Invesco's approach to Sustainability Preferences:

Principal Adverse Impacts, Sustainable Investments & the EU Taxonomy

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1. Introduction

At Invesco, we recognize that clients have diverse needs, including when it comes to investing sustainably. Our approach to implementing sustainability preferences contributes to our aim of delivering a broad range of solutions that enables clients to align their ESG values with their investment decisions.

Our approach is client centric. We are implementing sustainability preferences thoughtfully and rigorously while recognizing the current challenges of data disclosure and coverage. We believe this transparency is vital in supporting the industry going forward.

In this guide, we tell you more about our approach and how it contributes to our overall goal of serving our clients.

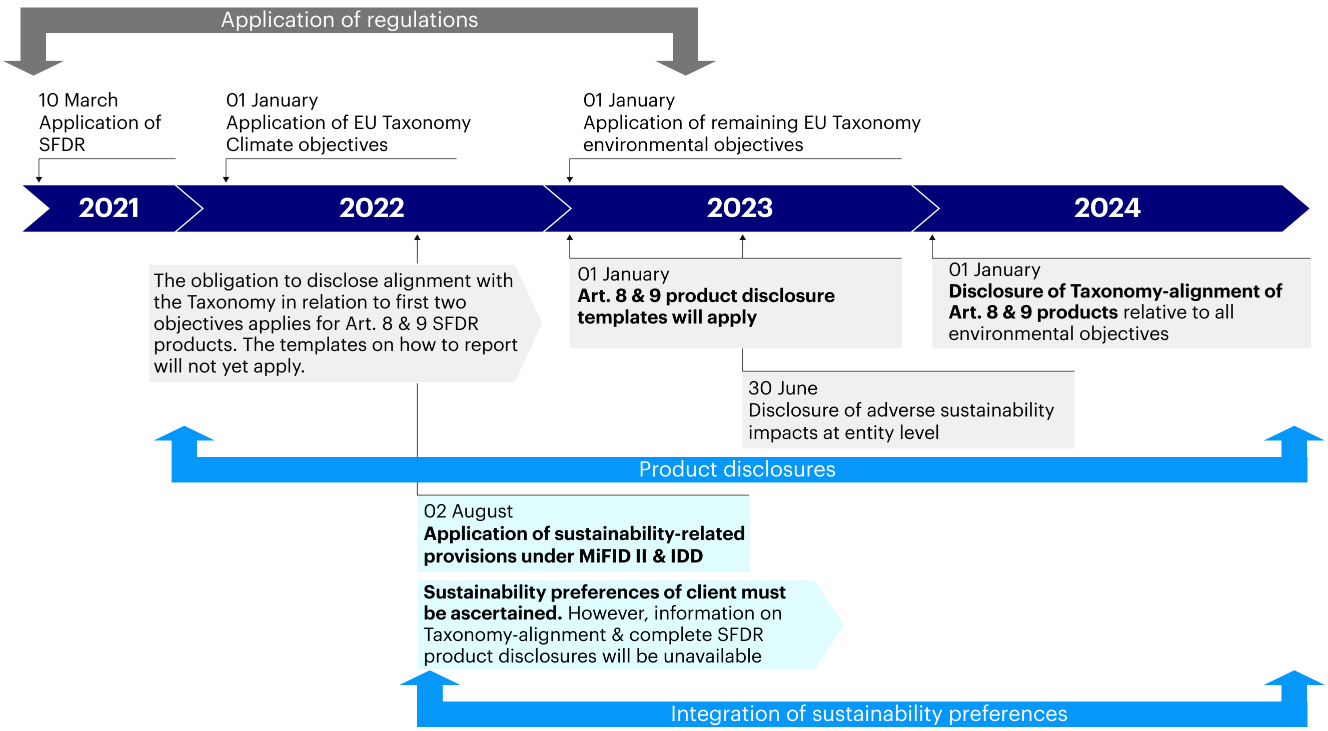
2. An Overview of Sustainability Preferences

2.1. Our SFDR Journey

In March 2021, Invesco welcomed the Sustainable Finance Disclosure Regulation (SFDR) that was implemented as part of the EU's Sustainable Finance Action Plan.

The SFDR is designed to help institutional and retail clients understand, compare, and monitor the sustainability characteristics of investment products by standardizing sustainability disclosures. It is intended to provide greater transparency on what criteria have been applied to products by categorizing them, based on their credentials.

