WELLINGTON
MANAGEMENT®

Sustainable approach applied to FDC's sub-fund *FDC SICAV Obligations Monde – Actif 3*

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Within our Global Bond portfolio, we incorporate Environmental, Social, and Governance (ESG) factors in our assessment of security selection and sovereign risk.

Security selection

We believe material ESG factors can have a significant impact on the performance of the companies in which we invest, and so we have developed a process to integrate ESG factors, alongside valuations, fundamentals and market technicals, in the management of portfolios.

Wellington Management's ESG Research team applies a quantitative ESG ratings methodology to more than 8,500 companies that generates an overall ESG rating, as well as individual ratings for Environment, Social, and Governance risks. These quantitative ESG ratings are based on a combination of proprietary and third-party data and expressed on a scale of 1 to 5 with 1 being the best rating and 5 being the worst. Analysts can then conduct more in-depth research and engage directly with issuers, when appropriate, to ensure Wellington Management demonstrates best practice as an active owner

Portfolio managers specialized in credit idea generation have developed a repeatable framework for integrating these ESG ratings into their portfolio construction. This framework focuses on the Environmental and Social ratings because the analysis of Governance factors has long been a staple of our credit research analysts' core responsibilities. The process combines these Environmental and Social ratings with a relative value assessment for each issuer:

- Global Bond portfolios typically avoid issuers with internal ratings of 5 regardless of valuation as we view these securities as being of potentially higher risk relative to level of potential return. This is similar to the way in which issuers rated Sell by the Credit Analysts are excluded from portfolios to reduce the risk of falling into potential value traps.

- Exposure to issuers with a rating of 4 is also limited given their riskier investment profile, unless those issuers are likely to adequately compensate investors for these risks – valuations need to be compelling:
    - for issuers with ESG ratings of 4 for either Environmental or Social factors, the team looks for the issuer's spread to be greater than the average spread of its industry. The issuer's industry spread should also be meaningfully greater than the benchmark index, or the specific issue is a short-maturity security that is less likely to be materially impacted by the Environmental or Social risks identified prior to the maturity of that particular security.

To assist in implementing this framework, Portfolio Managers receive daily reports that highlight portfolio holdings with weak ESG ratings. In addition, representatives of Wellington Management's Investment Products & Strategies team meet with the Portfolio Management team on a monthly basis to conduct comprehensive ESG reviews of portfolios. These monthly ESG portfolio reviews help Portfolio Managers identify the greatest ESG risks and opportunities in portfolios.

Sovereign risk

Historically, research has focused on a sovereign's ability to pay its debts. However, ability to pay is no longer the only consideration for investors; they also need to gauge the willingness of sovereigns to make their bond payments.

We use a number of factors to gauge the ability and willingness of governments to pay their debts. Inputs include contingent liabilities of the state or metrics such as total debt to exports or revenue to debt, among others. However, the issue of willingness to pay necessitates the inclusion of politics into one's risk assessments, as it can be a major factor in determining how bond markets will behave.

To assess willingness to pay, we consider the World Bank's Government Effectiveness index in our bond rating analysis. Research shows that sovereigns with strong governance scores tend to be awarded high credit ratings, while countries regarded as having corruption problems tend to have lower credit ratings.

Inputs that can be used to assess the ability to pay include financial and economic ratios as the ones mentioned above. However, to assess the ability to pay, we also look at social factors, such as the World Bank's Ease of Doing Business index, which indicates how well the regulatory framework in a country supports the setting up and running of businesses. Countries, which score poorly in the index typically, have larger corruption and unofficial (black market) economies. The more-business friendly a country is, the higher tends to be the credit rating. A business-friendly environment is also consistent with higher tax revenues for the state which positively contributes to the ability to pay.

The "S" and "G" in ESG therefore give us valuable additional information when we are evaluating the risk of investing in sovereign debt, and in identifying return opportunities in better-positioned countries.

As available data continues to improve in this area, we expect to continue to enhance our approach to integrating material ESG factors into our evaluation of sovereign bonds.