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Questions & Answers

Q&A: responsible investing and ESG integration

Understanding environmental, social and governance (ESG) investing

The responsible investing (RI) universe has seen a significant growth over the past few years, and, consequently, this growth has raised a number of questions as to what RI means for investors, companies and how this implemented across portfolios. In this document, we aim to answer the most frequently asked questions and examine how RI is applied at AXA Investment Managers.

Back to basics: responsible investing and ESG integration

Back to basics: responsible investing and ESG integration

In the first section of our Q&A document, we answer frequently asked questions on responsible investing and discuss why it matters. We also assess the challenges and opportunities of ESG integration and look at how meaningful the United Nations' Sustainable Development Goals are for investors.

How do we define responsible investing?

Responsible investing (RI) refers to an investment process which incorporates environmental, social and governance (ESG) factors into its approach. RI enables clients to align their investments with global megatrends that are changing the investment landscape. Issues such as increasing regulation, the growing need for risk mitigation and a heightened social conscience can be more effectively addressed by integrating ESG factors into the investment process.

How does ESG integration help create value?

ESG allows firms to foster a meaningful change in the global economy, and in the communities in which we live and work. We believe that ESG analysis leads to more effective investment solutions that address global challenges and create sustainable value for our clients.

Is there a difference between socially responsible investing and ESG integration?

ESG refers to the environmental, social and governance practices of an investment that may have a material impact on the performance of that investment. The integration of ESG factors is used to enhance traditional financial analysis by identifying potential risks and opportunities beyond technical valuations. The main objective of ESG integration remains financial performance.

Socially responsible investing (SRI) goes one step further than ESG by actively eliminating or selecting investments according to specific social/sustainable guidelines. The underlying motive could be religion, personal values or political beliefs. SRI strategies use ESG factors to shape the objectives of the strategy and/or apply negative or positive screens on the investment universe.

Responsible investment is a young industry that lacks widely-acknowledged and precise norms, guidelines and definitions.
So far, there is an understanding that responsible investment is a generic term that refers to a wide range of approaches that integrate ESG criteria in the investment process. Responsible investment can take on a variety of forms and should help to identify and to mitigate investment risks.

What are the challenges of ESG integration?

We have witnessed a rapid growth in ESG integration over the past few years, but challenges remain. Defining standards, terminology, ratings and the quality and disclosure of data remains a difficult issue and with no global standard in place, investors can find it difficult to compare ESG offerings across different firms.

At AXA Investment Managers (AXA IM) we focus on three dimensions to the data: correct, forward looking and standardised (the latter so that it can easily be aggregated and communicated to all stakeholders).

We ensure that ESG data frameworks are validated by investment experts as well as our risk management organisation. To achieve systemic change, ESG indicators should be integrated into core indices and accounting standards, making reporting more standardised and therefore comparable. Regulatory bodies must play a role in incentivising companies to report on ESG issues, and allow for greater engagement, make ESG data more quantifiable and educate the general population on the importance of ESG considerations when making investment decisions.

What is impact investing?

Impact investing focuses on financing businesses and projects that are designed to have intentional, positive and measurable impacts on society, while simultaneously delivering financial market returns. Impact investing harnesses the power of capital towards solving 'real issues' facing society and steering the power of capital towards 'greater utility'.

Are the United Nations' Sustainable Development Goals meaningful for an investor?

By creating the Sustainable Development Goals (SDGs), the United Nations (UN) has called the investment community to action to contribute to their ambitious targets. The UN recognises that finance plays a vital role in facilitating and directing capital flows and developing new financing models that steer strategies towards initiatives that promote sustainability. While they have been endorsed by many major global investors and the business community, there is also a risk related to the potential dilution of the SDGs. This can occur when investors link them to their investments without providing evidence of their contribution to the goals in a measurable way.

The UN SDGs articulate the world's most pressing sustainability issues and can support investors in recognising sustainability trends, and the potential for long term financial performance, by investing in sustainable economies and markets. Over the long-term, the SDGs aim to achieve economic growth without compromising our environment or placing unfair burdens on societies.

