

# ALIGNMENT WITH THE PARIS AGREEMENT

How Lyxor measures  
the temperature of its funds

Lyxor Sustainable & Responsible Investment



**LYXOR**  
Asset Management  
SOCIETE GENERALE GROUP

## OUR METHODOLOGY

Lyxor<sup>1</sup> measures the alignment of its equity and corporate bond funds with the climate goals of the Paris Agreement. Our methodology calculates a fund’s temperature using the GHG emissions intensity (or ‘carbon intensity’ when converted into CO<sub>2</sub> equivalent) of the issuers to which a fund is exposed.

### 1. Carbon intensity and decarbonisation

Lyxor’s methodology uses carbon data provided by S&P Trucost. This data includes issuers’ past carbon intensity, as well as forward-looking carbon intensity. An issuer’s carbon intensity is measured either per physical unit, or per economic unit, depending on its economic sector.

For issuers in carbon-intensive sectors such as power production, steel, aluminium, cement or aviation, we measure carbon intensity per physical unit (kWh, ton of steel, etc.). Measuring these issuers’ alignment with the Paris Agreement is based on the Sectoral Decarbonisation Approach (SDA), developed by the Science Based Targets initiative (SBTi)<sup>2</sup>. The SDA approach defines a decarbonation trajectory for companies to meet the carbon intensity target of their sector, defined by a climate scenario. A company’s decarbonisation trajectory depends on its initial carbon intensity, its market share and whether it plans to increase or decrease that market share. Sectoral carbon intensity targets derive from the scenarios of the Energy Technology Perspectives (ETP 2017) of the International Energy Agency<sup>3</sup>.

For issuers in other sectors, or active in multiple sectors, carbon intensity is measured per economic unit: their value added (profit). For these issuers, alignment with the Paris Agreement is based on the Greenhouse gas Emissions per unit of Value Added (GEVA) approach. This approach starts with the assumption that each company in the global economy should decrease its carbon intensity at the same annual rate as the global economy itself, to be aligned with the climate goals of the Paris Agreement. The reduction rates derive from the Representative Concentration Pathway (RCP) scenarios of the Intergovernmental Panel on Climate Change (IPCC)<sup>4</sup>.

### 2. Fund temperature scoring

To calculate a fund’s temperature, issuers’ past and forward-looking carbon intensity are compared to the theoretical decarbonisation trajectory for each temperature scenario. Using the distance between the real trajectory and the target trajectory, and the issuer’s activity production (in physical or economic units), a volume of emissions is specified under or over the theoretical carbon budget for a defined temperature.

For each issuer in a fund, a share of its volume of emissions under or over a carbon budget for a defined temperature is allocated to the fund. The share of emissions allocated depends on the proportion of the issuer value owned by the fund, calculated as the share of stocks or bonds owned by the fund on the enterprise value<sup>5</sup>. These allocated volumes of emissions are summed, and their sum represents the fund’s volume of emissions under or over the carbon budget for a specific alignment trajectory and temperature.

The temperature score of a fund is deduced from this indicator of allocated emissions volume under or over a carbon budget for a specific alignment trajectory.

*Note: only funds with a 80%+ coverage rate in the S&P Trucost database are included, meaning those funds for which at least 80% of their assets under management are covered by the database.*

## MAIN LIMITATIONS OF THE METHODOLOGY

There are several approaches to measure a portfolio’s alignment with the Paris Agreement. These approaches can result in different outcomes due to different structural assumptions in the models.

Lyxor’s climate alignment approach results in a simple and easily understandable temperature indicator. However, like every approach to measure a fund’s climate alignment, the approach has some limitations, which are described below. Consequently, the temperature results communicated by Lyxor on its funds can only be used as a support for evaluation and investment portfolio steering. Lyxor should not be held liable for any decision based on or on reliance on the alignment measures.

### **The approach does not include scope 3 emissions**

To this day, only scope 1 and scope 2 emissions (except for aviation, power generation and cement, whose scope 2 emissions are generally negligible relative to the sum of scopes 1 and 2) are covered. In 2021, the approach may be extended to scope 3 emissions for the Oil & Gas and Automotive sectors, for which scope 3 represents a notable share of their global emissions. More issuers reporting scope 3 emissions, and the development of climate scenarios that integrate scope 3, will be required to integrate these emissions into the approach for other sectors in future.

### **A fund’s temperature score has limitations as an input**

The measure of a fund’s temperature is based on various assumptions. It relies on data, some of which are forecast or modelled (such as estimates of past or future carbon emissions, etc.). The temperature indicator provides an input for investment decisions, but it should be evaluated with discernment and a critical mind, regarding the methodology, its assumptions and limitations. A fund’s temperature should not be trusted as a relevant and perfect value in every situation, and a decrease between two measurement periods does not necessarily result from a real decrease of emissions generated by issuers in a fund.

### **The methodology does not consider the specific sectoral challenges of issuers assessed using GEVA approach**

Most of the limits of this approach are related to the application of the economic approach GEVA for some types of issuers. The GEVA approach allows alignment to be measured across a large panel of issuers, ones that are not eligible for the SDA approach. But GEVA applies a unique emissions reduction rate to all sectors, with no consideration of each sector’s specific challenges and the changes needed to achieve the energy transition pathway of that sector.

### **Temperature scores can be volatile**

The use of economic data for the calculation of carbon intensity in the GEVA approach introduces volatility that may lead to meaningless temperature fluctuations. To limit the impact of inherent volatility, alignment is measured over several years, from historical data and forecasts. Temperature results may also be impacted by the variations of other parameters, such as changes in the fund composition, fluctuations of issuers’ values, or updates to scenario trajectories.

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