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# Invesco Quantitative Strategies ESG Policy

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## Introduction: Invesco's IQS approach to ESG integration

This policy sets forth the framework of Invesco Quantitative Strategies (IQS) ESG approach including engagement, proxy voting, and guiding principles for ESG integration into investments.

Invesco is a signatory to the UNPRI – Principles of Responsible Investment and recognizes the importance of taking into consideration Environmental, Social and Governance (“ESG”) criteria as part of a robust investment process in order to achieve long-term outcomes for our clients.

The centralized Global ESG team of Invesco delivers and equips investment teams with a best-in-class support platform of tools, research, resources, and training. The investment centres can tap into these resources to exercise its role to act as a fiduciary in the best interests of our clients and in addition to further encourage a strong corporate governance approach in our investee companies.

In the past decades, sustainability demands on financial assets – e.g. CO<sub>2</sub> footprint, corporate governance, regulatory and demographic changes – have risen in the market and IQS has accommodated this. IQS has been one of the pioneers in considering ESG aspects for clients. With over 30 years of history in managing dedicated ESG mandates, we have continuously developed and broadened our experience in the implementation of customized ESG criteria based on clients' beliefs, which derive from open conversations with our clients. Having incorporated proprietary aspects of governance for many years, we offer a holistic ESG approach taking ESG factors into consideration systematically at various levels of our portfolio management process. In addition, IQS conducts an active dialogue with carefully selected investee companies through engagement programmes and participates in investor-driven proxy voting enabled through Invesco's proprietary Proxy Voting Platform.

## ESG integration for Invesco Quantitative Strategies (“IQS”)

The investment team IQS applies an integrated ESG (environmental, social, governance) investment approach and has been managing customised sustainable investment solutions for more than 30 years.

With many years of experience, the team offers different approaches to integrate ESG criteria into the portfolio at different stages of the investment process across all asset classes. The IQS team follows an integrated ESG approach. The team takes ESG factors into account at several levels of their management process.

### **Holistic ESG consideration in our investment process**

Integrating key aspects of ESG

### **We consider ESG at several layers in our investment process:**

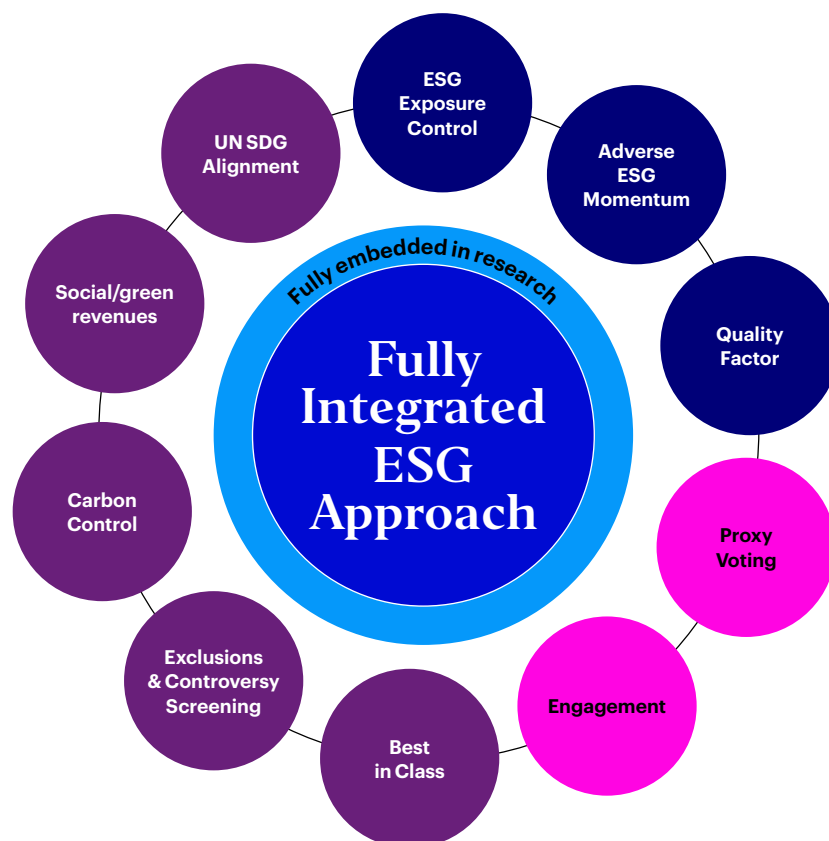
- Standardized explicit and implicit incorporation of ESG key aspects into our investment process
- Active dialogue with companies and investor-driven proxy voting using Invesco's proprietary Proxy Voting Platform
- Offering optionality to implement additional, customized ESG criteria tailored towards the client's needs
- ESG fully embedded in research processes and analytics and documented in every research note

