AXA Investment Managers

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# Putting ESG to work: Integration into platforms

"We believe that a powerful understanding of ESG risks and opportunities can help us to target sustainable financial returns while contributing to better outcomes for people and the planet."

**Chris Iggo,**
Chief Investment Officer, AXA IM Core

# Putting ESG to work



# AXA IM Core - ESG integration into platforms



# AXA IM Alts - ESG integration into platforms



# Putting ESG to work

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AXA IM is a long-term, responsible investor with the aim of delivering sustainable returns for clients. Over time, our investment processes have evolved to reflect the ever-greater focus on non-financial factors. We believe by building a powerful understanding of environmental, social and governance (ESG) risks into an investment, we can better target those sustainable returns while contributing to better outcomes for people and the planet.

We aim to achieve this goal via in-depth research, data analysis and the construction of portfolios which look to optimise both financial and non-financial factors. Our investment process reflects our core belief that a focus on sustainability can ultimately deliver the best economic and financial performance over the long term.

As part of that process we use an ESG scoring methodology called $Q^2$. This combination of the qualitative and quantitative builds on MSCI data with proprietary add-ons that constitute what we see as the real value-add in AXA IM's ESG scoring capacity: coverage, fundamental analyses, and instrument-level differentiation.

We believe this combination of external and internal qualitative ESG analysis helps us identify best-in-class companies – and laggards too. We have also worked to identify the ESG priority themes of most pertinence to portfolios. Our goal is to protect clients from ESG risks across all strategies and asset classes, and to uncover investment opportunities within those themes. In more focused strategies – such as green bonds or clean economy equities – we aim to hit tough ESG targets while simultaneously delivering financial returns.

The following sections look at our broad approach and our progress in 2021, before detailing our processes for specific investment platforms.

# Our broad approach to sustainability risks

AXA IM uses an approach to sustainability risks which is derived from the integration of ESG criteria in our research and investment processes. We implement the following two-step framework to integrate sustainability risks in investment decisions.

**Sectorial and normative exclusions policies covering ESG factors (information as of end 2021)**

Exclusion policies aim to exclude assets exposed to the most severe sustainability risks identified during our investment decision-making process

**ENVIRONMENTAL**

Climate (coal mining and coal-based energy production; oil sands production and oil sands-related pipelines), biodiversity (ecosystem protection and deforestation) and soft commodities (food commodities derivatives)

**SOCIAL**

Health (tobacco producers), labour, society and human rights (violations of international norms and standards; severe controversies; controversial weapons manufacturing; white phosphorus weapons producers; exclusion of investments in securities issued by countries where serious violations of human rights are observed)

**GOVERNANCE**

Business ethics (severe controversies, violations of international norms and standards), corruption (severe controversies, violations of international norms and standards)

**ESG scoring methodologies for corporates, sovereigns and on green, social and sustainability bonds.**

The use of ESG scores in the investment decision process enables AXA IM to focus on assets with an overall better ESG performance and to seek lower sustainability risks

This framework is complemented by:

- **In-house ESG research** on key themes including climate change, biodiversity, gender diversity and human capital management, cyber security and data privacy as well as on health, nutrition and corporate governance, supported by broker research as well as regular meetings with companies, participation in conferences and industry events. This research helps us to better understand the materiality of these ESG challenges for sectors, companies and countries.
- **Internal qualitative ESG and Impact analysis** at company and country level.
- **ESG key performance indicators (KPIs):** Investment teams have access to a wide range of extra-financial data and analysis on ESG factors, across asset classes. More specifically, a package of environmental KPIs is available in the front office tool to allow a full understanding and analysis at issuer level. This leverages our relationship with providers such as MSCI, Trucost, and Beyond Ratings.
- **Stewardship strategy:** We adopt an active and impactful approach to stewardship (engagement and voting) by using our scale as a global investment manager to influence company and market practices. In doing so, we strive to reduce investment risk and enhance returns as well as driving positive impacts for our society and the environment. We believe these are key to achieving sustainable long-term value creation for our clients.

*[See Disclaimer: note 1]*

# 2021 updates

We view ESG integration as a constant and evolving process. With that in mind we are always seeking to enhance the methods we use to assess the ESG quality of assets and strengthen the policies that seek to protect clients from ESG risks. In 2021, we improved our approach through a series of measures.

**A strengthened ESG scoring methodology.** Previously, we combined data from three providers, but we now strongly rely on a single-provider ESG scoring model which is coupled with an instrument-level differentiation and an overlay of AXA IM's own analysis. Entitled $Q^2$, this new and enhanced qualitative and quantitative approach offers increased coverage, fine-tuned fundamental analysis and a robust system of challenge and audit to deepen our understanding of ESG risk and opportunity.

**The reinforcement of existing sectorial and normative exclusions** to eliminate companies and sovereigns exposing portfolios to ESG risks and to exclude companies that have the worst practices in terms of managing their environmental impact, governance and social practices.

## PALM OIL

We extended our existing palm oil policy in June 2021 with a more comprehensive approach to ecosystem protection and deforestation. In addition to the exclusion of companies involved in unsustainable palm oil production, including land rights conflicts and illegal logging issues, we now ban companies which face significant land use controversies and are responsible for biodiversity loss in relation to soy, cattle and timber. We also reinforced our engagement approach with companies involved in those issues, to help change and improve practices.

