

The Future of Paris Aligned Investing

What gets (mis)measured gets (mis)managed

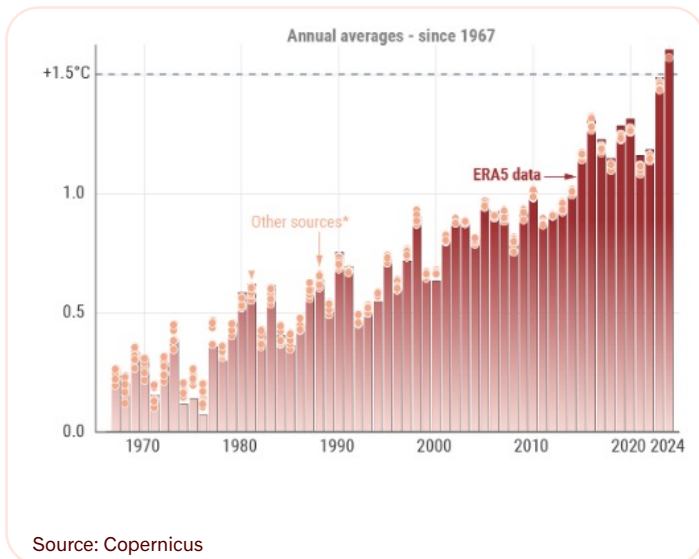
By Lauren Juliff and Henrik Wold Nilsen

2025



Almost a decade on from the signing of the Paris Agreement in 2015 it seems a reasonable time to reflect on progress and what that means for 'Paris aligned' investors. Unfortunately, 2024 was not a good year for climate mitigation progress and annual average temperatures continued to rise, hitting +1.5C for the first time as illustrated in Figure 1.

Figure 1 - Global annual average temperatures since 1967



Source: Copernicus

Even as Los Angeles burned earlier this year, the political mood music was sombre for climate action. Biden's Inflation Reduction Act (IRA) sparked a big, multi-year shift towards renewable energy investments in the USA, which Trump threatens to unwind. Further, rapid technological advancements in China have led to an influx of low-cost climate mitigation products that have been received unenthusiastically in the West with both Europe and the US seeking to implement trade barriers such as tariffs on Chinese Electric Vehicles (EVs).

Figure 2 - The Times cartoon



Source: The Times



Geopolitics has not been the only headwind for Western progress on climate mitigation. Strong competition from China as well as slow local policy progress and underfunding in Europe has led to companies scaling back production of clean technologies such as lithium-ion batteries, EVs and hydrogen projects. With political parties that do not prioritise climate mitigation attracting a greater share of votes and some rotation within central parties away from climate-positive policy rhetoric (e.g. Germany), companies are no longer being penalised for rolling back on their previous climate commitments. In the US, Trump's choice for Energy Secretary is the CEO of a shale gas company who calls Net Zero 2050 strategy "unachievable and perhaps undesirable" where "the cure is far worse than the disease"¹. This is a new type of climate scepticism. Where previously cynics would refute that climate change was man-made, they now argue that the problem is over-blown and there are other, more urgent, issues to address.

Climate Action Tracker monitors aggregate commitments from world nations in relation to the global ambitions laid out in the Paris Agreement.