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Source: Invesco. For illustrative purposes only.

The IQS team's investment process is built on the factors Momentum, Quality and Valuation, which can explain the long-term risk and return characteristics of equities.

The team has identified that some signals within the Quality factor show positive correlation to governance factors. The calculation of these Quality signals is part of the daily factor assessment for all assets and the multi-factor investment process. These Quality signals prefer companies with a high balance sheet quality which, for example, buy back shares and do not show disproportionate balance sheet growth. Governance factors also prefer companies in which management acts in the interests of shareholders and does not pursue unprofitable business projects.

Besides the implicit integration via the Quality factor, the team also explicitly uses its measures Adverse ESG Momentum and ESG Exposure Control. The team applies these measures to manage the risks which are associated with weakly scoring companies or portfolios.

For the Adverse ESG Momentum, the investment universe is screened daily for significant ESG downgrades. The team's research has shown that companies that experienced severe downgrades tend to underperform their peers in the following months. Therefore, the investment in companies which suffered severe downgrades is restricted.

Additionally, the team uses the ESG Exposure Control. During the regular rebalancing the ESG exposure of the equity portfolio is managed against the exposure of the portfolio's benchmark. The team targets an exposure that is approximately at or above benchmark level. The key point is guarding against a risk that historically has been small but is expected to be material in the future.

Beyond a broad-based integration across all portfolios, customization to cater individual client needs can be integrated. A carbon control can be applied during portfolio construction to obtain a better overall carbon footprint in comparison to an underlying benchmark, investment universe or to the portfolios own historic carbon footprint.

Additional customized ESG criteria in form of best-in-class and controversy monitoring can be implemented to meet client specific ESG requirements, as well as internationally recognized norms, conventions and renowned ESG quality labels.

Furthermore, thematic approaches to ESG can be realized by an explicit focus on social or green revenues. Lastly, a dedicated United Nations Sustainable Development Goals (UN SDGs) alignment can be integrated through targeting investments in companies that derive revenues from the provision of goods and services aligned with SDGs.

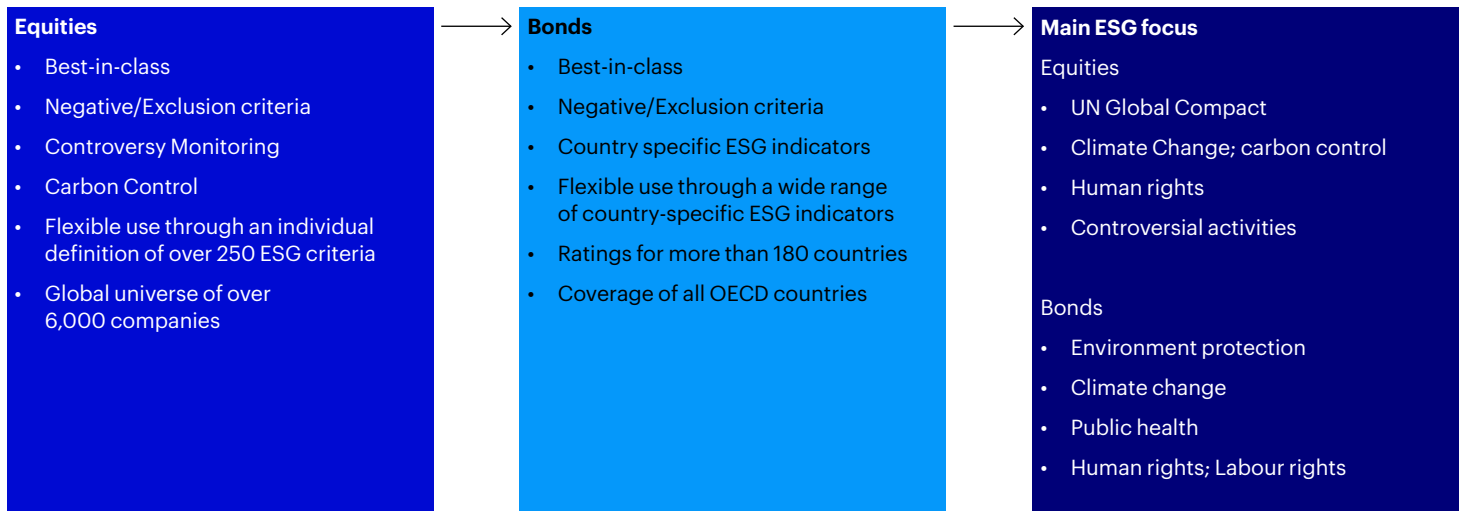
Using a wide range of data fields, the investment team is able to define a set of ESG criteria. Exclusion criteria and negative criteria can be used to eliminate companies that fail to meet certain ESG criteria, while with positive criteria, companies can be identified, which are particularly characterized by sustainable economic development, positive products or processes.

