Franklin Templeton Fixed Income Sustainable Investing Framework

Franklin Templeton Fixed Income Sustainable approach applied to FDC's sub-fund SICAV Global Bonds – Active 1.

Overarching ESG Strategy

The sustainable investing approach applied by Franklin Templeton Fixed Income comprises integrated ESG analysis, product and service-based exclusions, a modified 'best-in-class' approach, and a tilt that is based on our own internal proprietary methodology. In addition, we observe an engagement strategy and use proprietary modelling to analyse our sovereign holdings. This means that the funds, including the sub-fund, apply a minimum ESG rating that is required for investment, as well as a climate transition analysis that results in favoring issuers which are transitioning to low-carbon economy. While the funds operate without a formal divestment strategy, the portfolio manager exercises judgement where it is checked if a company engages in egregious activity that is specifically excluded by the ESG strategy itself.

Integrated ESG analysis

The sub-fund leverages an investment process that integrates environmental, social and corporate governance (ESG) data points as part of each analyst's risk-based assessment. Within each industry sector, analysts identify and evaluate material ESG issues, and price them into their fundamental debt assessment. An economic analysis of risks inherent in sovereign and corporate bonds ensures that clients are compensated for the risks they are taking.

For sovereign research, the sub-fund utilises macro and country specific research that leverages on a newly developed sovereign research model. This model provides a methodological approach to quantifying the extent to which a country is exposed to specific ESG risks, based on multiple data points collected annually. The model was constructed using a regional approach to test, and thus giving more depth and gradation to an area of the world that has relatively high ESG scores. The sovereign ESG methodology assesses a country's exposure and management of the factors that we believe affect the prosperity of a country in the long term.

The broader fund range employs an engagement strategy whereby certain thematic engagement is undertaken, in addition to the normal engagement that is carried out within the fundamental research process.

For company specific ESG issues, each sector analyst engages with the companies that they cover, should additional disclosure or information be required.

For thematic engagement, the investment management will prioritize those issues that are systemic and can have a potential material impact on all companies in portfolio. For the sub-fund as well as the broader European Fixed Income funds, the management team views water scarcity strategy, climate change and energy transition as 'systemic and with a potential material impact'. Engagement is therefore carried out on those issuers that are deemed to be 'high risk' according to our internal assessment.

Negative/ Exclusionary Screening

FDC bespoke exclusion list

We screen out all issuers from the FDC's exclusion list (https://fdc.public.lu/en/investissement-responsable.html, section "Implementation of an exclusion list").

UN Global Compact

The sub-fund will not invest in companies that repeatedly and seriously violate one or more of the ten principles of the United Nations Global Compact. We use MSCI data and our internal due diligence process to validate this requirement.

Weapons

We do not invest in companies involved in the production or sale of anti-personnel mines and cluster bombs; companies involved in the production or sale of chemical, biological and depleted uranium weapons, as well as companies that manufacture civilian firearms. We do not invest in companies that derive more than 5% of revenue from such weapons.

We use MSCI ESG Research to define these restrictions. A soft alert system is set up so that managers receive a notification when they try to purchase securities where more than 1% of revenue is derived from such weapons.

Tobacco

We do not invest in companies that manufacture tobacco. Further, we will not invest in companies that derive 5% or more of revenue from tobacco retail or distribution. To identify such companies, we use MSCI ESG Research on tobacco which identifies publicly traded companies that produce, distribute, retail, license or supply key tobacco products and services. A soft alert system is set up so that managers receive a notification when they try to purchase securities where more than 1% of revenue is derived from tobacco.

Fossil Fuel

The investment team believes that companies which derive unacceptable levels of revenue from the most polluting fossil fuels are a material risk to the sub-fund as well as to the environment. We use MSCI ESG Research's data to identify companies that are decarbonizing at a slower rate than their peers and we may engage around their carbon emission strategy improvement.

Coal

We do not invest in companies which derive more than 5% of their revenue in exploration, mining, extraction, transportation, distribution or refining of thermal coal. We use MSCI ESG Research's data to identify these companies.

Unconventional oil & gas

Companies must derive less than 5% of revenue from Unconventional Oil & Gas. We use MSCI ESG Research's data to identify these companies.

