ESG INTEGRATION POLICY

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Our approach

As responsible investors, we consider part of our fiduciary duty to manage environmental, social and governance (ESG) risks and opportunities when investing on behalf of our clients. We believe that by integrating ESG analysis into our investment process, we will be able to seek for long-term performance through risk mitigation, identifying growth opportunities and recognising the financial value of intangible assets, while striving to achieve positive outcomes for society and the environment.

We define our ESG research process through the evaluation of a company's purpose and responsibility. For us, purpose refers to the impact that the company expects from its goods and services; while responsibility refers to how a company manages its ESG risks in achieving its purpose. Our approach to integrate ESG into our investment process for all our equity and fixed income funds can be divided into 4 steps:

1. Avoid – We avoid companies that conflict with our principles and values. Due to their activity, standards or behaviour, we exclude them from our investment universe. We choose to only invest in companies with sustainable business models that exhibit long-term growth perspectives.

2. Analyse – We analyse the firm's ESG practices alongside conventional financials. Our proprietary ESG research system helps us to assess the impact of a company's business on the world – and the world's impact on its business – to capture as many risks and opportunities as possible.

3. Engage – We engage with companies on ESG-related issues. This includes exercising our shareholder voting rights1, helping instil best practices, clarifying our views or holding senior management accountable when issues arise.

4. Communicate – We communicate our actions and achievements with our clients. We provide full transparency related to ESG issues primarily through our website, where we publish fund documentation, reports, policies and insights from our experts.

As active managers, we conduct bottom-up analysis across all our investments. We identify the structural levers of sustainable growth and how well a company is positioned to take advantage of the opportunities the sustainable transition presents, in order to focus our investment on delivering positive outcomes for society and the environment.

When integrating ESG into this process, our approach is in line with the Principles for Responsible Investment's (PRI) definition[1]: "*the systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions."*. Please refer to Table 1 below for the definition of E, S & G as defined by the PRI, of which we are a signatory since 2012. We have also included the guidance from PRI on what constitutes ESG integration in Table 2. ESG integration can be applied across all asset classes, as it has been proven to work equally well in fixed income and equity markets.

Table 1[2]: PRI's definition of E, S & G

Environmental (E)	Issues relating to the quality and functioning of the natural environment and natural systems. These may include for example: biodiversity loss, greenhouse gas (GHG) emissions, climate change, renewable energy, energy efficiency, air, water or resource depletion or pollution, waste management, stratospheric ozone depletion, changes in land use, ocean acidification and changes to the nitrogen and phosphorus cycles.
Social (S)	Issues relating to the rights, well-being and interests of people and communities. These may include for example: human rights, labour standards in the supply chain, child, slave and bonded labour, workplace health and safety, freedom of association and freedom of expression, human capital management and employee relations; diversity; relations with local communities, activities in conflict zones, health and access to medicine, HIV/AIDS, consumer protection; and controversial weapons.
Governance (G)	Issues relating to the governance of companies and other investee entities. These may include for example: board structure, size, diversity, skills and independence, executive pay, shareholder rights, stakeholder interaction,

[1] For more information on the Principles for Responsible Investment, visit www.unpri.org
[2] Source: Principles for Responsible Investment website www.unpri.org

	disclosure of information, business ethics, bribery and corruption, internal controls and risk management, and, in general, issues dealing with the relationship between a company's management, its board, its shareholders and its other stakeholders. This category may also include matters of business strategy, encompassing both the implications of business strategy for environmental and social issues, and how the strategy is to be implemented.

Table 2: ESG Illustration

What does ESG actually mean?	**What does ESG NOT mean?**
• Analysing financial information and ESG information; • Identifying material financial factors and ESG factors; • Assessing the potential impact of material financial factors and ESG factors on economic, country, sector, and company performance; and • Making investment decisions that include considerations of all material factors, including ESG factors.	• ONLY certain sectors, countries, and companies are prohibited from investing; • Traditional financial factors are ignored (e.g., interest risk is still a significant part of credit analysis); • Every ESG issue for every company/issuer must be assessed and valued; • Every investment decision is affected by ESG issues; • Major changes to your investment process are necessary; and, finally and most importantly, • Portfolio returns are sacrificed to perform ESG integration techniques.