How has ESG evolved at AXA Investment Managers?

Responsible investing is part of our DNA, and this section looks at how we have developed our ESG approach and offering, how it is implemented and the impact AXA Group has on our approach.

What are our identified ESG risks, and what does this mean for portfolios?

As a responsible investor we want to manage ESG risks and opportunities when investing on behalf of our clients. Consequently we have identified certain sectors we will not invest in above a specified threshold. Sectorial exclusions on controversial weapons, palm oil, soft commodities and coal are applied across all assets.

Going beyond this, we have developed ESG standards which are applied to our responsible investing (RI) and ESG integrated open-ended funds, and will be available to institutional clients on an opt-in basis. The AXA IM ESG standards also include ESG corporate analysis and scoring, and thematic engagement and voting.

These standards help us to manage ESG risks and focus on material issues such as climate change, health and social capital, while also considering severe controversies and low ESG quality. Because of these ESG standards, the following sectors and areas will be excluded from our RI and ESG integrated funds:

- Coal and tar sands producers
- Tobacco
- Defense
- Severe breaches of United Nations Global Compact (UNGC) principles
- Low ESG quality companies

For full details on the exclusions and our ESG standards, please read our AXA IM ESG standards policy.

What is AXA IM's approach to ESG integration?

Portfolio managers and financial analysts at AXA IM are provided with information to ensure ESG risks and opportunities are incorporated into their analysis. This includes:

- ***ESG scores:*** these are calculated twice a year using a proprietary methodology developed and maintained by the central RI team.
- ***Internal research:*** ESG analysts within the investment teams can support portfolio managers and financial analysts in their analysis of a company.
- ***Internal and external ESG research:*** Our internal ESG research focuses on climate change, human capital and health. This analysis is supported by broker research, regular meetings with companies and participation at conferences and industry events. The RI team also provides analysis, training and views on controversies.

How is ESG developed at AXA IM?

Leveraging its two decades of RI experience, AXA IM is integrating ESG analysis into all its investment platforms, providing portfolio managers with access to proprietary ESG scores and key performance indicators (KPIs) in their front office tools, as well as additional data and research.

The central RI team at AXA IM focuses on thematic research, corporate governance and shareholder engagement along with developing quantitative solutions. Headed by Matt Christensen, the team is comprised of 14 experienced professionals, including 10 RI analysts, with an average of 13 years' experience[1].

At a platform level:

- Rosenberg Equities has a dedicated ESG team comprising of five ESG specialists headed by Kathryn McDonald.
- Framlington Equities has a team of three specialists dedicated to ESG research, who

support portfolio managers on a day-to-day basis in the analysis of companies.
- The fixed income and high yield teams have reinforced their credit analysis team, and each has been trained to incorporate ESG considerations in their analysis of issuers.
- AXA IM Real Assets has experts dedicated to leading and overseeing the inclusion of sustainability considerations in the activity of the platform.
- Our multi-asset team work closely with the equity and fixed income platforms to integrate ESG through two major pillars. Read more on page 15.

What does AXA IM's ESG and SDG offering consist of?

We categorise our offering into three levels:

ESG embedded– All of our funds (excluding index and fund of hedge funds) benefit from internal responsible investment policies, active engagement and proxy voting. In addition, the ESG score and carbon footprint are displayed on the factsheet of all AXA IM funds[2], and, all portfolios benefit from the AXA IM RI sectorial policy, which include coal, palm oil, controversial weapons and soft commodities.

ESG integrated – Our ESG analysis is integrated across all our investment platforms, which allows our investment teams to take account of ESG risks and opportunities when making investment decisions that are tailored to clients' objectives. ESG integrated mutual funds also apply our ESG standards policy, with additional exclusions on coal and tar sand producers, tobacco, defense, United Nations Global Compact (UNGC) breaches and poor ESG quality. Additional ESG KPIs are displayed in the reporting of these funds[3].

