Ostrum
ASSET MANAGEMENT

Enhancing your power to act

SEAMLESSLY NAVIGATING TODAY'S ESG CHALLENGES

Double interview of **Gaëlle Malléjac,** *Head of Portfolio Management for Insurance and ALM Solutions*
and **Joséphine Chevallier,** *ESG Integration Responsible, ESG Strategy*

This material is intended for professional investors only

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Investors have identified ESG investment as the main driving force for a shift to a more sustainable world and a fair transition. Yet the slew of regulation, the potential lack of inhouse resources and the cost of data make for three limitations that hamper their efforts in achieving their goals independently and acting effectively to support the energy transition.

What resources can asset managers mobilize to support their institutional clients, particularly insurers, health insurance companies and provident organizations?

How can they accompany their clients in meeting their own commitments to the climate and biodiversity?

1/ ESG IS ON EVERYONE'S LIPS RIGHT NOW, BUT EXACTLY WHAT DOES IT INVOLVE?

Joséphine Chevallier: *There are three fundamental components to ESG:*

- **Firstly, certain dimensions are purposely excluded from the investment universe.** This obviously includes higher-risk assets in terms of materiality or reputation – companies undergoing controversies – as well as businesses that breach the United Nations principles on human rights to give an example. However, we can also broaden this approach to companies that run contrary to our – and our clients' – ESR policies, for example in terms of the energy transition (we limit investments or even entirely withdraw from companies in the coal, oil and gas sectors) or healthcare, as we rule out funding for the tobacco industry.
- **Secondly, the quality of companies' ESG approach is assessed.** Fairly logically, this means that after excluding the companies we do not want to invest in, we then consider which corporations we actually do want to fund, by assessing both their risks and opportunities.
- **Thirdly, engagement,** which is the approach we take as investors to challenge existing practices, by pursuing dialogue with issuers – companies where we hold stocks or bonds – to support them in enhancing their strategies. This aspect was previously overlooked in the bond universe, but it has now become crucial as financial market stakeholders realize that in today's markets, corporate debt is constantly growing, so financing provides a crucial area for action.

View our sector policies: https://www.ostrum.com/en/our-sector-policies

> *"With corporate debt constantly growing, financing has become a crucial area for action to support issuers in developing their practices".*

2/ HOW DO YOU ASSESS THE QUALITY OF ISSUERS' ESG APPROACH?

Joséphine Chevallier: There is no one-size-fits-all approach to assessing issuers' ESG quality: rather we take a comprehensive strategy to be as far-reaching as possible.

Firstly, we analyze material challenges in detail, **looking at the specific ESG risks and opportunities for each issuer, as well as the broader risks and opportunities for its business sector as a whole.**

If we look at the very familiar automotive sector by way of example, we are careful to pre-empt transition risks resulting from forthcoming changes in regulation. These will impose more stringent emissions standards, and their effects will ripple out across the company in several ways, affecting revenues, operational costs and investments, to name just some. We therefore assess each sector's ability – and the capacity of each of its issuers – to prepare for and adapt to the future market environment.

We are also aware that some sectors are poised to undergo in-depth transformation, or even see their business contract, so we must prepare for these assets' devaluation risk and the impact for our investor clients.

For more details, read our report on how economic sectors are impacted by climate change, how they adapt, and find out about transition risk:

https://www.ostrum.com/en/publication/how-economic-sectors-adapt-climate-change

We then look beyond these so-called material factors – i.e. aspects that can affect companies' future financial performances – to **take on board non-financial analysis criteria.** These dimensions reach beyond specific materiality for each company to consider the social impact resulting from governance, sustainable resource management, the energy transition and regional development. We use this analysis to assign a specific rating to each issuer with a view to comparing to its competitors and bolstering our support for best-performing companies, as well as managing the non-financial quality of our investments.

> *"Analysis of issuers' ESG quality is crucial as investment performances will no longer be judged solely on the basis of financial showings in the future. They will also increasingly incorporate sustainability factors, reflecting issuers' success in taking on board today's transitions in their business models, particularly in terms of the climate and biodiversity".*

3/ LOOKING TO INVESTORS, HOW DO OUR CLIENTS APPLY ESR POLICIES IN THEIR INVESTMENT PORTFOLIOS?

