

Transition Label Eligibility Criteria

Preamble:

LuxFLAG aims to periodically revise the eligibility criteria of its labels as the market evolves.

The eligibility criteria list the requirements of the product, the process and the portfolio that the applicant needs to fulfill to be eligible to receive the Transition Label.

The scope of the Transition Label's Eligibility Criteria is standardized across financial products (as defined below) which are distributed to retail, private or institutional clients.

This Transition Label addresses specifically investments actively supporting sectors and activities contributing to climate, environmental or social outcomes, even in hard-to-abate sectors or geographies where current alignment with green or social standards is not yet achievable and where progress is both necessary and underway.

Financial products and services, such as investment funds¹, insurance products, discretionary mandates, pension plans, indices or structured notes are included in the definition of "Applicant".

Management companies, investment managers, Alternative Investment Fund Managers (AIFMs), insurance companies, banks are included in the definition of the "Manager of the Applicant" or the "Manager".

¹ Investment funds may include, but are not limited to, Undertakings for Collective Investment, collective investment schemes, RAIFs, ELTIFs, etc.

In order to obtain a Transition Label, both an Applicant and its Manager must comply with the following eligibility criteria set out by LuxFLAG.

1) The Applicant shall:

- a) Have an investment strategy that promotes ESG (Environment, Social, and Governance) characteristics or that includes one or more sustainable investment objective(s) and;²
- b) Have an investment selection process considering results of initial and ongoing ESG due diligence on 100% of investments (excluding cash) and;³
- c) Include Transition objectives in its investment strategy contributing to the climate, environmental and/or social Transition⁴. These objectives must be time-bound, monitored and periodically reported. The Applicant shall hold at least 50% of Transition-related investments (see Appendix I) with a clear and direct link to activities consistent with and directed towards the ambition of reaching the Transition objectives and;
- d) Apply exclusionary criteria in line with the Transition Label Exclusion Policy (see Appendices II and III), including underlying investments and;
- e) Demonstrate compliance with, and effective integration of, a stewardship strategy that addresses sustainability issues throughout the investment process and in investment decisions. Stewardship shall focus on engaging issuers exposed to material ESG risks, with particular attention to sectors with higher impacts.

Stewardship minimum thresholds are:

² For Applicants subject to the Sustainable Finance Disclosure Regulation (“SFDR”), this requirement will be assessed on their alignment with the Article 8 or Article 9 classifications. For Applicants not subject to the SFDR, this requirement will be assessed on the Applicant’s legal and reporting documentation, as well as its non-financial objectives described therein. In addition, the equivalence of regulatory and/or supervisory frameworks of non-EU countries with the EU framework will be assessed on the equivalence decisions of the European Commission and the Luxembourg national supervisory authority (the “CSSF”).

³ Such criterion shall be achieved using data either from an external provider or via a proprietary methodology or a combination of both.

⁴ The European Commission’s definition of Transition is available under the publication accessible at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023H1425> and the International Institute for Sustainable Development (IISD) illustrates Social Transition here: <https://www.iisd.org/system/files/2022-08/social-taxonomy-sustainable-investing.pdf>

- at least **20%** of investments facing material ESG risks must be covered if engagement is conducted **directly**; or
- **50%**, if engagement is conducted **collaboratively**.

In addition to the above-mentioned stewardship minimum thresholds, the following requirements apply to the two (2) below sector-specific engagement⁵:

- *High Sustainability Risk Sectors*⁶:

Engagement is mandatory and a time-bound transition plan must also be in place or under development.

High sustainability risk sectors include, but are not limited to, energy-intensive and/or high CO²-emitting industries and sectors, i.e. hard-to-abate sectors, like manufacture of cement, basic chemicals, plastic, steel, aluminum production, traditional mining, intensive livestock farming, palm oil cultivation, maritime transport and aviation, but also others industries and sectors, i.e. high social risk sectors, like extractive industries, textiles & apparel, agriculture (e.g. pesticides and Genetically Modified Organisms) and construction.

- *All Other Sectors*:

Engagement and a transition plan are recommended.

In both cases, engagement efforts and transition plans should align with, and be directed towards, achieving the transition objectives.

