

NOVETHIC SRI LABEL Regulations 2011

Introduction

The Novethic SRI Label, launched by Novethic in 2009, aims to provide **individual** investors with a framework for SRI products offered by investment managers. As the Label is assigned by Novethic's SRI Research Centre, an independent body, investors are ensured that an SRI process exists with the greatest transparency possible regarding the SRI product(s) available. Label methodology is subject to advisory review by a committee of experts.

This document has been translated into English. If there is any inconsistency or ambiguity between the French version and the English version, the French version shall prevail.

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Terminology

The two terms prevalent throughout this document, SRI and ESG, may be used interchangeably by product providers.

The following definitions are from the Transparency Code for publicly available SRI funds established by the AFG, the French Asset Management Association, and FIR, the French Social Investment Forum:

- **Socially Responsible Investment (SRI)**

Application of sustainable development principles to investment. This approach involves systematically taking into account Environment, Social and Governance (ESG) aspects in addition to the standard financial criteria when making investment decisions. The practices used to implement this approach vary, but are generally based on positive screening, exclusions or a combination of the two. Funds may also initiate dialogue with issuers as part of their approach.

- **ESG Criteria**

Environmental criteria: The direct or indirect impact of an issuer's business on the environment.

Social criteria: The direct or indirect impact of an issuer's business on stakeholders with regard to universal values (human rights, international labour standards, anti-corruption, etc.).

Governance criteria: The processes, regulations, laws and institutions that influence how a company is managed, administered and controlled. They also cover relations with the different stakeholders and the objectives that govern company strategy. The main actors include the company's shareholders, management and Board of Directors.

1. Labelling procedure

The labelling procedure is carried out once a year, and results are announced in the autumn. Once awarded, the label is valid for one year subject to the verification of product compliance with label criteria six months later, in the spring.

The labelling procedure follows the steps below:

- Call for applications: An application is sent to all SRI investment managers present on the French market, as identified by Novethic. Applications are also available upon request.
- For each labelling period, applications must be submitted prior to a deadline set by Novethic. Once the complete application has been submitted, Novethic may ask further questions or request additional documents. Items provided by the investment manager in the application must be valid and in effect when the application is submitted. Future commitments are not taken into account.
- Novethic processes all complete applications in the order in which they are received and determines which funds will be awarded the Label. The investment manager is then notified of the results a few days prior to their public release.

The same procedure applies for the Novethic SRI Label associated awards.

2. Labelling terms

A. Eligibility

SRI funds of all asset classes can qualify, provided they are:

- Authorised by the AMF (French Financial Services Authority) to be distributed in France.
- Available for individual investors. Investment managers must prove that funds are available to individual investors in one of the following ways:
 - a. Fund presented on the website of the investment manager or retail distributor under the section dedicated to individual investors.
 - b. Fund presented as part of a life insurance product available to individual investors.
 - c. Fund available through retail investment channels (internet platforms, private banking, etc.).
 - d. Funds actively distributed through a bank or insurance network.
 - e. Employee savings pooled funds also qualify.

B. Specific cases

- Feeder funds are eligible. The master fund must meet Criterion 1, while the feeder fund must meet Criteria 2, 3 and 4. All the information relating to the master fund and required by the Label criteria must be available to feeder fund investors either directly or by referring the master fund.

- For funds invested partially or exclusively in other funds, two scenarios have been identified:
 - a. These funds account for less than 10% of the assets of the applicant fund. If the funds are SRI¹, they are deemed to have been subject to ESG screening. Otherwise, they fall into the 10% of assets that are not screened (see Criterion 1).
 - b. These funds account for more than 10% of the assets of the applicant fund: The funds must then have the SRI label. As labelled funds themselves have a tolerance threshold, the tolerance range of the applicant fund is reduced to 5%. This prevents excessive potential exposure to non-SRI securities but leaves the applicant investment manager some leeway for cash management.

In either case, both the applicant fund and its underlying assets must comply with the label's transparency criteria for direct investments (SRI screening process, extra-financial reporting and fund composition).

- ETFs are also eligible. The index construction process, whether or not external to the investment manager, is analysed as is any engagement approach that may be applied vis à vis companies included in the index.
- Structured or guaranteed funds are not eligible.
- Derivatives are not accepted within eligible SRI funds unless used exclusively for hedging purposes. The principle of SRI is to guarantee the highest possible degree of traceability, and it must therefore remain within the real economy.
- Securities-lending funds are eligible. The investment manager must have a repatriation policy applicable to securities lent that would allow it to vote at the general meetings of the companies in which it invests.