¹ Chris Wright quoted from CNBC

Figure 3 – Climate Action Tracker Update for COP29

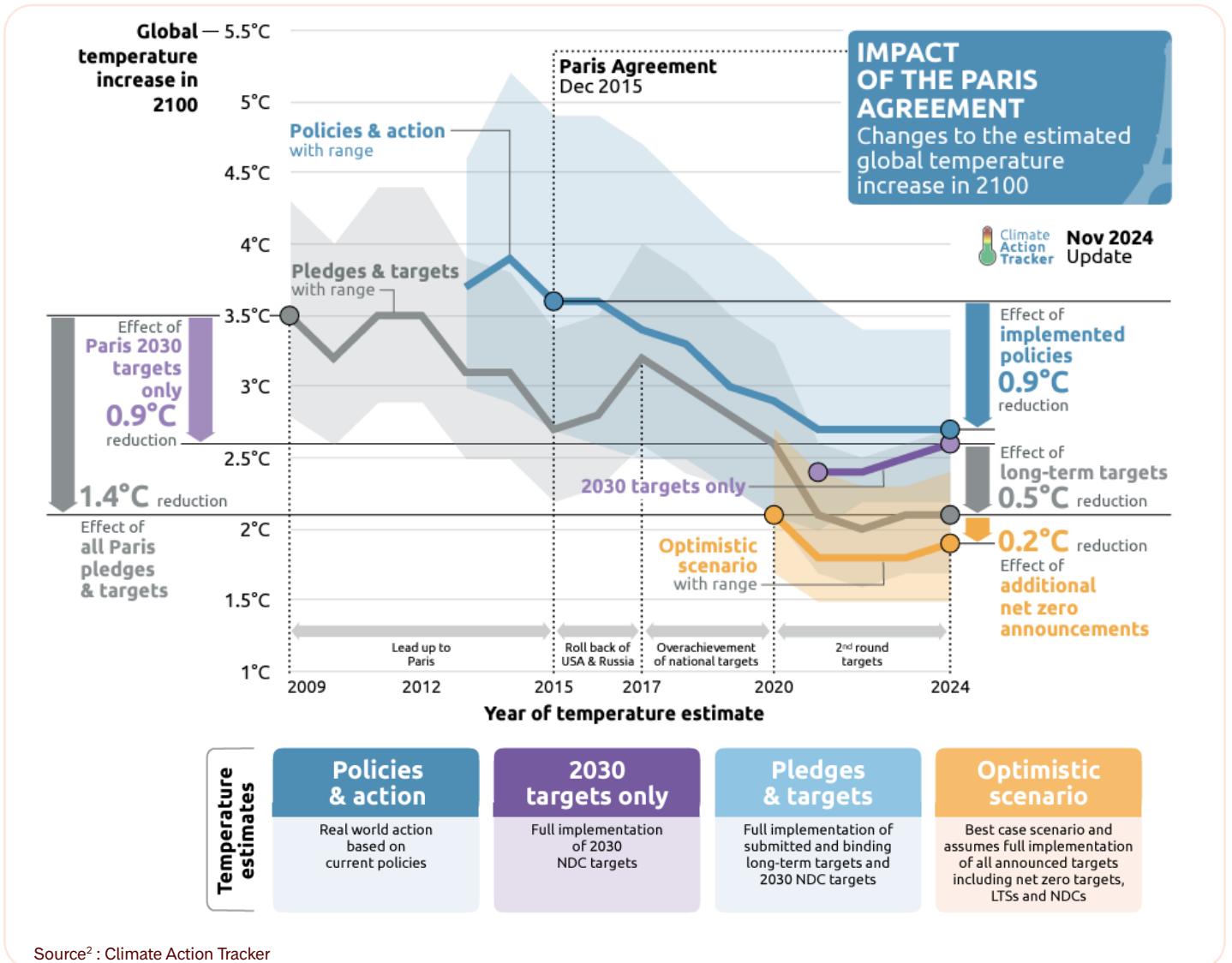


Figure 3 shows that, after the initial enthusiasm following the Paris Agreement, there has been no progress on implemented policies (blue line), Nationally Determined Contributions (NDCs) (grey line) or more ambitious targets announced outside of the Paris legal framework (yellow line) since 2021.

Without an immediate return to ambitious action, the gains made since Paris risk becoming a high-water mark rather than the foundation for deeper cuts in emissions.

The Paris Agreement's 5-year ratcheting-up mechanism, which was designed to drive greater ambition, is not only failing to accelerate action at the pace required but has seemingly plateaued at a critical moment. It could be that a step change was expected to follow in 2025, but despite the mechanism, only 13 of the 195 countries that signed the Paris Agreement met the recent 2025 deadline for the 'NDCs 3.0' and only five of those were the 'developed/ rich' countries³.

² Climate Action Tracker, [Global Update - November 2024 - As the climate crisis worsens, the warming outlook stagnates](#)

³ [Over 90% of countries fail to submit new NDCs by deadline - Climate Action Network](#)

What does a Trump presidency mean for Paris-aligned portfolios?

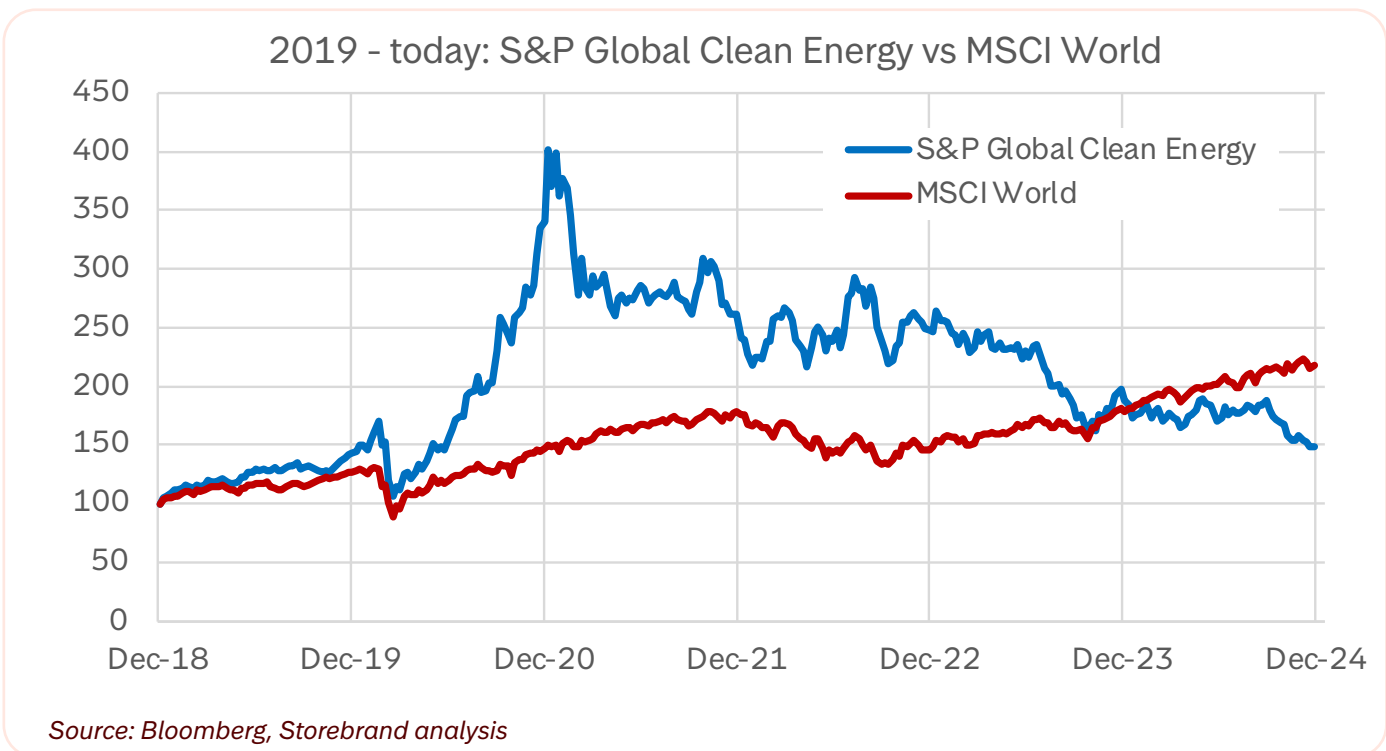
President Donald Trump used his first few days in office to pull out of the Paris Agreement, declare a national energy emergency and state his intention to boost domestic fossil fuel production. Although the impact of his actions on global average temperature levels presented in Figure 3 remains unclear, the outlook for global cooperation in the fight against climate change is decidedly negative. Yet, for all the “drill, baby, drill” rhetoric coming out of the US, the world’s fastest growing consumer of oil for over 30 years has been China where demand is now waning⁴. The majority of global growth out to 2050 will come from emerging and developing economies that are leading the way on clean technologies. In China, which has already hit its 2030 clean energy goal⁵ and emissions have plateaued, there are expectations that fossil fueled power output will now begin to fall as the rapid roll out of renewable energy continues⁶.