These sectors may not be subject to immediate alignment with the EU Taxonomy or the PAB rules but still benefit from voluntary engagement strategies to address wider ESG opportunities and risks.

f) In addition, the following specifications apply **at instrument level**:

- If investments into investment funds exceed 10% of the Applicant's net assets, a minimum of 75% of the investee funds must comply with criterion 1.a) above, including a look-through on underlying investments.

⁵ The United Nations Principles for Responsible Investment (UNPRI) defines engagement as "interactions between the investor and current or potential investees on ESG issues. Engagements are undertaken to influence (or identify the need to influence) ESG practices and/or improve ESG disclosures." LuxFLAG would require engagement to be monitored and reported, including at least the following aspects: theme, target outcome and timeline.

⁶ The activities listed here are non-exhaustive and their interpretation by LuxFLAG may vary over time and depending on the data provider. The accuracy and completeness of the data provided by third parties cannot be guaranteed. LuxFLAG assumes no responsibility or liability for any damages that may arise as a result of the use of such data.

This criterion shall be met by investing in funds that are subjected to an ESG assessment or confirmed as aligned with internationally recognized standards.

- ii. Investments in sovereign bonds must demonstrate a dedicated approach, either using an external provider or via a proprietary methodology or a combination of both.
- iii. Investments in other bonds must be composed of at least 75% of green bonds, social bonds, sustainability bonds, sustainability-linked bonds, and/or Climate Transition Bonds (CTBs) compliant with internationally recognized standards or frameworks.

For the inclusion of CTBs or any debt instrument specifically targeting high-emission sectors, the Applicant must ensure that the underlying documentation includes the following technical safeguards:

- Technological Necessity: Substantiation that lower-carbon alternatives for the specific activity are currently technologically or economically unfeasible within the local operating context.
 - Lock-in Mitigation: A formal assessment or verification that the financed assets do not lead to 'carbon lock-in', ensuring they remain compatible with a long-term pathway to net-zero and do not delay the deployment of near-zero substitutes.
 - Strategic Alignment: Confirmation that the instrument is backed by an issuer-level transition strategy that is science-based, quantitatively measurable, and includes a time-bound plan for the phase-out of unabated fossil fuel capacity.
 - Reporting & Verification: Commitment to annual impact reporting and external verification of the allocation of proceeds to the specified transition projects.
- iv. The use of derivatives is limited to hedging and efficient portfolio management purpose only.
 - v. Investments in passive or index-based products are limited to 15% of the Applicant's assets, unless they use an EU Climate-Transition benchmark, an EU Paris-aligned benchmark or any other ESG benchmark.

2) The Manager of the Applicant Investment Product shall:

- demonstrate best reporting and market practices;⁷
- be duly authorized by a competent supervisory authority of an EU Member State, or subject to a regulatory and/or supervisory regime that could be considered equivalent to that of EU Member States⁸; and
- demonstrate a commitment to develop and implement best practices in the management of responsible investments by being signatory to recognized responsible investment frameworks⁹.

⁷ This documentation should consist of at least a publicly available ESG and/or Impact report and in addition, but not limited to, CSR/Sustainability guidelines/policy, Annual CSR/Sustainability report, Engagement policy, Stewardship policy,

Transition plan applicable at the level of the Manager of the Applicant or at the level of its group.

⁸ The equivalence of regulatory and/or supervisory frameworks of non-EU countries with the EU framework will be assessed premised on the equivalence decisions of the European Commission and the Luxembourg national supervisory authority.

⁹ Recognized responsible investment frameworks such as, but not limited to, the United Nations Principles for Responsible Investment (UN PRI).

Appendix I – Transition-related investments

Transition-related investments must have a clear and direct link to activities compatible with, and contributing to the climate, environmental or social transition, such as but without limitation:

- (a) investments in undertakings or economic activities with a transition plan at the level of the undertaking or at activity level, including but not limited to, companies that are i.e. manufacturing products or providing solutions for the transition;

***Climate transition plans** may be issued using frameworks such as, but not limited to, transition plans contemplated under the Corporate Sustainable Reporting Directive (CSRD), the Corporate Sustainability Due Diligence Directive (CSDDD), the Glasgow Financial Alliance for Net Zero Transition Plan (GFANZ NZTP), the UN Secretary General’s High-Level Expert Group on the Net-Zero Emissions Commitments of Non-State Entities (HLEG) recommendation 4, the International Sustainability Standards Board (ISSB) – IFRS S2, or the ISO 14068 (Net Zero Guidelines – under ISO Climate Change Standards).*