Sustainable investing – This includes companies within the eligible ESG and impact investing universe. Impact investing goes beyond ESG risk monitoring and focuses on financing businesses and projects that are designed to have intentional, positive and measurable impacts on society while simultaneously delivering financial market returns.

What are the scoring methodologies used by AXA IM?

The corporate scoring methodology at AXA IM is developed and maintained by the RI team. We use raw ESG company/country data from ESG research providers and cover more than 7,200 companies and 100 countries with our quantitative scoring system[4]. We aggregate the raw quantitative data (including climate change, resources and ecosystems, human capital, board oversight and controls, etc) of specialised rating agencies and then provide each company/country with a score from 0 - 10. Portfolio managers then have access to the individual scores of each company, to assist the investment decision making.

Further to this, an analytical tool is also available to help investment professionals see the score of an issuer and its history, along with voting/AGM results and CO2 emission rates.

For sovereign issuers, we rely on ESG indicators published by recognised international sources. We distinguish two groups of countries, mature and progressing. For these two groups, we can rely on specific indicators, considering the level of socio-economic development of these countries.

In addition, proprietary scoring methodologies are implemented for certain alternative asset classes such as commercial real estate loans, infrastructure and leveraged loans.

What influence does AXA Group have on AXA IM's ESG approach?

The AXA Group has regularly affirmed its commitment to responsible investment over the past 20 years, and to its belief that ESG factors have the potential to affect investment portfolios across asset classes, sectors, companies and regions and therefore affect risks and returns.

AXA IM has been working closely with its parent company over the years, and plays a pivotal role in the implementation of AXA Group's RI strategy, including the development of ESG scoring, definition and implementation of an ambitious climate strategy, etc.

AXA IM work closely with the AXA Group on the RI strategy and roadmap, benefitting from the work done collaboratively.

1. AXA IM as at 30.06.2018
2. Starting in Q1 2019
3. Available upon request
4. AXA IM as at 30.06.2018

What does ESG mean at platform level at AXA Investment Managers?

In this section we examine how ESG is implemented, and, how it has evolved across four asset classes at AXA IM: fixed income, multi-asset, Framlington Equities and Rosenberg Equities.

For each asset class we answer five questions:

1/ What is the process within the platform for integrating ESG?
2/ How has ESG evolved within the platform?

Responsible investing and fixed income

Responsible investing and fixed income at AXA IM

In this section we examine how ESG is implemented within our fixed income range and how it has evolved across the platform.

1/ What is the process within the platform for integrating ESG?

We leverage AXA IM's proprietary ESG scoring to cover our broad fixed income universe. ESG scores are directly fed into our portfolio management tool which is used daily by portfolio managers, providing them with easy access to ESG scoring and key performance indicators. We developed ESG dashboards and reporting, allowing the managers to measure the footprint of the portfolios. We believe detailed reporting is key to providing our clients with a high level of transparency for the investment process.

