary limitations associated to the proposed frameworks (part 3).

It is assumed that **the reader is familiar with the concepts of the ACT assessment methodology that underlines this paper**. If not it is encouraged to read the ACT framework, notably regarding the ACT assessment design on the performance score (9 modules).

2. Foundations

2.1. GLOBAL DESIGN

The simplest way to translate the scoring in a categorization would be to focus directly on the global score, setting for instance that a company with a robust and credible transition plan is a company that has at least a 12B= score.

This simple approach however could lead to some undesired effects/open questions:

- Articulation of the three dimensions between themselves (what is a “11B+” against a “12D-“?)
- Possible compensation effects between modules leading to an overall sufficient score despite some key elements being obviously insufficient (e.g. a very bad trend in past / future of the GHG emissions reflected through bad module 2/4 scoring but fully optimized management / engagement / commitments processes leading to good scores otherwise)
- Possible extreme situation where factually the performance score is very good but there are obvious qualitative elements leading to highlight a lack of credibility of the company (e.g. deny of certification of the GHG information issued by the company, captured by the narrative score).

In addition, based on stakeholder expectations as presented in part 1, the need to design a progressive scale leads to create “intermediate” categories focusing on specific aspects, two having emerged:

- companies having set credible ambitions, without particular view on whether they are actually on track or not (category 2a “committed”)
- companies not necessarily having set credible ambitions but performing good, taking ground on the common-sense principle: “well done is better than well said”. (category 2b “performing”)

Each of these intermediate categories need a more granular assessment than a global performance score to be identified.

Thus emerges the idea that in the methodology some modules are “core” (e.g. target setting and actual GHG performance) whereas other are more “complementing” the global picture (typically the policy module). This is already highlighted in the weighting but aggregation of all the nine topics can lead to some undesired results. As issues are not necessarily the same by sector, there is a need to assess by sectoral methodology which module can be considered as “core” and which is “complementing”.

These elements lead to set a framework that adds to the global score (i) complementary safeguards on dedicated modules or narrative / trend score (that leads to an automated downgrade and (ii) dedicated focus on some modules in order to identify intermediate categories. From this reflection the following framework designed has been issued:

Category	1. Transitioning in a credible and robust way	2a. Committed	2b. Performing	3. Not transitioning in a credible and robust way
Criteria application	Criteria are cumulative			Criteria are alternative
Global performance score	≥ threshold	No threshold.		< threshold
Performance modules scores	“Core” modules ≥ Thresholds Adapted by sector.	Module 1 ≥ threshold	“GHG trends” modules (2-4) ≥ threshold	

Narrative score	≥ global threshold ≥ global threshold on some sub-dimensions?	< global threshold < global threshold on some sub-dimensions?
Trend score	≥ threshold	< threshold

The following parts will dig on the "core" module concept and identification across sectoral methodologies (part 2.2) and provide justifications on the thresholds ultimately retained as presented in the abstract (part 2.3).

2.2. "CORE" MODULE CONCEPT

As presented in part 2.1, there is a need to identify in each sectoral methodology what are the modules that represent a key element of the transition assessment, which justify a dedicated check in order to ensure a minimum scoring.

Weightings of each module across the 17 ACT methodologies have been studied internally. Main outputs are the following:

- Module 1 ("ambitions" module) represents usually 15% of the weighting except for Finance (20% as it encompasses both GHG and non GHG targets[4]) and Retail (10% only). Due to the necessity of assessing anyway the ambition of the target setting, it has been chosen to set this module as "Core" for all methodologies.
- Weighting of modules can depend on a sub-type of activity within a methodology (e.g. upstream or downstream player in Oil & Gas) and particular split of business. Usually, modules 2-4[5] and modules 6-7[6] are connected one to another with the sum of the weightings of these modules being constant. Therefore it has been chosen to assess the "core" feature of these modules together, modules 2 and 4 representing the "production" modules whereas modules 6 and 7 representing the "engagement" modules.
- Modules (2+4) still represent *a minima* 25% of the weighting. They are always deemed "core" modules across all methodologies.
- Modules (6+7) can represent strictly more than 20% **for some methodologies only** (Finance, Transport, Property Developer, Pure Downstream players in Oil&Gas). Therefore they are deemed "Core" only for some sectors.
- Module 3 weighting sometimes interact with modules 2 and 4. However due to lower weighting and usually more qualitative features, it has been chosen not to consider this module as "core" for any methodology.
- Other modules (5, 8, 9) have usually a lower weighting and are considered as "complementing" modules. Notably Module 9 Business model is usually at 10% or less, except for Glass sector where it represents 15%. It has been however investigated that this was due mainly to the decrease of other "complementary" modules (mainly module 8) rather than an actual point of attention on the business model for this sector.