## ESG STANDARDS

In September 2021, our ESG Standards policy was revised, reflecting a reinforced consideration of human rights when assessing corporates and sovereigns. This revision aimed to further align investment processes with several global initiatives and norms. These include the United Nations Guiding Principles on Business and Human Rights, the International Labour Organization conventions, the United Nations Global Compact, and the OECD Guidelines for Multinational Enterprises, with the exclusion of issuers which do not comply with those norms.

## SOVEREIGNS

As for sovereign investments, AXA IM avoids investing in debt instruments issued by countries where worst forms of human rights violations are observed. To screen countries, AXA IM uses the Civil Liberties Index from Freedom House and the Child Labour index from UNESCO. The prevalence of slavery is assessed by the Walk Free Foundation.

## UNCONVENTIONAL OIL AND GAS

In November 2021, AXA IM announced new exclusions and an engagement programme on unconventional oil and gas. These were rolled-out in early 2022 with the update of the Climate Risks policy.

# Equities – Fundamental

We believe the consideration of important non-financial factors, as seen in AXA IM's ESG priorities, puts us in a far better position to deliver on our aim of providing sustainable equity returns over the long term. There are four key reasons for this:

1. They help identify companies with serious ESG risks
2. They help improve our understanding of how long-term issues are integrated into a company's strategy
3. They allow us to refocus portfolios around companies that have implemented good practices in terms of their governance, environmental and social impacts
4. They can potentially help improve companies' performance by informing an active dialogue around the management of ESG issues, thereby limiting our ongoing exposure to risks

### How we achieve this

We take a 360° approach to company evaluation through three steps:

### Quantitative

First, we incorporate ESG scores into our front-office tools, internal research models and risk reports. In addition, investment professionals have access to voting/AGM results, carbon emissions data, comparative tables by sector and details of alignment with the Sustainable Development Goals (SDGs).

### Qualitative

It is our intention to go beyond pure quantitative scoring and to gain a detailed and nuanced understanding of how a company is intending to deal with its ESG challenges. This type of deep-dive qualitative focus forms the second pillar of our investment approach. It is our goal to incorporate ESG risks and opportunities more systematically into our portfolio construction and modelling as part of our risk/return/fair value assessment.

This type of analysis is undertaken when we visit companies, meet them face-to-face to discuss and understand how their ESG and sustainability policies and practices are supporting long-term strategic goals. The responsibilities of portfolio managers and ESG analysts include consideration of ESG factors at corporates and the proactive monitoring of related risks and opportunities ahead of portfolio construction. We also analyse many securities with no, or low ESG ratings, as a complement to ESG scoring.

### Engagement and voting

We see ourselves as key influencers towards better and more responsible corporate behaviour and disclosure. Our engagement with corporate management teams is central to genuine active asset management. This dialogue on ESG integration expresses our conviction as long-term responsible investors and seeks to avoid negative issues which can damage portfolio returns. It also aims to influence company management teams to build resilience by taking the right steps to enhance their sustainability profile and practices.

The definition and implementation of our voting policy is overseen by a Corporate Governance committee which is attended by representatives from AXA IM's Responsible Investment Coordination & Governance and ESG Research teams as well as some members of the AXA IM equities platform and implemented in close partnership with the investment teams.

## CASE STUDY - INTEGRATION IN STRATEGIES

Our social progress strategy adopts an impact investing approach and has been specifically designed with the aim of having a direct and positive effect on society while shaping a more sustainable future for the world. It seeks to do that by investing in companies that address a range of social needs – from the most basic to more advanced needs which sustain human progress. As such, the strategy typically invests in listed companies which have demonstrated a strong impact and a clear alignment with social UN SDGs.