Many market commentators highlight the economic forces at play in shifting the global energy landscape to a cleaner, greener future. For example, the Telegraph recently pointed out that since 2015 clean technology has performed a “market miracle” with renewables costs dropping further and faster than anticipated – the money is following profit over policy with double the amount of capex going into renewables (\$2 Trillion) vs hydrocarbons⁷.

Our strategy for aligning a core equity portfolio with the goals of the Paris Agreement uses a range of climate indicators to tilt investment towards companies that we believe will benefit from unexpected changes in Paris Agreement implementation speed and away from those that we believe will suffer. We refer to this as a ‘climate beta’ exposure, alongside the primary market beta exposure from holding a portfolio optimised to a market cap-weighted global equity index.

We also incorporate a basket of ‘pure play’ climate solutions companies, which are largely missing from cap-weighted core equity indices due to their size. This sub-portfolio provides exposure to a broad and diversified range of companies in renewable energy, low carbon transport, recycling, water and other emerging technologies such as CCS. This is incorporated in a low-risk manner within our risk optimisation framework so that overall tracking error remains relatively low given the meaningful climate tilt. Over the past few years, our climate solutions positions have been a drag on relative performance, reflecting the broader market dynamics illustrated in Figure 4 below.

Figure 4 – S&P Global Clean Energy Index vs MSCI World since 2019



Source: Bloomberg, Storebrand analysis

⁴ Financial Times, FT View 23 January 2025: [When peak Chinese oil demand meets ‘drill, baby, drill’](#)

⁵ [China Hits Clean Energy Goal Six Years Ahead of Schedule | OilPrice.com](#)

⁶ [China’s fossil-fuelled power output may fall in 2025 for first time in decade | Reuters](#)

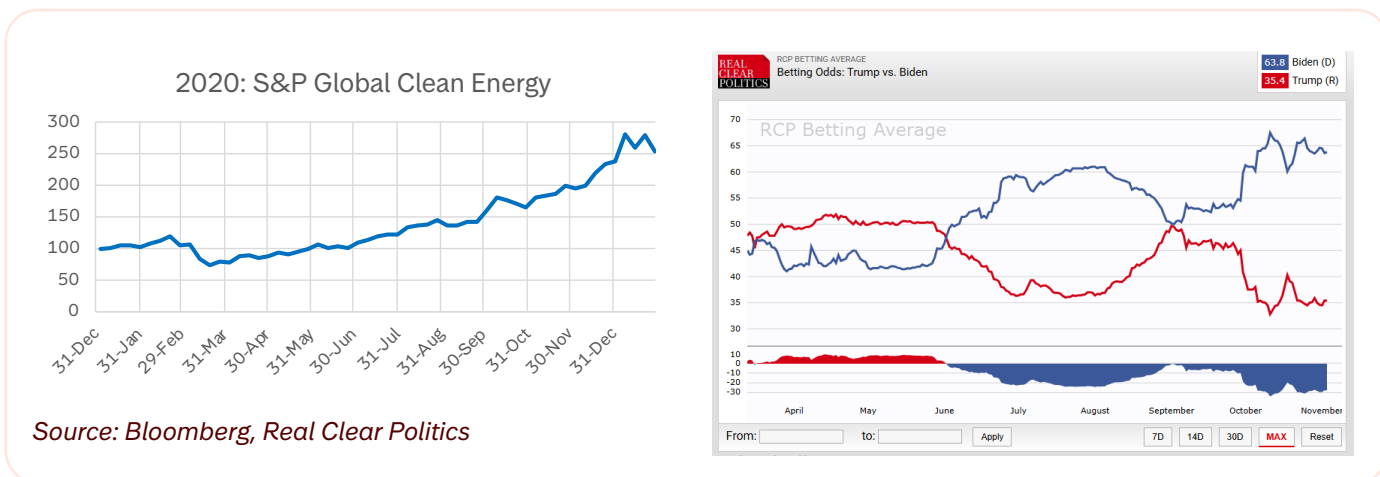
⁷ The Telegraph, 31 January 2025: [Right-wing wokeism can’t stop green tech winning the global energy war](#)

The S&P clean energy index began outperforming the broader market in summer 2020 – Trump’s last year in office – when expectations of Biden being elected began rising, as shown in Figure 5.

