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Principal Adverse Impact

Negative Impact (Principal Adverse Impact PAI)

The European Union (EU) regulation on sustainability-related disclosure requirements in the financial services sector (SFDR) defines 18 core indicators that can have an adverse impact. Mirroring the Positive Impact (considerable, substantial, significant impact), the Negative Impact (adverse, negative, strong negative impact) describes opposite consequences.

The Carnot Impact process focuses on reducing consumption by making better, i.e. more efficient, use of the product factors employed. Concrete fields of application are the topics of energy and natural resources. Focusing on the issue of reducing consumption is an effective filter, so that most companies with significant adverse impacts in climate indicators and other environment-related indicators do not even enter the investment universe. By verifying and documenting that sustainability is part of the company's strategy, the likelihood of significant adverse impacts in the areas of social and employment issues, respect for human rights, and combating corruption and bribery is greatly reduced. By excluding companies with controversial activities, the adverse impacts are further reduced. Finally, portfolio companies are screened individually for significant adverse impacts (PAIs) using an ESG bottom-up analysis, taking into account the industry-specific profile of environmental and social risks. PAIs are examined, recorded, commented on, and assessed against the SDG grid. At the portfolio level, PAIs are reduced through engagement and through non-investment or divestment.

The table below explains how adverse sustainability impacts (PAIs) are mapped to the relevant SDGs in the Carnot Impact process (SDG Mapping).

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7. Carnot Impact Process: Principal Adverse Impact (PAI) and SDG Mapping

Adverse sustainability indicator	SDGs affected	Summary remarks
1. GHG emissions	13 CLIMATE ACTION	The GHG emissions Scope 1/2/3 of portfolio companies are assessed. Companies with significant GHG emissions are assigned a negative impact with regard to SDG 13. The investment guidelines exclude the particularly problematic producers of fossil raw materials. Operators of coal-fired power plants are only considered if their overall generation mix has a low carbon footprint. Companies with other critical activities, such as airline operations, chemicals, steel or cement production, are only considered for investment if they undertake extraordinary efforts, particularly in research and development, to make the company and the industry as a whole more CO2-friendly.
2. Carbon footprint		See PAI 1
3. GHG intensity of investee companies	13 CLIMATE ACTION	The GHG intensity of the companies is analysed and compared to the GHG reduction effects of the products in the Energy Efficiency theme - Carnot Capital's main investment theme. When assessing PAI, not only the effective emission intensity is evaluated, but also the efforts to reduce emissions, especially in the area of R+D. Portfolio companies outside the energy efficiency theme are assigned a negative score on SDG 13 if they produce energy intensively.
4. Exposure to companies active in the fossil fuel sector	13 CLIMATE ACTION	Companies that extract fossil raw materials are excluded from the investment universe. Companies that offer technologies and services for such companies are not excluded in principle. For such companies, the GHG impact of the technologies and services (as in other industries) is compared with the GHG impact of the industry standard technology.
5. Share of non-renewable energy consumption and production	13 CLIMATE ACTION	Electricity producers with fossil power plants are only considered as an exception (see PAI 1). Energy intensive companies with a high share of fossil energy and no positive impact in energy efficiency receive a negative SDG 13 rating.
6. Energy consumption intensity per high impact climate sector	13 CLIMATE ACTION	A high energy intensity is assessed negatively in relation to SDG 13 if the products have no or only a low energy saving effect or if the proportion of fossil energy in the energy mix is above average.
7. Activities negatively affecting biodiversity-sensitive areas	14 LIFE BELOW WATER 15 LIFE ON LAND	A negative assessment with regard to SDG 14 & 15 is given to companies whose emissions significantly pollute water or soil, and companies whose products impair biodiversity and promote monocultures. Particularly critical are fertilizer manufacturers, manufacturers of pesticides, soil cultivation machines, plants for the pulp industry, river power plants, and shipping companies with ships without ballast water treatment.

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8. Emissions to water	6 CLEAN WATER AND SANITATION	Portfolio companies are screened for emissions to water and assessed negatively, if applicable, if they belong to a process industry (chemicals, food, waste recycling, recycling, etc.). In the case of companies in the fishing industry, efforts to prevent emissions are assessed and positive consideration is given to the fact that the industry produces animal proteins with low water consumption.
9. Hazardous waste and radioactive waste ratio	7 AFFORDABLE AND CLEAN ENERGY 12 RESPONSIBLE CONSUMPTION AND PRODUCTION	Companies with nuclear power plants are excluded from the investment universe, except for shareholdings that are smaller than the exclusion threshold or activities in trading. Other companies are screened to determine whether hazardous waste is generated in production and whether it is treated without significant adverse effects. The PAI analysis also considers whether the products themselves generate hazardous waste, e.g. PVC.
10. Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises	8 DECENT WORK AND ECONOMIC GROWTH 16 PEACE, JUSTICE AND STRONG INSTITUTIONS	Companies known to have violated the OECD Guidelines for Multinational Enterprises are ranked with a negative impact on SDG 8. Particular caution is required for companies with substantial operations in countries with a poor ranking on the Corruption Index.
11. Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises	8 DECENT WORK AND ECONOMIC GROWTH 16 PEACE, JUSTICE AND STRONG INSTITUTIONS	Carnot checks whether the portfolio companies monitor compliance with the OECD Guidelines for Multinational Enterprises and whether they handle complaints. An assessment with regard to SDG 8 is negative (only) if the company does not document any efforts in terms of the concerns in the OECD Guidelines.
12. Unadjusted gender pay gap	5 GENDER EQUALITY 10 REDUCED INEQUALITIES	Carnot takes note of the companies' reporting on gender distribution and earnings gaps. However, we do not derive any strong negative or negative impacts in terms of the SDGs from this.
13. Board gender diversity	5 GENDER EQUALITY 10 REDUCED INEQUALITIES	Carnot takes note of gender diversity in governance bodies, but does not infer strong negative or negative impacts in terms of the SDGs.
14. Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	Companies involved in controversial weapons are excluded from the universe. For other weapons, a tolerance threshold of 5% applies. These companies will be assigned a negative score on SDG 16.

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15. GHG intensity	Not applicable (Investments in sovereigns and supranationals)
16. Investee countries subject to social violations	Not applicable (Investments in sovereigns and supranationals)
17. Exposure to fossil fuels through real estate assets	Not applicable (Investments in real estate assets)
18. Exposure to energy-inefficient real estate assets	Not applicable (Investments in real estate assets)