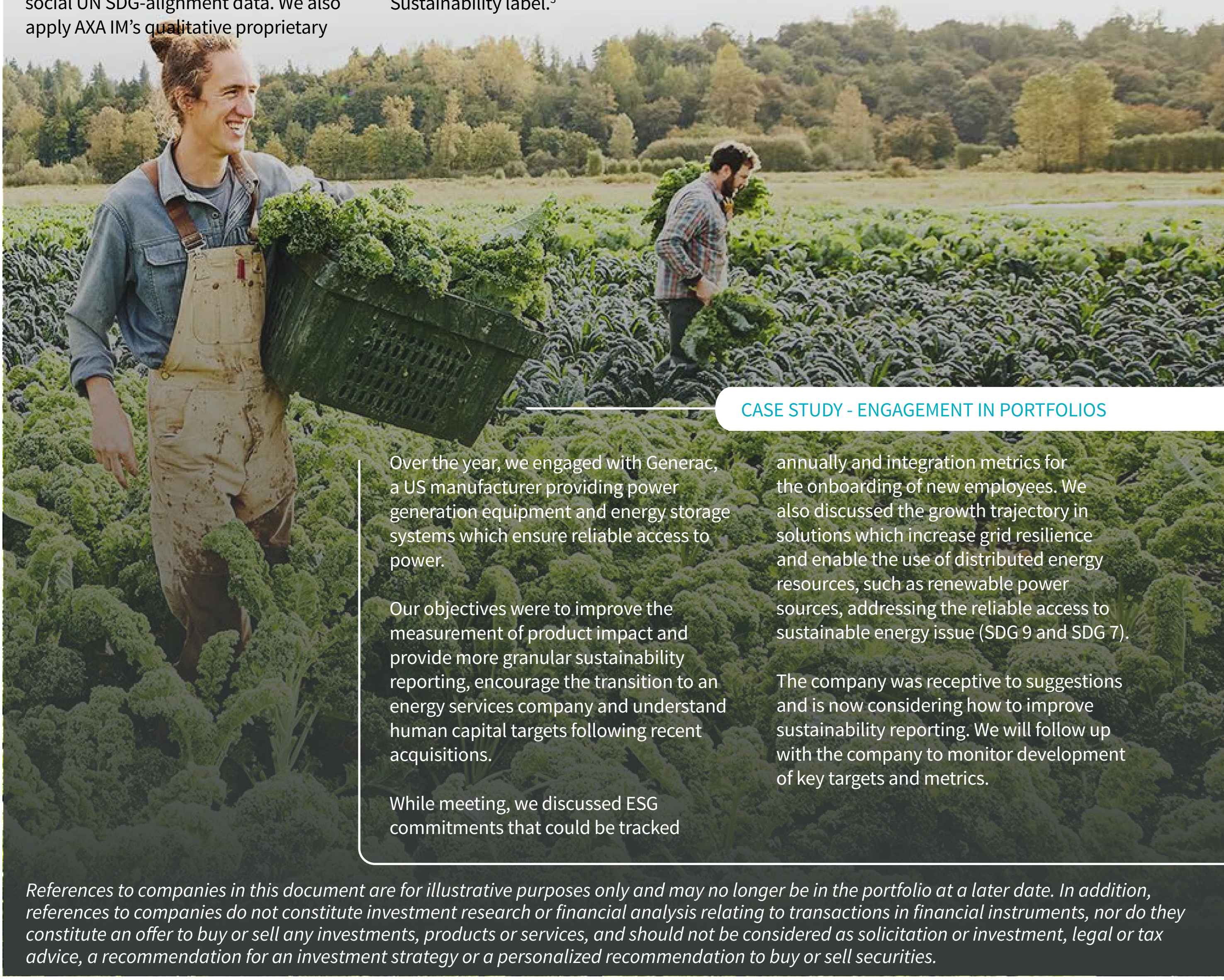
The strategy focuses on several challenges where the scale of unmet need creates opportunities for companies to improve outcomes for underserved people such as affordable housing, financial inclusion, access to healthcare solutions, nutrition, safety, education and entrepreneurship.

When defining the investment universe for the strategy, we apply a socially responsible investment (SRI) 'selectivity' approach. We exclude from the available universe companies which are in the bottom 20th percentile, by using a combination of external and internal social UN SDG-alignment data. We also apply AXA IM's qualitative proprietary impact framework[1] to evaluate the alignment of company activities to UN SDGs, then to quantify their degree of impact towards social issues.

Finally, to comply with France's Label ISR guidelines[2], the SRI approach is supplemented by a commitment of the strategy to outperform its benchmark on two key performance indicators - carbon intensity and water intensity. On top of AXA IM's sectorial and normative exclusions, the strategy applies additional exclusions on unconventional and conventional oil and gas, power generation, coal, tobacco and weapons to comply with the Towards Sustainability label.[3]

By adding environmental objectives to this social-focused strategy, we ensure the social objective does not come at the expense of environmental performance.

Using an unconstrained, multi-cap strategy, we seek to invest in publicly listed companies in developed and emerging markets which offer high growth potential through a focus on providing services across a range of social needs.



## CASE STUDY - ENGAGEMENT IN PORTFOLIOS

Over the year, we engaged with Generac, a US manufacturer providing power generation equipment and energy storage systems which ensure reliable access to power.

Our objectives were to improve the measurement of product impact and provide more granular sustainability reporting, encourage the transition to an energy services company and understand human capital targets following recent acquisitions.

While meeting, we discussed ESG commitments that could be tracked annually and integration metrics for the onboarding of new employees. We also discussed the growth trajectory in solutions which increase grid resilience and enable the use of distributed energy resources, such as renewable power sources, addressing the reliable access to sustainable energy issue (SDG 9 and SDG 7).

The company was receptive to suggestions and is now considering how to improve sustainability reporting. We will follow up with the company to monitor development of key targets and metrics.

*References to companies in this document are for illustrative purposes only and may no longer be in the portfolio at a later date. In addition, references to companies do not constitute investment research or financial analysis relating to transactions in financial instruments, nor do they constitute an offer to buy or sell any investments, products or services, and should not be considered as solicitation or investment, legal or tax advice, a recommendation for an investment strategy or a personalized recommendation to buy or sell securities.*

[1] Driving Impact in Listed Assets Investments, AXA IM. https://www.axa-im.com/who-we-are/impact-investing
[2] Critères d'attribution - Label ISR (lelabelisr.fr)
[3] The Quality Standard | Towards Sustainability

# Equities - Equity QI

We believe that ESG insights enhance our traditional financial analysis. Our research shows that ESG data can help identify potential risks and opportunities beyond technical valuations, allowing us to better understand the possibility of reputational damage and identify how firms are adapting to meet new market challenges.

At Equity QI, ESG is not just an additional factor to consider at the portfolio construction stage. Our research into the link between ESG information and the fundamental drivers of long-term risk and return has been coded into our proprietary factor models.