Since outperforming in 2020, clean energy stocks have struggled, falling around 60% since the start of 2021 versus a 50% gain for the broader index⁸. In 2024 the performance of renewables companies was broadly flat before really dropping off in Q4 – reflecting that the US election result was not priced in until October (Figure 6).



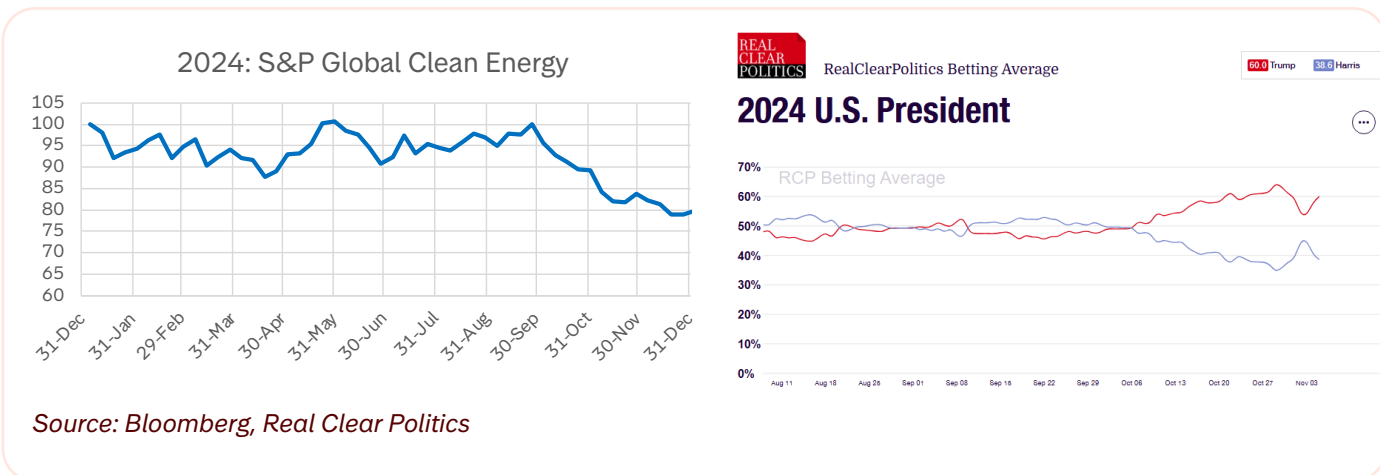
Figure 5 – S&P Global Clean Energy Index in 2020 and US President Betting Average



There appears to be a link between US election expectations and the performance of clean energy stocks. The previous peak for green stocks in January 2021 coincided with the Democrats taking control of the senate by a narrow majority and the market expecting that they would vote through Biden’s IRA. There was another uptick when Biden entered office (represented in the M shape on the LHS chart in figure 5) but performance for solutions stocks has been on a downward trend ever since.

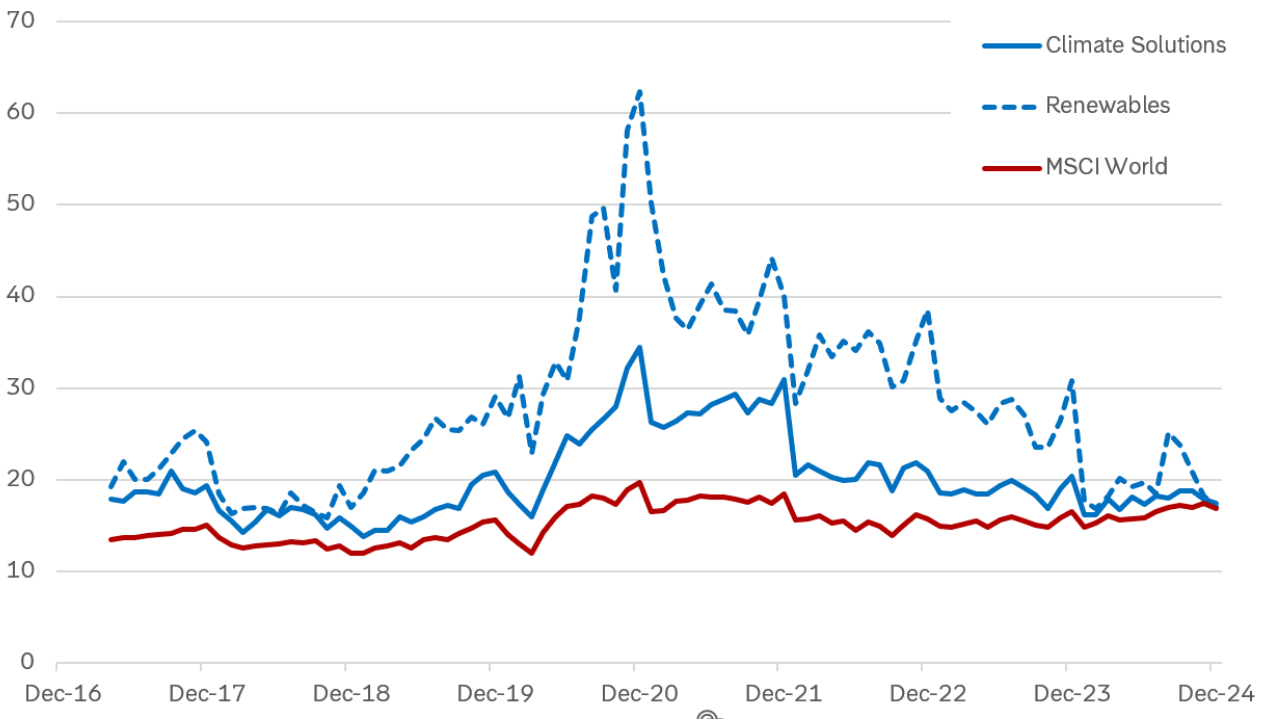
We first began including a basket of climate solutions companies in our portfolio in 2017 and, as illustrated in Figure 7, their median PE is now the same as the broader market for the first time. The valuation has almost halved from its January 2021 peak, reflecting the current pessimism of investors. While Trump re-entering office is certainly not positive for climate solutions, the valuation for these companies is now close to historic lows. We do not try to time the market with our climate solutions investments and have a consistent allocation (~12%), aiming instead for long-term alignment with the goals of the Paris Agreement. This reflects our belief that climate change is a financially material risk – and opportunity – that must be addressed and that a tilt towards positive climate beta necessitates an allocation to a diversified basket of solutions to the problem.