C. Processing fees

Novethic charges a processing fee of **EUR 500 per fund**.

Investment managers must pay the processing fee for the application to be reviewed.

Processing fees are not refunded if the label is not awarded. They are charged to cover the expenses incurred in reviewing the application. They are in no way to be considered as payment to obtain the Novethic label.

D. Compliance monitoring

Novethic reserves the right to verify that labelled funds still comply with Label criteria at any time. If any aspects of the labelled funds have changed, investment managers are asked to submit information in order to check whether their compliance with Label criteria has been compromised. The compliance of all funds with Label criteria is reviewed systematically in the spring, six months after the Label is awarded.

The investment manager must accept Novethic's requests for any documents or other information used to attest to the fund's compliance with Label criteria (application

¹ Identified as SRI by Novethic, whether or not they are labelled.

documents in addition to on-site interviews, if necessary). In exchange, Novethic shall not disclose this information if it has not been made public by the investment manager, and the investment manager has expressly indicated in the application that said information must not be published.

E. Non-compliance after the label has been awarded

If the fund does not comply with Label criteria, or if Novethic identifies a change in a fund's management or communication procedures that impacts its compliance with Label criteria, a review shall be initiated following the steps below:

- Contact is made with the investment manager for a closer examination of the items in question.
- The investment manager has one month to renew compliance with Label criteria.
- If the appropriate measures are taken, the Label is maintained.
- If the investment manager's reply implies that it cannot comply with Label criteria, or if the appropriate measures are not taken within the required one-month timeframe, the Label is withdrawn. All Label withdrawals are included in Novethic's communication on its Label.
- In either case, the investment manager is notified of Novethic's decision.
- In case of Label withdrawal, the investment manager must remove all references to the Novethic SRI Label from all of its communications related to the fund.
- Funds that have lost the label cannot re-apply the following year.

F. Change in criteria

Novethic may revise the Label Regulations every year. Any changes in the Novethic SRI Label criteria are indicated when the Label Regulations are sent to the investment managers listed by Novethic as active on the French SRI market at the time of the call for applications.

3. Criteriology

A. Novethic SRI Label: 4 fundamental requirements

To be awarded the label, funds must meet four criteria which represent the minimum guarantees for a fund to be qualified as SRI and meet basic transparency requirements. Three of these four criteria were further broken down into sub-criteria. In order to be considered for the Label, compliance with all Label criteria must be in effect at the time the application is submitted, rather than set as an objective to be reached thereafter.

The Novethic SRI Label application includes the list of documents required to validate the fund's compliance with Label criteria. Novethic may request additional documents. This information shall remain confidential if it has not been made public by the investment manager, and the investment manager has expressly indicated in the application that said information must not be published. Refusal to provide these items could compromise the awarding of the Label.

Furthermore, by submitting an application, the applicant expressly acknowledges that Novethic's interpretation shall prevail regarding the compliance of the criteria listed below. Consequently, applicants can inform Novethic in writing if they do not agree with this interpretation. Novethic shall in no way be held liable if the Label is not awarded, regardless of the reasons set forth. In particular, Novethic shall not be liable for repayment of application fees, as indicated in section 2.C of this document.

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Criterion No. 1 Environment, Social and Governance (ESG) Analysis - SRI Management

ESG analysis

ESG issues must be taken into account in the management of the fund. To assess this criterion, Novethic looks at whether the management process integrates:

- an **ESG rating** based on structured analysis

OR

- at least a **qualitative ESG analysis** that has a documented impact on selection and/or exclusion and/or engagement amongst issuers.

Whatever specific combination is applied, **Environmental AND Social AND Governance** issues must all be assessed and/or rated, even if the approach emphasises one or more of these categories over the others. Approaches whereby certain business sectors are favoured or excluded are not sufficient to meet this criterion.

Irrespective of the fund's SRI approach, Novethic reserves the right to determine whether an ESG information source is relevant given the investment universe, in particular when it is the fund's only source.

SRI management

The SRI management strategy must encourage the best extra-financial practices amongst issuers.