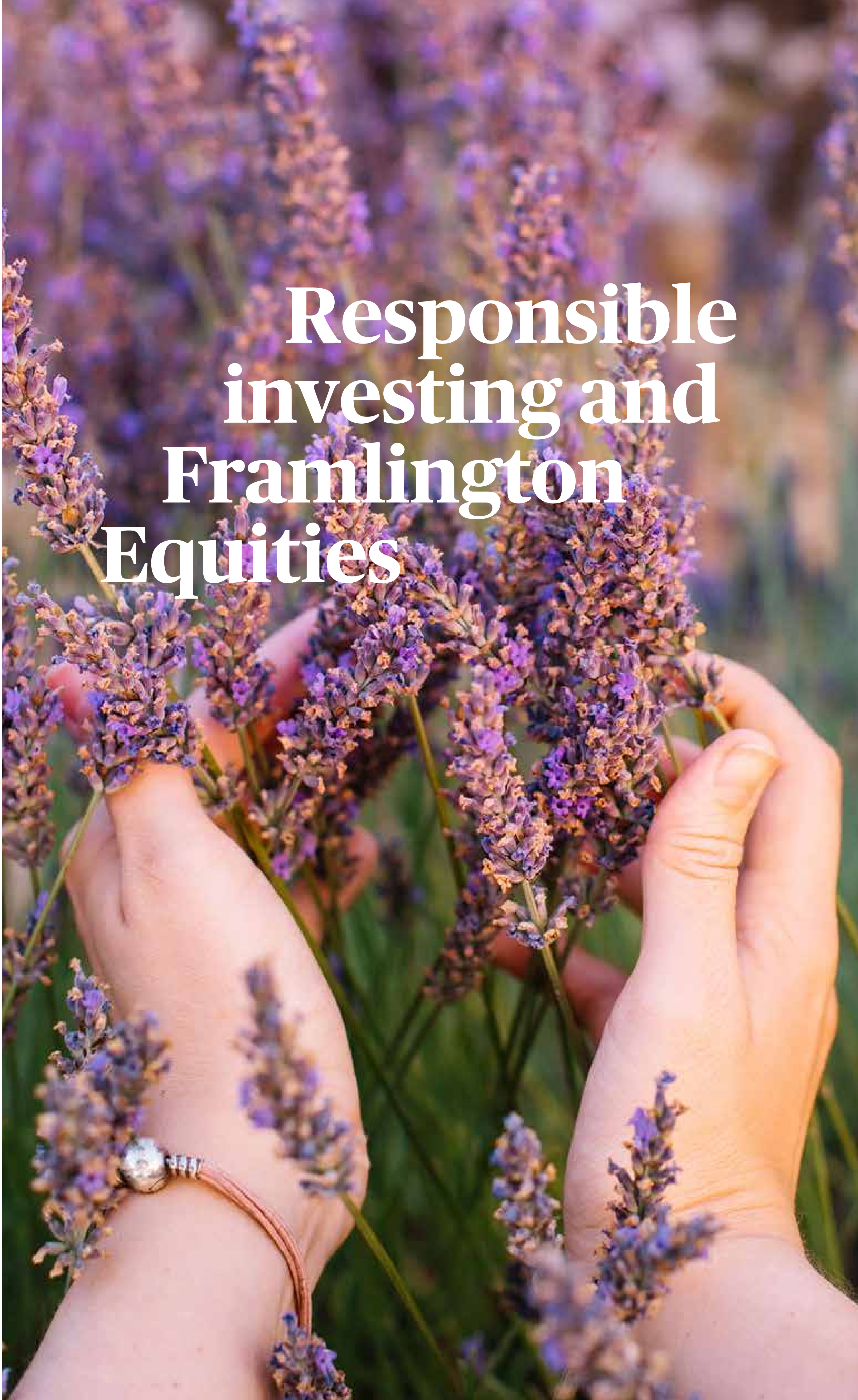
We integrate ESG factors into our fundamental credit research framework, which aims to help portfolio managers assess how companies are mitigating ESG risk and taking advantage of these criteria to improve their competitive position in their own sectors. ESG factors are also integrated in our regular risk monitoring by our portfolio engineers.

The responsible investment team conduct regular training for our fixed income team on ESG considerations and ensure a strong governance to align our strategic commitment to mainstream ESG within the investment process. Dedicated ESG experts at the platform level contribute to an efficient integration into our investment process.

2/ How has ESG evolved within the platform?

At AXA IM, responsible investing is part of our DNA and within fixed income, we been progressively integrating ESG into our investment process. Beginning with a focus on dedicated products and client requests, we are now developing a full integration of ESG factors into our core investment process. ESG has been integrated into our funds since June 2002, and, since then, we have continued to build ESG integration into our investment process, and we are now developing our capabilities towards impact investing.

Responsible investing and Framlington Equities



Responsible investing and Framlington Equities at AXA IM

In this section we examine how ESG is implemented within our Framlington Equities range and how it has evolved across the platform.

1 - What is the process within the platform for integrating ESG?

