ESG risk integration policy

Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector ("SFDR") defines a sustainability risk as *"an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment"*. The aim of this policy is to describe how sustainability risks are factored into our processes within Banque de Luxembourg and its entities, including our subsidiary and asset manager BLI – Banque de Luxembourg Investments.

I. BANQUE DE LUXEMBOURG'S RESPONSIBLE APPROACH

In light of the European Union's sustainable finance strategy, the expectations of our clients and our desire to actively participate in the transition towards more sustainable and inclusive finance, our ambition is to further develop our business model and product range with respect to societal responsibility and environmental, social and governance (ESG) factors. Convinced of the merits of this approach, both in terms of sustainability and performance for our clients, we will be devoting considerable efforts to it in the months and years to come. We hope to continue with a gradual approach that builds on our robust, time-honoured principles. Naturally, factoring non-financial data into the investment process is not without its difficulties. As a small bank and asset manager, Banque de Luxembourg and Banque de Luxembourg Investments (BLI) therefore apply a best-efforts approach.

View our non-financial report (in French, English will be published in coming weeks).

II. INTEGRATING ESG RISKS

1. Our strategy

Mindful of our responsibilities and committed to ethical business conduct, we seek to protect our clients, and our stakeholders more broadly, by pairing commercial opportunities with deeply held values.

Efforts to considerably strengthen our compliance and prudent risk management system in recent years are a clear indication of our determination to go above and beyond regulatory standards. Indeed, additional resources have been allocated to the teams in control functions – Compliance, Risk Management and Internal Audit – enabling them to provide even greater support to staff members on a daily basis. In this regard, increasing the resources at control functions' disposal forms an intrinsic part of our responsible approach.

Corporate social responsibility (CSR) and analysis of ESG considerations are core aspects of Banque de Luxembourg's BLU25 strategy, which is made up of four commitment pillars:

1. Safeguarding the future of Banque de Luxembourg through good governance and ethical business conduct,
2. Forging long-term, caring relationships with our employees,
3. Supporting the ecological, social and societal transition,
4. Reducing our environmental impact.

We provide our stakeholders with a transparent summary of our progress in relation to these four commitment pillars through our non-financial report.

2. Our investment solutions and funds

We offer our clients both discretionary management and investment advisory solutions. We have made consideration and assessment of ESG risks an integral part of our strategy and investment processes through steps such as integrating ESG factors, excluding certain sectors and analysing controversies, as well as through our commitment policy.

Since investment funds managed by BLI form the core of our offering, the BLI management philosophy, set out below, is clearly reflected in Banque de Luxembourg's investment processes.

2.1. ESG governance

Within Banque de Luxembourg, the investment committee of the Private Banking Investments (PBI) team discusses ESG-related matters on a regular basis. All discretionary management portfolios undergo an ESG review at the same time.

Within BLI, the Socially Responsible Investment Committee (SRIC) coordinates strategic ESG projects. Once a strategic framework has been defined, a team of dedicated SRI strategists and analysts is responsible for putting it into practice by engaging in an ongoing dialogue with all relevant teams within BLI.

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BANQUE DE LUXEMBOURG

2.2. ESG research

Our ESG research draws on various external data sources. In particular, the quantitative ESG rating system used in the investment process is based on ESG ratings issued by the MSCI ESG Manager (MSCI) platform. MSCI calculates an exposure score indicating a company's level of exposure to each specific risk based on its business sector coupled with its geographic location. MSCI then analyses the company's ability to manage the various risks identified. The company also provides controversy analysis, which constitutes a key component of MSCI's ESG assessment process.

We also use the following sources of external research:

– Bloomberg ESG data;

– Company reports and data; and

– Brokers' research.

2.3. Analysing controversies

Candidates for investment and companies whose securities are held in the portfolio are subject to constant monitoring to identify noteworthy ESG events that could affect the company's business model, its reputation and potentially therefore the investment case. This monitoring is conducted through an MSCI alert system, which flags up any controversies involving the companies held.

An ESG controversy may be defined as a real-world incident or situation in which a company is accused of behaviour with an adverse impact on the various stakeholders (employees, suppliers, local communities, the environment, shareholders, etc.).

These events could affect the company's business model, its reputation and potentially therefore the investment case. Examples include VW's Dieselgate scandal and BP's Deepwater Horizon oil spill.

When a controversy arises, it is initially analysed on the basis of the controversy classifications assigned by MSCI (green, yellow, orange and red flags). Companies involved in the most severe controversies (in other words, those with a red flag), must be withdrawn from the investment universe within three months of their change in status.

