Lupus alpha
Sustainability Report 2023

Lupus alpha

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Dear Readers,

A good three years after the implementation of the Sustainable Finance Disclosure Regulation (SFDR) in March 2021, it is time to take stock. The benchmark should be the overarching goal of the regulation: to create greater transparency regarding sustainable investments and to channel more capital into sustainable products. In light of ongoing criticism from market participants and the impending revision of the SFDR, it can be said without hesitation: there is still much to be done to achieve effective regulation.

Is more capital being directed into sustainable investing? At first glance, yes: According to the Forum Nachhaltige Geldanlagen (FNG), the investment volume of public funds, mandates, and special funds classified under Article 8 or Article 9 SFDR rose to 542.6 billion euros in 2023 – a 14 percent increase. However, this view is clouded by BVI statistics, which have recorded net outflows from sustainable public funds since Q3/2023. Part of the volume growth is therefore due to the market effect. Net inflows, on the other hand, come from the institutional sector. Institutional investors, in particular, have long defined sustainability criteria as a fixed component of their investment guidelines and continuously develop these. The pioneers include church institutions, for whom Lupus alpha has considered corresponding, particularly ethical, guidelines since its founding.

BVI figures indicate that the long-standing stable trend toward sustainable investments is weakening. It seems that regulation, in particular, is slowing down this trend. Apparently, the SFDR does not lead to more transparency – its actual purpose – but rather creates confusion among private investors. In case of doubt, financial advisors are more likely to check the „No“ box in client dialogue.
New ideas need to prove themselves first:

How effective is it to regulate the names of funds or to introduce an ESG scale modelled after Nutri-Scores for food? Such requirements often lead to apparent transparency that helps no one. Additionally, the entire project suffers from a central gap that urgently needs to be closed, as the BVI demands: There is still no fundamental definition of what constitutes a sustainable product.

What is needed is regulation with a sense of proportion instead of a tight regulatory corset, so that capital markets can fully play their mobilizing role in the long-term transformation of the economy. Regardless, Lupus alpha remains true to its principles: We provide maximum transparency about our strategies, thus enabling investors to make their own informed decisions.

Yours sincerely

Corporate responsibility

Our relationships with our clients, business partners, employees and shareholders are defined by fairness, solidarity and trust.

LUPUS ALPHA – WHO WE ARE

Lupus alpha was founded in October 2000 as one of Germany's first independent asset management companies. With a partnership-based corporate structure and independence from banks, the founding partners laid the foundation for a unique corporate culture that provides optimum support for a focus on quality and performance and offers long-term prospects for the Company's top performers. This has made Lupus alpha a genuine alternative to the competitors dominating the market to this day. Since the company was founded, we have focused on investment approaches in specialised asset classes with particular return drivers. Starting with the European small- and mid-cap segment, Lupus alpha succeeded in generating lasting added value for investors with one of the largest and most experienced teams in Germany specialising solely in small and mid caps as well as an active bottom-up approach based on fundamental research. As one of the first providers of absolute return concepts, Lupus alpha continued to specialise in 2003 and expanded its product range into the area of Alternative Solutions. This development was triggered by growing demand for liquid alternative investment approaches among institutional clients and a wider statutory framework.

Today, the product portfolio includes investment concepts in the asset classes equity, convertible bonds, collateralised loan obligations, volatility, value protection and risk overlay. With almost 100 employees, including 35 portfolio management specialists, we use specialised strategies to systematically uncover new alpha sources and sustainable risk premiums for our investors. By doing this, we create innovative opportunities for them to further diversify their overall portfolio.

Lupus alpha has set itself an ESG mission statement in 2022, which will guide the ESG strategy in the coming years:

Lupus alpha has stepped up to create value and added value from responsibility: We support people and institutions in shaping their financial future. We are convinced that it is impossible to separate provision for the financial future from responsibility for a future in which we all want to live.

Responsible investing makes an important contribution to this. Since its founding in 2000, Lupus alpha has placed long-term responsibility for achieving superior investment results and building and maintaining trusting and resilient relationships with clients, employees and other stakeholders at the forefront of its actions and investments.

As asset managers, we are aware of our fiduciary responsibility to our clients at all times. Responsible investing is inextricably linked to this fiduciary responsibility. It is our goal to achieve consistently superior returns for our clients and to identify and manage risks at an early stage. By carefully and comprehensively considering ESG factors, we can identify special investment opportunities and detect sustainability risks earlier.

We have signed the UN Principles for Responsible Investment (UN PRI) in 2015 and joined the Forum Nachhaltige Geldanlagen (FNG) as a member in 2019.

We have defined the key topics and formulated measures for achieving these goals in our ESG-strategy. The Executive Board is responsible for Lupus alpha's ESG-strategy. All employees are responsible for ensuring that it is implemented effectively as part of their respective roles.