START: Carmignac's Proprietary ESG Research System[3]

START is our proprietary ESG research system that enables us to systematically integrate ESG research into the investment process. The system combines third-party data sources with our in-house analysis to provide a forward-looking view of how a company is managing its stakeholders and therefore its ESG risks and benefitting from opportunities. We strongly believe that a company that looks after its stakeholders (such as those shown in Figure 1) creates sustainable and positive financial, societal and environmental value. ESG risks are critical to understanding a company's business practices as well as forecasting its financial performance. Our ESG research system is built on a framework formed from past academic research and the guidelines of various industry bodies such as the Sustainable Accounting Standards Board (SASB), Global Reporting Initiative (GRI), in order to conduct comprehensive ESG analysis. We also use external company ESG data collated from a selection of leading data providers.

Figure 1: Stakeholders

START's 4-step process:

1. **Group: Companies are allocated to one of Carmignac's proprietary ESG-90 industry groups**
   - Key stakeholders and risks are identified for each group. Different stakeholders (employees, customers, suppliers, environment, community, board etc.) have differing significance depending on sector and geography
   - Once assembled by common 'materiality', companies are grouped with others that have similar material ESG risk profiles

2. **Collect: Large amounts of raw data concerning business practices are collected from a range of specialised data sources**
   - Data sources including company reported data and past and present controversies
   - We utilise the data to compare each company against over 30 identifiable and relevant sustainable metrics ("Indicators") and assess the firm across each of the E, S & G elements (see Table 3 below)
   - Positive and negative sentiment is measured by utilising alternative data sources that provide signals on emerging risk

[3] *The proprietary ESG system START combines and aggregates market leading data providers ESG indicators. Given the lack of standardisation and reporting of some ESG indicators by public companies, not all relevant indicators can be taken into consideration. START provides a centralised system whereby Carmignac's proprietary analysis and insights related to each company are expressed, irrespective of the aggregated external data should it be incomplete*

Table 3: Comparable Indicators

Environmental	Social	Governance
Carbon Emissions –Direct & First Tier Indirect (tonnes CO2e)	% Employee Satisfaction	% Audit Committee Independence
Carbon Intensity- Direct & First Tier Indirect (tonnes CO2e/USD mn)	Employee Turnover	Compensation Committee Independence
Flaring of Natural Gas	Female Managers	Nomination Committee Involvement
Total Energy Use/Revenues	Average Employee Training Hours	Board Size
Renewable Energy Use Ratio	Lost Time Due to Injury Rate	Independent Board Members
Energy Use Total	Employee Fatalities	Average Board Tenure
Total Waste / Revenues	Chief Executive Salary Gap	% Board Gender Diversity
Waste Recycled /Total Waste	% Gender Pay Gap	Highest Remuneration Package
Accidental Spills	% Customer Satisfaction	Long Term Objective-Linked Executive Compensation
Water Use / Revenues		Sustainability Compensation Incentives
Water Recycled		
Fresh Water Withdrawal Total		

3. **Rank: The companies are ranked against their peers and given baseline rating**
   - Companies are ranked against peers from similar regions, market capitalisation and ESG-90 industry group to ensure the least amount of metric discrepancies and biases
   - Based on the above, we provide each of the E, S and G pillars with a score from A-E, before aggregating them to give an overall A-E company score (see Table 4 for A-E rating explanations).