We believe that integrating ESG information complements our fundamental insights and may change our opinion of the economic worth of a stock. Accordingly, we believe the thoughtful use of ESG insights can help investment outcomes, help reduce risks and potentially improve long-term returns for our clients.

### How we achieve this

Our investment approach enables us to systematically incorporate non-financial information directly into our models alongside traditional financial data.
We take data from a variety of external vendors and we incorporate the ESG scoring framework that is maintained centrally and used across AXA IM's investment teams.

Once the data is in our system, we can work with it in a variety of ways, including research, analysis and reporting. However, using this information to help construct portfolios ensures that ESG data directly contributes to investment outcomes.

We add ESG scores and key performance indicator targets alongside our traditional alpha and risk measures when we optimise portfolios. This approach ensures that in our systematic construction of portfolios, when faced with two stocks of identical profile from a traditional investment perspective, our optimiser will favour the one with the highest ESG rating, all other considerations being equal.

Beyond optimisation, our research into the links between ESG and the fundamental drivers of long-term risk and return has led to innovative enhancements of our stock selection models. For example, the impact of a company's carbon footprint on its share price is included within our proprietary value factor model and the diversity of a company's board contributes to our view of its future earnings quality.

We believe our approach allows us to build portfolios with a better-than-benchmark ESG score and lower carbon/water intensity in a consistent and repeatable manner.

Finally, when constructing portfolios with specific SDG contribution targets, access to a database which provides UN SDG scores on a large universe of stocks helps us to target specific SDGs.

CASE STUDY - INTEGRATION IN STRATEGIES

Our climate-focused strategies deploy additional data and processes to balance the objectives of decarbonisation today with investing in the global transition to a low-carbon economy. When working with clients who wish to address climate change through their investments, we have come across a common challenge – an ambitious target on current portfolio carbon intensity reduction may limit exposure to companies which are directly enabling the global transition through the products and services they offer, or to transitioning companies within high-stake industries. This is because these companies often contribute a high proportion of the world's carbon emissions.

Our climate focused strategy seeks to manage this complex trade-off by using a combination of divestment and investment allocation to the providers of climate solutions within our optimisation framework. This should allow us to reduce portfolio carbon intensity whilst actively investing in companies that are contributing to the mitigation of climate change and enabling the shift to more sustainable energy use through their products, services and technology.

We believe that aligning portfolio allocation with both reported and forward-looking measures of climate awareness sends a strong message to companies that are accelerating the transition to a low-carbon economy is an important investment consideration for us and our clients.

**Carbon Offsets**

In 2021, we launched a carbon offset strategy that builds on this and further aims to compensate for the emissions owned by the portfolio which cannot be eliminated today.
After the investment process has reduced portfolio carbon intensity as far as possible (through divesting from the worst polluters and preferencing companies with lower carbon intensity when constructing the portfolio), the equivalent number of carbon contracts are retired. These contracts finance hand-picked projects which aim to preserve the environment and target multiple UN SDGs, providing another tool which we can use to have a direct impact on climate change. Our clients are demanding more action on climate, and we will continue to evolve our offering to meet these needs.

*No assurance can be given that our investment strategies mentioned in this document will be successful. Investors can lose some or all of their capital invested. Our strategies are subject to risks including, but not limited to: equity; emerging markets; global investments; investments in small and micro capitalisation universe; investments in specific sectors or asset classes specific risks, liquidity risk, credit risk, counterparty risk, legal risk, valuation risk, operational risk and risks related to the underlying assets.*

# Fixed Income

Effective fixed income portfolio management seeks to maximise risk-adjusted returns. Given the asymmetric risk profile of this asset class, AXA IM's fixed income investment teams believe limiting downside risk is a key driver of long-term performance – and that ESG plays an important part in that.

Our credit analysts use ESG to identify material concerns that could impair the credit quality and long-term sustainability of issuers in our markets. This process helps to identify those risks most relevant to credit investors, which should in turn help to minimise downside risk. Analysts and portfolio managers incorporate a wide range of ESG factors into credit analyses, focusing on those most relevant to a given credit.

ESG factors are also important for sovereign and quasi-sovereign debt and are therefore integrated into our investment process, with different quantitative indicators for sovereign issuers to corporate issuers.

Our investment process applies AXA IM sectorial exclusion policies as well as AXA IM ESG standards exclusion policies to ESG integrated and sustainable funds – i.e. Article 8 and Article 9 for funds in scope of the EU's Sustainable Finance Disclosure Regulation (SFDR) – with a number of evolutions in 2021.[4]

### How we achieve this

ESG analysis is embedded into our active fixed income research process and credit analysts incorporate ESG analysis in their internal research reports. These reports highlight the relevant ESG strengths and weaknesses as well as an issuer's performance on specific issues. Analysts also comment on actions that management is taking to mitigate ESG weaknesses and its targets to improve ESG performance.

## CASE STUDY - INTEGRATION IN STRATEGIES

The launch of our Global Green Bonds strategy in 2015 reflected AXA IM's commitment to containing climate change and supporting the growth of the green bonds market.