RESPONSIBILITY TOWARDS CLIENTS AND BUSINESS PARTNERS

We place particular emphasis on maintaining a cooperative relationship with our clients to ensure that we can recognise their needs as accurately as possible at all times and offer them a genuinely personalised service. Sustainable investment strategies have long formed part of these client needs and have been gaining significance for some time now. In light of this, our integrated range of services also includes implementing tailored solutions for our institutional investors using our own sustainable investment approaches. We also provide our clients with regular reports and up-to-date information on our investment strategies to ensure maximum transparency with regard to the investment process, performance and relevant ESG indicators. We promptly inform clients of any changes or adjustments to products or processes and keep them up to date with the latest developments at all times. As well as taking comprehensive measures to ensure compliance with laws and regulatory requirements as a matter of course, Lupus alpha also applies the Rules of Conduct issued by the Bundesverband Investment und Asset Management (Federal Investment and Asset Management Association - BVI). Ensuring that our relationships with our clients, business partners and employees are defined by fairness, solidarity and trust and that we communicate transparently with all stakeholder groups is important to us. Lupus alpha expects its employees to behave with integrity towards its clients and business partners to avoid conflicts of interest and act consistently in the interests of the clients. Furthermore, all processes are constantly monitored in accordance with relevant rules. Employees who work with our business partners receive regular training on issues such as preventing money laundering and insider trading in order to become aware of these issues. Individual departments are also subject to regular risk monitoring to ensure that operational and procedural risks are constantly monitored.

As part of our outsourcing partners' risk analysis, we assess how they implement ESG criteria within their companies. If individual criteria are not met, we reserve the right to take further action and terminate existing business relationships in cases of doubt.

RESPONSIBILITY TOWARDS EMPLOYEES

Lupus alpha's corporate culture is defined by open, constructive communication, a high degree of personal responsibility and the satisfaction of our employees. A positive working environment is as crucial as professional development and wellbeing. We help our employees to continually develop their professional and social skills and open up their professional prospects. After all, only highly motivated staff can deliver the best performance for our clients. Dedicated, skilled employees make a decisive contribution to the long-term success of the Company and help us to gain an important competitive advantage in the asset management sector. This means not only attracting the best talent but also motivating them to be top performers and keeping them at the Company in the long term. We treat each other as equals and invest systematically in young talent and leaders who actively take responsibility and drive Lupus alpha forward.

The annual Open Forum employee survey was introduced back in 2000 to promote an open critical exchange of views between employees, management and partners. This communication platform contributes to the internal discussion and helps us to form opinions about issues that are important to our employees, which in turn enables us to respond with specific measures where appropriate. Employees across all departments are also included in the further development of the Company's strategy via the annual targets workshop, where suggestions from our employees are collected, discussed and prioritised. Selected proposals are then incorporated into annual target planning and the necessary measures are implemented by cross functional project teams.

In 2021, all employees had the opportunity to contribute to the „Lupus alpha 2025“ strategy process. This was done through an ideas contest, an employee survey, and several workshops. Due to the very high response, the concept for a continuous ideas management system was developed in 2022, which went live for the first time in 2023. Throughout the year, employees had the opportunity to submit ideas as part of the ideas contest. At the end of the year, the best three ideas were awarded prizes. The program received a great response, with over 100 ideas submitted, many of which related to sustainability. Currently, some of these ideas are being evaluated for their feasibility.

Professional development

When it comes to professional development, Lupus alpha offers various programs tailored to our employees' individual roles. In addition to the Introduction Course, which provides an overview of all of the Company's divisions, additional opportunities are also available to new employees. Every new joiner is assigned an experienced senior manager as part of Lupus alpha's mentoring program. This program promotes the systematic integration of new colleagues. Regularly, internal "Lunch & Learn" events are held, during which various departments present detailed investment strategies, processes, or background knowledge to all interested colleagues.

A special advanced training programme is also available to employees promoted into leadership roles. Combined with professional external training seminars, the Leadership Program provides new leaders with the best possible preparation for their new role within the Company and their team.

The Company specifically promotes professional development in the area of sustainable investments with CESGA® (Certified ESG Analyst) certification from EFFAS[1]. Employees also have the opportunity to make use of the part-time CFA program or MBA degree courses. The aim is to provide the best possible personalised training for our employees that takes their personal wishes and needs into account while also meeting professional requirements.

Health

Actively promoting the health and wellbeing of our employees is an important issue at Lupus alpha. All staff have access to a fitness studio where they can develop and prepare an individual training plan with a personal trainer. Employee-organised sports groups also meet regularly to prepare for in-house competitions or the J.P. Morgan Corporate Challenge race in Frankfurt. In addition to sport, healthcare is also a top priority at Lupus alpha. The healthcare program has been running for many years. It is open to all employees and includes a complete diagnosis day at the DKD Helios Clinic in Wiesbaden every three years, where a comprehensive check-up and specialist care modules are provided.

Additionally, employees can participate in various services offered by the medical service (B·A·D Gesundheitsvorsorge und Sicherheitstechnik GmbH) throughout the year, such as vision and hearing tests, workshops on ergonomic seating, or flu vaccinations. Since 2018, Lupus alpha has also provided all employees with an employer-funded private supplementary health insurance.