Best-in-Class strategies refer to the construction of an equity portfolio by the active selection of companies that rank among the leaders of their sectors in terms of ESG issues. IQS uses a ranking framework whereby no companies or sectors are automatically totally excluded from a given investment universe. Instead, all companies are provided with a score based on the points achieved in relation to various positive and negative factors. These point scores can be then used to develop a preference approach by either identifying companies which are best in sector or are over a certain threshold score.

In order to assess companies and countries around dedicated ESG criteria and controversial activities, the IQS team uses a combination of Moody's ESG Solutions, MSCI ESG, Sustainalytics and ISS (Institutional Shareholder Services) to assess compliance. However, this can be supplemented with other service providers where appropriate.

To implement ESG criteria in equity and multi-asset portfolios, IQS has access to a specialised database that covers over 6,000 listed companies worldwide. Companies are analysed on the basis of 250 different criteria for all relevant ESG fields. These include environment, corporate governance, human rights, labour conditions etc.

### ESG Screening for Equities and Sovereign Bonds



Source: Invesco. For illustrative purposes only.

## Equities

A wide range of ESG issues can be assessed




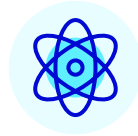
					
<b>Environment</b> Environmental management Environmental systems Environmental performance Nuclear power Water use & pollution Biodiversity Climate change Greenhouse gases	<b>Governance</b> Board practice Bribery & corruption Code of ethics ESG risk management Political donations Woman on the board Stakeholder responsibility	<b>Human rights</b> Guidelines ILO standards Child labour Forced labour Discrimination Union issues	<b>Solution companies</b> Positive products Positive services Safety Healthcare Environmental technology	<b>Stakeholder issues</b> Stakeholder policy Stakeholder systems Stakeholder reporting Employee issues Community involvement	<b>Other ESG controversies</b> Abortion Alcohol Gambling Firearms & Armaments Cluster munition Pornography Tobacco Genetic engineering

Source: Invesco. For illustrative purposes only.

Within IQS' multi-asset product range, we facilitate the application of ESG criteria to sovereign bonds by using a country sustainability rating. To assess a country in terms of sustainability criteria, a large number of indicators are used from the arena of political and social issues as well as environmental issues. These are combined into an overall rating by our ESG consultant. In addition, details of how well countries perform on specific concerns, such as nuclear power as a percentage of nationally produced energy consumption and religious freedom can also be provided.

## Sovereign Bonds

A wide range of ESG issues can be assessed

			
<b>Environment</b> Biodiversity Climate change CO <sub>2</sub> -Emissions Nuclear energy Environmental pollution Renewable energy Water use Infrastructure	<b>Social</b> Human rights Equal opportunities Child labour Child mortality Healthcare Labour standards Unemployment Income distribution Education spending	<b>Governance</b> State leadership Bribery & corruption Civil rights Legislation Political stability	<b>Other ESG Controversies</b> Death penalty Military expenditure Spending on nuclear energy Nuclear weapons Religious freedom

Source: Invesco. For illustrative purposes only.

