PAI Methodology

(Principal Adverse Impacts)

BLI – Banque de Luxembourg Investments

Contents

1 Purpose of this document

This document summarises the methodology deployed by BLI – Banque de Luxembourg Investments (‘BLI’) for taking account of the principal adverse impacts (PAI)

i. for the following asset classes:
   - equities
   - bonds from private issuers
   - bonds from sovereign issuers
   - investment funds, and

ii. as regards individual securities held by the Products specified in section 2 (the ‘Products’), as regards the Products themselves, and as regards BLI itself (the ‘PAI Methodology’).

This document forms part of the provisions specified in the contractual and/or pre-contractual documents governing the Products. In particular, it is intended to provide additional, non-contractual information to the provisions specified in the contractual and/or pre-contractual documents governing the Products. This document is intended for any person investing in a Product or interested in investing in a Product who wishes to know more about the PAI Methodology applied by BLI.

As the PAI Methodology may evolve over time due to various factors (e.g. changes in the regulatory framework, availability of relevant data, etc.), this document may be amended without this necessarily resulting in changes to the contractual and/or pre-contractual documents governing the Products.

Any person investing in a Product or interested in investing in a Product is therefore invited to consult BLI’s website to check the current version of the PAI Methodology in case this might have a bearing on any decision by the person in question concerning an investment in the Product.

The purpose of this document is not the advertisement or promotion of any financial products of a collective investment undertaking nature. This document is not therefore an advertising communication within the meaning of Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014.

2 Scope of application

The PAI Methodology summarised in this document applies to the following products:

- investment funds (and their sub-funds) (i) whose portfolio is managed by BLI (thus excluding investment funds (and their sub-funds) for which BLI acts as management company or alternative investment fund manager but whose portfolio management is entrusted to a third party[1]) and (ii) whose contractual and/or pre-contractual documents indicate that the PAI Methodology applies; and

- any other product (including discretionary management mandates) (i) for the part of the portfolio managed by BLI and (ii) for which the contractual and/or pre-contractual documents indicate that the PAI Methodology applies.

[1] For these products, the PAI Methodology established by the delegated manager applies.

3 Regulatory Framework

PAI is a key concept in the European Sustainable Finance Disclosure Regulation (SFDR). It is one of the principal elements of the European Commission's action plan on sustainable finance, which aims to provide greater transparency on the sustainability of financial products and is intended to guide private investments towards sustainable investments. In this context and within the meaning of the SFDR[2], PAIs are defined as “negative effects, material or likely to be material on sustainability factors that are caused by, aggravated by or directly linked to investment decisions and advice performed by the legal entity”.

PAIs can therefore be considered as the negative environmental, social or governance consequences of economic activities in which investments are made.

4 Purpose and scope of the PAI Methodology

The purpose of the PAI Methodology is to describe the analysis and prioritisation of the principal adverse impacts defined in the SFDR framework, so that the negative sustainability impacts of the selected companies' activities can be taken into account.

It considers PAIs at three levels:

- at the level of individual securities with sustainability objectives to show that they do not harm other sustainability objectives (‘do no significant harm’ or ‘DNSH’)
- at the level of the Products taking PAIs into account
- at the level of BLI's declaration of the principal adverse impacts (‘PAI Statement’) pursuant to Article 4 of the SFDR concerning the disclosure of information on the consideration or otherwise of PAIs as regards sustainability as a result of its investment decisions.

[2] Regulation. 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

5 Definitions

Controversies	A controversy indicates a company's involvement in incidents related to extra-financial and/or financial elements.
Exclusion	An exclusion is the act of prohibiting a portfolio from holding the securities of a company due to business activities deemed unethical, harmful to society or in violation of laws or regulations.
Governance	The set of rules, practices and processes by which a company is managed (governed), the management of which is supervised.
UN Sustainable Development Goals (SDGs)	The 17 Sustainable Development Goals provide a roadmap to a better and more sustainable future for everyone. They address global challenges including poverty, inequality, climate, environmental degradation, prosperity, peace and justice.
UN Global Compact	A United Nations initiative aimed at encouraging companies around the world to adopt a socially responsible attitude by committing to integrate and promote a number of principles relating to human rights, international labour standards, the environment and the fight against corruption.
UN Principles for Responsible Investment (UN PRI)	The six Principles provide a range of possible actions to incorporate ESG concerns into investment practices.