A mobility budget that can be used, among other things, for the purchase of tickets for public transportation, but also for the leasing of a job bike, gives our employees the opportunity to actively and sustainably shape their commute to work.

[1] The European Federation of Financial Analysts Societies.

RESPONSIBILITY TOWARDS SOCIETY

Since Lupus alpha was founded, we have regularly supported non-profit organisations such as Aktion Mensch, Schritt für Schritt –Hilfe mit System e.V., Oxfam, German Cancer Aid (Stiftung Deutsche Krebshilfe) and other regional institutions. In addition to making annual donations to nationwide organisations, we also support local causes close to our heart. Since 2006, we have provided financial support in Frankfurt and participated in the "Frankfurter Kinderbüro" Christmas campaign to make the wishes of children living in precarious circumstances come true, once again enabling around 50 children to receive their own personal presents shortly before Christmas in 2023. In recent years, this initiative has reached more than 5,000 children in Frankfurt each year. We also encourage and support any voluntary work carried out by our employees by granting them leave of absence, for example.

Responsible investment

We systematically integrate ESG factors into the investment process and use a flexible range of tools to incorporate ESG risks.

OUR APPROACH

We understand responsible investing to mean:

- the integration of environmental (E), social (S) and governance (G) factors into the investment process and risk management as well as
- the frequent exchange with companies that we invest in, on topics regarding E, S and G factors, asking critical questions and trying to initiate changes.

We believe that these non-financial factors have an impact on a firm's long-term financial performance. Companies with weaker sustainability standards usually have higher E, S and G risks.

In addition to fulfilling our fiduciary obligations to our clients, our goal is to enter into a long-term constructive dialogue with the portfolio companies. These conversations are the core of our equity strategies and we consider them to be essential for our long-term investment success.

In this context, we not only perceive ESG factors as additional risk factors, but also see in particular the opportunities and potential arising from the restructuring of the economy toward greater sustainability. In particular, companies that can benefit from the underlying structural growth drivers or transform their business model accordingly offer great opportunities.

SPECIFIC ESG APPROACHES

As a specialized active asset manager, we focus on the following areas:

- Small and mid caps
- Convertible bonds
- CLOs
- Derivative Solutions (value protection, volatility, risk overlay)

Here, we select specific paths for dedicated sustainability funds and mandates depending on the respective investment approaches and individual client needs.

Exclusions (negative screening)

In all our sustainable funds, we employ revenue-based and norm-based filters. This excludes investments in companies engaged in specific industries or sectors, and/or proven to violate social standards and principles of good corporate governance.

In our sustainable strategies, we have applied additional exclusion criteria beyond minimum requirements (excluding controversial weapons) for many years. Revenue-based exclusions comprise sectors such as:

- Coal mining and power generation
- Fracking
- Nuclear power
- Weapons and armaments
- Alcohol and tobacco

Norm-based exclusions include:

- Violations of the UN Global Compact (UNGC)
- Violations of international human rights conventions and inadequate response/accountability by the company
- Violations of ILO core labour standards within the company and its supply chain, and inadequate response/accountability by the company
- Severe controversies

The exact criteria for exclusions vary by strategy and fund according to investor preferences and regulatory requirements.

Positive screening and best in class

We screen the investable universe with respect to a wide range of ESG criteria. ESG scores and ratings can be used, but also data on the companies' contribution to sustainable development goals (SDGs) or the carbon footprint might be considered. In portfolio construction, preference is given to companies that have superior ESG profiles in relation to one or more of these factors, e.g. by giving them a higher weighting as in the Lupus alpha Sustainable Return fund. In addition, these factors can be optimised at the overall portfolio level to outperform a benchmark.

UN Sustainable Development Goals

With the adoption of the United Nations' 17 SDGs, at the end of 2015, the international community formulated a global agenda for sustainable development. On this basis, central topics can be identified which contribute to sustainable development on different levels (economic, social, ecological), e.g.

- renewable energies,
- medical technology,
- water supply.

Using external ESG data providers, the products and services of companies can be analysed with regard to their positive contribution to these topics. It is also possible to identify which of a company's activities have a negative impact on one or more goals. This data can be used to construct portfolios that are specifically targeted at one or more of these objectives. The Lupus alpha Sustainable Convertible Bonds, for example, actively includes the SDG contribution of companies in investment decisions.

Consideration of principal adverse impacts on sustainability factors (PAIs)

In principle, we measure the PAIs of the portfolio companies in all our funds.

For our sustainable strategies, selected PAIs from the areas E, S and G are explicitly included in the investment process via exclusions and engagement. For explicit inclusion in the investment processes of our sustainable strategies, it is necessary that the required data is available and qualitatively appropriate for a large part of the investable universe. Otherwise, consistent integration into the investment decision is not possible.

