

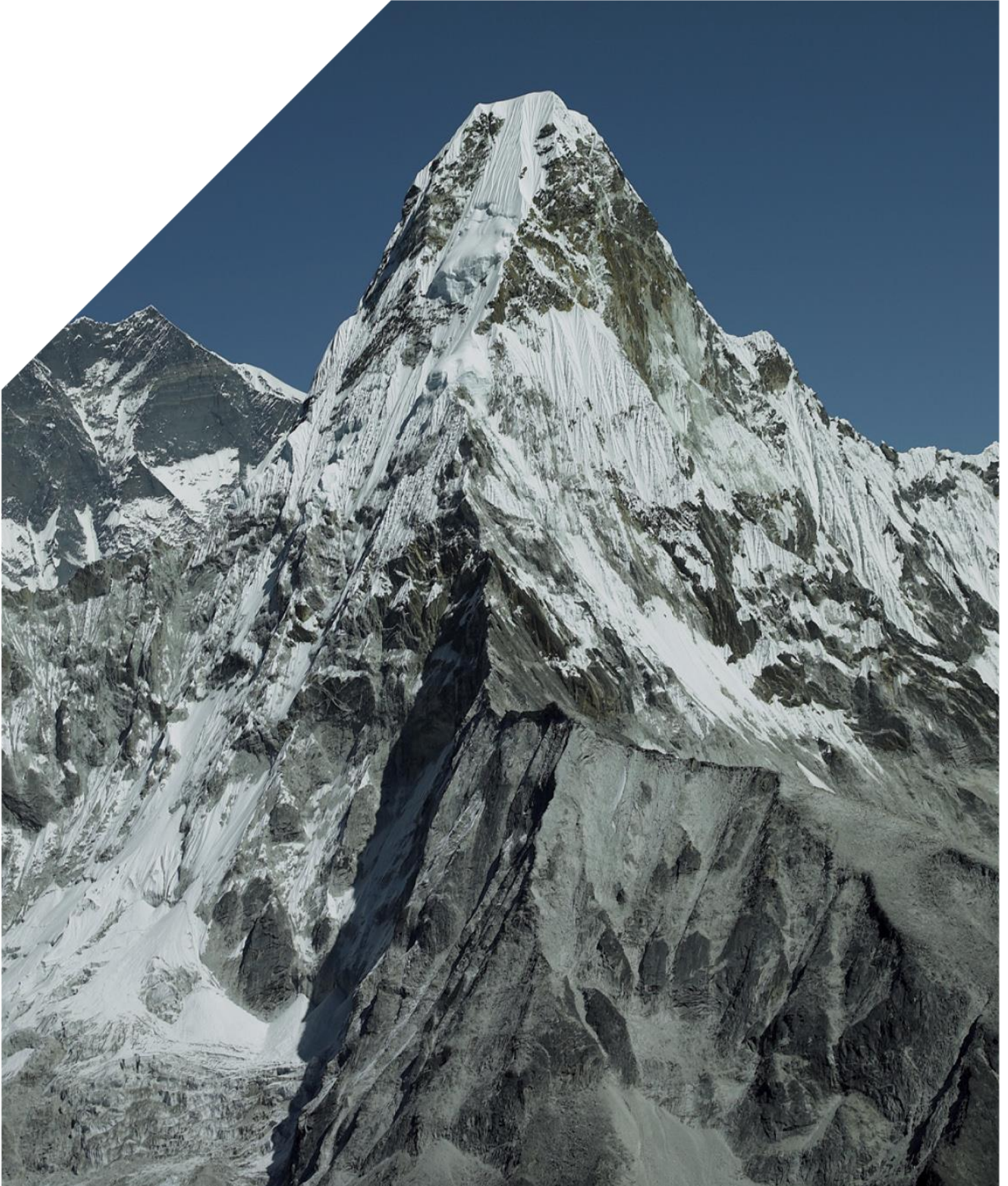


## **Invesco Systematic and Factor Investing**

Invesco EUR Corporate Bond ESG Short Duration Multi-Factor UCITS ETF

Responsible Investment Policy

June 2022



# **Invesco Systematic and Factor Investing**

## **Invesco EUR Corporate Bond ESG Short Duration Multi-Factor UCITS ETF**

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# Invesco Systematic and Factor Investing

## Invesco EUR Corporate Bond ESG Short Duration Multi-Factor UCITS ETF

01

### Executive Summary

The Invesco EUR Corporate Bond ESG Short Duration Multi-Factor UCITS ETF (the fund) follows an ESG integrated multi-factor strategy. While strict ESG filters are applied, the investment team aims at earning factor premiums, using their proven multi-factor investment approach which considers Carry, Value and Low Volatility in the fixed income market. The fund invests in EUR denominated corporate bonds. The consideration of sustainability criteria is an integral part of every step of our investment process.