Different SRI approaches are accepted (best-in-class, best effort, weighting, norm-based exclusions, engagement, etc.) provided they are structured and have a **genuine and explicit** impact on the selection or weighting of securities in the portfolio, or on engagement with the companies in which the fund invests. This impact must exist for each type of issuer (companies, national and local governments, supranational bodies, etc.). In the case of qualitative analysis, the transparency of the process and reporting will be specifically reviewed to determine the impact on the composition of the portfolio or engagement practices.

Novethic may request additional information to better understand the relationship between the financial and extra-financial aspects of managing the fund.

ESG screening and SRI management must be applied to at least **90%** of the portfolio in terms of both assets (excluding cash and any community investment sub-funds) **AND**

number of stocks **AND** exposure², for all asset classes. As a result, a maximum of 10% can be invested in assets that have not been subject to extra-financial screening.

Specific case

The use of derivatives must be limited to instruments with a stable leverage effect used to hedge certain market risks. Derivatives must comply with SRI management: the fund's exposure to underlying assets that are not eligible according to its SRI process, such as macro-hedging, is limited to 10%. This rule does not apply to currency and interest rate swaps, as the fund's ESG screening and SRI approach cannot cover their underlying assets.

Criterion No. 2 Process transparency

Investors must be able to understand the fund's SRI characteristics and their impact on how it is managed. To do so, the following aspects are checked:

- The investment manager must publish an answer to the Transparency Code of AFG-FIR (French Asset Management Association - Social Investment Forum) or Eurosif guidelines regarding the applicant funds. This public document must be less than one year old.
- The answer to the Transparency Code must include up-to-date information about the SRI process including the ESG screening resources AND steps. According to the structure of the Transparency Code, the investment manager's resources must be mentioned in section 3, "ESG Screening Process", and the ESG screening steps listed in section 4, "Assessment, screening and investment policy".

The document must be dated, written in French and clearly available directly on the relevant fund page of the website of the investment manager and/or French retail distribution network. The fund's response to the Transparency Code must be informational in nature for individual investors. Otherwise, Novethic may also request the publication of a more concise and accessible document.

Specific cases

- The investment manager must specify how it uses derivatives. If derivatives are used, section 4 of the Transparency Code must specify any rules applied to limit their use and any ESG analysis or screening of underlying assets and/or counterparties.
- For funds involved in securities lending or invested in repurchase agreements, the investment manager must specify in section 6, "Voting policy", of the Transparency Code whether it has a repatriation policy applicable to securities lent, which allows it to vote at the general meetings.

² If leveraged derivative instruments are used, the absolute value of the exposure to SRI securities resulting from this leverage effect will be taken into account in the analysis of this criterion.

Criterion No. 3 Extra-financial reporting

The extra-financial reporting on the SRI fund must include:

- **Qualitative information on Environmental AND Social AND Governance issues** that have resulted in recent investments and divestments or structured engagement approaches towards issuers. If no transactions have taken place in the portfolio, descriptions of the ESG characteristics of a few issuers in which the fund is invested should be provided.

AND/OR

- **Quantitative information on the fund's ESG characteristics.** Background information must also be included (comparison with the benchmark or the investment universe or long-term evolution). The investment manager must provide a brief description of how these indicators are calculated, including the rating scale and the proportion of the portfolio covered.

This information must encompass all fund securities, particularly when the fund is invested in different asset classes.

The reporting must specify the **impact of ESG screening on the initial universe** in the form of a selectivity rate, exclusion rate or a presentation of the weightings associated with ESG ratings; this impact must appear for each type of issuer (companies, national and local governments, supranational bodies, etc.).

Extra-financial reporting must be **published at least on a quarterly basis**. Publication may be deferred for up to one month between the end of the ESG reporting period and online publication.

Extra-financial reporting may be separated from financial reporting, provided it is as easy to access as financial reporting and effectively covers the portfolio securities and not merely general SRI issues. This does not mean that general SRI issues or the company's activities should not be taken into account. However, these factors alone do not meet Criterion 3 standards.

The reporting must be dated, written in French and clearly available directly on the relevant fund page of the website of the investment manager and/or French retail distribution network. Fund providers are encouraged to include it in sales literature sent to individual retail customers (brochures, etc.).

Specific case

For engagement funds, extra-financial reporting must monitor the engagement initiatives in progress.

Criterion No. 4 Reporting on the composition of the portfolio

The full list of securities in the portfolio must be published. It must be clear for the investor and thus enhanced following the custodian's inventory for greater clarity. More specifically, the **names of issuers** must be easily **identifiable** (commonly used name rather than financial appellation), and the type of asset (equity, bond, etc.) must be

specified for each security. The investment manager shall specify at the beginning of the document if the fund is invested in a single type of asset.

