Invesco ESG Loan Investment Process Overview

January 2021

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Invesco's ESG approach to senior loans

At Invesco, we manage roughly USD 32.9 billion[1] in senior secured bank loans for institutional, retail, and high net worth clients globally. Senior loans are an alternative asset class – they are privately arranged debt instruments (usually below investment grade). Investors look to add bank loans to their asset allocation strategies because they provide appealing returns through various economic cycles – they are senior in the capital structure, secured by all assets of the company, and they provide stable current income floating with prevailing interest rates. However, loans are not a security. Each loan has unique characteristics tailored to the underlying corporate issuer. Often senior secured loan issuers are private companies or may be sponsored by a private equity firm with no publicly available information.

A growing segment of Invesco's bank loan clients are focused on ESG and have asked for a commingled ESG managed bank loan portfolio. In 2015, we began incorporating ESG considerations into our investment process as part of our consideration of credit risk for each issuer. However, investors are seeking a quantifiable approach to better understand Invesco's ESG considerations, as well as our ability to screen out issuers. More importantly, investors are looking for bank loan managers that will actively engage management with respect to their ESG policies and progression. As such, Invesco's loan team is able to offer investors a rigorous multi-pronged approach to ESG screening.

Because senior loans are private instruments, there is only a small pool of the investable universe that are rated by outside ESG rating providers. For Invesco to offer an ESG product that would work with clients' needs, during 2018-2019 Invesco developed a proprietary framework for rating each issuer from an ESG perspective.

As a result, the credit analysts of Invesco Senior Secured Management, Inc. (ISSM) are responsible for independently rating each loan they cover from an ESG perspective. They conduct diligence reviews with issuers' management teams to inform a rigorous, multifaceted screening process in which each loan is measured on a scale of 1 to 5 (with 1 indicating "no risk" and 5 indicating "high risk") on numerous ESG factors, as listed in figure 1.

To derive an issuer-level ESG rating, ISSM uses a weighting schematic for the issuer's broad industry category. These ratings are averaged into an overall ESG score that is approved by ISSM's Investment Committee, subject to updates and reviews on at least an annual basis.

While management teams have generally been very receptive to ISSM's approach, facilitating active engagement with an issuer can sometimes present a challenge. ISSM excludes from its ESG portfolios any issuer whose management refuses to engage and/or for which appropriate ESG scores cannot be determined.

Applying the firm's own proprietary ESG approach to senior loans has led to many positive outcomes, the most significant of which has been ISSM's ability to provide an investment solution that meets its clients' ESG objectives. ISSM has received considerable interest in its approach from existing and prospective clients alike, and the firm is always looking to broaden this capability.

Another major result is that ISSM has substantively enhanced its analytical skills with regard to ESG risks. Although the process of rating each issuer has been time-consuming and complex, ISSM's credit analysts are now leaders in understanding the implications of ESG issues across the investable universe – and, as such, they are able to make more impactful investment decisions.

Engaging management teams on the importance of ESG from an investor perspective has been another benefit of ISSM's approach. While the firm does not have voting rights or control over issuers' ESG

Figure 1
Factors that are incorporated into our ESG rating include, but are not limited to:

Environmental Pillar	Social Pillar	Governance Pillar
– Natural resources – Pollution & waste – Supply chain impact – Environmental opportunities	– Workforce – Community – Product responsibility – Human rights	– Management – Shareholders – Board of Directors – Auditor – Regulatory issues – Corporate social responsibility Strategy – Anti-corruption – Business ethics

Source: Invesco. For illustrative purposes only.

1 Invesco Senior Secured Management, Inc. AuM as at 31 December 2020.

activities or conduct, ISSM's position as one of the largest managers of multi-credit strategies enables us to emphasize to management teams the importance of ESG issues in relation to their ability to raise capital in this market.