***Social transition plans** should be built around internationally recognized standards including but not limited to, UN Guiding Principles on Business and Human Rights, ILO conventions, OECD Guidelines and the IISD’s Principles-Based Social Taxonomy for Sustainable Investing¹⁰ and be part of pre-investment due diligence.*

- (b) investments in undertakings or economic activities with science-based targets that are supported by information ensuring integrity, transparency and accountability;

Science-based targets may be issued using frameworks such as, but not limited to, the Science Based Targets initiative (SBTi), the Transition Pathway Initiative (TPI), or the Net Zero Asset Managers Initiative (NZAM).

- (c) investments in portfolios using the EU Climate Transition Benchmarks (CTB) and/or the EU Paris-aligned Benchmarks (PAB);

- (d) investments in Taxonomy-aligned economic activities, including, but not limited to:
- transitional economic activities as defined by Article 10(2) of the Regulation (EU) 2020/852 for the climate change mitigation objectives,
 - enabling economic activities as defined by Article 16 of the Regulation (EU) 2020/852

¹⁰ The International Institute for Sustainable Development (IISD) illustrates Social Transition here: <https://www.iisd.org/system/files/2022-08/social-taxonomy-sustainable-investing.pdf>

- Taxonomy-eligible economic activities becoming Taxonomy-aligned in accordance with Article 1(2) of the Commission Delegated Regulation (EU) 2021/2178 over a period of maximum five (5) years, or exceptionally ten (10) years;

(e) investments in undertakings disclosing material impacts and actions under ESRS S1–S4¹¹, particularly on fair working conditions and access to essential services; or investments in economic activities promoting decent work, adequate living standards and inclusive communities¹²; and

(f) investments reflecting commitments to reduce adverse environmental and human rights impacts in line with Articles 5–12 of the Corporate Sustainability Due Diligence Directive (CSDDD)¹³, which require due diligence, risk mitigation, and remediation across operations and value chains. These investments may include business models promoting social and environmental integrity, transparency, and accountability throughout the transition process.

¹¹ The European Sustainability Reporting Standards (ESRS), including ESRS S1 to S4 are available under the publication accessible at https://eur-lex.europa.eu/eli/reg_del/2023/2772/oj

¹² The Social Investment Framework released by Accelerating Impact and LuxFLAG.

¹³ Articles 5-12 of the Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859, accessible at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32024L1760&qid=1753457858485>.

Appendix II – Transition Label Exclusion Policy

A. List of sectors and activities¹⁴, in which investments must be excluded:

Controversial behavior: Investments in companies which may be involved (whether credibly alleged or actual involvement), and/or whose management bodies may be involved in severe or very severe harm in violation of one or more of the following: the UN Global Compact Principles, the UN Guiding Principles on Business and Human Rights, the ILO conventions, and the OECD Guidelines for Multinational Enterprises on Responsible Business Conduct (see Appendix III. A for further details).

Controversial jurisdictions: Investments in sovereigns and/or corporate issuers and/or individuals or other entities in countries or entities listed in one of the following: the United Nations Security Council sanctions regimes¹⁵, the list of high-risk jurisdictions subject to a Call for Action by the Financial Action Task Force¹⁶, the consolidated list of persons, groups and entities subject to the European Union sanctions¹⁷.

Controversial weapons: Investments in companies involved, or through owned entities, in the manufacturing of controversial weapons, including anti-personnel mines, cluster munitions, chemical, biological weapons, white phosphorus, depleted uranium weapons and nuclear weapons and/or essential components of such weapons and/or services in relation to such weapons, (see Appendix III. B for further details).

Tobacco: Investments in companies deriving their revenues from production or cultivation of tobacco, or more than 15% from sales and/or distribution of any traditional tobacco products, as well as tobacco-related products (including without limitation e-cigarettes and next-generation tobacco/nicotine products) and/or tobacco-supporting services (including without limitation filters, smoking halls).

