



# **ESG INTEGRATION POLICY**

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## 1

## WHAT IS ESG INTEGRATION?

ESG Integration is part of the ESG Incorporation which is (next to Active Ownership) one of two building blocks of Ethias Sustainable and Responsible Investment Policy.

CONSIDERING ESG ISSUES WHEN BUILDING A PORTFOLIO (known as: ESG incorporation)			IMPROVING INVESTEES' ESG PERFORMANCE (known as: active ownership or stewardship)	
Integration	Screening	Thematic	Engagement	Proxy voting
ESG issues can be incorporated into existing investment practices using a combination of three approaches: integration, screening and thematic.			Investors can encourage the companies they are already invested in to improve their ESG risk management or develop more sustainable business practices	
Explicitly and systematically including ESG issues in investment analysis and decisions, to better manage risks and improve returns.	Applying filters to lists of potential investments to rule companies in or out of contention for investment, based on an investor's preferences, values or ethics	Seeking to combine attractive risk return profiles with an intention to contribute to a specific environmental or social outcome. Includes impact investing.	Discussing ESG issues with companies to improve their handling, including disclosure, of such issues. Can be done individually, or in collaboration with other investors.	Formally expressing approval or disapproval through voting on resolutions and proposing shareholder resolutions on specific ESG issues.

As stated in the table above, the Principles for Responsible Investment (PRI) define ESG integration as "the explicit and systematic inclusion of ESG issues in investment analysis and investment decisions."<sup>1</sup> Put another way, ESG integration is the analysis of all material factors in investment analysis and investment decisions, including environmental, social, and governance (ESG) factors.

**It means** that leading practitioners are:

- 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.

**It does not mean** that:

- 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 our investment process are necessary, and, finally and most importantly,
- portfolio returns are sacrificed to perform ESG integration techniques.

A full ESG Integration may lead to the following approach (source: UN-PRI for listed equity<sup>2</sup>):

<sup>1</sup> <https://www.unpri.org/investment-tools/what-is-esg-integration/3052.article>

<sup>2</sup> <https://www.unpri.org/download?ac=11174>



Eurosif<sup>3</sup> defines ESG integration as "the explicit inclusion by asset managers of ESG risks and opportunities into traditional financial analysis and investment decisions based on a systematic process and appropriate research sources". This type covers explicit consideration of ESG factors alongside financial factors in the mainstream analysis of investments. The integration process focuses on the potential impact of ESG issues on company financials (positive and negative), which in turn may affect the investment decision.

Environmental issues concern any aspect of a company's activity that affects the environment in a positive or negative manner. Examples include greenhouse gas emissions, renewable energy, energy efficiency, resource depletion, chemical pollution, waste management, water management, impact on biodiversity, etc.

Social issues vary from community-related aspects, such as the improvement of health and education, to workplace-related issues, including the adherence to human rights, non-discrimination and stakeholder engagement. Examples include labour standards (along the supply chain, child labour, forced labour), relations with local communities, talent management, controversial business practices (weapons, conflict zones), health standards, freedom of association, etc.

Governance issues concern the quality of a company's management, culture, risk profile and other characteristics. It includes the board accountability and their dedication towards, and strategic management of, social and environmental performance. Furthermore, it emphasises principles, such as transparent reporting and the realisation of management tasks in a manner that is essentially free of abuse and corruption. Examples include corporate governance issues (executive remuneration, shareholder rights, board structure), bribery, corruption, stakeholder dialogue, lobbying activities, etc."

Materiality is a key component of ESG integration. ESG integration involves integrating only the material ESG issues that are considered highly likely to affect corporate performance and investment performance:

- If ESG issues are considered material, an assessment of their impact is carried out.
- If ESG issues are analysed and found not to be material, an assessment is not carried out.

The assessment of materiality requires an understanding of the top ESG issues affecting a particular country or sector. Practitioners collate ESG information from various sources –company reports, filings and websites, the internet, ESG research providers, and so on– to determine the most material ESG issues per company or sector. They then refer to and assess the list of material ESG issues for each investment, periodically reviewing the list for changes in material ESG issues.