At Framlington Equities we ensure a 360° approach to company evaluation through three steps:

1.1/ *Quantitative* – The first step relies on incorporating AXA IM's internally-developed ESG scores into our front office tools, internal research models and portfolio risk reports. The score of each company is a starting point to understand how they are positioned on each of the ESG criteria/sub criteria and how this score has developed over time.

1.2/ *Qualitative* – Our intention is to go beyond a pure quantitative scoring to gain a detailed and prospective knowledge of how a company is intending to respond to ESG challenges. This type of analysis is undertaken when we visit companies and meet management teams face-to-face to discuss and understand how their ESG and sustainability policies and practices are supporting their long-term strategic goals.

1.3/ *Engagement* – We see ourselves as key influencers in helping to create better and more responsible corporate behaviours and disclosure. We view ESG integration as part of expressing our conviction as long-term responsible investors, avoiding negative issues that can damage portfolio returns but also influencing management to take the right steps towards enhancing their sustainability profile and practices.

2/ How has ESG evolved within the platform?

Framlington Equities has always acted as a long-term investor that aligns its investment strategy to industry trends, develops a deep understanding of the companies, their management team and the success of their business model. We have been pioneering the management of RI portfolios since the launch of our first RI mandate in 1998, focusing on European small and mid-cap companies supporting employment in France.

As long-term investors, non-financial risks and factors have always been integrated into our analysis and we now integrate ESG considerations into investment decisions, with an increasing number of our strategies becoming ESG integrated under MiFiD II. We have three ESG analysts[5] embedded within the investment team, providing a view on company ESG risks and opportunities on a proactive and reactive basis.

5. AXA IM as at 30.06.2018

Responsible investing and multi-asset

Responsible investing and multi-asset at AXA IM

In this section we examine how ESG is implemented within our multi-asset range and how it has evolved across the platform.

1/ What is the process within the platformfor integrating ESG?

We decided to mainstream ESG integration within our multi-asset strategies through two major pillars:

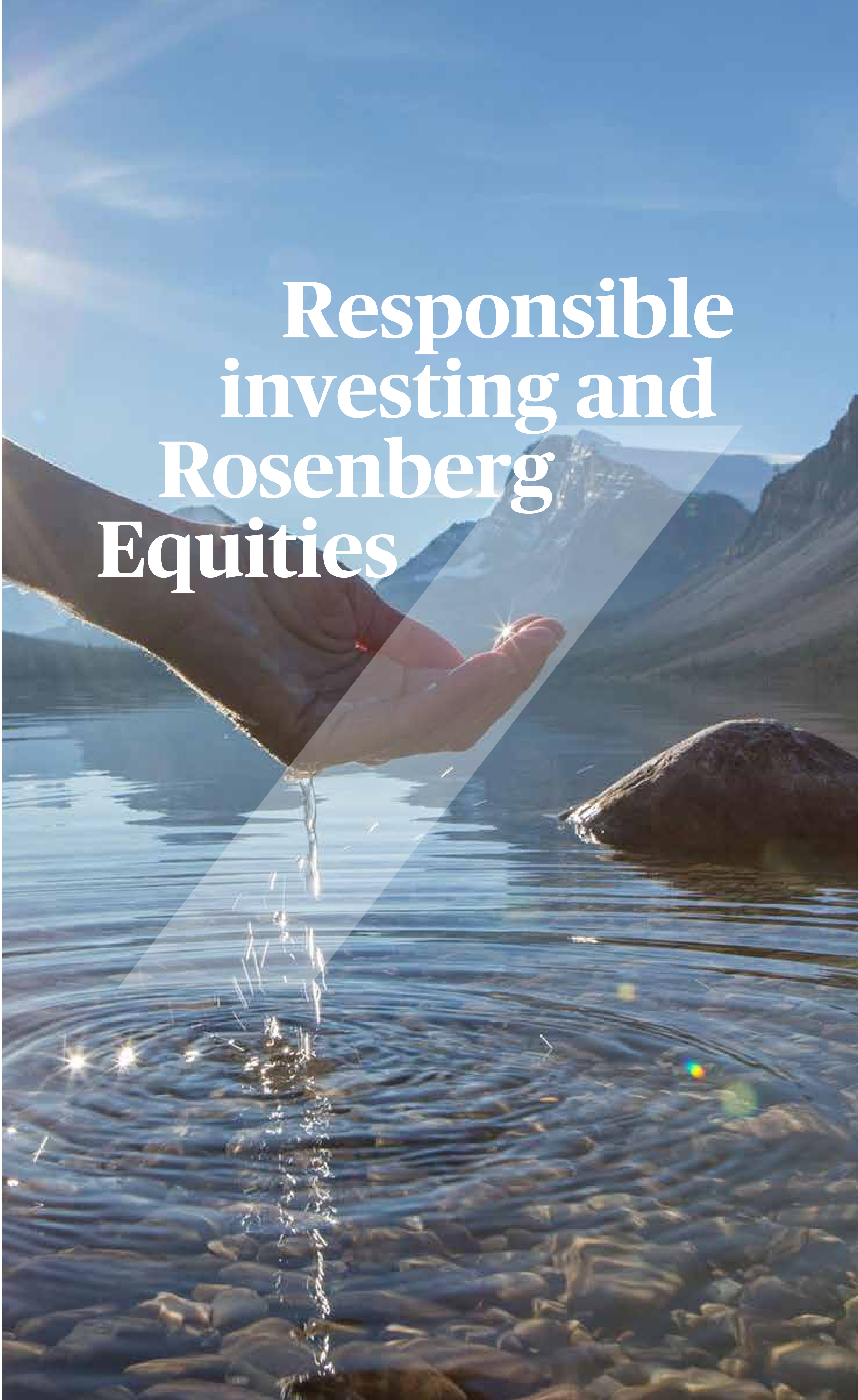
1.1/ *Technology and quant solutions* — Our portfolio managers have access to AXA IM's proprietary ESG scoring framework to assist in their decision-making. This also enables us to develop ESG reporting on a clear majority of our portfolios and mandates.