B. Mandatory Standards for High-Emission Activities

The following activities are identified as **High Sustainability Risk Sectors** based on the technical exclusion thresholds defined in **Article 12 of Regulation (EU) 2020/1818**. For the purposes of

¹⁴ The activities listed here are in no way exhaustive and their interpretation by LuxFLAG may vary over time depending on the data provider. The accuracy and completeness of the data provided by third parties cannot be guaranteed. LuxFLAG assumes no responsibility or liability for any damages that may arise as a result of the use of such data.

¹⁵ Additional information is available at <https://www.un.org/securitycouncil/sanctions/information>.

¹⁶ Additional information is available at <https://www.fatf-gafi.org/en/home.html>.

¹⁷ Additional information available at <https://data.europa.eu/data/datasets/consolidated-list-of-persons-groups-and-entities-subject-to-eu-financial-sanctions?locale=en>.

this Label, any investment (Equity, Debt, or Loans) meeting these criteria is subject to the **Mandatory Engagement** and **Time-bound Transition Plan** requirements of **Section 1.e**.

1. **Thermal Coal & Lignite:** Entities deriving $\geq 1\%$ of revenue from the exploration, extraction, or refining of hard coal and lignite.
2. **Oil Fuels:** Entities deriving $\geq 10\%$ of revenue from the exploration, extraction, or refining of oil fuels.
3. **Gaseous Fuels:** Entities deriving $\geq 50\%$ of revenue from the exploration, extraction, or refining of gaseous fuels.
4. **High-Intensity Power Generation:** Entities deriving $\geq 50\%$ of revenue from electricity generation with a GHG intensity of more than **100 g CO₂e/kWh**.
5. **Hard-to-Abate Industrials:** Entities deriving $\geq 5\%$ of revenue from the manufacture of cement, basic chemicals, plastic, steel, aluminium, and other sectors identified in Section 1.e.

Stewardship Requirements for these Sectors:

To maintain eligibility, the Applicant's mandatory engagement with issuers in these sectors must verify the following "internationally recognized" safeguards:

- **Carbon Lock-in Assessment:** Verification that the investment does not extend the life of an emissions-intensive asset beyond the point where lower-carbon alternatives are feasible.
- **Methane & Flaring Mitigation:** For all oil and gas activities, the existence of a quantified plan to reduce methane leakage and flaring.
- **Technological Justification:** Documentation supporting the unfeasibility of near-zero alternatives in the current operating context.
- **Sunset Clauses:** Presence of explicit milestones for the phase-out of unabated fossil fuel capacity in line with science-based pathways.

LuxFLAG reserves the right to update this Exclusion Policy at regular intervals as the market evolves.

Appendix III. – Internationally recognised standards referred to in the controversial behaviors and controversial weapons exclusions

A. Controversial Behaviours exclusion

Internationally recognized standards include, without limitation, the following:

- the Universal Declaration of Human Rights;
- [the United Nations Guiding Principles on Business and Human Rights](#);
- [the OECD Guidelines for Multinational Enterprises on Responsible Business Conduct](#);
- [the International Labour Organization’s Fundamental Labour Conventions](#);
- the International Bill of Human Rights;
- [the United Nations Global Compact](#); and
- the Declaration on Fundamental Rights and Principles at Work.

For sovereign issuers, human rights due diligence may rely, without limitation, on the Freedom House Index and the Transparency International’s Corruption Perceptions Index.

In the case of companies operating in conflict-affected or high-risk areas, their investments are required to be subject to robust human rights due diligence processes, including engagement, particularly where credible allegations of human rights’ violations have been identified.

B. Controversial Weapons exclusion

Relevant international conventions include, without limitation, the following:

- the Geneva Protocol (1925) (on chemical and biological weapons);
- the Treaty on the Non-Proliferation of Nuclear Weapons (1968);
- the Convention on the prohibition of biological weapons (1972);
- the Convention on Cluster Munitions (2008);
- Protocol III to the Convention on Certain Conventional Weapons (1980) (on incendiary weapons);
- the Convention on the Prohibition of Chemical Weapons (1993);
- the Convention on the Prohibition of Anti-Personnel Mines (Ottawa Treaty) (1997); and
- the Treaty on the Prohibition of Nuclear Weapons (2017).