ROADTEST

LAYMAN REPORT

ASSESSING LOW CARBON TRANSITION

ACT Finance | Investing

April 2024

1. CONTEXT OF THE ROAD TEST

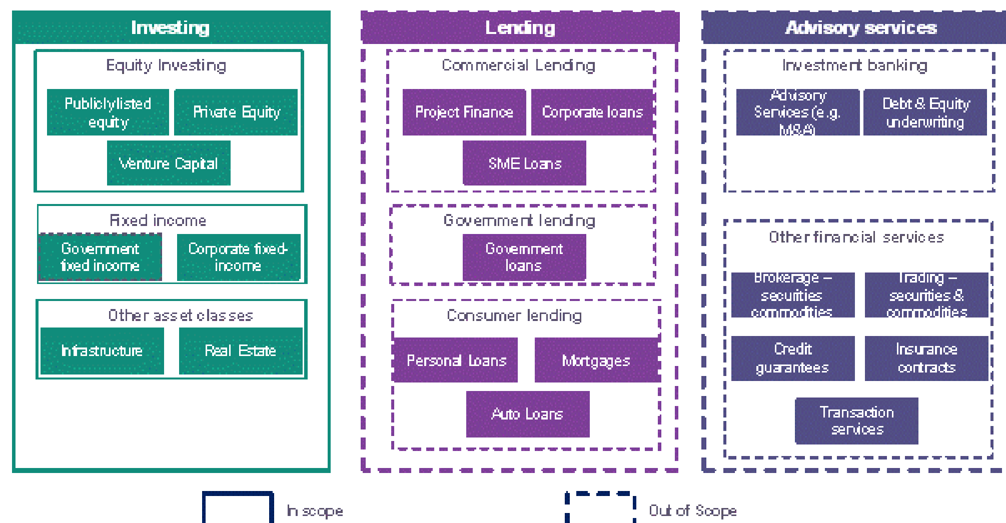
ACT FINANCE - INVESTING

While the emissions of an investor's business operations and value chain have some impact in terms of emissions, the most material impact of a financial institution comes from their financed emissions. Thus, investors have a key role to play in the transition regarding the support of companies which are transitioning and the shift of their financing towards climate solutions. Over the last decade, methodologies and initiatives have evolved to reflect market understanding of financed emissions and support the development of calculation and attribution approaches and relevant metrics. The main challenge of the finance sector is defining and assessing what is within the scope of the financial institution's control and what is "fair" to assess.

ACT FINANCE - INVESTING METHODOLOGY

For the past eight years, ADEME, CDP and WBA have been working together on developing the 'Assessing low Carbon Transition' (ACT) initiative, a methodology to assess companies that have set climate commitments and want to take climate action in line with the Paris Agreement. The ACT methodology uses a holistic approach to assess a company's climate strategy and determine its readiness to transition to a low-carbon economy.

The ACT Finance methodology aims at assessing financial institution climate strategy on an international level. The methodology cannot cover all activities performed by financial institutions. Thus, the methodology has been split into two sub-methodologies: banking and investing. Some other activities (trading, brokerage, insurance coverage) have been disregarded due to complexity, lack of expertise, data, or methodology at the time (see Figure 1)



GOALS OF THE ROAD TEST

The project's objectives were:

- to road test the ACT Investing draft methodology and accompanying tools.
- to provide recommendations to refine the methodology.
- to ensure that the methodology is relevant and robust for the sector.
- to engage investors and other stakeholders in the low carbon transition.

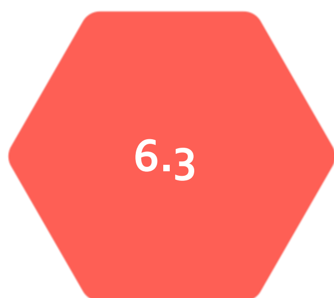
The aim of the road test **is not** to make individual or collective judgement on the maturity of the sector.

The road test for the ACT Finance Investing Methodology has been carried out, on behalf of ACT, by Deloitte, I Care and Technopolis.

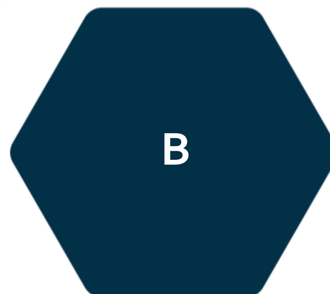
ASSESSED INVESTORS

2. RESULTS OF THE INVESTORS ASSESSMENTS

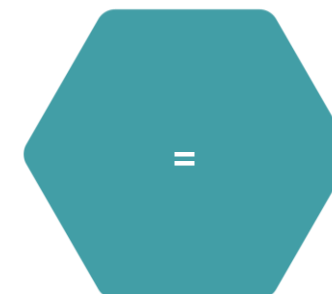
OVERALL RESULTS



The average performance score was 6.3/20 where 14.8 was the highest and 3.2 the lowest score. The top performer's score is driven by its effective business model and its investment thesis with support provided to the investees, both aligned with the low-carbon transition. The best scores are the result of a developed low-carbon transition plan, with investees engagement strategies and exclusion policies. The lowest scores can be due to lack of engagement strategies and low portfolio carbon performance. Regarding the latter, there was a global lack of maturity regarding the complex yet core question of defining what a transitioning / sustainable asset or company is. In addition, data gathering was deemed challenging for most of financial institutions. Tool and methodology will need an update to ease the usability as well as best rewarding the learning curve for financial institutions.