Initial credit screening
Screening is employed to exclude companies and/or issuers from the investment universe that do not meet the Invesco ESG Senior Loan Strategy's (the "Strategy") ESG criteria (including but not limited to: level of involvement in the production of tobacco and tobacco products, gambling, controversial weapons (including nuclear weapons), whole or partial engagement in the cultivation, production or distribution of cannabis or cannabis derived products for the purposes of recreational use (including any company that derives a part of its revenue from recreational cannabis), extraction of thermal coal, extraction of fossil fuels from unconventional sources (including Arctic drilling, tar sands, shale oil and gas, or other fracking activities and/or mining of oil shale), generation of electricity above a defined percentage from coal-fired power plants, as well as status in terms of respecting the UN global compact principles). In addition, the Strategy may not invest in loans from companies that have an aggregated ESG rating or single category E, S, or G ratings above levels set within the internal ESG rating methodology.

The investment screening process begins with the analyst. ISSM maintains an experienced analyst team aligned by industry, with a dedication to being experts in each industry covered. The credit analysts are responsible for surveillance and analysis of issuers in their sectors. Invesco's bank loan credit analysts conduct diligence reviews with issuers' management teams to inform a rigorous, multifaceted screening process. Each loan is measured by our analysts on a scale of 1-5 for risks related to 16 ESG factors under separate pillars for E/S/G.

The fundamental bottom-up credit analysis conducted by the analyst determines the initial eligibility of an asset for inclusion in any portfolio. The analysts research all primary and secondary investment opportunities in terms of both appropriateness of credit quality and risk/return profile. The screening process includes a complete review of the issuer's financial performance, discussions with the arranger's banking team, and often times a discussion with the issuer's management team. All primary investment opportunities undergo a formal review process, ending in either the preparation of a credit analysis memorandum and Investment Committee discussion for transactions that are recommended for approval or a decline memorandum circulated to the entire team.

For transactions that are declined, the analysts discuss their rationale with their team leader and often times with the co-heads of credit to ensure that each transaction receives due consideration.

ESG ratings process
As noted earlier, ISSM's credit analysts are responsible for independently rating each loan they cover from an ESG perspective. They conduct diligence reviews with issuers' management teams to inform a rigorous, multifaceted screening process in which each loan is measured on a scale of 1 to 5. 1 = negligible risk; 2 = low risk; 3 = average risk; 4 = above average risk; and 5 = high risk.

To date, Invesco's bank loan analysts have conducted ESG specific diligence reviews with issuer's management teams – often being cited as the first or the most progressive bank loan analysts from an ESG perspective. In doing so, we have independently rated over 750 issuers from an ESG perspective.

As mentioned above, each loan is measured by our analysts on a scale of 1-5 for risks related to multiple ESG factors under separate pillars for E/S/G. There are 16 factors within the E/S/G pillars that our credit analysts' rating contemplates (noted in figure 2 under #4).

As part of this process, ISSM will seek to engage with companies to ensure that they are minimizing and disclosing the risks and maximizing the opportunities presented by climate change by implementing a strong governance framework which clearly articulates their respective board's accountability and oversight of climate change risk and opportunities, taking action to reduce greenhouse gas emissions across their value chain and providing enhanced corporate disclosure on their carbon emissions.

Minimum ESG ratings criteria and certain sector exclusions are applied during portfolio construction.

Figure 2
Invesco Bank Loan Platform: Responsible investing methodology

1

ESG considerations are integrated into Invesco's fundamental research process.
ESG plays a critical role in Invesco's credit underwriting process and is a key discussion factor in the investment team's credit evaluation of potential investment opportunities

2

Each credit analyst spends a great deal of time getting to know borrowers' management teams, sponsors, key suppliers and customers.
This insight, communication and exposure, provides Invesco's investment team with an intimate look at the company's underlying activities, which allows for an opportunity to incorporate elements of ESG into the investment process