Power Generation

We do not invest in companies involved in power/heat generation which derive more than 30% of their revenue fossil fuels and/or 10% or more thermal coal. We use MSCI data to validate these requirements.

Adult Entertainment

The sub-fund will not invest in companies that produce adult entertainment. Further, we will not invest in companies that derive 5% or more revenue from adult entertainment. We use MSCI data to validate this requirement.

Gambling

The sub-fund will not invest in companies that produce gambling services or products. Further, we will not invest in companies that derive 5% or more revenue from gambling. We use MSCI data to validate this requirement.

Gender, diversity, and remuneration

We assess the management of social factors of the issuers that we invest in as well as a companies' ability to attract, retain and develop human capital. Analysts consider such factors as the strategy and programs around employee engagement, training and development, and benefits; percentage of women on board; gender pay gap ratio and degree of racial and ethnic diversity in the workforce, on the executive management team and board; and controversies related to labor rights and discrimination.

At firm level, we offer an educational series to promote inclusion, mitigate unconscious bias and increase cultural sensitivity awareness. We encourage inclusion through our employee-led Business Resource Groups. We participate in indexes and industry surveys to help us evaluate how we're doing against our peers. We partner with organisations like Women in Capital Markets and joined the CFA Institute's Diversity & Inclusion Experimental Partners Program to help us foster a more inclusive investment industry. Our chief diversity officer is Regina Curry.

Taxation

Our analysts conduct fundamental analysis to assess all risk factors associated with investment opportunities which include issues related to taxation. This fundamental analysis allows us to identify risks that companies may face and evaluates the extent to which companies may face ethics issues such as fraud, executive misconduct, corruption scandals, enhanced public and regulatory scrutiny as well as potential liabilities because of actual or perceived avoidance of corporate income taxes.

Use of Derivatives

Derivatives are used in the context of efficient portfolio management, for hedging purposes and to adjust our country, sector, interest rate and currency exposure on the sub-fund.

Oppressive or dictatorial regimes and use of the death penalty

We are wary of countries where dictatorial or oppressive dominate – such regimes would typically flow through to a disregard for shareholder rights, bad governance, and a lack of regard for the ordinary institutions that would reassure investors. While we would expect the Freedom house index to be an effective proxy for these regimes, the governance of these regimes is considered in detail in our investment process. Our proprietary sovereign ESG model, available to the whole investment team, includes data points reflecting civil liberties, rule of law and freedom of press, among others. Regarding the death penalty, we leverage 'Legality of Death Penalty' (government_death_penalty) data point in MSCI to map countries allowing the capital punishment.

Divestment Guidelines

The portfolio management team will divest from a security within three calendar months in the event of a rating change, downgrade, or contravention of any of the sub-fund's stated policy. Where investment in the security is erroneous and contrary to stated policy from the outset, the portfolio management team will divest as soon as is practically possible, to prevent or minimize overly punitive loss for clients.

Other

The sub-fund adheres to the Franklin Templeton Controversial Weapons Policy

Statement on the Modern Slavery Act 2015

Sovereign Analysis

The sub-fund will not invest in countries that exhibit insufficient scoring according to the Freedom House Index.

Best-in-class Approach

The sub-fund will not invest in companies that present an overly egregious ESG risk profile. Going forward, this has been ratified into a formal policy that precludes investment into companies that fall below our internal tolerance level – defined having rating of CCC according to MSCI.

Climate Transition Performance Analysis

We have created a proprietary framework that we apply to global indices to accurately assess relative performance across a suite of environmentally focused metrics. We can apply this methodology to any index, and portfolio managers and analysts can view this information in real-time, alongside our own internal fundamental analysis.

For the sub-fund, we remove from our investable universe the issuers that score in the bottom 20% according to this methodology. This results in favoring investment in issuers that we believe are responding better or faster to the risks of climate change.

Engagement

We carry out thematic engagement where we believe that ESG risks are excessively high. This includes environmental externalities such as water management (including effluent, pollution, and biodiversity), energy transition risk and climate change risk. We also carry out this engagement where we would like to ascertain what the performance of a broader industry is like. We then assess the feedback and address any outliers with continued engagement.

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