The composition of the portfolio must be **published at least twice a year**. To avoid the risks associated with the disclosure of sensitive information and meet the regulatory requirements in some countries, publication may be deferred by no more than one month following the end of the reporting period. The actual date of the portfolio composition must therefore be within the past seven months. The weighting of each investment within the portfolio is not required for disclosure.

The publication must be dated, written in French and clearly available directly on the relevant fund page of the website of the investment manager and/or French retail distribution network.

To offer greater transparency for investors, investment managers are advised to publish this list of portfolio investments more frequently than every six months and include a summary on each security's ESG characteristics, in anticipation of potential questions from investors.

Specific cases

- For feeder funds, the entire composition of the master fund must be published, clearly specifying that it is a feeder fund.
- For derivatives, the composition of the portfolio shall specify the types of instruments used.

B. Two "awards" associated with the Label

Two advanced categories were defined for Label-compliant funds. If the fund shows that it meets these additional requirements, it can be attributed one of the two following "awards":

1. Engagement Award

As part of the fund management strategy, engagement practices are applied and documented with regard to Environmental AND Social AND Governance criteria in order to promote ESG approaches within companies. They must not be limited to mere questions on some business aspects; resources, policy and objectives must be pre-defined and included in the communication sent to investors.

This implies an annual engagement established with **a significant number of companies** held in the portfolio and **reporting published at least once a year**, which includes:

- Reasons for engagement
- Specific improvements expected
- Depending on the advancement of the process, information on one of the following items:
 - Responses from the company to requests from the investment

manager

- Impact of the engagement process on fund management, such as divestment with the appropriate public communication
- Filing and/or support of a resolution at a general meeting
 - Impact of the engagement approach on company ESG practices.

For greater transparency and clarity for investors, this reporting must mention the names of the companies and the issues involved in the engagement approach.

This reporting must be dated, written in French and clearly available directly on the relevant fund page of the website of the investment manager and/or French retail distribution network.

The investment manager must provide the companies concerned with official communication on the engagement approach³ and the improvements expected. Novethic may ask the investment manager for access to the documents communicated.

2. ESG Indicators Award

The fund manager or an independent expert must measure the **fund's extra-financial performance** based on specific, publicly available ESG indicators.

The methodology for calculating indicators must be clearly and transparently explained. Data must be updated at least once a year.

For funds that received the ESG Indicators Award the previous year, extra-financial performance must be measured and **monitored over time** (at least for the two previous years).

The document presenting the measured extra-financial performance must be dated, written in French and clearly available directly on the relevant fund page of the website of the investment manager and/or French retail distribution network.

4. Stakeholders associated with the Novethic SRI Label

A. Consultation with SRI fund promoters: Technical Council

Composed of SRI analysis and management professionals from the SRI commission of the French Asset Management Association AFG, the Technical Council is consulted every year regarding the labelling process. This is done to collect the points of view of practitioners in an organised and multilateral way concerning ESG screening and SRI management techniques used by investment managers. The members of the Council are proposed to Novethic by the AFG.

B. Approval of methodology: Committee of Experts

The Committee of Experts is comprised of representatives from organisations dedicated to promoting SRI, consumer organisations or independent SRI specialists. It offers its opinion on the consistency of the methodology with the philosophy of the Label and

³ This type of communication requires a traceable document addressed to the management of the company and signed by the management of the fund management company.

approves any amendments to the Regulations every year. Its members are co-opted by Novethic.

5. Communication associated with the Label

The Novethic SRI Label is associated with a logo including the year the Label was awarded with a specific version for each of the two Label Awards.

Investment managers that wish to use the Label in their fund communication must agree to the terms set out in the "Label Communication Charter" provided when the label is awarded, which include:

- Communication using the Novethic SRI Label is prohibited without Novethic's consent, except for standard communication as described in the Label Communication Charter. In the latter case, investment managers are still required to systematically send the communication to Novethic.
- Only the pages or documents dealing specifically with labelled fund(s) may refer to the Label.
- If a list of funds includes both labelled and unlabelled funds, it must clearly state which funds have been awarded the Label.
- An SRI fund distributor can in no way use the Novethic SRI Label as a guarantee of the financial performance or security of a labelled fund.