[4] Namely engagement, financing and exclusion targets.
[5] Module 2 on the GHG emissions of the production of the company (ie Scopes 1+2) and module 4 on the GHG emissions of the sold product. A typical example of variations would be for Electric Utilities sector from a "pure" generation profile to a pure "retailer" profile.
[6] Module 6 on the engagement of upstream chain value and Module 7 on downstream chain value.

In the end, the following table of “core modules” is designed:

ACT Methodology	"Core" modules		
	“Ambition” module	“Production” modules	“Engagement” modules
Agriculture & Agrifood	1	2+4	
Aluminium	1	2+4	
Auto	1	2+4	
Building construction	1	2+4	
Property Developer	1	2+4	6+7
Cement	1	2+4	
Chemicals	1	2+4	
Elec Utilities	1	2+4	
Glass	1	2+4	
Iron & Steel	1	2+4	
Oil & Gas	1	2+4	
Pulp & Paper	1	2+4	
Real Estate	1	2+4	6+7
Retail	1	2+4	
Transport	1	2+4	6+7
Finance	1	2+4	6+7
Generic	1	2+4	

2.3. THRESHOLD JUSTIFICATION

This part provides elements of justification on the thresholds chosen in order to operationalize the categorisation framework. These thresholds, based on the philosophy of the ACT methodology, have been tested on a significant sample of assessments in order to ensure its realistic feature. Output as of 2023 is that the framework is stringent, but not unreachable, in line with the global state of the economy.

2.3.1. THRESHOLD FOR “AMBITION” MODULE 1

The main indicators of module 1 are the “alignment” indicators assessing the ambition of a GHG target against the relevant Paris Agreement Aligned trajectory. This is made through the calculation of a “commitment gap” vs. a benchmark (see example below extracted from the Electric Utilities methodology).

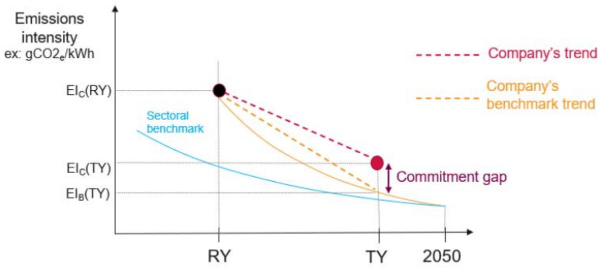


FIGURE 3: TREND RATIO AND COMMITMENT GAP

Thus, being aligned with Paris Agreement means by construction a 100% score and no less.

Actual achievement of a 100% score is however contextualized by several effects: some corrective haircuts taking into account imperfections of the targets (e.g. a target covering only part of the GHG missions[7]). Furthermore module 1 encompasses complementary indicators on time horizon of the target, target achievement, and for notably ACT Finance non-GHG targets. Finally, the assessment is highly sensitive to the choice of the benchmark which, even if it is regularly updated, might from time to time be not fully adjusted to the company with legitimate rationale (e.g. specific geographical or sectoral positioning of the company).

Thus, due to these various elements, the minimum threshold to be reached in order to consider that the company is satisfactory aligned on this module has been set at a **minimum 75% scoring**.

This threshold will be used to (i) test if a company is eligible to the "2a. Committed" category, provided that the narrative and trend scores are good, and (ii) be used together with other "core" modules to test if a company is eligible to the "Transitioning" category.

2.3.2. THRESHOLD FOR "ENGAGEMENT" MODULES 6+7

These modules will be used only for some sectors where they are deemed "core" (Property developer and Real Estate, Transport and Finance).

These modules are qualitative, based on "maturity matrix" that aim at evaluating, on a given issue (e.g. what is the perimeter of my engagement activities? From no clear perimeter to at least 90% of stakeholders in term of economic or GHG value. What is the nature of engagement required? Ranging from unclear qualitative actions to scientifically-based quantitative objectives). Five categories from 0% to 100% by 20% steps are scheduled:

Evaluation level	Basic	Standard	Advanced	Next practice	Low-carbon aligned
Score	0	0.25	0.5	0.75	1

Regarding alignment, it is considered that **a satisfactory score is at 50% minimum**. This is aligned notably with the underlying assumptions of the trend score.

On a technical standpoint, the threshold is tested against the relative weighted average of module 6 and module 7 scores depending on the specific business model profile of the company.

Example: The module 6 is weighted 10% and the module 7 20%. Considering a respective 80% and 30% scoring, aggregated weighting will be:

$$80\% * \frac{10\%}{10\%+20\%} + 30\% * \frac{20\%}{10\%+20\%} \sim 46{,}7\%$$

Thus not passing the threshold.

This threshold will be used with other "core" modules to test if a company is eligible to the "3. Transitioning" category.