ENGAGEMENT

Active dialog with our portfolio companies plays an important role, particularly for our small- and mid-cap strategies. We therefore also consciously use this approach when implementing the topic of sustainability in order to strive for improvements together with the companies. In principle, our small- and mid-cap portfolio managers also talk and discuss sustainability with all companies. The intensity and specific topics always depend on the relevant sector and business model. In addition to this informal dialogue, we maintain a formal and documented engagement regarding selected PAIs in our sustainable small- and mid-cap strategies and in our sustainable convertible bond strategy.

SOLUTIONS

In special funds and mandates, we implement customised sustainable investment solutions for all asset classes. Clients can define all parameters according to their guidelines, for example revenue limits, thresholds for ESG scores/ratings, CO_2 data or SDG contribution. We are also able to develop and implement new approaches with our clients. In addition to company and sector-related requirements, we can also define performance indicators at portfolio level, whereby we always focus on the compatibility of the performance targets with the chosen sustainability approach. We are constantly refining our processes and analysis methods and utilise additional external data sources, provided they meet our data quality requirements.

INTERNAL AND EXTERNAL DATA SOURCES

In recent years, the scope and quality of available ESG data has steadily increased. We have taken this into account by investing in external research and internal expertise. We are committed to incorporating all available relevant information when managing our funds as well as in client reporting.

In particular, Lupus alpha uses two external data providers with respect to specialised ESG data: MSCI ESG Research and Bloomberg. These providers complement our own fundamental analysis for each company.

In the front office, we use an internally developed ESG tool that enables portfolio management to quantitatively check the compliance of its investments with ESG criteria, analyse individual securities in detail, and evaluate aggregated portfolio key performance indicators (KPIs). This tool is based on data from our external ESG data provider MSCI ESG Research. For issuers not covered by MSCI, we collect the required ESG data ourselves in direct company contact. In addition, we can also overwrite the MSCI data in our internal systems if we determine that it is incorrect or outdated. This process is always carried out under the dual control principle and must be fully documented.

When it comes to portfolio implementation, we use SimCorp Dimension (SCD) software. This enables us to consistently block excluded issuers, meaning that portfolio managers and implementers can be reliably stopped from acquiring shares in blocked companies.

SUMMARY

We incorporate ESG criteria into our investment process in a number of different ways:

- Integration in fundamental analysis,
- Exclusions via revenue-based and norm-based screening,
- Best-in-class or positive screening,
- Engagement.

With these approaches, Lupus alpha has various instruments at its disposal for incorporating ESG criteria into the portfolio construction process as necessary to achieve a positive and informed outcome. We implement tailored sustainable investment solutions for all asset classes in our special funds and mandates, including via a combination of different instruments.

Our Engagement

Our ESG insight is based on constructive dialogue with companies.

FOCUS ON CORPORATE DIALOGUE

Constructive dialogue with the companies in which we invest is an essential part of our investment processes. Our small- and mid-cap team completes around 1,500 company meetings each year. Our aim is to bring relevant ESG issues to the attention of the companies and to exert influence in order to address corresponding risks and initiate positive developments. For our explicitly sustainable small- and mid-cap strategies, we also conduct formal and documented engagement with regard to selected PAIs.

Governance issues play a particularly important role here, as the quality of corporate governance is crucial to a company's long-term success. In this area, we focus on the individuals acting on behalf of the company, the independence of its supervisory bodies and how the company avoids conflicts of interest. Issues concerning the configuration of remuneration systems for management are equally important when it comes to aligning the interests of management with those of shareholders and other legitimate stakeholders. It is also important to ensure that management has a transparent information policy.

Questions concerning the environmental sustainability of production, working conditions and occupational safety as well as compliance with legal standards – including along the supply chain – also play a crucial role. These issues can pose both direct economic and reputational risks with the potential to damage a company's brand and threaten its business model. Other topics discussed include resource consumption, production processes, growth plans and the company's climate strategy as well as the configuration of outsourcing relationships and employee participation. In addition, our portfolio managers also keep in touch with their portfolio companies on an ad-hoc basis as required, particularly in the event of new controversies. The companies' responses and measures are monitored and documented, and these findings are taken into account when we review our investment decisions.

Even in strategies where we do not have voting rights, we rely on dialogue strategies despite the reduced opportunities to exert influence. In our convertible bond strategies, we also use dialogue strategies with the portfolio companies despite the lack of voting rights and the associated reduced opportunities to exert influence. We also engage in CLO strategies. However, due to the structure (structured product), this relates to the individual CLO manager or the individual CLO deal and not to the underlying loan issuers. We are increasingly talking to CLO managers about opportunities for ESG integration in the selection of underlying loans.