The investment process of the fund is based on two key building blocks: an ESG approach and bond selection.

1	<b>ESG Approach</b>	<ul style="list-style-type: none"><li>Using integrated ESG screening combined with additional ESG criteria.</li><li>Implement ESG criteria using Moody's ESG.</li></ul>
2	<b>Bond Selection</b>	<ul style="list-style-type: none"><li>Multi-factor selection process focused on EUR investment grade corporate bonds using a proprietary multi-factor investment approach which exploits premiums using the factors Carry, Value and Low Volatility.</li></ul>
3	<b>Engagement</b>	<ul style="list-style-type: none"><li>Entering into an active dialogue with companies that have weaknesses in the field of ESG.</li></ul>

02

### Holistic ESG consideration in the investment process

The team's research shows implementing ESG considerations in the fixed income context has notable implications on the portfolio characteristics. In particular, higher ESG ratings tend to lower the spread of fixed income securities. There are different approaches managers can circumvent this bias. One is to simply accept it, a strategy common for passive managers. The result is a lower expected return for the investor. On the other hand, active strategies tend to compensate by using bonds with higher spreads (carry factor), which in turn might translate into higher drawdown risks.

The team, however, follows an integrated factor approach. By buying securities with attractive factor characteristics that adhere to ESG criteria, the team is able to construct well-balanced and ESG-compliant fixed income portfolios.

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The team applies both best-in-class criteria as well as exclusion and negative criteria further described below:

**Best-in-Class criteria:** By applying best-in-class criteria, companies are identified that display excellence in sustainable management and sustainable products or processes. They fulfil ecological and social requirements particularly well, ranging from climate efficiency and low water consumption to labour safety and satisfaction.

**Exclusion and negative criteria:** By applying these criteria, companies, sectors or countries are excluded from the investment universe which fail to fulfil certain ESG criteria or that violate international norms and standards according to the definitions of the International Labour Organisation (ILO), the OECD or the United Nations.

Using data provided by Moody's ESG Solutions (formerly known as Vigeo Eiris), 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, with positive criteria, companies can be identified, which are particularly characterised by sustainable economic development, positive products or processes.

With the integrated best-in-class approach, the investment team also focuses on the best performing companies in their sector with respect to the company's ability to transition into a low carbon economy.

The Invesco EUR Corporate Bond ESG Short Duration Multi-Factor UCITS ETF uses the following exclusion criteria:

	Controversial Activities	Excluded if
Coal	Turnover derived from thermal coal mining	$\geq 5\%$
	Turnover derived from burning coal for power generation	$\geq 5\%$
	Proportion in electricity generation fuel mix from coal	$\geq 10\%$
	Structural increase of thermal coal activities over 3 years	Yes
Unconventional oil & gas	Revenues that comes from projects or the extraction of tar sands and oil shale, as well as the proportion of reserves in tar sands or oil shale	0%
	Involvement in fracking activities	yes
	Involvement in arctic drilling activities	yes
Fossil fuel industry	Revenues are derived from fossil fuel industries	$\geq 5\%$
	Structural increase of fossil activities over 3 years	Yes

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<b>Bio-diversity</b>	Controversies in the field of endangering biodiversity	<b>Yes</b>
<b>Pollution</b>	Controversies in the field of preventing and managing of accidental pollution or soil pollution	<b>Yes</b>
<b>Community involvement</b>	Controversies in the field of community involvement (including e.g. impact of operations on the local economy, responsible tax strategy, transfer of technology and skills)	<b>Yes</b>
<b>Nuclear power</b>	Turnover from nuclear power	<b>&gt;=5%</b>
	Proportion in electricity generation fuel mix from nuclear power	<b>&gt;=5%</b>
<b>Civilian Firearms</b>	Manufacture or sale of civilian firearms or related products	<b>&gt;=5%</b>
	Manufacture of civilian firearms or related products	<b>&gt;=5%</b>
<b>Military</b>	Sales that are related to military sales including key parts or services for conventional weapons	<b>&gt;= 5%</b>
	Controversial weapons	<b>0%</b>
<b>Tobacco</b>	Turnover from production and distribution	<b>&gt;=10%</b>
	Turnover from production	<b>&gt;=5%</b>
<b>GMOs</b>	Production of genetically modified organisms	<b>&gt;=5%</b>
<b>Stem cell research</b>	Research on human embryonic stem cells or on human foetal stem cells	<b>Yes</b>
<b>Labour &amp; human rights</b>	Controversies regarding human rights in the community in particular freedom of association & collective bargaining	<b>Yes</b>
	Controversies in integrating social standards into supply chain	
	Controversies with respect to child & forced labour	