We have sought to build a robust eligibility framework to ensure the strategy is entirely focused on green bonds that can potentially offer the same returns as a comparable conventional bond, with the added benefit of enabling projects with environmental benefits in a transparent manner. The green bond market has grown sharply over the last few years, and now offers more diversification in terms of asset classes, regions and issuers.
A universal 'green bond' definition is still in the making, but several standards are being put forward by major market actors. Our portfolio managers invest only in green bonds that conform to the eligible universe as set out by AXA IM's RI experts. These professionals use a proprietary analysis framework made of four pillars to define the investible universe.[5]

The strategy has been awarded with the French Greenfin Label and the Belgian Towards Sustainability Label.[6]

[4] AXA IM RI Sectorial policies and ESG Standards. axa-im.com/our-policies
[5] https://www.axa-im.com/who-we-are/impact-investing]
[6] https://www.ecologie.gouv.fr/label-greenfin The Quality Standard | Towards Sustainability

Within our credit process, analysts also include a qualitative ESG template in their models, assigning a view with respect to company management and momentum of ESG issues related to industry and peers. In the template, credit analysts highlight ESG strengths as well as concerns and mitigating actions, ESG KPIs, and comments on governance structure.

Within both credit and sovereign research, the key ESG topics, risks, and KPIs highlighted are at the discretion of the analyst, allowing them to select topics and risks most relevant to the issuer. Each credit and sovereign analyst has been trained on ESG issues relevant to their assigned sector(s) or region, drawing from several third-party sources, including the Sustainability Accounting Standards Board (SASB), TCFD, MSCI, Sustainalytics and others including rating agencies and sell-side research.

Portfolio managers and analysts have access to multiple sources of ESG data (internal and third-party). Among the key ESG topics, risks and KPIs recently highlighted were greenhouse gas emissions and details of any issuer plans and targets to reduce those emissions, as well as water intensity, labour relations and board diversity. For sovereigns we have particularly targeted carbon dioxide emissions, energy use, renewable energy consumption and the water exploitation index.

Analysts and portfolio managers continue to increase engagement and sustainability dialogue efforts by further addressing sustainability topics in regular financial-oriented discussions with companies. Discussions are also taking place with sovereign issuers on ESG topics during regular meetings with Treasuries. A fixed income Head of Sustainability was appointed in 2021 who participates in multiple AXA IM RI committees and collaborates closely with the RI Experts teams on a regular basis.

In 2021, we broadened the scope of ESG integration, including in our US and Asian High Yield strategies. This was achieved thanks to a strong collaboration between our analysts and portfolio managers. Our scale has enabled us to dedicate resources to study companies not covered by third-party providers in these specific markets.

Over the coming months, we intend to focus on our commitment to bring all assets under management in line with the Paris Agreement goals. We have expanded our low carbon range to European High Yield and Emerging Markets. We are also reshaping our institutional Buy and Maintain strategies to incorporate a clear decarbonisation trajectory. We expect this trend to continue over the coming 12 months, with further developments in our active fixed income strategies.

## CASE STUDY - ENGAGEMENT IN PORTFOLIOS

In April 2021, French real estate group Gecina solicited its bond investors to propose modifications of the use of proceeds of its bonds, from “general corporate purposes” to “the financing or the refinancing of a portfolio of eligible green assets”. We had several discussions with Gecina on its green bond framework as it sought to take this highly unusual step – seeking the agreement of bondholders to turn its entire outstanding debt into a green bond programme. Bondholders were expected to vote for a consent solicitation to validate this initiative.

We were sceptical when we first discussed this project with the company. We considered it could be an opportunistic initiative, and a little unfair to other green bond issuers that have made the transparency efforts on their green bonds for many years. In addition, we felt there was a good deal of uncertainty around Gecina’s ability to provide relevant and complete impact reporting – something we expect from green bond issuers. Our first understanding was that reporting would be provided, but for the entire pool of eligible assets and not for the assets that will actually be refinanced by these green bonds.

We communicated our doubts to Gecina and to the banks in charge of the initiative, as well as stressing our expectations for a best-in-class approach on such a project. We believe we made our voice heard and received some clarification on expectations for the green bonds – notably around impact reporting. Gecina took our feedback (and likely feedback from other investors too) into consideration and has stated it is committed to providing impact reporting that is in line with our requirements – i.e. having impact metrics for effectively funded eligible assets.

We decided that the undertakings made addressed our concerns and supported Gecina on its consent solicitation. This was mainly due to the efforts made by Gecina to align with our needs and expectations and to clarify its position on the topics we highlighted. We will continue to closely monitor Gecina’s impact reporting to check if promises have been fulfilled.

# Green, social and sustainability bonds engagement

Engagement with bond issuers is an important aspect of our active ownership programme, as we are long-term investors and often hold bonds to maturity. Engaging on ESG issues is a critical way to ensure we manage the value of our bond investments over time.

**Our engagement goals and activity**

In 2021, we published an update of our framework for assessing green, social and sustainability bonds (GSSB). More specifically, the framework now includes AXA IM's criteria for assessing social and sustainability bonds, given the significant growth in the market as a result of the pandemic and the growing area of focus this represents for the business. It demonstrates how AXA IM has strengthened its overarching assessment of each GSSB bond issuance, particularly in relation to the consistency between an issuer's own sustainability ambitions and its GSSB issuance.

We met with 43 GSSB issuers in 2021. Beyond alignment with the recommendations of the International Capital Market Association's Green Bond Principles, our main area of focus was to discuss GSSB alignment with issuers' sustainability strategies and forward-looking ambitions. We have seen some positive outcomes: More and more issuers established concrete ESG objectives and disclosed it within GSSB frameworks. On the other hand, given our higher expectations, poor ESG profiles and ambitions at certain issuers were a significant factor in our deciding that some GSSB issuance was not eligible in 2021.

