CCLA

GOOD INVESTMENT

Sustainability approach for short duration bond funds

Fixed interest at CCLA

Federated Hermes Limited[1] (FHL) has been appointed by CCLA as the sub-investment manager of both the COIF Charities Short Duration Bond Fund and the CBF Church of England Short Duration Bond Fund. The funds adopt FHL's approach to managing and integrating ESG risks, corporate governance and controversies.

This document summarises this approach.

Screening companies

Before a company becomes part of the funds' investment universe, FHL ensures it meets certain standards. Companies that fail to meet these minimum criteria are excluded by FHL from consideration. These are:

- Companies that generate any of their revenues from the manufacture of controversial weapons[2] or by providing either an essential and/or tailor-made product or service to the manufacturers of controversial weapons and companies that generate over 10% of their revenues from production of conventional weapons.
- Companies that generate any of their revenues from the production of tobacco products and companies that receive over 5% of their revenues from tobacco distribution.
- Companies that generate over 10% of their revenues from gambling products.
- Companies that generate over 5% of their revenues from the extraction of unconventional oil sands. In addition, the sub-investment manager excludes companies that are in contravention of the principles of the UN Global Compact.

In addition, FHL applies the values-based restrictions of the COIF and CBF Short Duration Bond Funds, which can be found in the funds' respective scheme particulars and below:

- **Adult entertainment:** companies that derive more than 3% of revenue from the production and/or distribution of adult entertainment.
- **Gambling:** companies that derive more than 10% of revenue from the operation of gambling establishments and the provision of key support services and products.
- **Alcohol:** companies that derive more than 10% of revenue from the production and/or retail of alcohol and related products or services.
- **Tobacco:** companies that have any involvement in the production of tobacco and/or derive more than 5% of revenue from the production and/or retail of tobacco and related products/services.
- **Cannabis:** companies that derive any revenue from recreational cannabis and/or companies that derive 5% or more of revenue from the production and/or retail of medicinal cannabis would be restricted.

1 CCLA has appointed Hermes Investment Management Limited (HIML) as investment manager. HIML is a wholly owned subsidiary of Federated Hermes Limited (FHL). For the purpose of this document, the entity will be referenced as FHL.

2 Controversial weapons form part of FHL's Mandatory Excluded Activities (manufacture or providing either an essential and/or tailor-made product or service to the manufacturers, at any revenue threshold) which are defined as follows:
- anti-personnel devices
- cluster munitions
- chemical and biological weapons
- depleted uranium weapons
- nuclear weapons
- white phosphorous-based munitions
- companies that own more than 25% of a company captured under the above description.

Further information can be found here: www.hermes-investment.com/uploads/2024/12/878fcd3b7674d09f0fa7eed869ffc002/fhl-responsible-investment-2024.pdf

- **Controversial weapons:** companies that have any involvement in the production of controversial weapons (core weapons and components). These are defined as landmines, cluster munitions, chemical and/or biological weapons.
- **Nuclear weapons:** companies that have any involvement in the production of core weapons and/or components of nuclear weapons.
- **Military weapons:** companies that derive more than 10% of revenue from the production of military weapons and equipment (core weapons, components and equipment/services) and/or the provision of key non-weapons related, tailor-made products for the defence industry.
- **Civilian firearms:** companies that derive more than 10% of revenue from the production and/or retail of civilian firearms (including key components).
- **High interest rate lending:** companies that derive more than 10% of their revenue from high interest rate lending.
- **Thermal coal extraction:** companies that derive more than 5% of revenue from the extraction of thermal coal and/or produce more than 10 million metric tonnes of coal (or have plans to expand their coal production).
- **Oil and gas extraction:** companies that derive more than 5% of revenue from the extraction of tar sands and/or companies that generate more than 10% of revenue from the extraction, production, and/or refining of oil and/or gas.
- **Generation of electricity and climate change:** electrical utility and infrastructure companies that intend to expand their coalfired generation capacity and/or businesses whose principal activity is the generation of electricity and have not demonstrated the ability to align their business with the Paris Climate Change Agreement (as defined by CCLA).
- **Sovereign debt:** no direct investment in sovereign debt from countries identified by CCLA as being amongst the world's most oppressive.
- **Collective Investment Schemes:** other investment funds that are assessed by the manager as having any exposure to landmines, cluster munitions, chemical or biological weapons or exposures that materially contradict the above approach. This is defined as having more than 10% of net asset value exposed to other precluded activity. As a final safeguard, we seek to ensure that the combined exposure to all restricted activities within such other investment fund holdings remains below 1% of the capital value of the fund. Due to a lack of data this approach to assessing the eligibility of Collective Investment Schemes is implemented on a 'best-endeavours' basis.
- The fund also applies the following further restrictions:
  - **Breast milk substitutes:** companies that do not meet the manager's minimum standards for breast milk substitutes, based on the Access to Nutrition BMS index.
  - **Animal testing on cosmetics:** companies in the Personal Products Global Industry Classification Standard Sub-Industry that have any involvement in testing cosmetics on animals. Due to regulatory requirements in some countries, exceptions will be made for companies that are identified as promoting alternatives to animal testing and which adopt a rigorous, responsible, animal testing policy.
  - **Abortifacients:** companies that produce single-purpose abortifacients.