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<b>Corruption</b>	Controversies in the field of corruption	<b>Yes</b>
<b>Cannabis</b>	Turnover from involvement in Involvement in recreational cannabis (production, distribution, services)	<b>&gt;=5%</b>
<b>UN Global Compact</b>	Fail to pass the global compact screening	<b>Yes</b>

*Definition of Controversial Weapons: Even though there is no official definition of the concept of controversial weapons, investors and stakeholders typically refer to weapons of mass destruction (nuclear, chemical and biological weapons) and some conventional weapons when they use the term controversial. These weapons are collectively referred to as controversial weapons because, in particular, they may be considered to be excessively injurious, to have indiscriminate effects or to damage the natural environment. International Humanitarian Law (IHL) prohibits or restricts the use of some weapons. Three rules of customary international law, binding on all States, apply to all weapons: the prohibition of weapons of a nature to cause superfluous injury or unnecessary suffering; the prohibition of weapons which are indiscriminate by nature; and the prohibition of weapons causing widespread, long-term and severe damage to the natural environment. Explicitly, those weapons include anti-personnel mines, cluster munitions, chemical weapons, biological weapons, nuclear weapons, incendiary weapons, non-detectable fragments, blinding lasers, white phosphorous and depleted uranium beyond others. The screening covers companies providing full weapon systems and platforms, or key parts and services, for controversial weapons*

*Definition of Key Parts or services for Weapons: Key parts include subsystems of the whole weapon system (e.g. if the system is a rocket, the motor, fins, and random are some of its key parts) as well as end products that are essential to weapon systems, such as combat equipment. Key services include services that are essential to weapon systems and combat, such as communication, testing or flight simulation training services, design services. Other examples of important subsystems for a weapons system, could be the barrel for a gun, ammunition magazines, engines and transmission for weapons platform, the fuze for munition, the guidance package for a missile, arming devices for warheads, targeting radars, etc.*

For the Best-in-Class approach, the investment team uses a holistic ESG Rating which considers the issuers' overall ESG performance based on industry-specific ESG indicators. The investment team excludes the worst scoring 50% per sector.

During the construction of the portfolio, the fund aims to reduce the aggregated Scope 1 and 2 greenhouse gas emission intensity by at least 30% compared to the market benchmark. Within the portfolio construction, companies are preferably invested, if they have joined the "Science Based Targets" Initiative or have set themselves quantifiable decarbonization targets.

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As a result of these ESG guidelines for screening, it is expected that the size of the investment universe of the Fund will be reduced by about 40% to 50% in terms of number of issuers.

The ETF does not invest in sovereigns of countries that practice the death penalty, as it is the ultimate cruel, inhuman and degrading punishment and a violation of the right to life.

The fund primarily invests into Corporate Bonds to achieve the investment objective. Derivatives can be used for hedging and efficient portfolio management (EPM). Those derivatives can be FX forwards, interest rate futures and index CDX. Derivatives used for those purposes do not have to fulfill all criteria outlined above.

The product does not use any derivatives on agricultural commodities.

The fund can invest into other CIS up to 10% of the fund's assets. Those investment schemes do not necessarily have to fulfill all criteria of this policy but they explicitly must promote environmental or social characteristics according to Article 8 or Article 9 or Regulation (EU) 2019/2088. Furthermore, the funds need to adhere to the criteria of the Towards Sustainability Initiative.

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### Engagement

Invesco Systematic and Factor Investing (SFI) enters regularly into dialogue with carefully selected target companies via the Global Engagement Service of Moody's ESG. The potential target companies are selected by SFI and a final selection of the companies to be engaged with is then agreed with Moody's ESG. In general, the team look to engage on topics related to the SFI Priority ESG Themes, which are Climate Change, Human Rights, Supply Chain Management, Water and Bribery/Corruption.

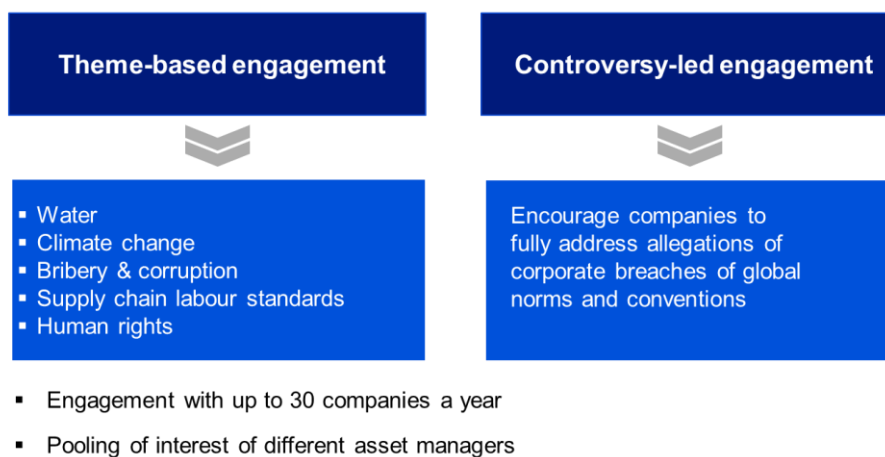
SFI selects investee companies which are at a size and stage making them likely to be influenceable. The objective is to identify weaknesses in the company's sustainability management and discuss these with management to enable the companies to achieve a better ESG performance in the medium to long term.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

SFI's engagement priorities can be differentiated between the following two methods:

1. 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.
2. Controversy-led engagement, which aims to prompt companies to observe internationally-recognized standards and conventions and correspondingly improve their company guidelines.