Controversies with an orange flag (those classed as severe) undergo in-depth analysis drawing on various sources of information, including internal research, external research, the media and company information (in particular, CSR reports).

Moreover, ongoing controversies are monitored twice a year so as to include any relevant new information.

2.4 Exclusions

Exclusions from the investment universe are set out below.

– Companies active in the following sectors:

  – Controversial weapons: companies that appear on the list kept by the NGO International Campaign to Ban Landmines – Cluster Munition Coalition (*ICBL-CMC*)[1] and are involved in the production of controversial weapons, such as anti-personnel mines, cluster munitions, depleted uranium and white phosphorus munitions, as well as chemical and biological weapons, are systematically excluded from our funds.

  – Coal: securities on the Global Coal Exit List (*GCEL*)[2], where the issuing company operates along the thermal coal value chain.

– Companies embroiled in major controversies. The MSCI alert system classifies controversies on the basis of their scale and impact (red, orange, yellow). Companies facing "red" controversies, i.e. the highest alert level, are excluded.

– (BLI only) Companies that do not comply with the United Nations Global Compact.

This list of exclusions is subject to change.

2.5. ESG policy

A. Discretionary BL Funds mandate

Discretionary BL Funds mandates are invested in funds managed by BLI. These funds implement a fundamental approach within both the equity component and the bond component.

1. www.stopexplosiveinvestments.org
2. https://coalexit.org/

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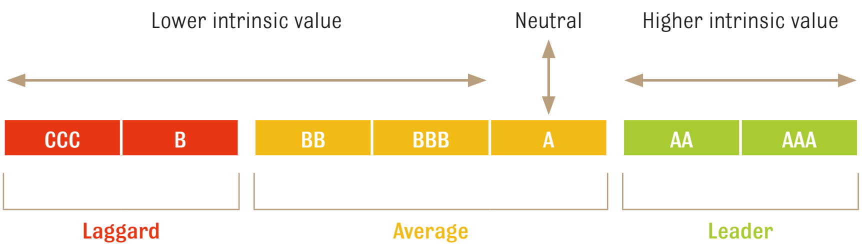
A.1 Selecting companies for the equity funds

The investment universe is made up of companies with transparent operations and clear business models. Our stock-picking methodology also relies on company valuation levels, since it is the price paid that determines the future return on any investment.

BLI integrates ESG risks and opportunities into its valuation model: hence, a company with a strong ESG profile will be assigned a higher intrinsic value, whereas a company lagging behind on ESG issues will be assigned a lower intrinsic value. This process is based on ESG ratings established by MSCI (AAA to CCC), where a rating of ‘A’ is considered neutral. As such, companies with a rating of A will not have their valuation model amended.

ESG rating scale established by the data supplier MSCI



A.2 Selecting issuers for the bond funds

Our bond investments focus on bonds from top quality issuers. The portfolio is constructed based on a set of criteria that include:

– Assessment of the macroeconomic context;

– The quality of government fundamentals (solvency);

– The portfolio’s sensitivity to interest rate movements.

BLI applies two major approaches within its bond portfolios, either individually or in combination depending on the funds in question:

– **ESG optimisation:** incorporation of ESG factors and non-financial elements in the analysis and selection process for individual issuers. The aim is to build a portfolio within each component (sovereign bonds and corporate bonds) with a strong ESG profile compared with the reference universe;

– **Impact investing**: investments made with a view to generating a positive social and/or environmental impact as well as a financial return. Several types of instrument with different characteristics are available:
  – Liquid strategies: mainly green bonds,
  – Alternative strategies: microfinance, project financing, housing, etc.

A.3 ESG approach at portfolio level

To supplement the ESG approach used for each of the funds that make up the managed portfolio, quantitative analysis is also conducted. We use MSCI scores (between 0 and 10) and then weight the score for each fund according to its weighting in the portfolio to calculate a score for the portfolio as a whole. This is then converted into a rating between AAA and CCC, using the MSCI scale.

Our aim is for the average rating of the portfolio to be A or higher, confirming above-average ESG positioning.