Figure 6 – S&P Global Clean Energy Index in 2024 and US President Betting Average



⁸ S&P Global Clean Energy Index vs. MSCI World Index in local currency, 31/12/2020-28/02/2025

Figure 7 – Median PE for climate solution stocks and MSCI World stocks



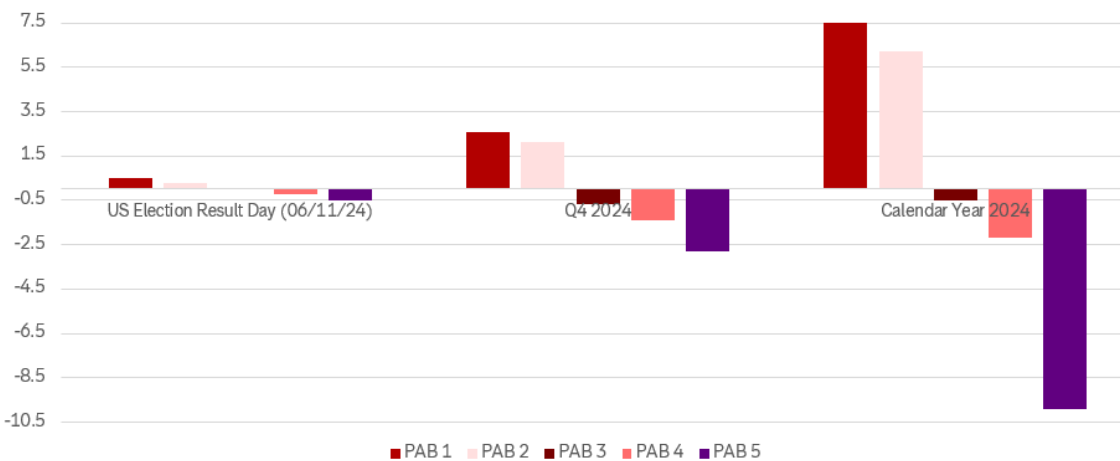
Source: Storebrand, MSCI, Factset. PE from analyst estimates. Climate Solutions = companies in Storebrand Global Plus Fund climate solutions portfolio – PM defined for >50% revenues or market cap from climate solutions activity. Renewables = subcategory of climate solutions portfolio containing companies related to renewable electricity generation.

What does Paris alignment really mean?

We have previously commented on the limitations of so-called ‘passive’ portfolio alignment with the goals of the Paris Agreement⁹. In our experience, systematic use of climate-related data in portfolio construction requires risk management oversight to avoid unintended consequences such as individual stock concentration and meaningful overweight positions in US tech.

We regularly monitor a range of funds tracking Paris Aligned Benchmarks (PABs) and find them to be extremely diverse in terms of risk exposures (tracking error to the parent benchmark), positioning and performance outcomes, despite following the same EU regulation. These differences occur due to index construction methodologies and inconsistent use of data sources. There is no single way to define a Paris-aligned portfolio, which is generally counter-intuitive to the mindset or goals of a passive investor.

Figure 8 – Paris Aligned Benchmarks and Trump



Source: Storebrand analysis using Bloomberg, all returns in USD shown as relative performance to MSCI World Index. Selection of various PABs which are tracked by at least one mutual fund or ETF distributed in Europe.

⁹ [Passive Pretenders ; Magnificent Performance of PABs](#)

At the end of 2023 we showed that the performance of PABs had largely been determined by their overweight positions in Magnificent Seven companies, rather than a climate tilt, and highlighted that this was likely an unexpected outcome for investors that bought into these strategies for 'Paris alignment'¹⁰.

We have noticed a similarly diverse, and in some cases very unexpected, outcome for PABs in 2024.

In Figure 8 we show the performance of index funds tracking five different PABs, constructed according to EU defined 'Paris-aligned' methodology, all from the same provider. We have charted the relative returns for each PAB tracker compared to the market cap weighted parent index for the day of the US election result, Q4 2024 and the full year 2024.

We draw two conclusions from this exercise:

1. The divergence in performance between these five 'passive Paris-aligned' global equity funds from a single vendor is remarkable. For investors choosing a new benchmark, the difference between returns of +7.5% (PAB 1) and -9.9% (PAB 5) in a single year is clearly an active choice.
2. Paris alignment according to EU benchmark rules is not the same as financial alignment with the Paris Agreement goals. Some of these so-called 'Paris-aligned' benchmarks outperformed on the news that Trump, along with his climate negative policies, was back in power.

A Paris Aligned Benchmark, designed according to EU regulation, will not necessarily provide financial exposure to the success of the Paris Agreement and may instead present meaningful unexpected risks relative to the market.