We also had discussions with existing GSSB issuers to follow up on their promises at the time of issuance. As part of our approach to the GSSB market, we want to make sure that issuers publish impact reporting and effectively allocate the proceeds to green and social projects. All in all, we were satisfied with GSSB issuers' reporting and actual proceeds allocation.

Another key topic of discussion with GSSB issuers in 2021 was around the inclusion of the EU Taxonomy and of the upcoming EU green bond standard in market practices. While it is still too early in our view to expect all issuers to align with these new requirements, we nevertheless have seen positive developments on this front. Issuers like E.ON, Erste Bank, Île-de-France Mobilités or the Republic of Slovenia adapted their GSSB frameworks to the EU Taxonomy technical criteria.

In 2021, we also developed our assessment framework for Sustainability-Linked Bonds (SLB). This market is still nascent, but we had the occasion to share our views and expectations with some SLB issuers as well as other market stakeholders.

As we move forward in this field, we will continue our work on GSSBs, and will leverage additional data points to guide our engagement with issuers, including in relation with the EU Taxonomy in this perspective.

Meetings with GSSB issuers will continue to discuss their frameworks and ESG strategy and to make sure any GSSB we invest in complies with our eligibility criteria. A deeper engagement programme is planned with existing green bond issuers for which we will consider whether their climate commitments and strategies are sufficient with regards to our assessment methodology.

In addition, we will have the same kinds of discussions with SLB issuers to ensure compliance with our eligibility criteria. We will also continue to review opportunities to influence the development of the SLB market and framework with the objective of encouraging quality and integrity on this market. Finally, looking at engagement in fixed income markets beyond GSSB, we plan to review in more detail how we can press for change as a large fixed income investor, considering the use of escalation techniques specific to this asset class.

# Multi Asset

As our clients demand more sustainable returns, the multi-asset platform has put an even greater focus on non-financial factors by expanding the use of our internal ESG framework to better address risks and target sustainable returns.

The multi-asset platform has been actively integrating non-financial factors into its investment process over the past year. As such, we have leveraged the progress on ESG integration within the equity and active fixed income platforms as well as emphasising ESG within our multi-asset strategies through two major pillars:

- **Technology and quant solutions**: Multi asset uses AXA IM's ESG scoring framework to fully cover our equity and fixed income asset classes. These scores are made available to portfolio managers through our front office systems as well as ad hoc simulations. Our portfolio managers can thus integrate this data in their decision-making tools as well as accessing ESG reports on a growing number of our portfolios and mandates.
- **Qualitative input**: Multi-asset portfolio managers use ESG research provided by the credit team and by ESG and Impact analysts. We believe that ESG factors can affect the financial performance of securities, and by integrating ESG factors in a significant way in their investment process, multi-asset portfolio managers seek to leverage the analysis to privilege investing in securities delivering good ESG quality or a substantial positive impact.

The multi-asset platform is also actively involved in AXA IM's focus on quality engagement. In order to influence companies to adopt better and more responsible corporate behaviours and disclosure, we participate alongside equity and fixed income engagement with corporate management. We also access the results of this engagement process to inform our clients of the progress made on certain negative issues which could weigh on future performance, as well as the actions taken to enhance their sustainability profile and practices.

## CASE STUDY - INTEGRATION IN STRATEGIES

Our Multi Asset Optimal Income strategy adopts an 'impact' approach. It is part of our ACT range and is focused on the theme of prosperity for people and prosperity for the planet, aligned with relevant UN SDGs.

As a global multi-asset impact strategy, it seeks to invest in businesses that focus on providing products or services and/or finance projects which have demonstrated a strong positive impact on social and environment and clear alignment with UN SDGs 1 to 16.

With regards to universe construction, the strategy can invest in equities and in debt securities, notably green, social and sustainability bonds. The investment process relies on two robust impact proprietary frameworks which aim to assess the eligibility of green, social and sustainable bonds and identify as well as monitor the sustainability-related and SDG-alignment of companies, to build the equity impact universe.

On top of AXA IM's RI sectorial and normative exclusions, the strategy applies additional exclusions on unconventional and conventional oil and gas, power generation, coal, tobacco and weapons to comply with the Towards Sustainability label.[7]

The strategy will report definitive and measurable data against impact key performance indicators and in line with the ISR Label framework.[8] This includes a commitment to outperform the investment universe on the '1.5°C Technology Opportunity Company Climate Value at Risk (CVaR)' indicator.

This measure is based on an approach developed by MSCI and designed to provide a forward-looking, return-based valuation assessment to measure climate-related risks and opportunities in an investment portfolio. The indicator measures the upside potential for companies with products and services that contribute to the climate transition (expressed as a percentage of the company's market value and calculated using carbon prices from the AIM CGE model).

We also monitor the carbon footprint of our portfolio which is expected to remain below that of its investment universe. Finally, within our bond bucket, we measure the emissions avoided (equivalent to 108 cars off the road).[9]

## CASE STUDY - ENGAGEMENT IN PORTFOLIOS

Bank Rakyat (BRI) is an Indonesian institution that provides micro loans in key areas for positive social impact. Our engagement objectives were to monitor the approach to sustainable financing and micro-finance initiatives (SDG 1) with a focus on palm oil (SDG 15) and coal (SDG 13). We have pushed for a greater adoption of certification among borrowers who produce palm oil as well as disclosure of information related to the environmental footprint of operations and the establishment of a robust sustainability reporting mechanism.