Formal engagement regarding CO_2 and board gender diversity

In our sustainable small- and mid-cap strategies and our sustainable convertible bond strategy, we consider selected ESG criteria in the form of formal and documented engagements. These criteria include CO_2 emissions and board gender diversity. While for some criteria, such as controversial weapons or severe violations of the UN Global Compact, only a strict exclusion is considered appropriate, CO_2 metrics and diversity provide a good basis for engagement. In line with the transition concept, we aim to positively influence companies and initiate improvements based on these two criteria. We believe this approach is more suitable than relying solely on strict exclusions. We conduct formal and documented engagements with companies that rank in the lowest quartile of their industry peer group in terms of CO_2 footprint and intensity (sustainable small- and mid-cap strategies) or in the lowest decile (sustainable convertible bond strategy), or where their board lacks female representation. However, if both criteria apply simultaneously to a company, it is deemed ineligible for investment by us.

Our engagement activity in 2023

In the reporting year, we were engaged in formal engagement processes with 55 companies, initiating new engagements with 24 and continuing 31 from the previous year. All engagements focused on CO_2 metrics. The following figures illustrate the engagements categorized by different criteria.

Figure 2: Ongoing engagements in 2023 by sector[3]

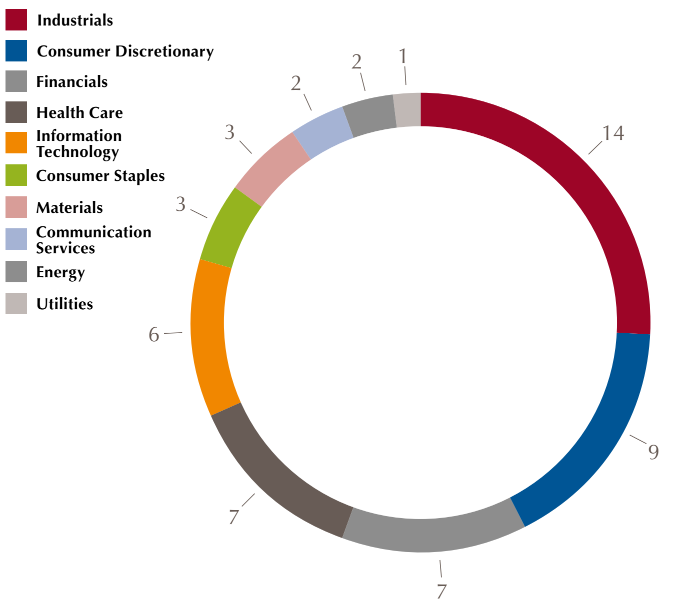


Figure 1: Ongoing engagements in 2023 by strategy[2]

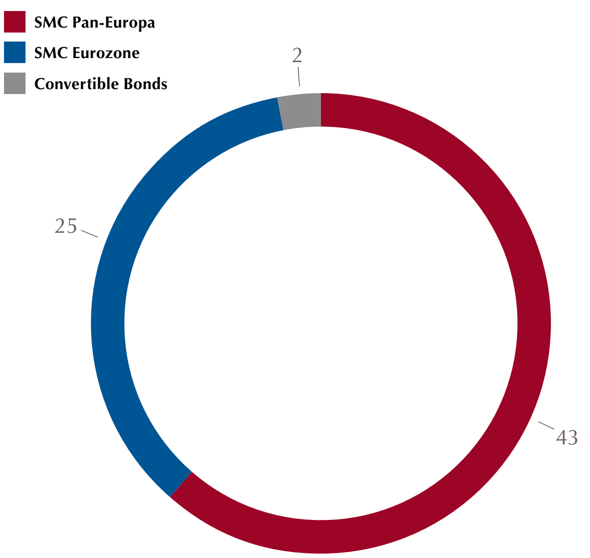
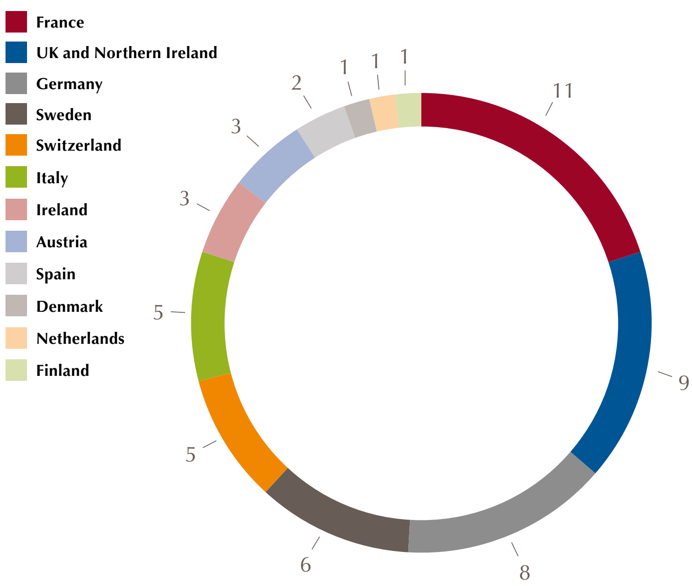


Figure 3: Ongoing engagements in 2023 by country



[2] An engagement case was assigned to a strategy if the company in question was included in the portfolio of that strategy during the current calendar year after the engagement began. Consequently, an engagement case may be assigned to multiple strategies.
[3] For the classification of sectors, we follow the GICS sectors. A company could not be assigned to any GICS sector, which is why the total sum of engagements in this graph is only 54.