When it comes to understanding portfolio climate risks, investors and regulators have so far tended to focus on improving transparency by compelling companies to report carbon emissions intensity metrics, espousing "what gets measured gets managed". But what if we are measuring the wrong things? Or what if our incomplete measurements are leading us to the wrong conclusions?

PABs, and indeed most portfolio climate risk management strategies, have been built on the foundational belief that portfolios must decarbonise¹¹. However, even if we have complete and accurate emissions data, reported according to the GHG Protocol standard for the Scope 1, 2 and 3 emissions of every company, that will not necessarily indicate which companies are most exposed to financially material climate-related risks. Companies' emissions intensity figures are not necessarily comparable and so decarbonising a total portfolio using a systematic target, such as 7% p.a., can lead to results that run counter to the goals of the Paris Agreement – such as underweighting or avoiding companies in emerging markets and climate solutions¹².

Our earlier whitepapers have discussed the reasons behind these unintended consequences from portfolio decarbonisation. That research led us to avoid incorporating Scope 3 emissions into portfolio construction, preferring to optimise the portfolio using Scope 1 and Scope 2 emissions while using our understanding of Scope 3 value chain-related climate risks to adjust the portfolio and override misdirected allocations.



¹⁰[The "magnificent" performance of climate index strategies - www.storebrand.com](https://www.storebrand.com)

¹¹ The PAB EU rule is that the index must decarbonise at least 7% p.a. based on an IPCC defined pathway for 1.5C.

¹² [Double whammy - www.storebrand.com](https://www.storebrand.com)

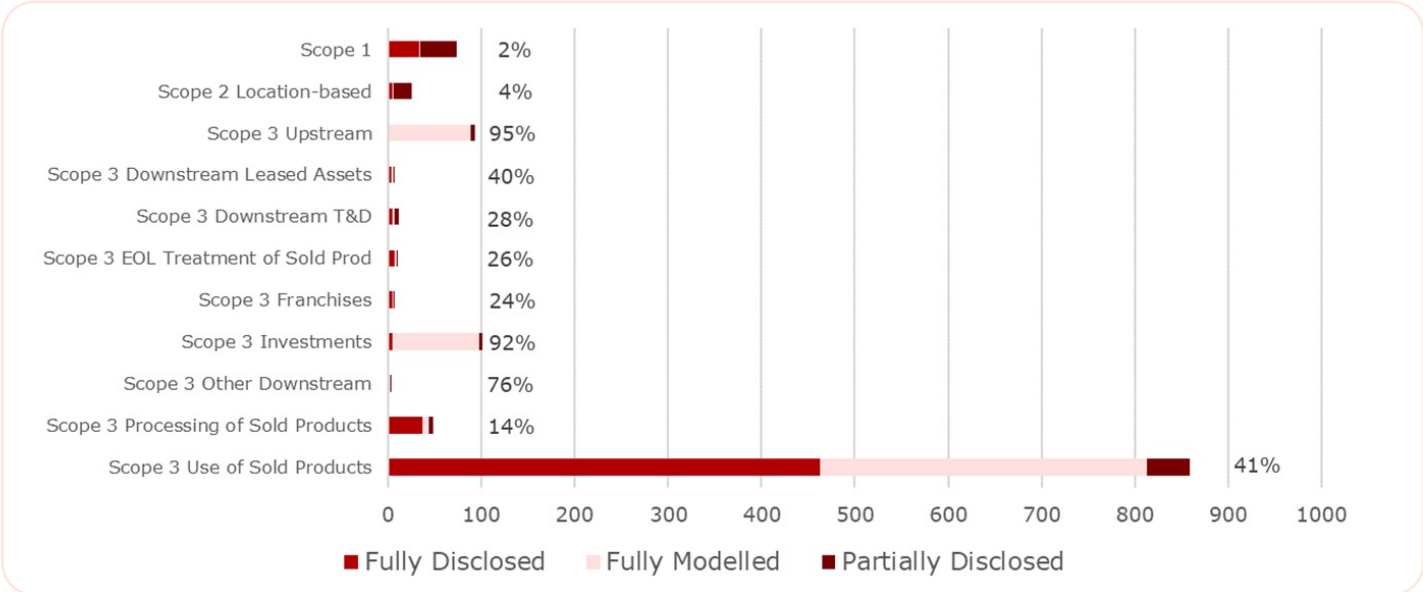
How do we move beyond Scope 1 and Scope 2 emissions intensity to a better understanding of portfolio climate risk?

Our approach is designed to evolve over time as climate research, policy and data improves, allowing flexibility in an ever-changing environment to respond to the latest available information. The main challenge for incorporating Scope 3 emissions has been the bundling together of 15 categories in a single metric, particularly in mixing fossil generated and clean technology generated power for 'use of product' emissions. Last year, following our series of white papers on the use of climate data in portfolio construction, we began researching the implications of incorporating a limited set of Scope 3 emissions data by assessing a breakdown of the underlying 15 categories from our data provider. There has long been an assumption in the market that the problem with Scope 3 emissions is largely due to missing data, but in our experience the 'use of sold products' category within Scope 3 is both dominant and a misleading indicator of risk in a global equity portfolio.

The large majority of emissions exposure in a global equity index portfolio is 'use of products' in Scope 3, followed by the 'investment emissions' and 'upstream' categories. The 'use of products' emissions offers a misleading indicator, not due to poor quality or missing data, but due to the mixing of fossil powered and electricity emissions which makes it unsuitable for portfolio integration. We have previously proposed a solution to this, if the GHG protocol guidance could separate category 11 into two parts¹³.