2.3.3. THRESHOLD FOR "PRODUCTION" MODULES 2+4

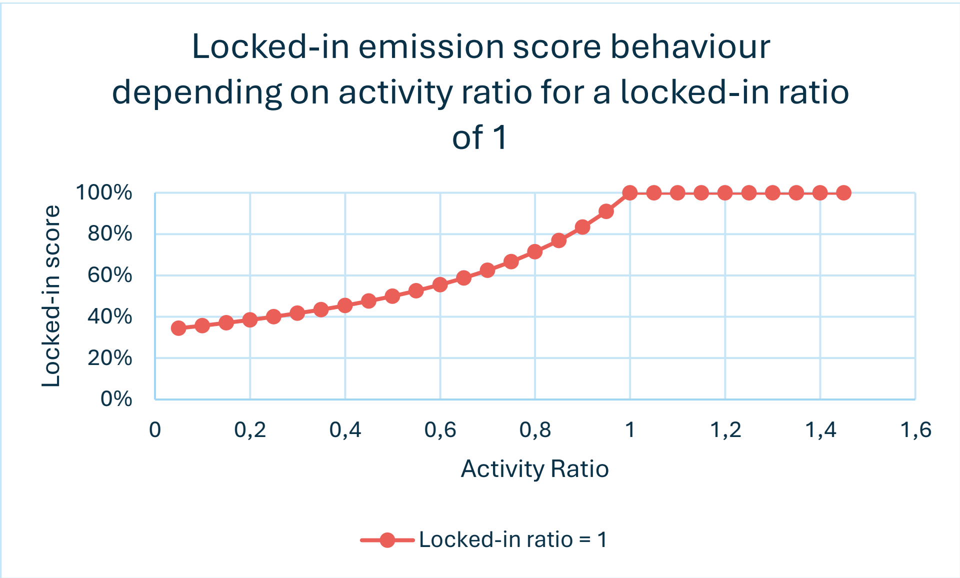
[7] For instance not covering a given GHG category but also covering only part of the activities, e.g. the factories in EU but not in Asia.

Depending on methodologies, underlying indicators are based on action gaps as for module 1 (see above)[8], but also locked-in emissions score or qualitative indicator.

Following the same rationale as for module 1 (see 2.3.1), in order to assess that the alignment of action gaps indicators, a 75% score is considered.

Following the same rationale as modules 6+7 (see 2.3.2), in order to assess that the alignment of qualitative, indicator, a 50% score is considered.

Locked-in emissions scorings are calculated by contextualizing the ratio between locked-in emissions and the theoretical carbon budget with an activity ratio between on one hand production "secured" through identified productive assets and on the other hand global forecasts. Scoring will therefore depend not only on the fact that the company keeps its locked-in emissions within its budget but also on the capacity for the company to have a planned overview of its future production (ie an activity ratio close to 1). Although the first move would be to consider that the company is aligned where the locked-in emissions are no greater than 1, this translates in different scoring depending on the activity ratio, as displayed by the graph below:



For instance the scoring is 67% where the activity ratio is of 75%, and 83% where the activity ratio is of 90%. An "aligned" score is therefore not straightforward to assess depending on the observed activity ratios.

Overall, based on the fact that the usual observed case is where the activity ratio is below 100%, and combined with the output of previous indicators, between 50% and 75%, **a 60% minimum threshold has been set**.

As for module 6+7, the threshold should be tested against the relative weighted average of module 2 and module 4 scores

Example: The module 2 is weighted 10% and the module 4 20%. Considering a respective 30% and 80% scoring, aggregated weighting will be:

$$30\% * \frac{10\%}{10\%+20\%} + 80\% * \frac{20\%}{10\%+20\%} \sim 63\%$$

[8] Trend in past and trend in future indicators. Whereas module 1 focuses on target vs. aligned benchmark, modules 2 and 4 focuses on actual trajectory (trend in past) or predictions based on production forecasts and expected levers of action (trend in future) vs. aligned benchmark.

Thus passing the threshold.

This threshold will be used to (i) provided that the narrative and trend scores are good, test if a company is eligible to the “2b. Performing” category and (ii) be used with other “core” modules to test if a company is eligible toe the “3. Transitioning” category

2.3.4. THRESHOLD FOR THE GLOBAL PERFORMANCE SCORE

The “global” level threshold good score is a concatenation of the expectations on the underlying modules:

- Module 1 linked to a 75% expectation
- Qualitative modules (6+7 but also 5, 8, 9 and sometimes, 3) linked to a 50% expectation (see 2.3.2)
- And finally “hybrid” modules encompassing various techniques (Modules 2+4, see 2.3.3) linked to a 60% expectation.

The ideal “aligned” score at global level would therefore be the weighted average of all these modules. This leads in a consistent way across sectors to **a global 60% minimum threshold**.

