ING Sustainability risk policy

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Risks can influence the value of investments. Managing those risks is an integral part of the investment process ING applies when it comes to managing discretionary investment portfolios and when providing investment advice. In this document we describe how ING Luxembourg takes sustainability risks into consideration within the investment and advisory process.

Summary

A sustainability risk means "*an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of investments*[1]". Poor management over any of these risks could result in a range of negative financial impacts on the investment (e.g. failure to remain resilient in a changing environment). For example, gender inequality in the board of a company could have reputational risk and therefore has the potential to affect the economic value of a company, which could negatively impact the result of the investment.

Not only individual companies, but also entire sectors can be negatively affected by sustainability risks. For example, if a sector does not adapt properly to the energy transition despite the increasing public and policy pressure to phase out unsustainable energy sources in the future, this can have negative consequences for the operations and profitability of that sector and therefore could negatively impact the result of the investment. The coal industry is a typical example.

For the above-mentioned reasons sustainability risks are a key factor and, like other risks, an integral part of our investment decision-making process for all portfolio management mandates and investment advice services.

We take sustainability risks into account on two levels:

- **Sector level**
  - By excluding sectors that by nature are more exposed to sustainability risks (e.g. Controversial weapons, Coal and Tobacco), we thus lower the sustainability risks we are exposed to.
- **Instrument level**
  - <u>For companies</u>: all companies are screened on sustainability risks by using the ESG risk rating provided by Sustainalytics (ESG meaning Environmental, Social and Governance) and the Non-Financial Indicator (NFI)[2], which is calculated on the basis of Sustainalytics data. These indicators give an indication of the magnitude of an organization's unmanaged ESG risk which could potentially have substantial impact on the company's economic value.

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[1] According to the Sustainable Finance Disclosure Regulation (EU)2019/2088.

[2] the Non-Financial Indicator (NFI) measures the extent to which a company has embedded sustainability in its organization. We use the NFI for equities, to understand how a company scores on the management of material environmental, social and governance issues compared to others within its sector

- For funds: we have a quantitative approach powered by Morningstar, based on Sustainalytics data, that uses the ESG score of underlying assets added up at fund level.
  This results in a bottom-up approach that looks at the sustainability risks of underlying holdings. This approach can eliminate severe and high sustainability risks. This does not apply to passively managed funds, like ETFs, as due to the nature of the instrument sustainability risks are not managed.
- For sovereigns: all sovereigns are screened on sustainability risks by using the credit rating provided by a credit rating agency (i.e. Moody's, Fitch or Standard & Poor's). The credit rating provides an insight in the willingness and capacity to meet the financial commitments of the sovereign. The sovereign analysis typically considers ESG factors in the context of the assessment of institutional quality and governance effectiveness, itself a key part of the overall analysis.
- For structured notes: we take sustainability risk into account by assessing the underlying guarantee structure. The issuer of the guarantee will be screened on sustainability risks by using the ESG risk rating[3] of the concerning company provided by Sustainalytics[4].

This does not mean that we will systematically disregard an instrument with high sustainability risks, but those instruments will undergo additional scrutiny. Such an instrument might still be included in the portfolio, but only when we expect that the higher risk will also result in a higher return or will be balanced by lower risk on other factors. For example, we could choose to invest in an oil company because the short time expected returns outweigh the sustainability risks. However, the portfolio manager will have to justify this choice by considering the preference of the client. All changes to the recommended Investment Universe are confirmed periodically in the Investment Management Committee, and more frequently, if circumstances require so.

Additionally, to reduce the sustainability risk of the companies, we actively search for a dialogue with them through the ING group. At a group level, via engagement and voting we try to persuade the management of companies to change their behavior or change the activities of a company whenever we deem this desirable. In this way we try to reduce (potential) sustainability risks. For more information regarding our engagement please consult our website ING Engagement Guidelines - https://assets.ing.com/m/cf4c40b1780fc7ae/original/ING-Engagement-guidelines-June-2020.pdf.

The sustainability risk policy will be reviewed on a yearly basis or more frequently if deemed necessary (e.g. further operational or regulatory changes).

[3] Sustainalytics' ESG Risk Ratings measure a company's exposure to industry-specific material ESG risks and how well a company is managing those risks.
[4] Sustainalytics, a Morningstar Company, is a leading independent ESG and corporate governance research, ratings and analytics firm that supports investors around the world with the development and implementation of responsible investment strategies