Banque de Luxembourg offers other forms of discretionary management as well as discretionary management through BL funds;

– Discretionary socially responsible funds mandate

– Discretionary external funds mandate

– Discretionary direct lines mandate

B. Discretionary socially responsible funds mandate

Discretionary socially responsible funds mandates invest in funds and trackers with embedded ESG investment strategies. In-depth qualitative analysis is carried out to assess the solidity of the management process, and the ESG approach in particular. To that end, various approaches may be applied to the portfolio:

– **The best-in-class approach,** which seeks to select companies with the best environmental, social and governance practices in their sector or industry;

– **The ESG integration approach,** which places equal emphasis on financial and non-financial criteria;
– **The thematic approach,** which targets a specific area, such as the environment, water management or gender parity;
– **Impact investing,** which aims to generate a positive environmental or social impact as well as financial performance. The key features of impact investing are its intentionality and the measurability of the impact.

In addition to qualitative analysis of funds' management processes, we try to determine whether the management company itself has also adopted a structured, sustainable approach. To that end, our team of analysts have put together a questionnaire that allows them to assess the extent to which the management company under review has weighed up sustainability risks and opportunities. This questionnaire serves as a point of reference when identifying the management company's positioning on sustainable investment, its philosophy and the concrete measures it has implemented.

Our system also includes a quantitative element, meaning that it relies on external ratings of the various investment vehicles included as part of the discretionary socially responsible funds mandate solution. We use the MSCI scores for this.

We then weight these scores by the vehicles' weightings in the portfolio to calculate a score for the portfolio as a whole. Our aim is for this average portfolio rating to be AA or higher, demonstrating that the portfolio has a strong ESG profile.

C. Discretionary external funds mandate

For this type of mandate, we rely on external ratings of the various vehicles included as part of the discretionary external funds mandate solution. We use the MSCI scores. We then weight these scores by the vehicles' weightings in the portfolio to calculate a score for the portfolio as a whole. This score is converted into a rating between CCC and AAA, where AAA is the best.

Our aim is for this average portfolio rating to be A or higher, confirming above-average ESG positioning.

D. Discretionary direct lines mandate

The discretionary direct lines mandate is built on two fundamental principles:

– **Diversification** (across asset classes, sectors and geographical regions):

  The portfolio construction process entails combining decorrelated asset classes, so that the total portfolio risk is lower than the sum of the risks of the various assets (or instruments) within it. This serves to minimise the risk per unit of return or maximise the return per unit of risk. We also focus on the relative valuation levels of the various asset classes.

– **Selecting high-quality securities:**
  – We use a resolutely entrepreneurial approach to identify companies that will generate high levels of profitability for many years to come. This long-term perspective, where the aim is to understand the various aspects of a company before investing so as to measure all associated risks, aligns very well with an ESG approach.
  – The investment universe is made up of companies with transparent operations and clear business models. Our stock-picking methodology also relies on company valuation levels, since it is the price paid that determines the future return on any investment.

  For this type of mandate, we rely on external ratings of the various vehicles included in the solution. We use the MSCI scores. We then weight these scores by the vehicles' weightings in the portfolio to calculate a score for the portfolio as a whole. This score is converted into a rating between CCC and AAA, where AAA is the best. Our aim is for this average portfolio rating to be A or higher, confirming above-average ESG positioning.

E. Application within the investment advisory service

The investment advisory service largely draws on our universe of recommended investment vehicles. These vehicles are being gradually classified using a sustainability scale with a view to achieving complete coverage of our universe, so that our advisers are in a position to make recommendations that take ESG risks into account.

Specifically, individual securities are selected on the basis of Banque de Luxembourg's fundamental approach and non-financial data is considered when assessing risks and opportunities.

If the client so requests, we favour investment funds with themes relating to sustainable development, such as renewable energy, water and healthcare.

2.6. Assessment of ESG risks

The investment process and ESG approach of investment funds and ETFs undergo in-depth analysis and ongoing monitoring. We assess ESG risks on a quantitative basis by tracking MSCI ESG scores and SFDR classifications. This modus operandi allows us to reduce the adverse impact of potential sustainability risks on the valuation of the various assets and the profitability of our management solutions.

2.7. Engagement and active shareholding

A. Commitment

The decision to implement an engagement strategy is partially determined by:

- Potential influence over the company in light of the percentage of shares held and for how long, the relationship with the management team and the company's geographic location; and
- An assessment of the incident, i.e. the urgency and seriousness of the issues at play determined according to the number of stakeholders affected, media coverage of the incident and NGO involvement as well as the level of financial and reputational risk associated with the incident.

While BLI engages in regular, proactive dialogue with investee companies, it is important to stress that the size of our portfolio positions relative to companies' stock market capitalisations naturally limits Banque de Luxembourg's potential influence and the effectiveness of forming a coalition with other shareholders.