2.3.5. THRESHOLD FOR THE NARRATIVE SCORE

The aim of the narrative score is to summarize the full conclusions of the analysis on a more qualitative way regarding the mobilization of the company on the topic, based on the following dimensions:

- Business model and strategy
- Consistency and credibility
- Data Quality[9]
- Reputation
- Risk

Final rating is provided through a single letter ranging from E (worst) to A (best) with an equal weighting of each dimension.

The purpose of this dimension is to cover cases where the performance scoring is good but there are non-captured red flags that undermine the credibility of the scoring. Thus the dimension is captured through a safeguard feature: a minimum threshold is required to access to category 1 or 2a/2b.

As the assessment is qualitative through maturity matrices, the minimum aligned score set is the same than for performance score, meaning 50%, which translates **in C** in term of minimum narrative rating. In other words it means that companies rated D or E are automatically in category 3.

As for the performance scoring there can be undue compensation effects. In order to cover this case a closer look on sub-dimensions has been added with the same rationale. Chosen categories are (i) Consistency and Credibility and (ii) Reputation in order to cover specifically the risk abovementioned.

2.3.6. THRESHOLD FOR THE TREND SCORE

The aim of the trend score is to answer the question: “If we come back in few years, would the rating tend to be better, equivalent or worse?”.

[9] Not yet embedded in itself in the framework but used in practice in some sectors.

Given the global context where the economy as a whole is lagging behind the transition commitments, it has been deemed sound to implement a complementary safeguard where companies receiving a “negative” trend score are considered as not transitioning in a credible and robust way.

3. Limitations

Going on a such a complex issue “is a company transitioning in a credible and robust way toward the Paris Agreement?” from a global in-depth assessment to a discrete categorization exercise **can’t go without significant limitations and simplifications**. However, the categorization is a necessary step toward **convergence of approaches in transition, notably in finance** and therefore actual shift in the financial flows and public policy implementations. The aim of this part is to list the acknowledged limitations.

3.1.1. ASSESSMENT INTEGRITY

Setting threshold leads necessarily to edge effects where from two almost equivalent companies, one will pass the other will fail on small differences (e.g. 61% on global performance for the first company vs. 59% for the second).

This is unavoidable by construction but this is acceptable to the extent that there is no too much variability in the scoring itself, meaning between two different analysis of the same company the output remains consistent.

This is handled through (i) regular updates and clarifications of the methodologies and associated tools and (ii) assessor’s own rules and processes, notably regarding quality control.

3.1.2. CONSISTENCY WITH OTHER INITIATIVES

The more the ACT categorization framework is consistent with other significant public or private initiatives (namely SBTi, GFANZ, CBI) the more the global objective of identifying in a consistent way the “right” companies to invest in will be achievable.

At the moment the “operationalized” frameworks are still nascent, this present paper of ACT being the first one in the context of the ACT initiative. Until a global standard emerge there is therefore a risk of still various standards leading to different outputs. This is covered on ACT initiative side by regular monitoring of activities on the topic, either at public or private level. As mentioned above, should a different single categorization framework emerged, this current paper would be updated in order to better cope with this framework (e.g. more granular /differently shaped categories).

To the moment one potential inconsistency risk has been spotted with the SBTi initiatives, the broad idea being that a company having a SBTi validated target should get a good ACT assessment module 1 score. Differences can however emerge, notably on the following aspects:

- Where SBTi focuses on the alignment of the target the module 1 of ACT contains additional elements: assessment of the time horizon design of the targets, assessment of the achievement of past targets.
- “Old” SBTi targets are not necessarily 1.5°C aligned (2° or well-below 2° alignment). However they still have a “validated” status, whereas ACT assessment relies on regularly updated scenarios that would mechanically decrease the score for a same target;
- Within target alignment assessment, ACT embeds various corrective aspects (such as for instance GHG coverage);
- ACT assessment vs. SBTi target perimeter (single entity vs. group for instance);

3.1.3. OTHER ASPECTS

The following limitations are highlighted:

- due to the “dilution effects” (various indicators, haircutting factors) a 75% threshold has been set on module 1 (see part 2.3.1). This means that, in theory, companies with non-fully aligned target (commitment gap >0%) can access to the “2a. Committed” category.

- Categories 2 (“2a. Committed” and “2b. Performing” don’t look at other criteria outside narrative and trend safeguards. This means in particular that the fact that a company is categorized as “2a. Committed” **does not imply any message regarding the quality of its action plan**.
- ACT assessment is performed regarding a given situation. Even if the trend score tends to provide a forward-looking value, it is recommended not to use a too-much-old ACT assessment (no assessment older than 3 years) in order to perform the categorization exercise, both due to evolutions of underlying benchmarks and evolution of the company itself.
- One could spot some limitations on a case where a company with a high performance score receives a “light” negative trend score. However, this case remains at the moment theoretical.