Engagement example Jazz Pharmaceuticals

Jazz Pharmaceuticals develops medicines for diseases with limited therapeutic options, including sleep disorders, epilepsy, and cancer. In 2023, the company was accused of improperly exploiting patents at the expense of patients. Jazz Pharmaceuticals patented and included in the Orange Book the distribution process for one of its key medications – a treatment for the rare sleep disorder narcolepsy. Following a court ruling, the patent in question was removed from the Orange Book. We thoroughly investigated this incident and personally requested the company to address the allegations. Since the legality of a patent is determined by the relevant authorities and not by the patenting company, we concluded that no blame can be attributed to the company for this matter. Lupus alpha takes ESG controversies very seriously but also considers it our responsibility to critically examine such issues if necessary and engage with the involved companies.

Formal engagement example Valmet Oyj

Valmet Oyj is a leading company in plant engineering, offering innovative technologies, automation solutions, and services to the pulp, paper, and energy industries. At the end of 2022, we initiated a dialogue with the company due to its poor CO_2 performance compared to the industry. Particularly the downstream Scope 3 emissions in Category 11 „Emissions from use of sold products" are high and account for more than half of the company's total emissions. In discussions with the head of the ESG department and the Investor Relations department, we explored the reasons behind the high emission levels and the significant increase reported for 2022. It was determined that the high values and the revision were due to the extended lifespan of the products. Following our feedback, Valmet Oyj committed to providing clearer transparency on the reasons for the high emissions in this category in future reports. Our exchange with the company underscores the importance of a nuanced approach to ESG data. While extending the lifespan of machines results in an increase in Scope 3 emissions, this is positive from a sustainability perspective (particularly in terms of resource consumption). We continue to engage with Valmet Oyj and discuss their existing plans for reducing Scope 3 emissions ("carbon-neutral production").

Formal engagement example Ratos AB

Ratos is a Swedish investment company that acquires and develops companies offering „product solutions" and „industrial services" for the transition to a more sustainable economy. Due to its relatively high CO_2 emissions compared to its industry peers, we initiated a dialogue with Ratos. During a discussion, we addressed, among other topics, the high Scope 3 emissions reported by MSCI and discussed opportunities to enhance CO_2 reporting. Ratos subsequently committed to improving its CO_2 reporting. For instance, plans include creating a dedicated sustainability report for each of its portfolio companies.

EXERCISING VOTING RIGHTS

For Lupus alpha, responsible corporate governance plays a key role in the sustainable value creation of its investments. Lupus alpha attaches great importance to representing the interests and voting rights of its investors vis-à-vis stock corporations. The voting right is one of the most valuable rights of the shareholder and obligates him to use it responsibly. Lupus alpha thus sees responsible corporate governance as playing a key role in the sustainable value enhancement of its investments. Accordingly, we exercise our voting rights in the funds that we manage as a capital management company. In doing so, we are guided by international and recognized standards.

Voting rights are generally exercised for positions above a certain threshold (taking into account costs and expected benefits) in order to promote sustainable corporate development of the portfolio companies. Voting rights for stocks below the thresholds are only exercised when critical agenda items or decisions with a significant impact on corporate governance or business policy are to be voted on.

Our principles for exercising voting rights can be found here:

https://www.lupusalpha.com/esg/#publications

Due to the close contact of our portfolio managers to the portfolio companies, potential concerns can be discussed with the companies at an early stage. Concerns and agenda items at the annual general meetings are thus often addressed and discussed before the vote.

Prior to each annual general meeting for shareholdings above the threshold described above, the agenda items are subjected to a thorough analysis and reviewed with the help of our voting rights philosophy. In addition, Lupus alpha receives independent analyses of agenda items from one of the leading external research providers in this field. These analyses and recommendations are then reviewed by Lupus alpha and are incorporated into the voting decision-making process. However, the final voting decision remains entirely at the discretion of Lupus alpha at all times. Due to our close contact with investee companies, Lupus alpha may also deviate from the guidelines in exceptional cases, provided that the company can credibly assure us that it has addressed any concerns or that it will comply with the request in a timely and binding manner. When engaging with companies, we also work with other investors on a case-by-case basis in order to exert a stronger influence.

In general, our goal is to address important ESG issues in advance, i.e., in regular company meetings, to initiate changes through dialogue, and thus to achieve good results together with the companies.

In 2023, Lupus alpha actively voted at 53 annual general meetings. In 22 cases, we voted against the management on at least one agenda item or abstained. Consequently, we were in full agreement with the resolutions put forward by the management at 31 annual general meetings.

The lower number of annual general meetings compared to the previous year is the result of a revision of our voting behaviour/process. Our focus is now increasingly on analysing the individual items on the agenda in detail and also consulting external research for support. The more intensive examination of selected companies and the increased care in analysing individual voting items means that we attend fewer annual general meetings. In return, we place particular emphasis on depth of content and targeted influence before and during the annual general meeting instead of conducting as many votes as possible.

