Investment viewpoint

The sustainability process in the Swiss Franc Fixed Income boutique

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Sustainability is firmly integrated in our approach. We offer sustainable investment solutions through the continuous development and integration of innovative and state-of-the-art sustainability metrics and standards. We actively invest the managed assets in a sustainable manner as standard.

Sustainability can be approached from different angles. Our investment approach combines different sets of actions and includes the application of four different layers:

The first step **of our sustainable process** is the implementation of a **negative screening**. It is divided into an exclusion and a restriction policy. The funds are strictly prohibited from making investments in companies that produce, trade or store any of the following controversial weapons as defined by the by the UN conventions:

- Anti-personnel mines; Cluster weapons; Biological and chemical weapons; Depleted uranium & White phosphorus

  The scope of this exclusion includes companies which are mentioned on the exclusion list under the categories anti-personnel mines, cluster munitions and nuclear weapons (outside of NPT) maintained by the Swiss Association for Responsible Investments ("SVVK – ASIR Exclusion List"). Moreover the funds are prohibited from making investments in companies that produce, trade or store at any level of revenue nuclear weapons and which are incorporated in states that are not signatory to the Treaty on the Non-Proliferation of Nuclear Weapons (NPT – 1968).

In addition, the funds are restricted from making investments in any of the following for the account of an In Scope Product:

- Tobacco - companies deriving more than 10% of their revenues from either production of tobacco products or retailing of tobacco products/services.
- Coal
  - Mining - companies deriving more than 10% of their revenues from thermal coal extraction.
  - Power Generation - companies deriving more than 10% of their revenues from coal power generation.
- Unconventional Oil and/or Gas - companies deriving more than 10% in aggregate of their revenues from any of tar sands, shale gas and oil and artic oil and gas exploration.

- Level 5 Controversies – companies with existing level 5 controversies according to the sustainalytics Global Standards Screening rating scale (identification of very severe breaches of international norms & standards as defined by the ten principles of the UN Global Compact, the OECD Guidelines for Multinational Enterprises, the UN Guiding Principles on Business and Human Rights (UNGPs) and their underlying conventions).

In all cases, any decision to limit a company based on the above restrictions (with the exception of the controversial weapons) is entirely at the discretion of the fund management company. The fund management company believes that a process based on complete exclusions (other than in the case of controversial weapons) does not necessarily result in the promotion of ESG factors, and that a forward-looking qualitative assessment may be necessary. This may be particularly true in the case of companies transitioning to a low carbon economy or when management and dialogue may result in a more effective and positive change to commercial practices affecting ESG factors.

The **second step** in our sustainability process includes a **positive screening**. It is translated into an overweight or an underweight of companies relative to the Benchmark based on, among other things.

- Their ESG practices as determined by Lombard Odier's proprietary rating methodology, namely "Lombard Odier ESG/CAR Industrial Materiality Rating Methodology". As companies face different challenges depending on the sector they operate, we have developed our own ESG Materiality rating methodology. It allows us to assess a company's sustainability relative to the issue that are most material to its industry. We have developed a framework of 14 dimensions that reflects the main ESG opportunities and risks across companies' value chain. Overall, we identify and rank the most material ESG dimension for 158 GICS Level 4 sub-industries. Each company receive a grade from A to D. We try as much as possible to favour companies with good ESG practices.

  The Swiss fixed income market is characterised by the poor quality of ESG disclosure of Swiss small and mid-caps (both public and private companies). Indeed, the quality of the data received, in terms of completeness and/or timeliness, is poor and the lack of coverage from ESG Data providers in the Swiss Fixed Income universe constitute an important deficit for ESG analysis. We addressed this latter issue addressed in 2020 by integrating ESG data generated by Inrate, a leading provider regarding Swiss issuers (also a provider of the recently created SIX's SBI ESG indices), into our methodology, thereby significantly improving the coverage.

While coverage has improved and we collect more and more information from Swiss issuers, some bias towards the larger companies remains in our ESG assessment of the Swiss universe. This bias is also explained by the fact that our universe contains a large portion of private companies (more than 40% of the SBI A-BBB domestic is private. These firms have fewer incentives from their shareholders to publish SRI reports and carbon targets.

- As a last point, in the CHF bond market, there are comparatively large concentration risks with a few issuers in certain benchmark indices. If these issuers have a poor ESG rating due to poor data quality, the comparison of the ESG rating between the portfolio and the benchmark can depend quite heavily on the overweight or underweight in these large issuers, which threatens to distort the general ESG rating.
- Their carbon footprint and decarbonization trajectory assessed using the Lombard Odier's proprietary tool, namely the "Lombard Odier Portfolio Temperature Alignment" - "LOPTA". LOPTA is a framework that assess not only the carbon footprint of companies, but also their temperature alignment based on macro-level data, industry/region revenue breakdowns, historical decarbonization trends and decarbonization targets.

  We are favouring companies that disclose their carbon data and targets. As mentioned above, the Swiss Market is not very transparent and we are relying on the third step of our sustainability process to improve the situation.

To address this, our **third sustainability process** is to actively use **engagement**. We have a dedicated team that is working with investment teams to reach the three LOIM stewardship priorities: 1) encouraging companies to adopt sustainable transition pathways; 2) promoting best-in-class business practices and 3) managing controversies.

We prioritize engagement with companies that we consider to be most at risk in relation to our three key stewardship objectives. To identify them, we rely on innovative proprietary tools, such as the Lombard Odier Portfolio Temperature Alignment ("LOPTA") tool or our proprietary ESG/CAR materiality framework ("LO ESG/CAR Materiality"). These tools help us to identify and engage with real potential laggards regarding sustainability transition and/or material business practices in their relevant company's industry.

And our **last layer** is regarding the **Impact Bonds**. Impact bonds regroups green, social, sustainable and sustainability-linked bonds. Green bonds represent a fast-growing market that offers investors the chance to use their capital to finance climate change solutions. As an example, when a company is issuing a new green bond, our sustainability team check whether or not the bond will be used for additional green, social or sustainable projects based on our criteria and if we can invest in it as a green bond. Most of the time we try to invest in the green bonds when we can choose between both. As a result, we are more invested in these than the benchmark.

Even though we are not bound by any agreement to this process, we are reporting on a monthly basis on data that are relevant for each layer. We communicate on controversies, the ESG grade, temperatures and carbon figures, the percentage of green bonds and engagements done in the different funds.

Sustainability processes and data are not yet perfect and the road is still bumpy. However, we are convinced that the direction taken is the right one. By implementing this four-layer approach, we try to have a broad coverage of the increasing sustainability problematic. Our vision is not written in stone, we continue to monitor the evolution of the thematic and the regulation and we update the models accordingly.