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EUROPEAN UNION TAXONOMY ALIGNMENT CALCULATION METHODOLOGY

EUROPEAN UNION TAXONOMY REGULATION

In December 2016, the European Commission mandated a High-Level Expert Group (HLEG) to develop an overarching and comprehensive Union strategy on sustainable finance. The report of the HLEG published on 31 January 2018 calls for the creation of a technically-robust classification system at Union level to establish clarity on which activities qualify as 'green' or 'sustainable', starting with climate change mitigation.

In March 2018, the European Commission published its action plan on financing sustainable growth, launching an ambitious and comprehensive strategy on sustainable finance.

One of the objectives set out in that action plan is to reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth. The establishment of a unified classification system for sustainable activities – the so-called EU taxonomy – is the most important and urgent action envisaged by the action plan.

The Taxonomy Regulation (Regulation (EU) 2020/852) was published in the Official Journal of the European Union on 22 June 2020 and establishes the general framework for determining whether an economic activity qualifies as environmentally sustainable for the purposes of establishing the degree to which an investment is environmentally sustainable.

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Six environmental objectives are covered by the Taxonomy Regulation: climate change mitigation; climate change adaptation; the sustainable use and protection of water and marine resources; the transition to a circular economy; pollution prevention and control; and the protection and restoration of biodiversity and ecosystems.

CHALLENGES ASSOCIATED TO THE CLASSIFICATION OF AN ACTIVITY AS ALIGNED WITH THE TAXONOMY

1. THE CONDITIONS TO BE RECOGNISED AS TAXONOMY-ALIGNED ARE COMPLEX

The EU Taxonomy Regulation sets out four conditions that an economic activity has to meet to be recognized as Taxonomy aligned:

- **Mapped to an eligible economic activity** – Only economic activities which occur in specific sectors identified by the EU are potentially eligible to be considered aligned with the Taxonomy.

- **Making a substantial contribution to at least one environmental objective** - The Technical Screening Criteria for 'substantial contribution' to an environmental objective ensure that the eligible economic activity either has a substantial positive environmental impact or substantially reduces negative impacts on the environment

- **Doing no significant harm (DNSH) to any other environmental objective** - The criteria for 'do no significant harm' ensure that the economic activity does not impede the other environmental objectives from being reached.

- **Complying with minimum social safeguards** - The Minimum Safeguards requirements of the taxonomy check that the company meets minimum social requirements embedded in the OECD Guidelines on Multinational Enterprises (MNEs), the UN Global Compact (UNGC) and the ten UN Guiding Principles on Business and Human Rights (UNGP).

2. THE CHALLENGE OF FINDING NON-ESTIMATED DATA

BNPP AM needs EU Taxonomy data to comply with product-level reporting obligations arising from the EU Taxonomy itself and from SFDR[1], and to take minimum percentage commitments in funds it wants to position for eligibility under the MIFID II Sustainability Preferences. However, the Taxonomy data available at mid-2022 does not cover the market widely enough.. The challenge faced by BNPP AM is to find reliable and robust data to start committing products on this criteria. This note will help you understand how we operated due diligence on our providers to achieve this.

BNP PARIBAS ASSET MANAGEMENT APPROACH

We reviewed several EU Taxonomy data providers, each proving to have their pros and cons. Following an initial broad-based survey of the market, we ultimately selected Bloomberg as our preferred vendor since this is in our view the provider offering the highest level of compliance with the requirements of the regulation. The methodology to consider an activity as Taxonomy aligned based on the data of Bloomberg has been carefully assessed and is described in the section below.

A. IDENTIFYING TAXONOMY ELIGIBLE REVENUES

The first step in an EU Taxonomy assessment consists of determining how much revenue a company makes from EU Taxonomy-eligible activities. NACE codes are used as the nomenclature framework to capture EU Taxonomy eligible sectors, providing broad coverage of economic activities.

B. ASSESSING THE SUBSTANTIAL CONTRIBUTION

Bloomberg calculates substantial contribution by applying a sector-based model of testing publicly available information about companies against the EU Taxonomy and the relevant Technical Screening Criteria. Through a series of methodology chapters, Bloomberg releases a detailed explanation of how a company operating in a given sector can demonstrate substantial contribution to only the climate change mitigation objective so far.