Timeline of SFDR Implementation



Since the initial adoption of product classifications (including Art. 6, 8, and 9 products), Invesco has taken several steps to meet the regulatory standards and the evolving needs of our clients.

In June 2022, Invesco disclosed our planned approach to meeting sustainability preferences under the Markets in Financial Instruments Directive (MiFID II) and Insurance Distribution Directive (IDD) by publishing our first European ESG Template (EET).[1] The document contains, at a product level, information on the SFDR classification of a product and whether it considers sustainability preferences.

1. We anticipate updating these templates with additional data fields by the end of 2022.

2.2. What are Sustainability Preferences and how are they met?

Amendments to MiFID II Delegated Acts and the IDD, which came into effect on August 2nd, 2022, introduce the concept of 'sustainability preferences'.

The requirements extend the existing broader suitability requirements (i.e., the understanding of a client's objectives, risk appetite and investment time horizons) to capture whether a client prefers that products in which they invest have characteristics or objectives in relation to Environmental, Social or Governance (ESG) factors.

There are three ways that products can be designed to meet sustainability preference expectations. They can:

1. Consider **Principal Adverse Impacts** on sustainability factor; or
2. Invest a minimum proportion in **Sustainable Investments** as defined in the SFDR
3. Invest a minimum proportion in environmentally sustainable investments as defined in the **EU Taxonomy** regulation

The sustainability preferences regime does not mandate a specific approach or threshold to meet these requirements but rather places the onus on the financial advisor to define the relevant criteria with the client.

2.3. Applying ESG Characteristics to Our Product Offering

Since adopting the SFDR back in March 2021, we have carried out a methodical review of our product range and where appropriate, classified in-scope products as Article 8 or Article 9.

Invesco intends to apply ESG characteristics to its product offering based on the positioning of the product on our ESG spectrum and the asset class.

The table below outlines how products within our Luxembourg SICAV platform have aligned with SFDR categories and the three ways products can be designed to meet sustainability preference expectations, including through consideration of Principal Adverse Impact (PAI) indicators or by investing in a minimum proportion of sustainable investments.

Luxembourg SICAV (Invesco Strategies) Implementation of ESG Characteristics

	Our ESG Capabilities					
	Integrated	Screened / Exclusionary	Responsible	Sustainable	Sustainable	Impact
Product 'characteristic'	Article 6	Article 6 or 8	Article 8	Article 8	Article 9	Article 9
Consider **Principal Adverse Impacts**		✓ (if Art. 8)	✓	✓	✓	✓
Invest in **Sustainable Investments (SI)**			10%[1]	10%[1]	>90%[2]	>90%[2]
–**Ensure Do No Significant Harm (DNSH)**			Yes, on the SI. Achieved through negative screen.	Yes, on the SI. Achieved through negative screen.	Yes. Achieved through negative screen.	Yes. Achieved through negative screen.
Invest in EU Taxonomy Alignment (not utilised at this stage for August 2nd- to be considered in the future)			May include but no minimum required	[> x%][3]	[> x%][3]	[> x%][3]

1. The 10% figure is the minimum target but can be agreed higher at investment teams' discretion.
2. Figure to be determined but likely to be >90% on the basis that a 'Sustainable' fund has a process that selects only sustainable assets
3. Invesco notes that current market data availability challenges reduce the value of establishing EU Taxonomy alignment targets at this time - this will be monitored and revisited as data availability improves, with climate-focused products anticipated to form the first tranche of commitments. Invesco intends to make EU Taxonomy alignment figures for a portfolio available on demand in the interim period.

Other asset classes, including ETFs and direct real estate, take slightly different approaches across Art. 8 and Art. 9 products. For example, our ETF products derive their nomenclature from the underlying Index Provider rather than follow the naming conventions outlined. Our direct real estate products are also an exception to the above nomenclature, but all Article 8 products consider principal adverse impacts, as explained below.

3. What does it mean to consider Principal Adverse Impacts?

3.1. What is a Principal Adverse Impact (PAI)?

The first way a product can meet sustainability preferences is through consideration of principal adverse impacts. A principal adverse impact (PAI) is a factor where the activities of a company or entity may have a negative impact on the environment or society. PAIs are determined by reference to the severity and frequency of the impact, will vary according to sector and geography.

A product which considers PAIs will take action to understand the activities of an investee company or entity and then follow-up where activities are deemed to have negative impacts through actions such as corporate engagement or exclusion from a portfolio. Approaches to consider and attempt to address such activities vary by strategy.