Table 4: START ratings

Rating	Explanation
A	Manages their risk effectively that have financial impact and communicates with investors
B	Flaws in management system led & working on improvement following recent financial impact controversies.
C	Aware of future risks but do not have adequate systems to manage impact of future financial material risk.
D	Do not understand & no action taken on recent controversies. Management doesn’t understand and not addressing risk
E	Not aware of the risk they are facing and has no management plan in place. Faced with controversies and has no plans

4. **Analyse- In-house expertise is applied to existing analysis**
   - Company knowledge, gained from firm visits and management meetings, provides insights into how a company's ESG and sustainability policies and practices are supporting long-term strategic goals
   - We produce an in-house rating (which overrides the baseline rating) as well as a written comment to detail their analysis and qualify their choice
   - We also conduct forward-looking analysis including trend analysis, to assess the direction of the company towards more sustainable practice
   - Finally, we consider the impact of the company by understanding how a company's goods and services affect society and the environment. This approach leverages the UN Sustainable Development Goals' framework.

This analysis is then incorporated into valuation analysis and informs the remainder of the investment process.

Inclusion of ESG in analysis for Equities

We believe that to deliver long-term value, a company needs to be just as focused on its business practices as on its financial performance. In our view, business practices are a key lever that drives financial return, in the same way that revenues or costs would. Ultimately, we believe that anything a business does needs to be sustainable, or it may face decline. Within equities, with START as the basis, all ESG analysis is a coordinated effort between the Portfolio Managers, the Research Analysts and the ESG Analysts.

Step 1: Financial Analysis

Businesses need to focus on the entire value chain of stakeholders which includes shareholders, regulators, employees, clients, suppliers, the environment and local communities. Our proprietary research generally focuses on companies with long-term sustainable growth that may be established through innovation, changing consumer patterns, regulation and disruption, to mention a few. Looking at these mega trends with an ESG lens is paramount to identifying long-term growth. We seek mainly to invest in companies that have resilient balance sheets, are able to deliver sustainable cash flows, and remain market leaders over the long term.

Step 2: ESG Analysis

To complete an investment rationale, full ESG assessment is performed and documented in our proprietary ESG research system, START, that brings together quantitative and qualitative research both from third parties and in-house. The initial step of this proprietary ESG analysis is to consult company reports, third-party reports or through direct company meetings to understand how individual companies are meeting the challenges of ESG related risk. Suppliers, clients and other stakeholders may also be consulted.

We also look at a company's impact and the sustainability of their business model in the context of the long-term transformative ESG trends. This helps us to understand how well the company is positioned to take advantage of new opportunities the transition may present. This forward-looking analysis is a critical step in understanding whether the company's performance is repeatable and sustainable over the long term.

Step 3: Company Valuation

Evaluating all the ESG factors and impact outlook, alongside financial analysis, is part of the fundamental analysis of our Analysts. Our Analysts can make the necessary adjustments to financial analysis to arrive at their final company valuation.

ESG Analysis at Portfolio Level

Aside from the individual company ESG assessment, ESG analysis helps the Portfolio Manager form a view with regard to the risk management of the total portfolio over the long run.

ESG Engagement

We see ourselves as part of a wider movement that is helping to shape more responsible corporate behaviour and increase transparency. We view ESG integration as part of expressing our convictions as long-term responsible investors, avoiding negative issues that can damage portfolio returns but also engagement with management to take the right steps towards enhancing their sustainability profile and practices. We target 100% voting participation and actively engage with senior management to discuss any disagreement on votes before making our final decision.

ESG integration within a long-short strategy

A responsible investment approach that includes ESG integration is typically considered to be for long-only investment strategies. However, we believe that short selling can help to achieve responsible investment goals through a number of ways. Firstly, shorting stocks that perform poorly against ESG metrics increases positive ESG exposure, whilst mitigating undesired ESG risks. Furthermore, by influencing capital flows, short selling can increase the cost of capital for the shorted issuers, causing an economic impact. Finally, shorting requires Portfolio Managers to conduct substantial in-depth analysis, which may bring to light new ESG considerations that were previously either unknown or overlooked by the wider market. In order to appropriately integrate ESG into our long-short portfolios, we make sure to consider ESG risks and opportunities for the long and short portfolios separately. This gives our investors a clearer understanding of how ESG affects our analysis and subsequent investments.