A.1 Individual engagement

We communicate with the companies in which we invest via various channels:

- Correspondence with the Board of Directors (BoD) or the team in charge of investor relations
- Company visits
- Attendance at roadshows
- Telephone calls when earnings are reported
- Companies' financial statements: annual reports, Investor Days, quarterly/half-yearly presentations
- Indirect channels such as broker studies

A.2 Collaborative engagement

The size of the positions in the portfolios relative to the stock market capitalisation of the companies in question naturally limits our potential influence and the effectiveness of forming a coalition with other shareholders. We would consider the option of collaborating with other shareholders where applicable, though, if doing so would be in the best interests of shareholders. Moreover, as a company, BLI plans to engage in active dialogue with businesses by supporting initiatives led by the Principles for Responsible Investments network or other groups. We may also consider taking part in initiatives launched by other groups of investors.

B. Share ownership

B.1 Banque de Luxembourg

The positions held in our portfolios represent a small portion of each company's capital structure. Banque de Luxembourg has therefore decided not to exercise its voting rights, but reserves the right to vote if doing so is necessary to protect the interests of shareholders.

B.2 BLI

As part of its ESG investment policy and voting policy, BLI subscribes to the Institutional Shareholder Services Inc. (ISS) sustainable voting policy. This policy is designed to support shareholder resolutions based on standards that enhance long-term value for shareholders and stakeholders while also aligning the company's interests with those of society at large.

This voting policy is in line with the aims set within the fund in the following areas:

- **Environment:** BLI positions itself in favour of resolutions calling for the reduction of greenhouse gas emissions (GHG). More broadly, BLI votes for resolutions where the aim is to obtain information on the climate-related financial, physical or regulatory risks the company is facing with respect to its operations and investments or the way in which it identifies, measures and manages these risks.
- **Social:** As regards respect for human rights, BLI generally votes in favour of the company adhering to internationally recognised standards and principles, such as the United Nations Global Compact and the standards laid down by the International Labour Organization (ILO). Votes in favour of motions linked to

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ILO principles are intended to promote labour rights, foster the creation of decent jobs, enhance social protections and strengthen social dialogue within the workplace.

– **Governance:** BLI votes in favour of resolutions where the aim is to ensure that the composition of the Board of Directors is suitable. This includes, but is not limited to, issues relating to BoD independence, remuneration, gender balance and appropriate skills for the role. BLI considers these matters to be crucial because they should theoretically guarantee adequate monitoring and assimilation of ESG issues, and this should prevent fraud, corruption and other serious violations of good governance practices.

C. Find out more

Banque de Luxembourg

Responsible investment

ESG policy

Commitment policy

BLI

Responsible investment

ESG policy

Engagement policy

Voting policy

Exclusion policy

3. Our financing services

Banque de Luxembourg applies sectoral policies as part of its financing activities, in accordance with the framework established by its parent company, Crédit Mutuel Alliance Fédérale.

These sectoral policies seek to define a set of rules governing the operations proposed to companies doing business in sectors with high levels of greenhouse gas emissions as well as an impact on healthcare and/or the environment. The purpose of these sectoral policies is to help clients with the transformation of their business model and thereby contribute to the fight against global warming, biodiversity loss and environmental degradation.

Sectoral policies are applied through specific analysis tables for each business sector. These analysis tables include counterparties' non-financial ratings, which we assess when deciding whether to proceed with financial and banking operations. In so doing, we promote ethical business relationships and seek to supplement financial analysis of the companies in receipt of financing with objective analysis of their non-financial performance and specifically their engagement with environmental, social and governance matters.

Sectoral policies have been drawn up for the following sectors:

– Transport;

– Coal;

– Hydrocarbons (Oil & Gas);

– Mining;

– Civil Nuclear Energies;

– Defence and Security.

A pilot project is being developing within Crédit Mutuel Alliance Fédérale with a view to conducting CSR analysis of unlisted companies and those not covered by a sectoral policy. This general CSR analysis is the subject of a pilot project within a French subsidiary of Crédit Mutuel Alliance Fédérale and should be rolled out to all entities during 2022.

Find out more

III. A PROGRESSIVE APPROACH

We view our approach as a gradual process of upskilling and our strategy will continue to evolve as regulations change and advances are made in the field so that it reflects our vision as regards ESG as fully as possible. In the coming months, we will be enhancing the integration of ESG considerations in terms of governance, the internal control system and internal training for all staff.

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