The average narrative score was B on a scale ranging from A to E, indicating an overall medium alignment with a low-carbon scenario. In general, companies received lower narrative scores for the Business model and strategy dimension, where analysts noted that transition plans were not developed enough to provide evidence of strategical repositioning of the financial institutions. Reputation is the dimension with the average best score, as most of the companies were not involved to reputational concerns. The other dimensions (Consistency and Credibility, Data Quality and Risk) are all on the average around 2.4/4 because of dispersion among companies regarding maturity of data collection processes, risk management and robustness of the transition plans.

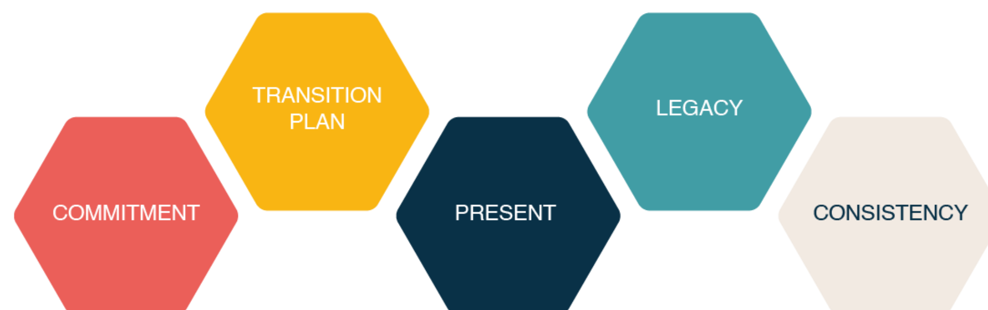


The average trend score was rated equal (=). This score assesses whether companies are likely to receive a better (+), similar (=) or lowest (-) score if they take the assessment in a few years. The trend score considers as a baseline a sub-set of forward-looking indicators from the performance score. A complemented layer of expert judgement is then applied in order to take into account holistic information / perspectives. Given the high correlations with the performance score, the analysts extensively relied on the expert judgement layer. 5 companies out of 14 obtained a positive trend score, based on new policies strengthening their ambition.

The tool might be refined with specific questions in order to gather more adding value and frame better the expert judgement.

OVERALL PROFILE OF THE 5 ACT DIMENSIONS

While each ACT methodology is sector-specific, they are all based on the ACT Framework methodology and as such there are fundamental commonalities among all of them. The assessment's main goal is to evaluate past, present and (anticipated) future company performance to determine the company's maturity level with respect to its transition to a low-carbon economy. The ACT initiative focuses on five guiding principles to determine company performance:



1

Most investors have set portfolio emissions reduction targets, but largely using carbon economic footprints (tCO_2e/M€ invested), rather than sector-level emissions reduction targets (in physical intensity or in absolute emissions) which are more significant as the biggest challenge for investors remains to support the real economy decarbonization. Investors should cover carbo-intensive sectors in portfolios by such targets.

Coal phase-out policies are broadly consistent, however oil & gas policies remain highly heterogeneous from one investor to another, which could lead to strong distinction in ambition between investors.

2

Investors have set many action levers to reach their targets, including the reinforcement of exclusion policies, investees engagement and climate metrics integration in investment processes. However, these are rather a sum of individual actions than a comprehensive and formalized strategic transition plan, which doesn't highlight how objectives will be achieved. In addition, the level of maturity varies considerably between participants, and they rarely disclose financial-related information. Investors still need to strengthen their low-carbon transition plans and monitor how their action plan contribute to their decarbonization goals.

3

Most investors monitor current emissions against economic footprint or intensity targets (tCO_2e/M€ invested or revenue) which doesn't provide enough information on their contribution to global decarbonization efforts. In addition to that, most investors are not able to provide either how their capital allocation is actually directed towards supporting the transition or develop low-carbon companies. The challenge for investors will be to develop clear definitions and measurement of portfolio companies' transition level.