Sustainability goals and changes

We are prepared for the growing requirements in the area of sustainability.

In 2023, the further development and critical review of our ESG approach were of central importance. This included peer group comparisons, adaptation to new and improved data, and compliance with regulatory standards. To ensure that this process continues successfully, the exchange of knowledge and professional development of our employees is essential. Our interdisciplinary ESG office established itself in 2023 as a central team to facilitate necessary discussions on ESG topics and ensure timely dissemination of ESG information across departments.

STRATEGIES AND FUNDS

In this committee, we further developed the ESG methodologies of our sustainable funds. For our dedicated sustainable small- and mid-cap strategies, we introduced a minimum share of sustainable investments by the end of 2022. Specifically, we commit to investing at least 20% of the fund's volume in explicitly sustainable investments with environmental or social characteristics according to the SFDR. To be classified as sustainable, these investments must meet additional criteria beyond the ESG standards applicable to all investments in our sustainable funds. Furthermore, we tightened revenue thresholds to align them with changed market standards.

For all our sustainable funds (Article 8), we have also incorporated CO_2 intensity in addition to the carbon footprint as an environmental-related PAI to allow for a more differentiated assessment within an industry.

Our funds once again received sustainability awards. The Lupus alpha Sustainable Smaller Euro Champions and the Lupus alpha Sustainable Smaller Pan European Champions were again awarded the FNG-Label and improved their rating from one to two stars. Additionally, the Lupus alpha Sustainable Convertible Bonds Fund was awarded the FNG-Label for the sixth consecutive year and received an additional two out of three possible stars. We view these awards as confirmation of the quality of our holistic ESG investment approach. The awarding of stars to our funds demonstrates that we not only meet the FNG minimum standards but also adhere to additional criteria in areas such as institutional credibility, product standards (such as the ESG research process), and portfolio focus (e.g., exclusions that go beyond minimum criteria).

REGULATION AND REPORTING

2023 marked the second reporting year under the Sustainable Finance Disclosure Regulation (SFDR). In January, „Level 2" of the regulation came into force, complementing and specifying „Level 1", which was introduced in March 2021. Specifically, „Level 2" further elaborated on the content, methodology, and presentation of company- and product-specific disclosure obligations (in the so-called Regulatory Technical Standards – RTS).

In line with these regulatory changes, we first published the RTS annexes for pre-contractual information and annual reports for our Article 8 funds. At the corporate level, we disclosed our first PAI (Principal Adverse Impact) statement in accordance with the RTS requirements (Article 4 SFDR). This statement explains our approach to adverse sustainability impacts at the corporate level and assesses our performance against these indicators for the first reporting period (calendar year 2022). Next year, we will be able to introduce benchmark values for the first time and provide commentary on any changes.

To provide our clients and stakeholders with the highest level of transparency, we publish both our product- and fund-specific ESG methodologies, as well as fund-specific ESG reporting on our website. Additionally, we generate ESG reports tailored specifically to the preferences of our institutional clients, which are provided, for example, on a monthly basis.

DATA AND TOOLS

The aforementioned regulatory changes necessitated adjustments to our ESG data and systems. With the evolution of the SFDR, calculation methods for the PAI (Principal Adverse Impact) statement at the corporate level were established, which we integrated into our systems. Additionally, we transmitted SFDR data for our Article 8 UCITS funds registered in Luxembourg to the CSSF for the first time.

In addition to these regulatory-driven adjustments, we ensured that changes in our ESG methodologies were implemented in our systems. By incorporating a minimum share of sustainable investments into our sustainable small- and mid-cap funds, we are considering additional ESG criteria in our investment decisions. These criteria include contributions to the SDGs, the Do-No-Significant-Harm principle, and further exclusion criteria related to economic activities. The necessary ESG factors were identified and integrated into our systems: into the Data Warehouse (DWH), into SCD for compliance checks, and into our internal ESG tool. This allows portfolio management to consider the new criteria in compliance checks and detailed analysis. Furthermore, engagement rules were expanded by including the additional PAI indicator CO_2 intensity in our internal rulebook.

Two years ago, we developed and successfully established an internal ESG tool across teams. Through close interdisciplinary collaboration, new ideas for enhancing this tool to improve internal reporting of ESG data and risks are continually emerging. For example, last year we incorporated climate risks into the tool. We consider physical climate risks as materially relevant to individual issuers and measure them in risk management. The ESG tool now enables analysis at any time of how physical climate risks, driven by acute and chronic risk factors, impact countries and issuers.

Moreover, we introduced an auto-evaluation function. This allows any portfolios or indices to be automatically assessed against desired ESG criteria that go beyond those in our ESG methodologies. This facilitates comprehensive ESG analyses in just a few steps, such as evaluating the impacts of new ESG criteria and examining index exposures to specific ESG criteria. For instance, we created a watchlist for companies engaged in fossil fuels, which is automatically updated weekly.