3

Each new loan is independently measured on a scale of 1 to 5 for risk related to Environment, Social and Governance factors by our credit analysts.
These ratings are averaged into an overall ESG score that is approved by our investment committee and reviewed and updated annually
1 = negligible risk
2 = low risk
3 = average risk
4 = above average risk
5 = high risk

4

Factors that are incorporated into our ESG rating include, but are not limited to:
- Environmental pillar (natural resources, pollution & waste, supply chain impact, environmental opportunities)
- Social pillar (workforce, community, product responsibility, human rights)
- Governance pillar (management, shareholders, board of directors, auditor, regulatory issues, corporate social responsibility strategy, anti-corruption, business ethics)

Source: Invesco. For illustrative purposes only.

The Strategy's team employs screening to exclude companies and/or issuers from the investment universe that do not meet the portfolio's ESG criteria, including but not limited to:

– level of involvement in the production of tobacco and tobacco products,

– gambling,

– controversial weapons (including nuclear weapons),

– whole or partial engagement in the cultivation, production or distribution of cannabis or cannabis derived products for the purposes of recreational use (including any company that derives a part of its revenue from recreational cannabis),

– extraction of thermal coal,

– extraction of fossil fuels from unconventional sources (including Arctic drilling, tar sands, shale oil and gas, or other fracking activities and/or mining of oil shale),

– generation of electricity above a defined percentage from coal-fired power plants,

– status in terms of respecting the UN global compact principles), as well as based on the status of these companies and/or issuers in terms of respecting the UN global compact principles as assessed by third party providers for the global universe they cover, as updated from time to time.

In addition, the ESG strategy of ISSM may not invest in loans from companies that have an aggregated ESG rating or single category E, S, or G ratings above levels set within the internal ESG rating methodology, and will disinvest within 6 months from loans for which the aggregated ESG rating or single category E, S, or G ratings rise above these limits, as determined by the Investment Manager's internal rating methodology.

To derive an issuer level ESG rating:

1. ISSM averages the various factors under each E/S/G pillar to determine Pillar Ratings.

2. ISSM then weights each pillar by the average E/S/G pillar weights published by MSCI ESG Research by industry sector to come up with an ESG Composite Score. Those pillar weights as of 30 September 2020 are shown in table 1.

3. These ratings are averaged into an overall ESG score. Each overall ESG rating is reviewed with, and approved by, ISSM's Investment Committee (the same committee that approves all senior loans from a credit perspective).

4. Each ESG rating is included in any new deal underwriting and reviewed at least (minimum) annually. ESG criteria will be reviewed and applied on an ongoing basis by ISSM, integrated as part of the investment process for credit selection and portfolio construction.

Table 1
ESG pillar weighting by broad industry
To derive issuer level ESG ratings, we further weight E, S and G factors by broad industry pillars as follows:

GICS Sector	Environmental pillar	Social pillar	Governance pillar
Communication Services	5.0%	54.8%	40.3%
Consumer Discretionary	21.1%	51.9%	27.0%
Consumer Staples	30.4%	46.8%	22.8%
Energy	49.6%	17.1%	33.3%
Financials	8.9%	58.7%	32.4%
Health Care	5.9%	49.1%	45.0%
Industrials	21.5%	38.1%	40.4%
Information Technology	21.4%	51.0%	27.6%
Materials	53.8%	23.0%	23.2%
Real Estate	32.9%	32.7%	34.4%
Utilities	57.6%	18.6%	23.8%

Source: MSCI ESG Research, average E/S/G pillar weights, as at 30 September 2020.
For illustrative purposes only.

Portfolio construction process
The senior secured loan market is comprised of roughly 2,000 issuers globally. The team will maintain internal risk ratings on about half of these issuers at any given time. This pool of loans represents the eligible investment universe for portfolio construction.

Figure 3
How does the ESG rating process work?