## Research

IQS is continuously researching the quantitative integration of ESG criteria. This includes a thorough analysis of new data sources, the evidence-based vendor selection but also the interaction of ESG characteristics with financial metrics. Particular focus of the ESG research team is a robust portfolio construction, which efficiently combines the financial criteria and the desired non-financial sustainability aspects. Further research is conducted on using Natural Language Processing to generate signals in the ESG area.

## Stewardship for IQS strategies

### Monitoring investee companies

The IQS investment process builds on three major return factors: Value, Quality and Momentum. Based on in-depth factor research, IQS uses proprietary factor definitions that are expected to deliver results in excess of standard factor definitions.

### IQS Factors

Thoughtful combination or proprietary signals



#### Value

- Cash Flow Yield
- Gross Profit Yield
- Earnings Yield
- Dividend Yield



#### Momentum

- Adjusted Momentum
- Earnings Revisions
- Event Momentum
- Linguistic Momentum



#### Quality

- Financing and Assets
- Profitability
- Fundamental Health
- Accounting Integrity

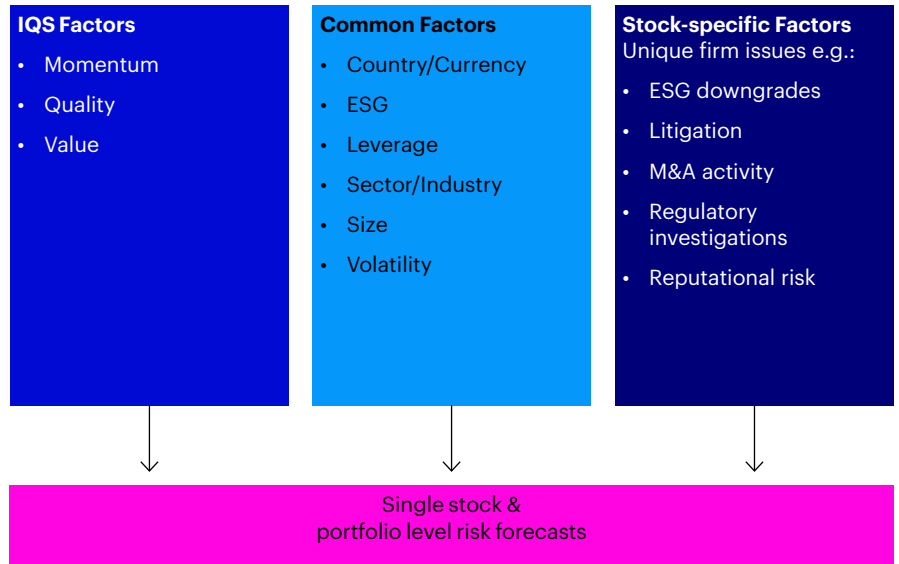
The respective building blocks of the IQS factors are selected by use of an in-depth research process that assesses the long-term predictive ability of the factor components with respect to expected future returns. For example, the team calculates Information Coefficients that measure the correlation between a factor-based forecast and the subsequent returns. In particular, each single building block used in the respective factor definitions must have a positive expected contribution for the overall factor's expected returns.

These factors are used with proprietary definitions that we think have the potential to achieve better risk-adjusted returns than standard factor definitions. Technically, we believe that proprietary factor definitions have the potential to harvest more than just basic factor risk premiums, e.g. including factor premiums that exist due to structural behavioural biases. These proprietary factor definitions include for example the application of Price to Cashflow measures within Value, more sophisticated measures of Momentum as well the consideration of particular quality components such as a fundamental health score (balance sheet strength). The IQS factor definitions are deeply research driven and fine tuning of factor definitions is an ongoing research focus. Finally, the weightings of the factors might differentiate to some extent across the regions.