1.2/ *Research* — Analysts within our fixed income credit research team are responsible for the integration of ESG factors in their financial recommendations which feed into our credit allocation/selection process. Our equity research platform is based on two complementary axes to ensure a comprehensive assessment of a company's fundamental/ESG profile and a thorough understanding of the financial impact of the ESG risks that can derail a company's growth prospects.

2/ How has ESG evolved within the platform?

At AXA IM, responsible investing is part of our DNA. Within the platform, ESG was first integrated across our Optimal Income range in September 2018 and we are continuing to build ESG integration into our investment process.

Responsible investing and Rosenberg Equities



Responsible investing and Rosenberg Equities at AXA IM

In this section we examine how ESG is implemented within our Rosenberg Equities range and how it has evolved across the platform.

1/ What is the process within the platform for integrating ESG?

We have a strong relationship with the RI team and our investment approach enables us to systematically incorporate ESG data directly and efficiently into our models. We take data from a variety of external vendors in addition to the corporate scoring framework that is maintained by the RI team. Once the data is in our system we can work with it in a number of ways, from research and analysis to portfolio construction and reporting. For example, we add ESG scores and KPI targets alongside our traditional alpha and risk measures. In this way, we guarantee that ESG will be 'part of the dialogue' when it comes to driving portfolio positioning and real investment outcomes. That said, we are unwilling to sacrifice the traditional risk and reward profiles of our strategies when integrating ESG, so when faced with two stocks of identical ESG scores, we would always favour the one with the highest alpha, all other considerations being equal.

2/ How has ESG evolved within the platform?

Rosenberg Equities has been running what used to be called SRI portfolios since the mid-1990's for our clients. The focus of these strategies was largely exclusionary. In 2014 we launched our first truly ESG integrated pooled fund in Australia and then launched the same strategy in the European market. We are pleased to announce that we have now integrated ESG in all of Rosenberg Equities portfolios.

For further information on AXA IM's approach to responsible investing and ESG integration please visit **www.axa-im.com/en/responsible-investing** or contact your local sales representative.

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