These measures demonstrate that we not only meet regulatory requirements but also go beyond to enhance our ESG data and tools, thereby improving our sustainability approach.

RISK MANAGEMENT

The consideration of ESG risks is an integral part of our risk management. Daily general risk reports which are sent to the responsible portfolio managers and CIOs, include the following ESG metrics and PAIs at fund level and for the benchmark:

- ESG score
- Carbon footprint
- Implied temperature rise[4]
- Proportion of companies with severe and very severe UN Global Compact violations
- Proportion of companies with active exposure to fossil fuels

In addition, a detailed ESG risk report is prepared and evaluated on a monthly basis at fund level. This is distributed to the Executive Committee (incl. Chief Investment Officers) and portfolio managers. The report contains the following information for fund and benchmark:

- ESG rating:
  – ESG rating distribution
  – ESG score and components (E, S and G) over time
- Carbon footprint:
  – Distribution of carbon footprint deciles
  – List of companies in the fund in the worst decile
  – Evolution of carbon footprint (Scope 1,2 and 3) over time
- Implied temperature rise:
  – Distribution by temperature
  – Implied temperature rise over time
- Controversies (violations of UN Global Compact):
  – Distribution by severity of controversy
  – Percentage of companies with serious controversies over time
  – List of companies in the fund with severe controversy
- Active exposure to fossil fuels:
  – List of companies in the fund with active exposure to fossil fuels
  – Exposure to fossil fuels over time
- Analysis of correlation of ESG score to market risk / credit risk / liquidity risk:
  – Correlation table
  – Regression chart

We obtain the underlying ESG data from MSCI. Changes from MSCI regarding the ESG score and implicit temperature rise were integrated into our calculations.

Physical and transitory sustainability risks are also covered by a quarterly report that includes all Lupus alpha funds. This is based on models developed in-house. In modelling climate risks, we incorporate scenarios from the Network for Greening the Financial System (NGFS). At the end of 2023, NGFS adjusted the scenarios due to current circumstances, including delayed implementation of policy measures and persistently high emissions. We have accordingly incorporated these adjustments into our own models.

[4] Implied temperature rise is a forward-looking metric, expressed in degrees Celsius, designed to show the alignment of companies, portfolios and funds with global temperature targets.

Outlook

We are expanding our expertise in the area of sustainability and acting as a solution provider for our customers.

Regulatory requirements

In the context of the upcoming PAI statement (reference period: calendar year 2023), comparisons to the previous year's data can and will be drawn for the first time. We will incorporate all clarifications provided by the European Supervisory Authorities (ESAs) into our calculation logic. The most important change to note is that the latest ESG data will be used for all quarters. These recent ESG data will be matched with the fund holdings at the end of each quarter.

We will continue to closely monitor developments in regulation to be able to react quickly and appropriately as needed. At the fund level, we are particularly focused on the fund naming guidelines of the European Securities and Markets Authority (ESMA), which will establish mandatory sustainability criteria for funds using sustainability-related terms in their fund names.

Another important change concerns the clarifications by the ESAs on the regulatory technical standards. In the ESAs' final draft expected in December 2023, amendments are proposed to the PAI indicators and the definition of sustainable investments, among other aspects. Therefore, in the next year, we will comprehensively review our data procurement and processing and make necessary adjustments to ensure smooth implementation of the new requirements.

At the corporate level, Lupus alpha will be obligated for the first time to report on sustainability in accordance with the Corporate Sustainability Reporting Directive (CSRD) in 2025. Therefore, in 2024, we will take all necessary measures to capture all required data for the reporting year 2025 and be prepared to report at the beginning of 2026.

Improvement of data structure, reports and tools

The evolution of our data structure, ESG reports, and internally developed front office ESG tools is an ongoing process, as the availability and quality of ESG data continue to improve. In the fiscal year 2023, we began evaluating an expansion of our data sources, and we will continue this process next year as well. Additionally, we will continue exploring the possibility of assessing ESG data from underlying loans in CLOs.

Expansion of engagement in initiatives

Lupus alpha has been an active member of the Forum Nachhaltige Geldanlagen (FNG) since 2019. To strengthen our commitment in climate protection, we have decided this year to select a suitable initiative and initiate the application process next year. Through membership, we aim to actively influence European-wide political frameworks and standards in working groups, establish a network with other institutional asset managers and investors, and gain exclusive access to specialized resources and information.

MEMBERSHIPS

2015 Principles for Responsible Investment (PRI)
2019 Forum Nachhaltige Geldanlagen (FNG)

COMPANY-RELATED DOCUMENTS WITH ESG FOCUS

Responsible Investing Policy
Principles for Exercising Voting Rights

PRODUCT-RELATED DOCUMENTS WITH ESG FOCUS (extract)

Lupus alpha Sustainable Convertible Bonds

– Factsheet, including ESG reporting
– ESG methodology
– Company portraits

EMPLOYEE QUALIFICATIONS

CESGA®(Certified ESG Analyst) certification from EFFAS

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