### Risk Forecasting: A Factor-based approach

Being a multi-factor investment strategy, rigorous risk management is a highly efficient built-in feature of the IQS investment process per se. Risk assessment is an integral part of the portfolio construction process. The investment team uses a proprietary equity risk model as the basis of the risk assessment, considering all relevant risk factors. The team's proprietary risk model allows them to consider both standard risk factors (to be neutralised to the highest possible extent, e.g. country or sector risks) as well as intended risk factors that are linked to the model. As a result, intended factor exposures are maximised while unwanted risks are widely neutralised. In addition, the proprietary risk model is aligned with the multi-factor return forecasting model in a sense that it uses the same building blocks in order to avoid misalignment of return and risk forecasts.

**Proprietary Risk Model to align return and risk perspective**



Source: Invesco. For illustrative purposes only.

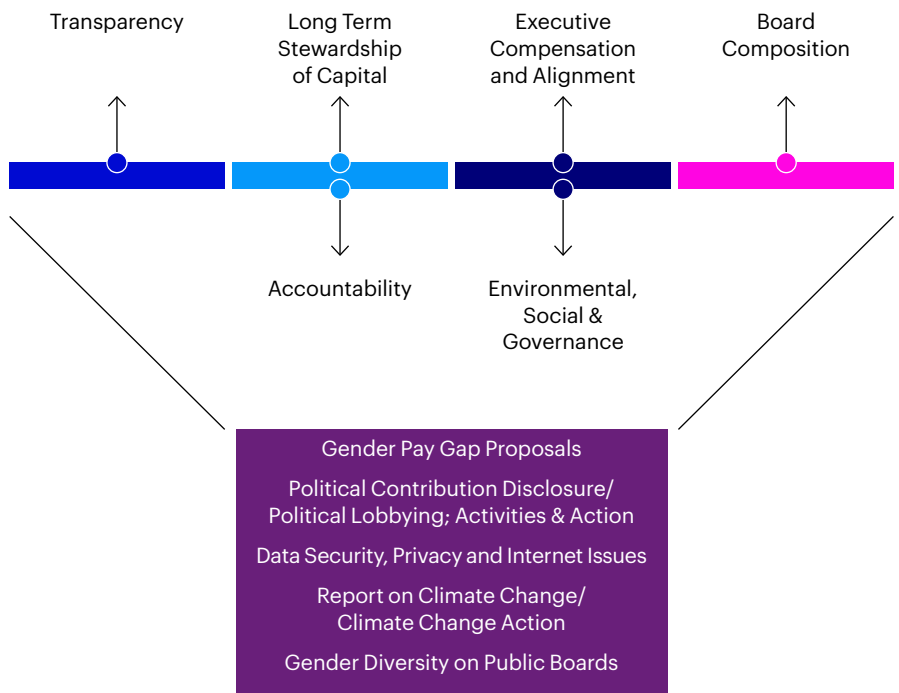
**Proxy Voting**

Invesco’s Proxy Voting approach is governed by the Global Proxy Voting Policy, which is premised on respecting the fund manager’s freedom to vote in what they believe is the best interests of the investors in the relevant fund or portfolio in order to achieve positive outcomes for clients.

To this effect, Invesco maintains a proprietary global proxy administration platform, known as “PROXYintel”. The platform streamlines the proxy voting and ballot reconciliation processes, as well as related functions, such as share blocking and managing conflicts of interest issues. This enables fund managers to vote in an efficient manner, increase transparency, share knowledge and effectively influence corporate practices and behaviours.

**Proxy Voting – Our good Governance Principles**

Support of ESG shareholder proposals through Invesco’s PROXYintel



Source: Invesco. For illustrative purposes only.

Invesco adopts and applies a dedicated ESG voting policy across managed funds, portfolios and mandates. Besides the support of shareholder proposals through Invesco's proprietary "PROXYintel" Fund Manager Portal, specific voting decisions on the following ESG topics are taken if applicable:

- Gender Pay Gap Proposals
- Political contribution disclosure/political lobbying
- Disclosure/political activities and action data security
- Privacy and internet issues
- Report on Climate Change/climate change action and
- Gender Diversity on public boards

### Engagement

IQS enters regularly into dialogue with carefully selected target companies via the Global Engagement Service of Moody's ESG Solutions. The potential target companies are selected by IQS and a final selection of the companies to be engaged with is then agreed with Moody's ESG Solutions. In general, the team look to engage on topics related to the IQS Priority ESG Themes, which are Climate Change, Human Rights, Supply Chain Management, Water and Bribery/Corruption but also Principal Adverse Impacts indicators.