1. Sustainable Finance Disclosure Regulation

C. DOING NO SIGNIFICANT HARM TO ANY OTHER ENVIRONMENTAL OBJECTIVE (DNSH)

Bloomberg calculates a DNSH pass rate in percentage for each of the six environmental objectives of the EU taxonomy at two levels:

- Level 1 evaluates entity level criteria of DNSH across the six environmental objectives, using a combination of the company's policies, processes and quantitative measures.

- Level 2 evaluates detailed sector-specific criteria of DNSH across the six environmental objectives, using a more detailed and granular combination of the company's policies, processes and quantitative measures. Level 2 data fields provide a set of data that more closely aligns with the DNSH criteria, but where Bloomberg has observed very low disclosure levels.

The user is in charge of defining a DNSH tolerance level above which a company is considered to pass the DNSH criteria. We decided to only pass companies with scores above a threshold of 0 for each DNSH Level 1 of the six environmental objectives.

D. COMPLYING WITH MINIMUM SOCIAL SAFEGUARDS (MSS)

Bloomberg MSS model has been built from company-level disclosure mapped across 35 data fields aligned to ILO's Declaration on Fundamental Principles and Rights at Work and ILO's eight fundamental conventions, as well as OECD guidelines. Bloomberg MSS model provides a percentage-based score to indicate the proportion of disclosure across three main categories of data:

- **Minimum mandatory data**: this is a set of entity-level data or policies that Bloomberg expect a company to publicly disclose.

- **Optional data**: this is a set of data that more closely aligns with the MSS requirements, but where Bloomberg has observed very low disclosure levels.

- **Red flags**: this is a set of data that would indicate further investee engagement or due diligence is required. Such fields could be due to a workplace health and safety violation or fine, or incident. The Red flags data set displays the findings per company which indicate potential misalignment with MSS requirements.

As for the DNSH screen, the user is in charge of defining a tolerance threshold above which a company is considered to pass the MSS criteria. We decided to only pass companies with scores equal to or above the median for each minimum mandatory data test.

We will continue to track the evolutions of the EU Taxonomy methodology of Bloomberg and other providers with the objective to use the best available data to determine whether an economic activity qualifies as environmentally (and eventually socially) sustainable.

BNP PARIBAS ASSET MANAGEMENT COMMITMENTS

Based on Bloomberg's data, we calculated the alignment rate with the Taxonomy of our investments and committed to the following:

Fund name	EU Taxonomy alignment rate commitment
BNP PARIBAS EASY ECPI Global ESG Hydrogen Economy[2]	15%
BNP Paribas Funds Energy Transition	10%
BNP Paribas Funds Climate Impact	8%
BNP Paribas Funds Environmental Absolute Return Thematic Equity (EARTH)	5%
BNP Paribas Actions PME ETI ISR	2%
BNP PARIBAS ACTIONS PME ISR	2%
BNP PARIBAS AQUA	2%
BNP Paribas Funds Aqua	2%
BNP Paribas Funds Global Environment	2%
BNP Paribas Funds Green Tigers	2%
BNP PARIBAS Euro Climate Aligned	2%
BNP Paribas Funds Sustainable Euro Multi-Factor Equity	2%
BNP Paribas Funds Sustainable Europe Multi-Factor Equity	2%
BNP Paribas Funds Sustainable Multi-Asset Balanced	2%
BNP Paribas Funds Sustainable Multi-Asset Growth	2%
BNP Paribas Green Business	2%
BNP Paribas Funds Multi-Asset Thematic	2%

Data source: BNPP AM/ Bloomberg as of August 2022

The investments in the funds are subject to market fluctuations and the risks inherent in investments in securities. The value of investments and the income they generate may go down as well as up and it is possible that investors will not recover their initial outlay, the funds described being at risk of capital loss. For a Complete description and definition of risks, please consult the last available prospectus and KIID of the funds

About SFDR categorisations:

- "Article 6" products either integrate environmental, social and governance (ESG) risk considerations into the investment decision-making process, or explain why sustainability risk is not relevant, but do not meet the additional criteria of Article 8 or Article 9 strategies.
- "Article 8" products promote social and/or environmental characteristics. These may invest in sustainable investments, but do not have sustainable investing as a core objective.
- "Article 9" products have a sustainable investment objective.

DEFINITIONS

ISR: L'investissement Socialement Responsable
ESG: Environmental, Social and Governance.
PASI: Principal Adverse Impact indicators
SFDR: Sustainable Finance Disclosure Regulation

2. Environmental, Social and Governance

October 2022 - Design: BNPP AM Creative Services - P2209099

VIEWPOINT

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