The Scope 3 'Upstream' and 'Investments' categories in our dataset remain largely estimated at 95% and 92%, respectively, and our analysis indicates that these are also unsuitable for portfolio optimisation due to radically different estimates for companies in the same industry. We continue to monitor the data quality and expect a new model to be released by our data provider later this year for the 'Upstream' category. It is worth noting that 'passive' climate index funds¹⁴ are constructed using a single metric for Scope 3 data, which is also used to calculate total portfolio emissions and feeds into the decarbonisation process.

Figure 9 – Scope 1, 2 and 3 emissions intensity for an MSCI World tracking fund by source and % of which is modelled



Source: Storebrand analysis, MSCI, Trucost

Figure 9 shows the Scope 1, 2 and 3 emissions intensity for a fund tracking the MSCI World Index. The data for Scope 1 and Scope 2 emissions is good quality, with minimal estimations – only 2% and 4% of those categories are entirely modelled by the data provider respectively. We are comfortable with incorporating this into portfolio optimisation as a reasonable indicator of how a company will respond to climate transition risks.

We believe the other categories in Figure 9 to be useful, however, subject to the data quality. We have now been able to assess and validate four additional categories for incorporation into portfolio optimisation, based on a manual review of company data, as follows:

- Processing of Sold Products
- Franchises
- End-of-life treatment of sold products
- Downstream transport & distribution

Our analysis shows that the data in these Scope 3 categories is of a reasonable quality, based on a company-by-company sense check, and they have therefore been incorporated into our model during December 2024

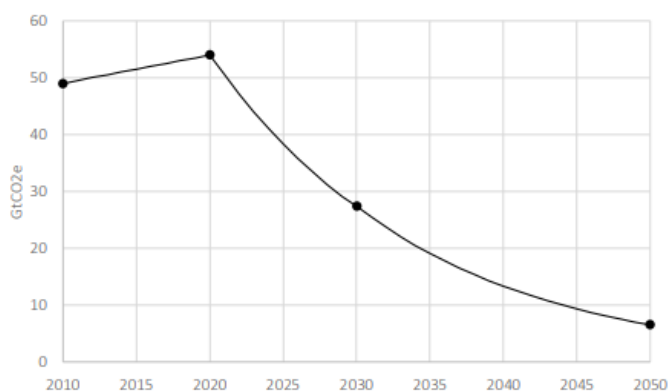
¹³ [The Climate Data Conundrum | Storebrand Asset Management - www.storebrand.com](https://www.storebrand.com)

¹⁴EU regulated Paris Aligned and Climate Transition benchmarks

Does portfolio decarbonisation even make sense anymore?

The EU climate benchmark regulation was created in 2019, using a synthesis of the latest available science on climate change from the IPCC 1.5C special report 'Global Warming of 1.5C' (SR15)¹⁵ as its reference point for achieving 'Paris alignment'. The EU Technical Expert Group (TEG) defined alignment as: "a benchmark is considered aligned with a given climate scenario if its own decarbonization pathway, meaning the on average per year reduction of its carbon intensity since inception is in line with the scenario"¹⁶.

Figure 10: Worldwide emissions trajectory, based on data from IPCC AR5 Climate Change 2014 Synthesis Report, IPCC SR15 report Chapter 2 and Global Carbon Budget, 2018



Source: TEG final report on EU climate benchmarks and benchmark ESG disclosures, 30 September 2019

The SR15 presented a range of pathways considered consistent with limiting global warming to 1.5C by the end of the century, and in doing so delivered a stark message to policymakers and investors alike about the need for dramatic and rapid emissions reductions to meet the Paris goals¹⁷. The IPCC showed that limiting warming to 1.5C without the need for unproven 'large-scale deployment of carbon dioxide removal (CDR) measures' would require global net anthropogenic emissions to approximately halve by 2030, compared to 2010 levels, and reach net zero by mid-century. They illustrated this with mitigation pathways based on reduced energy demand and the decarbonisation/electrification of energy¹⁸.

Illustration – why estimated carbon intensity figures are problematic for portfolio construction

In our emissions intensity dataset, over 90% of the data in the Scope 3 investments category is estimated due to a lack of company reported data. In these instances, our data provider estimates the missing data by applying the emissions per USD of revenue reported by other companies in the same sector as a proxy. This works reasonably well when many companies in the sector are reporting data as revenues are broken down into hundreds of different categories, according to company activity, and estimates can be applied using a regression analysis. However, when only very few companies are reporting, the estimates can become skewed and unreliable.

In sense-checking our data for application to portfolio optimisation, we observed that most companies in the financials sector had the same emissions intensity – typical of estimated data – however we also noticed that some companies had radically different numbers.

For example, BlackRock has an investment emissions intensity of 5kg CO₂ per USD of revenue whereas Charles Schwab and online brokerage Robinhood have an investment emissions intensity of 4,721kg CO₂ per USD of revenue. These values and differences appear extreme and strangely out of kilter. On further analysis, we discovered that this was due to these companies being in different sub-industries for revenues categorisation. Charles Schwab and Robinhood are categorised under investment banking whereas BlackRock is categorised as asset management. They have subsequently inherited vastly different numbers for emissions intensity per USD of revenue based on a handful of companies that have reported in these categories.

Intuitively we do not believe Robinhood and Charles Schwab to be over 900x more exposed to climate transition risk than BlackRock – therefore we do not apply this data to our portfolio risk optimisation framework. Although this is a single example, we've seen similar effects for other industries and emission categories. Hence, we prefer to selectively include emission categories we observe are of high enough quality rather than including every existing datapoint.