3.2. Invesco's PAI approach

Invesco will consider PAIs in the majority of our Article 8 products.[2] Our exact approach varies by asset class, due to data coverage and applicability.

Investments in Corporates & Sovereigns

- For investments in corporates and sovereigns, our approach revolves around engagement. We carry out a qualitative and quantitative review of key metrics (primarily the indicators defined in SFDR RTS Annex I, Table 1, see appendix).
- We identify priority investee entities using PAI thresholds and engage through methods such as letters, meetings, proxy voting.
- If no improvement is established through such corporate engagement, then Invesco may (if the strategy permits) proceed to divest and/or exclude investments.

Exchange Traded Funds (ETFs)

- Passively managed ETFs consider PAIs predominately through the relevant index methodology. Index constituents may have their weights adjusted, or be filtered out entirely, based on third party ESG scores which consider specific PAIs in their construction. Additionally, exclusions built into the index around controversial activities can intersect with the PAIs. Physical ETFs also follow the above PAI engagement process.

Direct Real Estate

- Invesco Real Estate (IRE) will consider PAIs applicable to real estate (as defined in SFDR RTS Annex I, Table 1, see appendix).
- These PAIs are tracked and monitored via a dedicated data management software (Deepki) or third-party consultants and will be reported on a regular basis with metrics and commentary on actions taken where applicable at the fund level.

2. We do not currently have sufficient data to consider PAIs on private credit products but are working with an external vendor to explore a potential centralized solution.

4. What does it mean to invest in Sustainable Investments?

4.1. An Overview of Sustainable Investments.

The second way a financial instrument can meet sustainability preferences by investing a minimum proportion in sustainable investments as defined in the SFDR. According to the regulation, the concept of 'sustainable investments' is defined as:

- Activities that contribute to the achievement of an **environmental or social objective;**
- Provided that such activities **Do No Significant Harm (DNSH)** to the environmental or social objectives set out in the definition; and
- Investee companies follow **good governance practices.**

It is at the discretion of industry participants as to how they create a technical framework that aligns with this broad definition, as funds have different objectives and require a suitable methodology to reflect this. Therefore, it is important investors understand the technical frameworks their asset managers are using to define 'sustainable investments'.