### **Engagement – Direct dialogue with companies**

Global Engagement Service



Source: Invesco, Vigeo Eiris. For illustrative purposes only.

Moody's ESG undertakes a detailed assessment of the themes for each company that the SFI 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.

SFI also leverages on the firm-level engagement and actively supports the Climate Action 100+ initiative.



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Invesco Systematic and Factor Investing (“SFI”) manages \$52B in assets as of March 31, 2022 across a variety of strategies. SFI seeks to deliver factors that are outcomes-based and consistent over time. The Fixed Income Factor Strategies team’s (“the team”) highest priority is that our factors perform as expected, month after month, so that clients can have confidence they are getting the exposures they seek. Accordingly, the team emphasizes several criteria. First, factor definitions are no more complex than necessary to capture the desired outcome. Unnecessary complexity adds costs in the form of inefficient turnover and reduced transparency. Similarly, Fixed Income factors must be robust to the realities of fixed income markets. It may not be possible to purchase certain bonds at attractive prices. Effective implementation must be achievable when only a subset of the eligible universe is held in a portfolio. Diversification must be maintained at all times. Excessive concentration adds undesirable idiosyncratic risks. Finally, risk premia factors are the most reliable and scalable factors in the fixed income asset class.

Disciplined investigation shows there are only a handful of factors that represent true risk premia with an underlying rationale that passes rigorous scrutiny. Data mining is a risk in any empirical research. To build confidence in our process, the rationale for these factors should, for the most part, extend across credit ratings, geographical regions and asset classes. Different than maximizing empirical results, the factors the team pursues are rooted in risk preferences, which show stability in aggregate across most markets.

It must be kept in mind that risk premia are exactly that, a premium obtained for taking on additional risk. It is also critical to understand the historical backdrop in which we operate. A super-cycle of globally declining interest rates over a multi-decade period and massive fiscal and monetary intervention since the global financial crisis materially impacted fixed income results. The team cross validates our factor design by looking at performance through specific regimes; verifying that the premium observed is commensurate with this risk.

Finally, the team believes that fixed income markets are materially different than equity markets. For example, the over-the-counter manner in which bonds are traded increases trading frictions, reduces transparency and affects investor behavior. Market weighted bond indexes are not sized by investor demand the way equity indexes are. There are numerous (largely subtle) differences between equity and fixed income investors. For these reasons, fixed income factor strategies must be constructed and managed utilizing expertise and experience in the asset class and not a simple replication of equity techniques. While some of the same phenomena are observable in both markets, idiosyncratic differences cause them to manifest in different ways. Effective fixed income factor implementation should seek to replicate the spirit of a desired risk premium, not a naïve implementation of a premium observed in equities. The Factors Strategies team leverages Invesco’s large, global fixed income and currencies platform to do just that.

When constructing factor-based portfolio, the team can utilize several different approaches. A full replication process or fully passive approach will buy all of the bonds specified by the factor-based index. This approach will have the lowest tracking error to the index but may incur costs due to inflexible trading constraints. An active implementation approach will deviate from the index to find those bonds which will minimize the cost of implementation while maintaining similar overall factor characteristics to the index. This approach is the most preferred within fixed income portfolio which seek to implement factors strategies within broad based fixed income universes. A synthetic approach will utilize derivatives such as CDS, futures, swaps and total return swaps to mimic the returns of the index. These portfolios allow for the cheapest cost in trading. However, they can have large tracking error and limited capacity. In practice, the team recommends a combination of all three approaches in order to implement factor portfolios most efficiently.

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### Fund Facts

#### Invesco EUR Corporate Bond ESG Short Duration Multi-Factor UCITS ETF

<b>Actively managed by Investment Centre</b>	Invesco Fixed Income Factor team
<b>ISIN</b>	IE000PA766T7
<b>Contracted Vehicle Type</b>	<b>Umbrella investment company with segregated liability between Funds and with variable capital</b>
<b>Domicile Country</b>	Ireland
<b>Launch Date</b>	22 June 2022
<b>Fund volume</b>	EUR 12m.

Source: Invesco as at 22 June 2022.

## Important information

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