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Inclusion of ESG in analysis for our corporate bond selection

Our corporate bond ESG assessment is integrated in the research process, which therefore enables us to include ESG analysis in our estimate of cost of risk. As a result of using START, the risks arising from ESG factors such as low-quality governance, under-representation of shareholders, or environmental risks are included in the analysis alongside financial ones.

The Research Process

Step 1: Financial Analysis

As ever, our goal is to maximise returns and net of the cost of risk, through a rigorous selection of issuers. For every investment, we estimate the cost of risk, which we define as the likelihood of a default occurring multiplied by the consequence of that default. In addition to the obvious financial risks, cost of risk so defined, encompasses the risks arising from low-quality governance, under-representation of shareholders and a company's failure to uphold occupational health, safety and similar standards, along with environmental risks. An issuer's net risk premium is thus equal to the difference between its interest earned and cost of risk. Hence, we seek to maximise risk premia, while keeping market and volatility risk under control.

Step 2: ESG Risk Analysis

Our credit specialists take environmental, social and governance (ESG) issues into account when analysing the companies we consider investing in. As we believe that a company's non-financial performance can have a lasting impact on its credit quality, our investment team uses START to determine ESG ratings for over 3,500 issuers. We also look at a company's impact and the sustainability of their business model in the context of the long-term transformative ESG trends which could be strong factors that reduce default risks over the cycle. This helps us to understand how well the company is positioned to take advantage of new opportunities the transition may present. This forward-looking analysis is a critical step in understanding whether the company's performance is repeatable and sustainable over the long term. Note that, we are convinced that a more flexible, non-benchmarked approach will generate better results, even as we take non-financial metrics into account. Instead of screening out companies faulted for performing poorly against ESG metrics – many of them stymied by large credit spreads – we interact with them in an effort to understand what's behind their poor practices and try to identify any potential room for improvement.

Step 3: Company Valuations

Our analysts evaluate all these factors, whilst also respecting firm-wide exclusions, as part of the fundamental analysis. Our analysts will make the necessary adjustment to the default risk incorporating ESG risks management and impact outlook, to arrive at their final company valuation.

ESG Engagement

Being owners of corporate debt does not exclude us from company engagement. We see ourselves as part of a wider movement that is helping to shape more responsible corporate behaviour and increase transparency. We view ESG integration as part of expressing our convictions as long-term responsible investors, avoiding negative issues that can damage portfolio returns but also engaging with management to take the right steps towards enhancing their sustainability profile and practices.

Inclusion of ESG in analysis for our supranational and sovereign bonds selection

ESG analysis plays a critical role in our supranational and sovereign bond analysis due to the systemic nature of such issues to the issuers. Issues such as political stability, demographic change, income inequality and natural resource availability are all pertinent factors which may affect risk. The research process found below will then drive sovereign valuation.

The Research Process

Step 1: Macroeconomic Overview

Countries are initially excluded based on poor macro-economic grounds and where we deem ESG factors are detrimental and represent a systemic risk.

Step 2: Norms-Based Screening

This includes countries or issuers under embargo or EU, UN and OFAC Sanctions and issuers recognized as having committed human rights abuses.

Step 3: In-Depth Proprietary Sovereign Sustainability Rating

Each country is analysed against several indicators that reflect how the country is governed, and assigned a ‘positive’, ‘neutral’ or ‘negative’ rating for each indicator. The indicators are based upon globally recognized impact monitors such as the IMF’s Fiscal Monitor, Transparency International’s Corruption Perception index, the World Justices' Project Rule of Law and Reporters Without Borders World Press Freedom index. The ratings are then aggregated into one ‘overall’ rating.

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