As of September 2021, palm oil financing was just under 6% of the loan portfolio with plantations representing 4.7% of the loan book, a 5% drop year on year. Some borrowers are still in the process of certification which has been delayed due the pandemic resulting in the deadline for certification being extended to the second half of 2022. Loans are only being offered to new borrowers for plantation replanting (thus not new farms) to avoid financing deforestation. If borrowers do not fulfil the requirements, BRI has the right to terminate their contract. In a similar vein, loans to coal power plants represented just under 3% of the loan book, decreasing 18% from 2020 with no new coal borrowers over the past year with the expectation that the coal exposure will continue to decline.

On financial inclusion, the company reiterated its commitment to the micro segment and increasing financial inclusion through access to financial services as a key part of their strategy. The company has completed acquisitions of entities in the ultra-micro system and plans to cross-sell between entities, allowing BRI to offer smaller loans and reach more borrowers. They expect 80% to 85% of loans to be in the micro segment going forward. They also have what we view as strict guidelines regarding responsible lending and monitoring what people can repay.

Finally, in line with our recommendations, the company is seeking to strengthen ESG reporting with management oversight.

The company has made reasonable progress since our last call. There have been delays regarding palm oil certification, but this is understandable in the context of the COVID-19 pandemic. We will follow up in the second half of 2022 to ensure remaining borrowers achieve palm oil certification.

[7] The Quality Standard | Towards Sustainability
[8] Critères d'attribution - Label ISR (lelabelisr.fr)
[9] Computed with an average of 4.6 metric tons of $CO_2$ per year by car – 18,500 Km per year) as of 31/12/2021

# Real Assets

Responsible investment sits at the core of AXA IM Real Assets' approach to business. We actively consider financial and non-financial criteria during our investment process, from origination of opportunities, to the investment assessment and decision-making process at acquisition, through to our active ownership of investments.

This integrated approach is fundamental to the good stewardship of our investments. By making specific non-financial considerations part of our investment processes, we believe we can ensure better visibility of sustainability-related risks and potential adverse impacts on our investments. This visibility should provide us with a broader perspective on asset- and sector-specific risks which then informs our underwriting and asset selection. Ultimately, it also helps to shape our view on investment risk, returns and liquidity, and we believe also enables our teams to better identify and unlock opportunities to enhance value for clients.

The integration of the assessment of sustainability risk at investment level and the application of group-wide sectorial exclusions and ESG-scoring methodologies can help us to address the most material sustainability risks at the time of an acquisition. From this position, we see an important opportunity to improve the performance of our investments through active management, stewardship and engagement. The goal is to amplify the impact we are able to generate through our investments while continuing to generate sustainable long-term returns for our clients.

## CASE STUDY - INTEGRATION IN STRATEGIES

### Listed Real Estate

In 2021, two engagement exercises were undertaken as part of the active stewardship of our Listed Real Estate investment platform.

First, we developed a survey questionnaire to gain a better understanding of the qualitative and quantitative metrics associated with the ESG practices and performance within each company. This data gives us deeper insight into ESG-related risk within investee companies in our investment portfolios and, over time, allows us clearer insight into the alignment between the performance of the assets in the underlying investments, and the aspirations of our clients and organisation.

The questionnaire was developed and issued over summer 2021. The survey was sent out to 72 listed real estate companies, with 29 respondents (a 40% response rate). The responses provided us with deeper insight into each company's approach, targets and actions in relation to carbon and climate-related risk.

Second, we sought to determine the level of alignment of investee companies' commitment to achieve net zero before 2050, for a specific portfolio. This insight was undertaken via direct engagement in addition to the analysis of publicly-available data.

Based on responses, investee companies were defined as follows:

- **Committed**: The companies have publicly committed to net zero and have set an explicit target date by which it will be achieved
- **Active**: The companies have defined targets to reduce their $CO_2$ emissions by a specified amount. However, they have not explicitly committed to net zero
- **No disclosure**: The companies have neither explicit mention of net zero nor publicly disclosed tangible target to reduce $CO_2$ emissions.

Beyond meeting reporting obligations under new and upcoming regulatory requirements, AXA IM – alongside our parent the AXA Group – is committed to supporting the goal of net zero as a member of the Net Zero Asset Managers Initiative. This means working with our clients and partners to target net zero carbon emissions from our investment platforms by 2050, or before.

We acknowledge the scale of this challenge and recognise that success will only come through active collaboration and partnership. Accordingly, through 2021 we undertook a series of structured discussions across our investment platforms to encourage companies, borrowers and tenants to consider and disclose their environmental strategy and performance. These efforts will be pursued as we go forward with additional questions on environmental strategies and performance progress.

### Commercial Real Estate Debt

For our Commercial Real Estate (CRE) Debt platform, we sought to actively improve the level of data visibility on underlying assets to better inform our view of environmental risks. Historically, access to such data in private or secondary markets has been poor, which has hampered visibility of the efficiency or underlying performance of assets. We undertook a two-step approach to improve this.