6 PAI definition

In order to identify and assess the Principal Adverse Impacts affecting sustainability, the European Commission has determined 64 PAI indicators classified by investment category: private issuers (equities and bonds), sovereign issuers and real estate.

The indicators are detailed in three tables in Annex 1 of the Delegated Regulation (EU) 2022/1288[3] (the 'Delegated Regulation').

- Table 1 lists the indicators to be taken into account by producers of investment products (14 for private issuers, 2 for sovereign/parastatal issuers and 2 for real estate investments).
- Table 2 lists additional environmental indicators (16 for private issuers, 1 for sovereign/parastatal issuers and 5 for real estate investments).
- Table 3 lists additional social indicators (17 for private issuers, 7 for sovereign/parastatal issuers and 0 for real estate investments).

Producers of investment products are obliged to take a position on the indicators listed in Table 1. They must also select one additional environmental indicator and one additional social

[3] Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with technical regulatory standards detailing the content and presentation of the information relating to the principle of 'not causing material harm' and specifying the content, methods and presentation for information on sustainability indicators and negative sustainability impacts, as well as the content and presentation of information on the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports.

indicator per investment category (private issuers, sovereigns and real estate investments) from the 46 additional indicators.

7 DNSH approach: PAIs considered at the level of individual investments.

Article 2 (17) of the SFDR defines a general framework for sustainable investments. The investment considered sustainable must be:

- in an economic activity that contributes to an environmental or social objective, enabling a sustainability objective to be achieved
- provided that:
  - the investment does not cause significant harm to any other sustainability objective[4] (DNSH); and that
  - the companies in which the investments are made apply good governance practices.

The DNSH dimension is thus an integral part of the definition of a sustainable asset under the SFDR.

BLI refers to the PAIs defined in Annex 1 of the Delegated Regulation to action the DNSH concept at the level of sustainable assets.

In addition, BLI has chosen an environmental and social indicator for the private and sovereign issuer investments listed in Tables 2 and 3 of Annex 1 of the Delegated Regulation.

The methodology for taking PAIs into account at the level of individual investments for the different asset classes is described in the following chapters:

- equities and private issuer bonds (chapter 7.1.)
- bonds from sovereign issuers (chapter 7.2)
- investment funds - multi-management (chapter 7.3.).

7.1 Analysis and integration of PAIs (equities and private issuer bonds)

Although most of the indicators to be taken into account and published are defined by the regulation, the analysis methodology is left to the discretion of the management companies. The DNSH concept requires the definition of a framework to make it possible to decide when an issuer's reported indicators are significantly harmful to a sustainability objective.

The indicators listed in Annex 1 of the Delegated Regulation can be grouped into numerical indicators and binary indicators.

In its analysis of the 14 mandatory PAIs applicable to private issuers, BLI distinguishes between 9 numerical indicators and 5 binary indicators, the criteria and methods of analysis of which will also differ depending on their category. BLI has also selected an additional numerical indicator and an additional binary indicator.

[4] The DNSH concept is intended to ensure that the pursuit of one sustainability objective does not undermine another sustainability objective. DNSH does not therefore apply to PAIs linked to an issuer's sustainability goal. Argued and documented research will make it possible to conclude that the PAI in question aligns with its sustainability objective.

Environmental indicators	**Type of indicator**
Greenhouse gases (GHG)	
1. GHG emissions	numerical
2. Carbon footprint	numerical
3. GHG intensity	numerical
4. Exposure to companies active in the fossil fuel sector	binary
5. Share of non-renewable energy consumption and production	numerical
6. Energy consumption intensity by sector with high climate impact	numerical
Biodiversity	
7. Activities with negative impact on biodiversity-sensitive areas	binary
Water	
8. Discharges into water	numerical
Waste	
9. Ratio of hazardous waste and radioactive waste	numerical
Social indicators	
Social and personnel issues	
10. Violations of the principles of the UN Global Compact and the OECD Guidelines for multinational companies	binary
11. Lack of compliance processes and mechanisms to monitor compliance with the above principles	binary
12. Unadjusted gender pay gap	numerical
13. Gender diversity in governance bodies	numerical
14. Exposure to controversial weapons	binary
Supplementary indicators	
15. Investments in companies that have not taken initiatives to reduce their carbon emissions	binary
16. Excessive compensation ratio	numerical

7.1.1 Treatment of numerical indicators

General framework for numerical indicators

For each of the mandatory and supplementary indicators, BLI has defined thresholds at which there is considered to be 'significant harm' to a sustainability objective.