<sup>3</sup> <https://www.eurosif.org/responsible-investment-strategies/>

The Sustainable Finance Disclosure Regulation (SFDR) is a European regulation impacting the financial industry with the objective to improve transparency of non-financial information. The regulation requires to classify financial products according to their level of sustainability ambition based on the following typology:

- Article 6 is the “default” classification, where financial products may integrate sustainability risks into the investment process, but do not promote any environmental or social characteristics and do not have sustainable investment as its objective;
- Article 8 is the classification of financial products promoting environmental or social characteristics;
- Article 9 is the classification of financial products that have sustainable investment as their objective.

The SFDR became applicable on March 10<sup>th</sup> 2021 (Level 1). Since January 1<sup>st</sup> 2023, the Regulatory Technical Standards (RTS) of SFDR apply (Level 2), requiring financial market participants (FMPs) to publish annexes to the periodic report and to the pre-contractual disclosures (including EU Taxonomy information), as well as publish sustainability-related disclosures on its website.

## 2

## THE LINK WITH TOWARDS SUSTAINABILITY (TS) LABEL

The label TS considers ESG Integration as a mandatory ESG strategy for any sustainable product. This ESG integration policy therefore aligns with Ethias's ambition to align with the TS Label requirements, as presented in the Quality Standard<sup>4</sup>.

## 3

## THE SCOPE OF THE POLICY

As ESG Integration is a process to apply with regards to investment decisions, all asset classes of Ethias investment portfolio are in the scope of the Policy.

As a reminder, the different asset classes are:

- Sovereign Bonds,
- Listed Equities,
- Corporates Bonds,
- Real Estate,
- Mortgages,
- Private Debt and Private Equity (including via Alternative Funds),
- Cash and financial products used for Treasury,
- “Traditional” Investment Funds (UCITS, ...),
- Participations.

## 4

## DETAILED POLICY PER ASSET CLASS

For all asset classes, Ethias aims to apply the **double materiality principle** in its ESG Integration process and for all asset classes, identifying:

- i. the likely impacts of sustainability risks on the return of the product
- ii. the risk of principal adverse impacts on sustainability factors (ESG) of each investment.

<sup>4</sup> <https://towardssustainability.be/the-label/quality-standard>

## 4.1 SOVEREIGN BONDS

This asset class also includes Supra & regional (sub-country) entities like regions, community, county, city, etc. For the regional bonds, the ESG integration policy considers the country to which the sub-national bond belongs to.

Ethias uses information obtained directly from the issuer, data sourced from ESG data providers or rating agencies (e.g., MSCI) and publicly available data.

On the Sovereign Bonds asset class, Ethias aims to:

- obtain a weighted average Government Rating of A for the investment portfolio.
- take into consideration the following principal adverse impacts:

GHG intensity of investee countries in the qualitative internal assessment of investments –known as **PAI 15 under SFDR**–Number of investee countries subject to social violations (absolute number and relative number divided by all investee countries), as referred to in international treaties and conventions, United Nations principles and, where applicable, national law –known as **PAI 16 under SFDR**–. This one should be **equal to 0**.

## 4.2 LISTED EQUITIES AND CORPORATE BONDS

Ethias uses information obtained directly from the issuer<sup>5</sup>, data sourced from ESG data providers, rating agencies (e.g., MSCI) and publicly available data.

For the listed equities and corporate bonds, the investment manager aims to:

- obtain a weighted average ESG Score of A for the investment portfolio. The IVA company rating takes into account the materiality of ESG factor as it accounts for companies' exposure to industry-material ESG risks and their ability to manage those risks relative to peers.
- take into consideration the principal adverse impacts, an especially:
  - GHG emissions. This is the sum of portfolio companies' Total GHG Emissions (Scopes 1, 2 and 3) weighted by the portfolio's value of investment in a company and by the company's most recently available enterprise value including cash –known as **PAI 1 under SFDR**–. Fund managers have the objective to decarbonize Ethias's global portfolio by 2050, as a consequence PAI 1 is included in the qualitative internal assessment by considering whether the company has set GHG emissions targets in line with SBTi.
  - Carbon footprint. This is the sum of portfolio companies' Total GHG Emissions (Scopes 1, 2 and 3) weighted by the portfolio's value of investment in a company and by the company's most recently available enterprise value including cash, adjusted to show the emissions associated with 1 million EUR invested in the portfolio –known as **PAI 2 under SFDR**–. Fund managers have the objective to decarbonize Ethias's global portfolio by 2050, as a consequence PAI 2 is included in the qualitative internal assessment by considering whether the company has set GHG emissions targets in line with SBTi.
  - GHG Intensity of investee companies. This is the portfolio weighted average of companies' Total GHG Emissions Intensity per EUR million Sales (t/EUR million sales). Portfolio weights are normalized when corresponding data coverage is less than 100%. This PAI is known as **PAI 3 under SFDR**. Fund managers have the objective to decarbonize Ethias's global portfolio by 2050, as a consequence PAI 3 is included in the qualitative internal assessment by considering whether the company has set GHG emissions targets in line with SBTi.

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<sup>5</sup> In case of no coverage of the issuer by an ESG data provider, the approach for Private Debt & Private Equity will apply.

- Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises. This is known as PAI 10 under SFDR-. The consideration of PAI 10 is further detailed in the Exclusion Policy.
- Unadjusted gender pay gap in the qualitative internal assessment of investments. This is the portfolio weighted average of company Gender Pay Gap ratio. This PAI is known as PAI 12 under SFDR.
- Board gender diversity in the qualitative internal assessment of investments. This is the portfolio weighted average of company Female Directors Percentage. This PAI is known as PAI 13 under SFDR.
- Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons). This is the sum of companies' weight in portfolio that have exposure to controversial weapons (landmines, cluster munitions, chemical weapons and biological weapons). This PAI is known as PAI 14 under SFDR. The consideration of PAI 14 is further detailed in the Exclusion Policy, which fully excludes companies deriving revenues from controversial weapons.

### 4.3 REAL ESTATE

Ethias uses information obtained directly from the issuer, data sourced from ESG data providers or rating agencies (e.g., MSCI) and publicly available data.

Most of the time, the ESG information available is much more limited for Real Estate investments in comparison with Listed Equity or Corporate Bonds.

This is the reason why Ethias has developed an internal methodology (or has chosen to obtain ESG oriented certifications such as BREEAM, WELL, DGNB, Energy Performance Certificate (EPC), ...) for new acquisitions and owned buildings based on the Real Estate asset class (offices, healthcare, logistics, residential, alternative and other asset classes).

#### New acquisitions

The information required to assess the below is requested via specific due diligence questionnaires sent out to the seller:

- For offices, logistics, alternative and other buildings, the availability and level of a building's BREEAM and/or WELL (or equivalent) certificates are considered in the investment process.
- For residential and healthcare buildings, when available, the Energy Performance Certificate (EPC) is considered in the investment process if BREEAM or WELL certifications are not available.

Furthermore, for all new acquisitions Ethias takes into consideration the following principal adverse impacts:

- Exposure to fossil fuels through real estate assets. This is the share of investments in real estate assets involved in the extraction, storage, transport or manufacture of fossil fuel -known as **PAI 17 under SFDR-**.
- Exposure to energy-inefficient real estate assets. This is the share of investments in energy-inefficient real estate assets -known as **PAI 18 under SFDR-**. Ethias follows the definition as stated in the EU regulation for energy-inefficient real estate assets:
  - Assets built before 31/12/2020, an EPC of C or below
  - Assets built after 31/12/2020, an PED below NZEB in Directive 2010/31/EU

#### Owned buildings (current portfolio)

For the current Real Estate portfolio, Ethias takes into consideration the following principal adverse impacts:

- Exposure to fossil fuels through real estate assets. This is the share of investments in real estate assets involved in the extraction, storage, transport or manufacture of fossil fuel -known as **PAI 17 under SFDR-**.
- Exposure to energy-inefficient real estate assets. This is the share of investments in energy-inefficient real estate assets -known as **PAI 18 under SFDR-**. Ethias follows the definition as stated in the EU regulation for energy-inefficient real estate assets:
  - Assets built before 31/12/2020, an EPC of C or below
  - Assets built after 31/12/2020, an PED below NZEB in Directive 2010/31/EU

Owned buildings of our current portfolio which do not fulfil the criteria displayed here above will either:

- Go through a capex plan in order to achieve higher ESG standards
- Be progressively divested and sold to third parties which will redevelop the building to more recent, and hence higher ESG standards.