¹⁵ [Summary for Policymakers — Global Warming of 1.5 °C](#)

¹⁶ [TEG final report on EU climate benchmarks and benchmark ESG disclosures - 30 September 2019](#)

¹⁷ Available pathways that aim for no or limited (less than 0.1°C) overshoot of 1.5°C keep GHG emissions in 2030 to 25–30 GtCO₂e yr⁻¹ in 2030 (interquartile range). This contrasts with median estimates for current unconditional NDCs of 52–58 GtCO₂e yr⁻¹ in 2030

¹⁸ [SR15 Chapter 2 LR.pdf](#)

The TEG used “the most ambitious GHG emissions pathway” from the SR15 to come up with a comparative emissions trajectory as shown in Figure 10. Using a simple geometric progression, they concluded that a minimum decarbonisation rate of 7% p.a. was required for a portfolio to be considered ‘Paris aligned’ under EU regulations.

This approach makes sense from an academic perspective but poses considerable challenges for constructing a ‘passive’ or systematic global equity portfolio, such as a PAB, which have become increasingly clear. We will just highlight a handful here:

- The global average emissions intensity of a market cap weighted equity benchmark is not reflective of global net anthropogenic emissions; decarbonising the MSCI World index by 7% a year would not reach the Paris Agreement goals.
- The Paris Agreement relies on the principles of equity for developing nations and “common but differentiated responsibilities” which are not reflected in a global average emissions reduction pathway.
- Decarbonisation pathways do not serve as routes for increasing exposure to climate mitigation technologies – they address the problem but not the solution.
- Aggregate Scope 1, 2 and 3 emissions data does not offer a full picture of climate risk exposure for a company or portfolio and can be misleading. For example, climate solutions companies often have high Scope 3 emissions intensity, due to a reporting quirk, and can subsequently be underweighted in a decarbonising PAB.
- A 7% p.a. average portfolio emissions reduction can easily be gamed without any real underlying impact¹⁹.
- Unfortunately, the advice of the IPCC was not heeded back in 2018, and global average emissions are still on the rise in 2025 rendering their decarbonisation pathways increasingly, and depressingly, unrealistic. The reality is that far faster and deeper global emissions reductions will be required between now and 2050 to meet the Paris Agreement goals and the pathway is not likely to be smooth and predictable.

Crucially, this does not mean that portfolio decarbonisation is not useful for addressing climate-related investment risk. Rather a nuanced approach to climate risk assessment, incorporating emissions reduction, is necessary. Some companies, industries and regions are more exposed to climate transition risk than others – and some companies will benefit from the transition. Rather than applying a rigid decarbonisation rate, our climate aware equity portfolio therefore avoids or tilts away from companies that will suffer in the low carbon transition and towards those that are likely to benefit.

Conclusion – what gets (mis) measured gets (mis)managed

Recent geopolitical and trade policy headwinds have challenged climate mitigation progress in the USA and Europe, contributing to investor returns from climate solutions companies trending downwards since 2020. While Trump’s re-election is a potential setback for climate change mitigation policy that may see the US pull back from its commitments in the short-term, global warming will continue to pose a threat for investors far beyond the next four years. Climate change continues to be a financially material risk for investors and there are powerful long-term trends towards decarbonisation by countries and companies all over the world, for example in emerging markets, due to the economic forces at play. Meanwhile the valuation of climate solutions companies is at a ten-year low, reflecting a lot of pessimism.

The real problem with Paris-aligned investing remains how to define and measure ‘Paris alignment’ – a simple EU defined portfolio decarbonisation trajectory of 7% p.a. based on the aggregate Scope 1, 2 and 3 intensity of companies is not the answer. Paris alignment according to EU benchmark rules is not the same as financial alignment with the Paris agreement goals. Some Paris Aligned Benchmarks counterintuitively outperformed on the news that Trump had won the US election and the divergence in performance of five PABs from the same vendor during a single year has been remarkable. There is no single way to define a Paris-aligned portfolio, which is generally counterintuitive to the mindset or goals of a passive investor.

PABs, and indeed most portfolio climate risk management strategies, have been built on the foundational belief that portfolios must decarbonise. However, even if we have complete and accurate emissions data, reported according to the GHG Protocol standard for the Scope 1, 2 and 3 emissions of every company, that will not necessarily indicate which companies are most exposed to financially material climate-related risks. The Scope 3 emissions category is problematic for a decarbonisation strategy due to the bundling of different sources of emissions in one metric. Passive climate index funds tend to be constructed using a single Scope 3 metric, which is applied in systematic decarbonisation. Within Scope 3 the ‘use of products’ category is both dominant and potentially a misleading indicator of climate risk for a global equity portfolio. Scope 1+2+3 emissions is not always a good measure of climate risk – and what gets (mis)measured gets (mis)managed. A portfolio decarbonisation approach is useful for addressing climate related investment risk – but it requires a nuanced understanding of emissions exposures. It must also offer the opportunity to discern between climate positive and climate negative exposures, where climate risk is determined by a range of metrics including forward looking alignment with solutions.

Paris alignment is about more than decarbonising a market cap weighted global equity portfolio in a systematic and indiscriminate manner. There is no single route to Paris alignment and our data is both imperfect and evolving, so we must allow for developments over time and flexibility in approach. We must also account for other, necessary features of the Paris Agreement, such as an increase in climate solutions technologies and consideration of equity for emerging markets.

¹⁹ [Climate Change Benchmarks: The Passive Pretenders | Storebrand Asset Management - www.storebrand.com](https://www.storebrand.com/asset-management)

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