In order to treat all companies fairly, each is compared with its peers in the same GICS sector[5] and geographic region[6]. BLI sets the DNSH threshold for each numerical indicator at the limit of the 5th quintile of the values of all companies in the same sector and geographic region.

An issuer will thus have passed the DNSH test of a PAI if it is among the top 80% of issuers in its sector and geographic region.

DNSH Greenhouse Gas Assessment

PAIs 1, 2 and 3[7] in Annex 1 of the Delegated Regulation refer to greenhouse gas emissions.

PAI 1: 4 indicators[8]

- Scope 1 GHG emissions
- Scope 2 GHG emissions
- Scope 3 GHG emissions
- Scope 1+2+3 GHG emissions

PAI 2: Carbon footprint

PAI 3: Carbon intensity

Taken individually, the information content of each of these indicators is limited. Large companies will have high absolute GHG emissions that should be considered in relation to their size and turnover. Conversely, small companies may have low absolute emissions but high intensities.

Given these considerations, BLI has decided to combine the three PAIs to assess the DNSH status of GHG emissions. To complement this assessment model, the additional binary PAI 'Investments in companies that have not taken initiatives to reduce their carbon emissions' is also considered.

BLI applies the methodology described in the chapter 7.1.1 to evaluate the various quantitative indicators used in the GHG emissions evaluation model: An issuer will thus have passed the test of an Indicator if it is among the top 80% of issuers in its sector and geographic region.

The additional (binary) PAI is based on the issuer's status under the Science-Based Target initiative ('SBTi') and provides additional information for deciding whether the issuer in question passes the DNSH greenhouse gas assessment.

BLI has adopted the following scoring model to assess the GHG DNSH status

PAI	Indicator	Score
GHG emissions	Scope 1 GHG emissions	1

[5] The Global Industry Classification Standard (GICS), created and maintained by Morgan Stanley (MSCI) and Standard & Poor's (S&P), is one of the two main industry classifications used in the financial world.

[6] Regions included: Europe, North America, Japan, Emerging Markets and Global.

[7] 1: GHG emission; 2: Carbon footprint; 3: GHG intensity.

[8] The calculation of greenhouse gas emissions is categorised into 3 scopes: Scope 1: direct greenhouse gas emissions; Scope 2: indirect energy-related emissions; Scope 3: other indirect emissions.

	Scope 2 GHG emissions	1
	Scope 3 GHG emissions	0.5[9]
	Scope 1+2+3 GHG emissions	0.5
Carbon footprint	Carbon footprint 1+2	1
Carbon intensity	Carbon footprint 1+2	1
	Carbon footprint 1+2+3	0.5
GHG reduction targets	SBTi 'Approved'	1
	SBTi 'Committed'	0.5.[10]

In order to pass the GHG DNSH test, an issuer must obtain a minimum score of 3.5.

In the case of an issuer having reached a score of 3 points, an analysis of the trend in absolute GHG emissions (Scope 1+2) over the last 5 years is carried out. If this trend is downward, the issuer will be awarded an additional 0.5 points.

Scoring and DNSH test for numerical indicators

In order to decide whether an issuer has passed the DNSH test for all the numerical indicators, BLI uses a scoring model:

- for each successful numerical PAI, the issuer is awarded one point
- an issuer passing the GHG DNSH test is awarded 4 points[11]
- an issuer achieving a minimum score of 7 out of 11 points passes the DNSH test for the numerical indicators.

7.1.2 Treatment of binary indicators

The five mandatory binary indicators are examined individually. The information reported by the binary PAIs reflects basic concepts that every company will be required to meet in order to claim no significant harm to any other sustainability objective.

Exposure to companies active in the fossil fuel sector

BLI excludes the following from its investment universe:

- companies listed on the Global Coal Exit List ('GCEL') and
- companies listed on the Global Oil & Gas Exit List ('GOGEL') that generate more than 25% of their revenues from the production of unconventional hydrocarbons.