#### 4.4 MORTGAGES

Ethias uses information obtained directly from the issuer, data sourced from ESG data providers or rating agencies (e.g., MSCI) and publicly available data.

Most of the time, the ESG information available is much more limited for Mortgages in comparison with Listed Equity or Corporate Bonds and therefore an ESG due diligence before the investment is key.

As for Real Estate assets, the information required to assess the below is requested via the due diligence questionnaires:

- For office, commercial, logistics, alternative and other buildings, the availability and level of a building's BREEAM and/or WELL (or equivalent) certificates are considered in the investment process.
- For residential and healthcare/nursing homes buildings, when available, the Energy Performance Certificate (EPC) is considered in the investment process if BREEAM or WELL certifications are not available.

On the Mortgages, Ethias takes into consideration the following principal adverse impacts (through collecting EPC attached to the financed building):

- Exposure to fossil fuels through real estate assets. This is the share of investments in real estate assets involved in the extraction, storage, transport or manufacture of fossil fuel -known as **PAI 17 under SFDR-**.
- Exposure to energy-inefficient real estate assets. This is the share of investments in energy-inefficient real estate assets -known as **PAI 18 under SFDR-**.

#### 4.5 PRIVATE DEBT AND PRIVATE EQUITY (INCLUDING PARTICIPATIONS)

Ethias uses information obtained directly from the issuer, data sourced from ESG data providers or rating agencies (e.g., MSCI) and publicly available data.

Most of the time, the ESG information available is much more limited in Private Debt and Private Equity in comparison with Listed Equity or Corporate Bonds.

This is the reason why Ethias has developed an internal methodology (based on a questionnaire sent out to investee companies or projects) to collect data on key (sustainable) issues and that needs to be filled out before any investment.

The ESG data is then considered in the qualitative assessment of the investment.

If the investment in Private Equity or Private Debt is done indirectly via a Fund (or any similar structure), the ESG Integration should be part of the due diligence questionnaire.

On the Private Debt and Private Equity, Ethias takes the same approach to the consideration of principal adverse impacts as Listed Equities & Corporate Bonds based on the ESG data collected in the due diligence questionnaire.

#### **4.6 CASH AND FINANCIAL PRODUCTS USED FOR TREASURY**

Cash is not subject to ESG Integration due to its nature. However, commercial papers and monetary funds are subject to an ESG analysis. Commercial papers follow the process described in the section of sovereign bonds and equities/corporate bonds and must also comply with Ethias's exclusion policy, depending on the type of issuer. The ESG integration process of Monetary funds follows the approach described in section 4.8 below (Traditional Investment Funds).

#### **4.7 "TRADITIONAL" INVESTMENT FUNDS (UCITS, ...)**

Ethias uses information obtained directly from the asset manager or via the look-through approach, from the issuer, data sourced from ESG data providers or rating agencies (e.g., MSCI) and publicly available data.

The ESG Integration for Funds is done via the due diligence process and the ESG part of the due diligence questionnaire completed for each Fund.

The ESG characteristics of funds (e.g., SFDR classification, labels, Morningstar Sustainability Rating) are then considered in the qualitative assessment of the investment.

On the "Traditional Investment Funds" asset class, Ethias aims to reach results which are aligned with positions taken in Listed Equities & Corporate Bonds with regards to ESG Rating and PAI analysed.

To measure it, obtaining information of positions held by the Fund must be agreed with the Fund Manager and required ahead of any investment.

# FOR MORE INFORMATION

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