ESG research
- Invesco analysts conduct proprietary research and interview management teams
- Due diligence

Investment committee
- Analysis presents key findings to senior investment committee
- Senior investment committee signs off on ESG rating

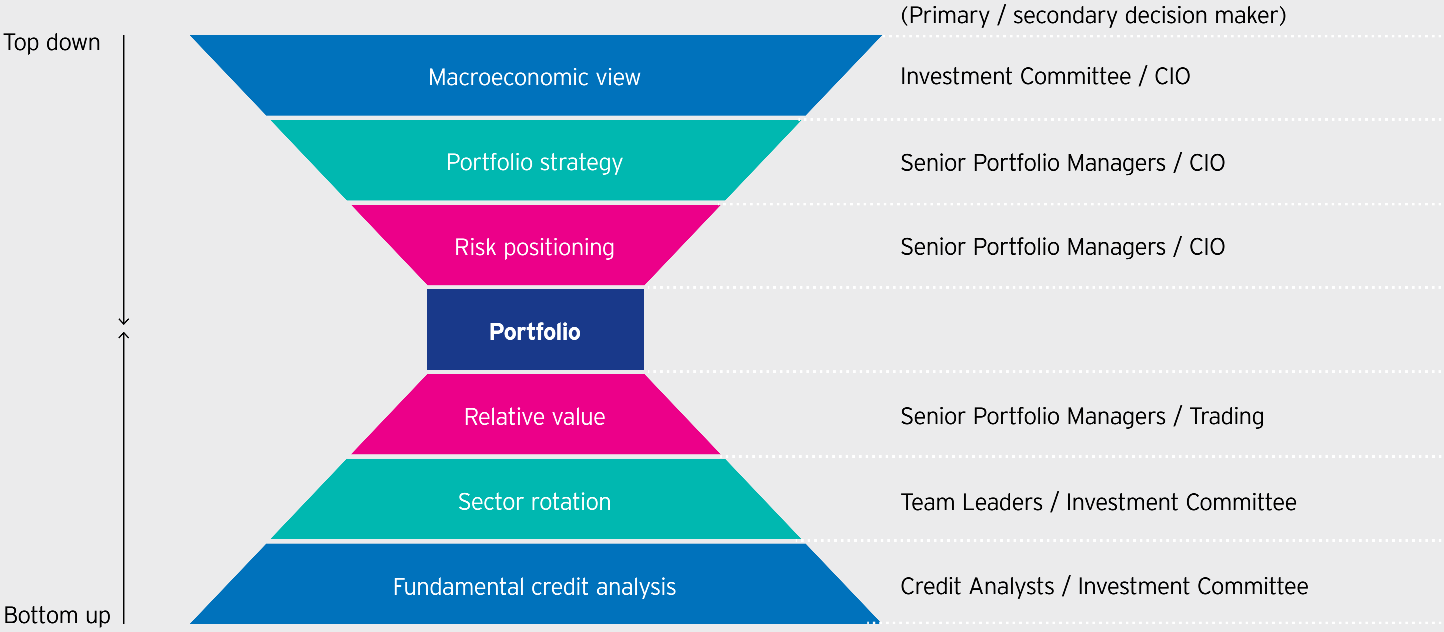
ESG risk factors
Analyst assigns 1-5 rating for each of the 16 identified ESG factors
1 = negligible risk
2 = low risk
3 = average risk
4 = above average risk
5 = high risk

Calculate composite ESG score
- Weighted by industry
- Leverage MSCI E/S/G pillar weights for each respective industry

Calculate average score for E, S and G pillar
- Weighted average score determined for E, S, and G pillar
- Portfolio screen for maximum E, S or G score

Source: Invesco. For illustrative purposes only.

Figure 4
Fundamental investment process with clear decision making philosophy
Disciplined and proven process drives strong investment results



Source: Invesco. For illustrative purposes only.