4

Past performance varies between participants. Some investors in the road test have not yet made their low-carbon strategies public and are just starting their sustainability journey on the reporting year evaluated (policies being validated afterwards). Moreover, climate alignment standards for investors have evolved considerably in recent years, leading to several changes in the scope of actions. This results in lower historical data availability and therefore less ability to compare participants historical performance.

5

Overall, assessments have shown that climate strategies were in place with different level of maturity but with some inconsistencies between public commitments and actions, the latter lagging behind the former. This can be shown in the different modules of the performance score and is also reflected in the narrative score.

3. CONCLUSION AND OUTLOOK

SUCCESS OF THE ROAD TEST

- Based on the evaluation process, the interaction with financial institutions, their underlined constraints, and the specificities of each of their activity, assessors believe that with some improvements to the tool and some methodological amendments (mainly Module 4, Module 1), **the Investing assessment will provide a fair reflection of a financial institution's readiness to transition to a low-carbon economy.**
- Investors involved in the road test were engaged, provided thorough feedback on the methodology, and are **interested in using ACT to formalize their transition plan**.
- **The current assessment methodology allows FIs to point out with clarity where the main gaps / areas** for improvement can be found with concrete examples from maturity matrixes, and encourages greater transparency on climate performance, strategies, and transition plans.
- **Clear process and good coordination with key actors.** The road test process has been clear and beneficial to key actors.

LIMITS OF THE ROAD TEST

- **Time spent on the data collection**: Module 4 and the historical data required (4 years) took up a lot of Financial Institution's time. More qualitative modules require a lot of back-and-forth and exchanges with various Financial Institution's departments and stakeholders. This strong involvement led to them spending more time on the project than they expected.
- **Usability of the tool:** without making the tool more user-friendly, companies will continue to find it challenging to use the tool and provide the data needed for the assessment (especially for Module 4). Companies are expecting more guidance directly available in the tool, and a more detailed explanation as to what is expected from companies.
- **Analyst's subjectivity:** assessors highlight the subjectivity of the scoring of some modules (essentially the qualitative modules). This limitation was addressed by harmonization meetings at the end of the road test.

MAIN CHANGES & RECOMMENDATIONS

All inconsistencies or issues experienced by the analysts and investors during the road test have been gathered in a logbook and integrated at the end of the road test after discussion with the Steering Committee and the Technical Working Group. The following points summarize the key recommendations that have been or will be addressed:

- **Improve the Climate portfolio performance Assessment**: The most common feedback theme from companies and analysts participating in the road test was the difficulty to answer Module 4 (due to lack of maturity in defining what a sustainable/transitional asset is, complexity of data collection and technical complexity of the indicator). Although a clear definition of what constitutes a sustainable/transitional asset is necessary for a financial institution wishing to align itself with a 1.5°C world, the lack of global maturity and technical difficulties necessitate refinements in order to capture the different levels of maturity.

- **Provide a more user-friendly tool:** A common feedback theme from companies and analysts participating in the road test was that more guidelines and clarification would be appreciated to support the data collection phase. This was the case for both the quantitative and qualitative Modules. The tool needed clearer instructions and more explanation of what information is required (General Information, Module 4). This will improve companies' ability to engage with the assessment and the quality of their submission. Some amendments have been made to simplify the data collection process.

- **Enhance the coordination with other industry initiatives** to consider the methodological guidelines of other standards, such as SBTi or the NZ Alliances, especially for sectoral targets (metrics accepted in the methodology) or global reduction ones. This improvement will mainly concern module 1 "Targets", and possibly module 4 “Portfolio climate performance”.

- **Ease the impact** of the level of data quality on the scoring of module 1 and provide more guidance on the coverage of sectoral target emissions according to the parts of the value chain of the different sectors covered.

- **Provide better suggestions and consider new areas of evaluation for module 9: Business models**, hence assessing this essential module in the light of existing tools and innovations, or those currently under investigation, and thus embed the effects of climate change on business operations and balance sheet management.

- Other technical points should be addressed:
    - Ratio of climate R&D expenditure to total R&D expenditure
    - The weighting of governance and climate expertise currently assessed based on a single person only in the assessment.
    - Improve the sector-classification granularity offered by the tool.
    - Redefine the scope of units of decarbonization targets (money intensity trajectories) accepted by the tool (Module 1) with appropriate haircuts.
    - Review of the trend rating (+, -, =), which is too strict at this stage.

METHODOLOGY RESHAPE AND REASSESSMENT

The lessons learnt from the road-test have been gathered with complementary elements and processed in order to improve both methodology and tool, notably:
- Weighting change of module 8 from 5% to 10% and of module 9 from 10% to 5%;
- Enrichment of some parts (transition plan coverage maturity matrix within 1.4, 4.2 portfolio management…).

These modifications have been tested on the performance score through a quick reprocessing of assessments. Results are the following, **with a global 6.6 (vs. 6.3 previously)**.