Gaëlle Mallejac: Our clients are primarily insurers, pension funds and provident organizations, with established ESR policies or specific convictions in this arena.

Our investment approach therefore enhances and extends their specific commitments. So when our clients have decided to focus on the energy transition and the fight against climate change as their key priorities, we work with them to develop the most representative indicators and reflect their own goals. When clients' ESR policies seek to address both environmental and social/societal concerns, we make sure that we specifically incorporate these dimensions in the way that their investments are managed.

This is embodied in our philosophy here at OSTRUM AM: *"Drawing on our investment expertise to enhance the impact of our clients' commitments".*

In practical terms, we always start by assessing portfolios and analyzing how closely they match the client's ESR/ESG strategy to ascertain any disparities between goal and reality.

We then discuss the analysis with the client, provide simulations of changes we could make to meet their goals and compute all the impacts for the portfolio, particularly in accounting and regulatory terms, as well as the effects on yield to maturity. These simulations factor in all dimensions of our insurance-related investment mandates.

> *"Insurance-related investment management is different from standard asset management. It is more complex and requires specific expertise, as portfolio managers must take account of a broad range of factors to meet the client's various goals, which include achievement of their energy transition targets and pledges to fight climate change."*

4/ ESG REGULATION IS REALLY RAMPING UP, SO WHAT REQUIREMENTS DO INSURERS AND HEALTH INSURANCE COMPANIES HAVE TO MEET?

Joséphine Chevallier: The financial industry – and sustainable finance in particular – is facing a plethora of regulation. The Green Deal alone – the European Union's sustainable finance plan – introduces or changes more than 70 pieces of legislation, a number of which include obligations for all investors.

In concrete terms, insurers and health insurance companies have to comply with two major pieces of regulation in the short term i.e. **SFDR and Article 29**.

- **SFDR** (Sustainable Finance Disclosure Regulation) waves in fresh transparency requirements for all financial industry players. They have been required to draft and publish their sustainability policies since March 2021: as of January 2023, they will have to report a number of indicators or explain why they are not in a position to disclose them.
- The other major regulatory change is **Article 29 in the French Law on Energy and the Climate** which amends obligations set out in article 173 of the French Energy Transition for Green Growth Act. Since March 2021, our clients have had to comply with requirements to publish a sustainability policy with a particular focus on climate and biodiversity aspects, while obligations will become more stringent from June 2022. Investors with more than €500m in assets will have to disclose their engagement policies and report on their investments' alignment with the Paris Agreement.

5/ CAN WE MOBILIZE FIXED-INCOME INVESTMENT TO MAKE AN IMPACT?

Gaëlle Mallejac: Impact implies the idea of intentionality i.e. pursuing goals alongside the financial performance objective, for example making a concrete contribution to the environmental cause that would not have been achieved without funding, and the ability to measure the actual impact.

This leads to different types of strategies.

> *"For an asset manager like Ostrum AM, impact also means engagement, i.e. exacting dialogue with the companies we fund to support them in enhancing their overall practices, while taking on board any potential social impacts from these companies' or their sectors' transitions".*

Investors can choose an impact fund, or they can also invest in sustainability bonds or incorporate tangible impact criteria such as decarbonization targets in management mandates to apply their ESG policy.

Ostrum AM is one of the key participants on the green, sustainability and social bonds market with exposure oc lose to €20 billion at December 31st 2021.
For more details: https://www.ostrum.com/en/acting-climate

The greater Paris region takes a giant leap towards a 2°C scenario

As an illustration, we invested in green bonds from the Société du Grand Paris which finances the Grand Paris Express to help modernize the existing Paris transportation network. This marks the largest infrastructure project in Europe with 200km of railway – 90% of which is underground – 2 million commuters per day, 68 new stations and 6 operations centers. This project makes a clear contribution to the energy transition as it supports users in the greater Paris region in switching from individual transportation methods that rely on fossil fuels – primarily cars – to electric public transport with zero emissions during the use phase. This transition will significantly reduce public GHG emissions from transportation, which is one of the largest contributors along with buildings. This project will be a powerful driver, helping the entire region achieve a 2°C scenario in line with France’s commitment to the Paris Agreement.

ADDITIONAL NOTES

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