For sustainable assets, the framework of exclusions in the area of fossil fuels is further strengthened (see BLI Sustainable Assets Methodology, link).

Activities with negative impact on biodiversity-sensitive areas

Companies involved in severe and very severe biodiversity-related controversies are excluded from BLI's sustainable asset investment universe[12].

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[9] Due to imperfections in the collection of Scope 3 data, BLI has decided to weight these data points with a score of 0.5.

[10] 'Committed' status corresponds to a company's intention to commit to the SBTi model but has not been confirmed by the initiator. Once confirmed, the status changes to 'approved'. The scoring takes into account the difference in quality of the two statuses.

[11] The GHG DNSH evaluation model comprises 4 PAIs.

[12] Assessment according to the MSCI ESG model

Violations of the principles of the UN Global Compact and the OECD Guidelines for multinational companies

BLI uses two indicators to assess an issuer's compliance with this PAI:

- UN Global Compact Compliance and
- Human Rights Compliance.

These indicators are derived from the MSCI ESG database and provide a view of the status of an issuer's compliance with international standards. Only issuers that have successfully passed these two indicators (status of 'pass' in the database) pass the DNSH test.

Lack of compliance processes and mechanisms to monitor compliance with the above principles

BLI considers that not having formal policies in place to ensure compliance with the above-mentioned international standards is not a sufficient condition for determining whether an issuer is generating 'significant harm' to a sustainability objective. For this reason, BLI lists companies that do not have policies in this area without defining a specific decision rule.

Exposure to controversial weapons

BLI excludes controversial weapons such as landmines, cluster munitions, depleted uranium, white phosphorous munitions, and chemical and biological weapons from its investment universe.

7.1.3 Special case: Impact bonds

BLI has developed a methodology for analysing impact bonds (green, social, sustainable bonds, etc.) and categorising the use of the funds granted (financing environmental and/or social projects).

If an issuer fails a PAI when the project funded by the impact bond directly targets the PAI in question, BLI considers the PAI in question as a pass for the issue.

7.1.4 Treatment of missing data

The relevance of a numerical or binary indicator is defined by a minimum sector/region coverage threshold of 40%. If this threshold is not met, the PAI indicator will not be considered relevant for the company – regardless of the value achieved. If a company does not publish data on an indicator but the 'market' coverage is above 40%, then the DNSH test on the relevant PAI will be considered a fail.

7.1.5 Decision rules

A company is considered not to be significantly harmful to a sustainability objective if it passes the DNSH test for the numerical indicators and the DNSH test for the binary indicators.

7.2 Bonds from sovereign issuers

BLI's framework for sovereign and parastatal issuers echoes that applied to private issuers. The DNSH concept also requires sovereign issuers to decide when an issuer's reported indicators are significantly harmful to a sustainability objective.

Annex 1 of the Delegated Regulation defines two indicators to be analysed for sovereign issuers. BLI has selected two additional binary indicators.

Mandatory indicators	Type of indicator
1. GHG emissions by GDP	numerical
2. EU Social Violation	binary
Supplementary indicators	
3. Freedom of expression	numerical
4. EU Green Bond Standard[13]	binary

7.2.1 Methodology used for numerical indicators

BLI has defined the thresholds for the numerical indicator at which it is considered to have reached 'significant harm' status.

In order to treat sovereign issuers fairly, each is compared to its peers (developed countries/emerging countries). BLI sets the DNSH threshold for the numerical indicator at the 5th quintile of peer values. An issuer will thus have passed the DNSH test of a PAI if it is among the top 80% of issuers in its category.

The methodology used for the special case of impact bonds from sovereign issuers is identical to that used for impact bonds from private issuers (see chapter 7.1.3.).

7.2.2 Methodology used for binary indicators

Issuers involved in violations of social rights and/or freedom of expression are excluded from the universe of sustainable assets.

7.2.3 Treatment of missing data

The methodology used for the treatment of missing data for sovereign issuers is identical to that used for private issuers (see chapter 7.1.4.).

7.2.4 Decision rules

The decision rules used in relation to sovereign issuers are identical to those implemented for private issuers (see chapter 7.1.5.).