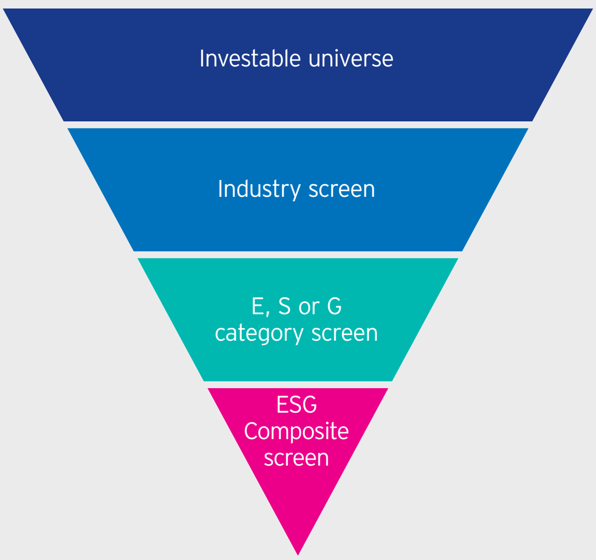
Portfolio managers have discretion to select from this pool within the predetermined limits established by the Investment Committee and group these investments in a manner consistent with the team's top-down view and portfolio-specific constraints (e.g., risk tolerance and investment guidelines). The portfolio managers work with the traders to source selected loans and execute trades at levels that seek to maximize return potential.

The rigorous application of the internal risk ratings is a central component of ISSM's portfolio management and construction process and is used to size position exposures and to help quantify the impact that an individual credit decision will have on modelled portfolio returns.

Portfolio construction and management decision making combines multiple disciplines
Portfolio management and oversight is directed by the Chief Investment Officer and senior portfolio managers. The portfolio management process combines multiple core disciplines and is a collaborative approach among the Chief Investment Officer (CIO), the Investment Committee, the senior portfolio managers, the team leaders, and the credit analysts (figure 4).

Through this ongoing process portfolio managers are provided with inputs and tools necessary to dynamically manage portfolios within the objective, investment guidelines and risk appetite of each strategy's mandate, including minimum ESG criteria and certain sector exclusions (figure 5).

Figure 5
ESG portfolio construction



1. Industry screen
Screening employed to exclude companies based on their involvement in:
- Production of tobacco products
- Gambling
- Controversial weapons
- Engagement in cultivation, production or distribution of recreational cannabis products
- Extraction of thermal coal
- Extraction of fossil fuels from unconventional sources
- Generating of electricity above a defined percentage from coal/fire plants
- UN Global Compact Principles

2. E, S or G category screen
Screen out issuers with an E, S or G category average above a specified threshold

3. ESG Composite screen
Screen out issuers with an ESG Composite score above a specified threshold

Source: Invesco. For illustrative purposes only.

Conclusion
ISSM invests and manages portfolios constructed of US, European, and global senior secured bank loans. As such, ISSM's credit analysts and Investment Committee are very focused on ESG issues surrounding the underlying and ongoing investment thesis for all investments. ESG plays a critical role in ISSM's credit underwriting process and is a key discussion factor in the investment team's credit evaluation of potential investment opportunities.

Prior to investing in a company and throughout the ownership of the company's debt, the senior loan investment team will engage with company management on a number of issues – including environmental, social and governance. These discussions are designed to enhance ISSM's understanding of the long-term economic value of the company which includes a thoughtful process and approach to determining whether to invest in a company.

ISSM's senior loan team has a fundamentals-based, bottom-up credit process and determines the initial eligibility of an asset for inclusion in any senior secured loan portfolio. Given the depth, knowledge and experience of the investment professionals dedicated to senior secured loan investing, each credit analyst spends a great deal of time getting to know borrowers, borrowers' management teams, sponsors, key suppliers and customers etc. Analysts are expected to interact with the management teams of their portfolio companies on a regular basis. These company meetings provide investment teams a better understanding of the long-term nature of the business, its key drivers, competitive position, and the achievability of management goals. This insight, communication, and exposure provides ISSM's investment team with an intimate look at the company's underlying activities, which allows for an opportunity to incorporate elements of ESG into the investment process.