ESG Methodology

Lupus alpha Sustainable Convertible Bonds

Target

Lupus alpha's corporate culture as an independent, owner-managed / partnership-based asset manager is clearly focused on sustainability. With the Lupus alpha Sustainable Convertible Bonds, we are responding to the growing demand for investment strategies with a sustainable focus. With this fund, investors who put emphasis on sustainable investments, benefit from the advantages of the convertible bond asset class. Thanks to their hybrid character of bonds and equities, this asset class offers convexity, which means a stronger participation in rising than in falling equity markets, a low interest rate sensitivity and advantages in diversification, while at the same time taking extensive ESG criteria into account.

Responsible investing makes an important contribution to making capital investments sustainable. As an investor with a fiduciary mandate from our clients, we therefore want to make our contribution and only invest in companies that pay sufficient attention to certain sustainability criteria.

In the Lupus alpha Sustainable Convertible Bonds strategy, the responsible portfolio managers conduct a large number of company meetings as part of the fundamental investment process. Sustainability topics, especially governance, are an integral part of the company analysis.

We review the appropriateness of our ESG methodology in an annual review process. Changes to the methodology are documented internally.

Methodology

All investable companies are classified according to environmental, social, ethical and governance criteria. The analysis includes, among others, social standards, environmental management, product portfolio and corporate governance. As part of a comprehensive negative screening process, securities that do not meet certain minimum standards are excluded. These apply to all securities[1] in the portfolio:

Environment:

- Violations of international biodiversity conventions and poor response/appraisal of the company
- Revenue from the mining of thermal coal > 5%
- Revenue from energy production from thermal coal > 0%
- Production and distribution of nuclear electricity (without tolerance limit)
- Revenue from products and services for the nuclear industry > 3%
- Revenue from uranium mining > 0%
- Revenue from oil & gas power generation (conventional methods) > 0%
- Revenue from products and services for energy generation from oil & gas (conventional methods) > 5%

[1] If issuer and underlying equity do not match, both are analysed in the negative screening process.

- Exploration of oil or gas by fracking or from oil sands (without tolerance limit)
- Production of GMOs[2] (without tolerance limit), e.g. for human consumption or for industrial use

Social:

- Violations of the UN Global Compact
- Violations of international human rights conventions and inadequate response/appraisal of the company
- Violations of ILO core labour standards in the company and the supply chain and inadequate response/appraisal of the company

Governance

- Very severe controversies
- Violations of international corruption conventions and poor response/appraisal of the company

Ethics

- Revenue from production & distribution of military goods > 5%
- Revenue from production of alcohol > 5%
- Revenue from distribution of alcohol > 33 %
- Revenue from production of tobacco > 5%
- Revenue from distribution of tobacco > 33 %
- Animal testing for non-medical purposes (without tolerance limit)
- Commercial/industrial (intensive) animal farming for the purpose of food production or fur farming
- Revenue through production, services and supply of pornographic content > 3%
- Businesses related to abortion
- Revenue from gambling > 5%
- Production/distribution/services of cluster munitions, anti-personnel mines and other controversial weapons
- Production of nuclear weapons or systems used to transport them, etc.

All companies that do not violate any of the above exclusion criteria are further analysed on the basis of positive criteria. Only companies that stand up a dedicated and comprehensive fundamental analysis and either make a significant contribution to the Sustainable Development Goals (SDGs) (> 10%) or have a positive contribution to the SDGs with a minimum ESG rating of BB are selected for the portfolio. In addition, companies with an ESG score better than 4.2 and which are not involved in any “major controversies” are eligible for investment. Furthermore, investments can be made in companies that have an ESG rating of at least A and no “very severe controversies”.

[2] GMO = genetically modified organism

Consideration of Principal Adverse Impacts on Sustainability Factors (PAIs)

In addition to the aforementioned criteria the following principal adverse impacts on sustainability factors are material and binding for the entire NAV:

Environment:

- **Carbon footprint & carbon intensity**
- Activities negatively affecting **biodiversity**-sensitive areas

Social:

- Violations of **UN Global Compat** principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises
- Exposure to **controversial weapons** (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)

Governance:

- **Board gender diversity** (no female board members)
- Cases of insufficient action taken to address **breaches of standards of anti-corruption and anti-bribery**

If an investee company has principal adverse impacts on the sustainability factors mentioned, this generally leads to exclusion. However, in order to offer companies the opportunity to improve on certain factors over time ("transition") we start an engagement process with companies concerning

- **Carbon footprint & carbon intensity** (if both metrics are in the bottom decile of corresponding IVA-industry)

or

- Insufficient **Board gender diversity** (no female board members).

We can only invest in the investee company if there are comprehensible plans for improving on these principal adverse impacts or if plans can be agreed on with the company in a direct dialogue. For these companies, we document the plans as well as the desired and implemented changes. If the desired targets are not met or if the company does not show the agreed willingness towards change, the position is sold as a last resort after several escalation levels.

The engagement process described above can only ever be applied to CO2-related PAIs or to board gender diversity. If an investee company requires engagement in both areas mentioned, we refrain from making an investment.

The aforementioned revenue limits, norm-based violations / controversies, ESG scores & ratings, SDG contributions and PAIs are analyzed and checked with data of our external research provider MSCI. Companies for which MSCI has not previously provided analysis are re-viewed internally. Information provided by MSCI is also reviewed internally, as portfolio management usually has direct access to the management of the companies under review and can critically review this information.

To determine the ESG score, MSCI identifies key ESG issues where companies in this industry are currently achieving major environmental or social externalities. The three pillars E, S and G are divided into ten so-called "themes" and a total of 37 "key issues". To obtain a final score, the weighted averages of the key issue scores are aggregated and the companies' scores are normalised by industry.

With the adoption of the Sustainable Development Goals by the United Nations, a global agenda for sustainable development was formulated. A total of 17 Sustainable Development Goals were identified to ensure sustainable development. With the help of the MSCI ESG Sustainable Impact Metrics, companies can be identified that have answers to the global challenges through their products and services and actively work for innovative solutions and a sustainable way of doing business. The tool is based on the following five key impact areas derived from the United Nations' 17 Sustainable Development Goals: Basic Needs, Empowerment, Climate Change, Natural Capital and Governance.

Developer of the strategy, users and data used

The strategy / methodology described above was developed by Lupus alpha. The portfolio management team is responsible for security selection in the global convertible bond segment and compliance with ESG criteria. As part of the detailed ESG analysis, external specialised data providers (in particular MSCI) are also used for sustainability research:

https://www.msci.com/msci-esg-manager

Exemptions & Sales Discipline

In justified and documented individual cases, there may be exceptions to the methodology described above. However, these are to be avoided by the portfolio management.

If there is a change at an invested company which means that the criteria / thresholds described above are no longer met in the medium term, the corresponding convertible bond will be sold, but at the latest within three months of portfolio management becoming aware of this.

Further information on the topic of sustainability at Lupus alpha can be found at https://www.lupusalpha.com/esg/.

Date	Version	Description
25.10.2021	1.0	Start of versioning
01.08.2022	1.01	Inclusion of PAIs; addition of a footnote (‘GMOs’); editorial changes
31.12.2022	1.02	Editorial changes
11.10.2023	1.03	Adding of carbon intensity and possibility of engagement in PAI consideration

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