Assessing ESG Factors

Once a company is included into the investment universe, FHL analyses its behaviour in three key areas: **Environmental, Social,** and **Governance (ESG)**. These factors help determine whether the company's actions could harm or enhance its long-term value.

- **Environmental:** FHL examines whether a company is working to reduce its environmental impact and prioritising long-term sustainability. They also assess if the company is vulnerable to sudden environmental incidents that could harm its value.
- **Social:** FHL evaluates whether the company ensures employee safety, treats workers fairly, and avoids producing harmful or faulty products.
- **Governance:** A key focus is the seriousness with which a company's management works toward building a sustainable, trustworthy business. The evaluation includes safeguards to prevent fraud, misconduct, and operational failures.

Although the same ESG criteria are applied across industries, FHL may emphasise a specific ESG factor depending on the company's sector, for example

- For industries like energy or materials, **environmental** considerations take priority.
- In banking and finance, **governance** is the primary focus.
- In consumer-focused businesses, **social factors** such as workers' health and safety and gender equality, and product safety are emphasised.

To ensure objectivity, FHL assigns each company an **ESG score**. This score reflects how well the company's ESG practices contribute to its long-term value.

FHL also incorporate scores from their sustainability team, which focus on:

- **Sustainable Development Goals (SDG):** How the company contributes to global goals like clean energy and reduced inequality.
- **Climate change impact (CCI):** How the company is addressing climate-related risks.
- **Sustainable leadership (SL):** Whether the company is leading in sustainable practices.

These scores are discussed in detail to determine whether a company is suitable for investment.

Using a proprietary model which includes the ESG Scores, FHL determines:

1. Whether ESG risks are accurately reflected in the company's valuation compared to its peers.
2. How potential changes in ESG performance might affect the company's market value in the future.

This approach ensures that ESG risks are carefully considered, helping to protect investments from unexpected challenges while supporting companies to create sustainable, long-term value.

Tracking progress

FHL regularly monitors each company's ESG performance. Analysts create detailed reports that include:

- Continuous monitoring of the company's ESG credentials, with ESG Score down-grades and upgrades reflective any changes in outlook. QESG[3] Dashboard: Trends showing whether the company's performance is improving or deteriorating relative to industry peers.
- Visual summaries of key ESG data and written explanations to provide context.

3 FHL have a proprietary ESG assessment framework that uses the unique engagement insights generated by 'EOS' at Federated Hermes, allowing FHL to identify companies that they believe are improving their ESG behaviour. This is called the QESG.

Engaging with companies to drive positive change

FHL engages with companies that have room for improvement. FHL maintains open, frequent discussions with company executives and board members, focusing on specific areas for improvement. Discussions may include topics such as reducing carbon emissions, improving worker safety, or addressing governance weaknesses. Milestones are set for companies to demonstrate progress, and performance against these milestones is regularly tracked.

Engagement is led by:

- **EOS[4] analysts:** Lead engagement efforts and maintain relationships with the companies.
- **Sustainable fixed income team:** Includes specialised engagers who create strategies and facilitate collaboration.
- **Credit analysts:** Participate in joint meetings and benefit from shared insights before and after discussions.

Ensuring good governance

Good governance refers to how responsibly a company is managed. FHL assesses governance practices based on:

- management structure
- employee relations and fair remuneration
- compliance with tax rules
- Avoidance of unethical practices.

FHL requires all companies to meet high governance standards. Severe controversies or abuses of power that remain unaddressed disqualify a company from investment consideration.

Companies must meet a minimum standard to qualify for inclusion in the firm's portfolios. Those that fail to meet this threshold are assigned an ESG score of 5 and excluded from mandates. Companies that meet or exceed governance standards are monitored to ensure continued compliance.

4 EOS at Federated Hermes Limited (EOS) is a stewardship service provider. Founded in 2004 on a legacy dating back to 1983, EOS advises on more than $2.1tn in assets to deliver corporate engagement and proxy voting services. EOS Stewardship | Hermes Limited.

Important information

This document is not a financial promotion and is for information only. It does not provide financial, investment or other professional advice. To make sure you understand whether a CCLA product is suitable for you, please read the relevant fund's key (investor) information document and the prospectus or scheme particulars (as appropriate) and consider the risk factors identified in those documents. CCLA strongly recommend you get independent professional advice prior to investing. Past performance is not a reliable indicator of future results. The value of investments and the income from them may fall as well as rise. You may not get back the amount you originally invested and may lose money.

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