7.3 Target investment funds

In cases of investment in target investment funds, BLI refers to the definition of DNSH applied within the target investment funds, as described in the Sustainable Assets Methodology document (link).

8 Consideration of PAIs at portfolio level

Although the SFDR requires a description of how PAIs are considered at portfolio level, it does not require the DNSH concept to be taken into account. BLI interprets the purpose of considering PAIs at portfolio level as enabling portfolio managers to make informed investment decisions.

BLI's tools in this area allow fund managers to:

- know the status of PAIs at the portfolio level

[13] BLI has decided to apply this indicator only after the regulation on the Green Bond Standard comes into force. No date has yet been set for the regulation to come into force.

- simulate the state of the PAIs in the event of changes in the portfolio.

In order to judge the status of the portfolios' PAIs, BLI uses the DNSH thresholds described above (according to sector and region). Because the DNSH thresholds differ by region and sector, data have to be normalised to make them comparable.

The calculations performed are:

- determination of the 'deviation from the DNSH threshold' (in % of the DNSH threshold)[14]
- aggregation of the values in proportion to the weighting of the securities in the portfolio.

The data are aggregated in a dashboard that shows the status of the PAIs at portfolio level and allows simulations to be performed for the portfolio if new positions are acquired or reallocations made.

This approach is implemented for any type of portfolio for which BLI has declared in the appendices to the prospectus that PAIs are taken into account.

9 Monitoring PAIs at the BLI entity level

Since BLI's investment strategies are managed according to a bottom-up approach, the aggregate characteristics of the portfolios are the result of individual management decisions. Accordingly, the definition of a binding framework for PAIs at the entity level is not relevant. Instead, the methodology adopted consists of aggregating the data from the portfolios of the Products concerned by the regulation (SFDR Articles 8 and 9). BLI ensures that the status of the PAIs is monitored through their systematic inclusion in the Products classified under SFDR Articles 8 and 9 where the portfolio is managed by BLI.

In the case of investment funds for which BLI acts as a management company or as an alternative investment fund manager but whose portfolio management is entrusted to a third party, the values of the PAIs are reported by the delegated managers.

At the management company level, the PAI data will be integrated into the Portfolio Management System (PMS) and monitored on the basis of:

- quarterly overviews
- reporting at the entity level in two sections, namely for portfolios managed by BLI and for those for which BLI is the delegated management company.

10 Updating the PAI methodology

This document will be amended to reflect eventual changes in the methodology for taking into account principal adverse impacts, organisational changes, or legislative and regulatory developments concerning risk management. Irrespective of these particular circumstances, the PAI methodology will be reviewed at least annually.

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[14] For example, a company with a PAI value of 5 versus a DNSH threshold of 10 has a deviation from the DNSH threshold of 50% whereas a company with a PAI value of 15 has a deviation from the DNSH threshold of 150%.

Legal information

This document has been written by BLI and describes the PAI methodology applied by BLI for the funds that fall within its scope. This document is not an advertising communication within the meaning of Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014. The economic, financial and non-financial information contained in this publication is provided for information purposes only based on data known at the date of publication. This information does not constitute investment advice or a recommendation or inducement to invest, nor should it be construed under any circumstances as legal or tax advice. No guarantee is given as to the accuracy, reliability, recency or completeness of this information.

BLI draws the attention of the recipient of this document to the need to apply the utmost caution when using any information relating to a fund, in particular the fact that **past performance is no guarantee of the future performance of that fund**.

Generally, BLI does not assume any responsibility for the future returns of these funds and shall not be liable for any decision that an investor may or may not make on the basis of this information. Interested parties should ensure that they understand all the risks inherent in their investment decisions and should refrain from investing until they have carefully assessed, in collaboration with their own advisers, the suitability of their investments for their specific financial situation, especially with regard to legal, tax and accounting aspects.

They must also take into account all the characteristics and objectives of the fund, in particular those referring to sustainability aspects in accordance with Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services.

Subscriptions to a fund representing units in a collective investment undertaking are only permitted on the basis of the current prospectus, the latest annual or semi-annual report and the Key Information Document (KID) (the ‘**Documents**’) of the fund concerned. The Documents may be obtained free of charge from BLI. All the Documents, including the sustainability information and the summary of investors’ rights are available on BLI's website: www.bli.lu