IQS selects investee companies which are at a size and stage making them likely to be influenceable. The objective is to identify weaknesses in the company's sustainability management and discuss these with management to enable the companies to achieve a better ESG performance in the medium to long term. Discussions can take place via telephone calls, personal meetings and written communication. Engagements are followed through over a period of years where necessary.

### Engagement

Direct dialogue with companies



Source: Invesco. For illustrative purposes only.

IQS' engagement priorities follow methods:

- Theme-based engagement, which aims to encourage companies to expose and reduce systemic risks in areas such as bribery reporting; climate change; human rights management systems; supply chain labour policy and water scarcity.
- Controversy-led engagement, which aims to prompt companies to observe internationally-recognized standards and conventions and correspondingly improve their company guidelines.

Moody's ESG Solutions undertakes a detailed assessment of the themes for each company that the IQS team has selected. This is based upon a long established and rigorous methodology and involves assessing the level of risk that a company is exposed to in any one area and then analysing how the company mitigates these risks.



### **Engagement Escalation and Collaboration**

IQS would conduct further engagement on a case-by-case basis depending on the response of the investee company and considering the set investment priorities and IQS Priority ESG Themes. Divestment from a particular investee company by IQS would be considered in case the engagement has not led to positive results or the investee company shows no signs of any better behaviour. Such cases are defined as Unsuccessful Engagements and these companies are placed on an Engagement Watchlist which is shared with other Invesco investment centres. Where a company is on the Engagement Watchlist, it will be flagged in our Global Proxy Voting System for careful consideration of any relevant voting and in particular the possibility of voting against the company will be considered by the relevant fund managers. IQS also engages collaboratively with other Shareholders from time to time, usually when Moody's ESG Solutions or another investor has submitted a proposal to do so.

### **Management of Conflicts of Interest**

In relation to conflicts of interest that exist in its stewardship and proxy voting activities, Invesco has adopted the Global Policy Statement on Corporate Governance and Proxy Voting which can be found [here](#) in addition to other regional conflict of interest policies which are available upon request from the respective Invesco entities.

## Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

## Important information

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Invesco Management S.A., Succursale en France, 18 rue de Londres, 75009 Paris, France.

Invesco Asset Management Deutschland GmbH, An der Welle 5, 60322 Frankfurt am Main, Germany.

Invesco Asset Management (Schweiz) AG, Talacker 34, 8001 Zurich, Switzerland.

Invesco Asset Management Limited, Index Tower Level 6 - Unit 616, P.O. Box 506599, Al Mustaqbal Street, DIFC, Dubai, United Arab Emirates. Regulated by the Dubai Financial Services Authority.

Invesco Investment Management Limited, Ground Floor, 2 Cumberland Place, Fenian Street, Dublin 2, Ireland. Regulated by the Central Bank in Ireland.

Invesco Management S.A. (Luxembourg) Belgian Branch, Avenue Louise 143/4, 1050 Brussels, Belgium.

Invesco Management S.A. (Luxembourg) Swedish Filial, c/o Kungsgatan 9 (Convendum), Box 3359, 103 18 Stockholm, Sweden.

Invesco Management S.A., Succursale Italia, Via Bocchetto 6, 20123 Milan, Italy.

Invesco Management S.A. Sucursal en España, C/Goya 6, 28001 Madrid, Spain.

Invesco Management S.A. Dutch Branch, Vinoly Building Claude Debussylaan 26, 1082 MD Amsterdam, Netherlands.

Invesco Asset Management Österreich – Zweigniederlassung der Invesco Asset Management Deutschland GmbH, Rotenturmstrasse 16-18, 1010 Wien, Austria.

EMEAXXXX/2023