First, we engaged with a third-party data provider to assist with the assessment of carbon emissions, based on estimated emissions per square metre for different asset types in different countries. This enabled us to generate an estimated carbon footprint for the portfolio. The natural limitations of this data set were then addressed by including a second step which involved structural dialogue with our borrowers via a survey as well as direct requests for energy consumption and carbon emission data for the underlying assets.

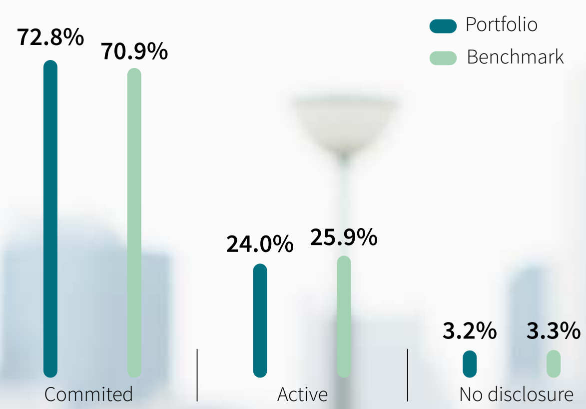
The dialogue was undertaken via questionnaire and the survey was developed and issued over summer 2021. The survey was sent out to over 40 borrowers, representing 61 loans valued at €9.6bn. We received 39 responses (a 63% response rate) representing €6.0bn.

This data has helped us develop a deeper level of insight into carbon and energy efficiency-related risk in our portfolios, in addition to our growing knowledge base of physical and transitional risk. The information will further inform refinancing opportunities and our ability to work more closely with borrowers and underlying assets in our journey towards net zero before 2050.

The graph hereafter shows the proportion of the portfolio defined as committed, active or no disclosure, compared to the investible universe, indicating a portfolio make-up which is largely representative of the benchmark, with slightly greater representation of committed companies.

The single company which had 'No disclosure' has responded to confirm that their commitments will be made public at their next annual general meeting.

**Proportion of invested companies commited to Net Zero**




Source: AXA IM – Alts, Company data as at 16/12/2021. Portfolio weights as at 31/12/2021.

# Structured Finance

The AXA IM Impact Investing strategy targets the delivery of market rate financial returns alongside the generation of positive, intentional, and measurable impact returns. Using alternative assets – private equity, venture capital, private debt, real assets and project finance – we invest in a broad range of impact themes that aim to deliver on our clients' impact objectives. Our guiding mission is to address the needs and aspirations of underserved people globally while protecting the natural environment and contribute materially and directly to the UN SDGs and targets that are relevant to our strategy.

We believe that the proper management of ESG issues is critical to the long-term sustainability of businesses, and as such, the consideration, integration, and active stewardship of ESG issues is a fundamental part of our investment process.

We have developed a framework for the management of ESG issues that takes account of the alignment of prospective investments with applicable AXA IM RI policies, ESG regulations, standards and norms such as the International Finance Corporation's Environmental and Social Performance Standards, the Environmental, Health and Safety Guidelines of the World Bank and the International Labour Organization. This assessment framework is applied to investments during due diligence and over the tenure of our investments.

In partnership with investee companies and projects, we develop and implement Environmental and Social Action Plans (ESAPs) as necessary, detailing corrective actions to be undertaken in relation to environmental and social risks identified as part of due diligence or subsequent monitoring activities. The ESAPs includes responsibilities and timelines within which corrective action needs to be undertaken. Where appropriate, we structure ESG and impact milestones as a condition for further disbursement of our investment capital and include these milestones in legal agreements.

CASE STUDY - ENGAGEMENT IN PORTFOLIOS

Komaza is a microforestry-to-wood products company with ambitions to become the largest sustainable forestry company in Africa. Komaza aims to tackle the drivers of deforestation and the associated loss of biodiversity and climate impacts.

Komaza partners with smallholder farmers in Kenya to use their surplus degraded land to grow highly effective carbon-sequestering trees. We believe Komaza could bring significant value to farmers, providing seed inputs, technical know-how and the value chain necessary to monetise the trees at a fair price for the farmers. To date, Komaza says it has planted about seven million trees on 8,000 hectares and improved financial outcomes for over 20,000 farmers.

The impact we hope for from Komaza includes the reforestation of degraded lands; climate mitigation using trees as a natural carbon sequestration solution; and climate-resilience, aligning the financial interest of local communities with conservation.

Alongside other investors, we are working closely with Komaza to create an environment where relevant environmental and social issues are aligned with the scale of its activities and ambitions. A comprehensive Environmental and Social Action Plan has been developed and is being implemented, covering a range of ESG issues including health and safety, biodiversity, employee relations, community and stakeholder management. Developed collaboratively, this comprehensive plan aims to ensure Komaza is robust enough to manage and mitigate ESG risks. This is in line with our belief that a proper management of ESG issues will provide a solid foundation for the company's ambitions to become the largest sustainable forest company in Africa.

**Disclaimer**

Note 1: The ESG data used in the investment process are based on ESG methodologies which rely in part on third party data, and in some cases are internally developed. They are subjective and may change over time. Despite several initiatives, the lack of harmonised definitions can make ESG criteria heterogeneous. As such, the different investment strategies that use ESG criteria and ESG reporting are difficult to compare with each other. Strategies that incorporate ESG criteria and those that incorporate sustainable development criteria may use ESG data that appear similar but which should be distinguished because their calculation method may be different.

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