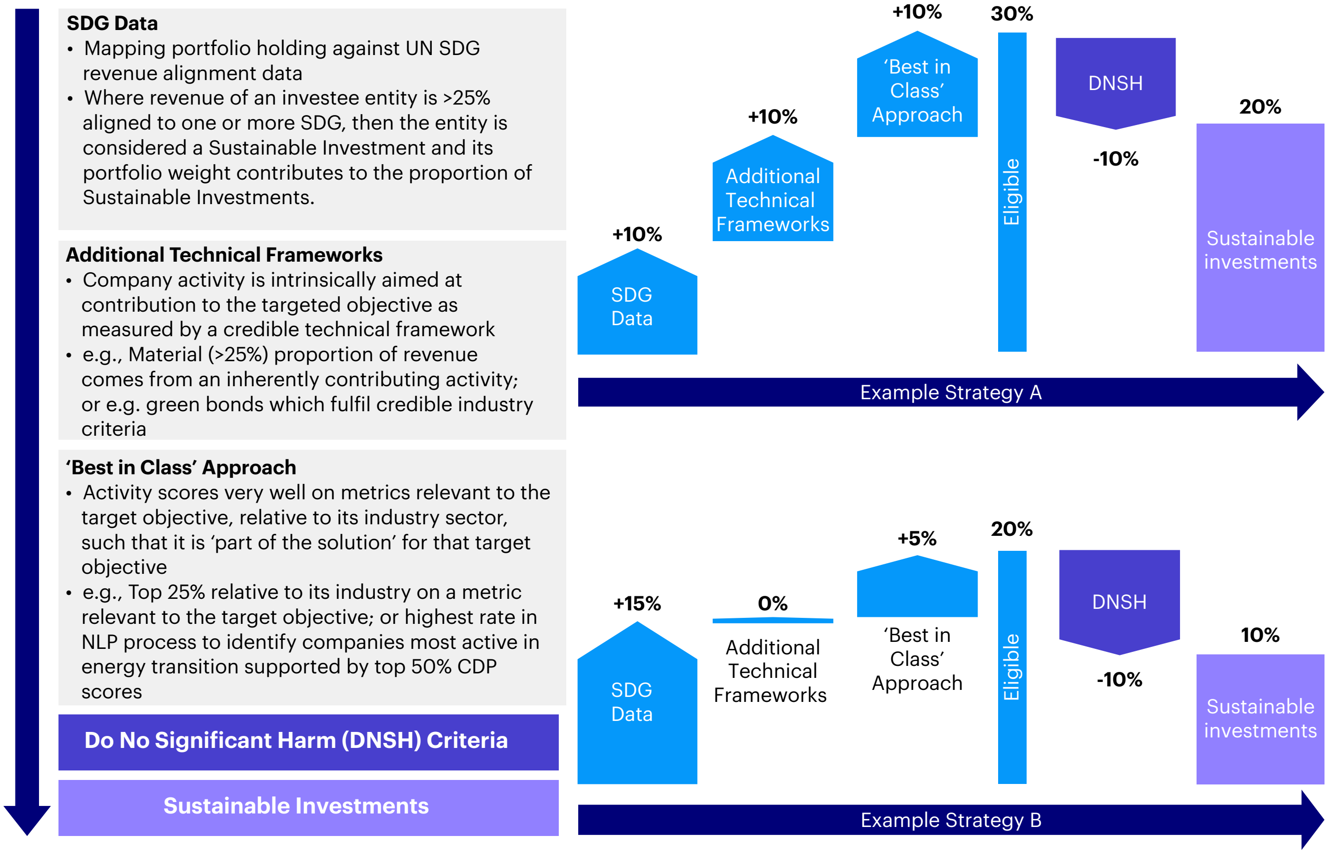
4.2. Invesco's investor-led approach

Invesco has created and applied technical frameworks across a broad range of Art. 8 and Art. 9 products and asset classes to align with the three requirements of the SFDR sustainable investments definition.

4.2.1. Identifying sustainable investments

Invesco's Article 8 Responsible and Sustainable products will commit to investing in a minimum proportion of sustainable investments. To do this, Invesco has adopted a framework (as shown below) for Article 8 Responsible and Sustainable funds which looks for revenue alignment with the United Nations Sustainable Development Goals (SDGs), additional technical frameworks, and/or ESG 'Best in Class' assets using proprietary research.

An overview of Invesco's process to identify sustainable investments for Art. 8 Responsible and Sustainable funds



For illustrative purposes only. Depending on the asset class, data availability, and specific strategy, investment teams may use a combination of the SDG data, additional technical frameworks and 'best in class' approach. See chart to the right for examples.

For active Article 9 products, Invesco will inherently select only sustainable investments through a bottom-up approach. Alternatively, Invesco's passive Article 9 products will rely on the methodology of index providers to achieve the same.

4.2.2. Screening against Do No Significant Harm (DNSH)

To align with the '**do no significant harm (DNSH)**' criteria, Invesco will take into account the mandatory principal adverse impact (PAI) indicators as listed in the Regulatory Technical Standards (RTS) where possible, alongside other ESG metrics and controversy screens to ensure sustainable investments are not adversely impacting the environmental or social objectives set out in SFDR.

For Article 8 products, where companies or entities fail DNSH criteria in such portfolios, those companies or entities will not be able to contribute to the 'sustainable investments' portion of the portfolio and, if they continue to be held, will be addressed through the PAIs process, such as engagement, detailed in Section 3.

Article 9 products already have DNSH criteria built into their investment processes to exclude the holding of any such investment and will transition to incorporate Principal Adverse Impact (PAI) indicators as DNSH criteria ahead of the SFDR RTS which comes into force on 1st January 2023.

4.2.3. Following good governance practices

To align with the 'good governance' aspect of the definition, all Invesco Article 8 and Article 9 products assess each issuer's governance rating to ensure that companies follow good governance practices in the areas of sound management structures, employee relations, remuneration and tax compliance.

5. What does it mean to invest in EU Taxonomy aligned investments?

5.1. What is the EU Taxonomy?

The third way a financial instrument can meet sustainability preferences is to invest a minimum proportion in environmentally sustainable investments as defined in the **EU Taxonomy** regulation. The EU Taxonomy is the cornerstone of European Commission's drive for clear standards on what can be considered as green investments. It sets out clear rules and thresholds sector-by-sector for an economic activity to be considered as making a significant contribution to one of the 6 environmental objectives.

An Overview of the EU Taxonomy?

6 Environmental Objectives
Climate change mitigation
Climate change adaptation
Water and marine resources
Recycling and waste management
Pollution prevention and control
Biodiversity

To be Taxonomy-aligned....	
Taxonomy Eligible	Economic activity that has been technical screening criteria for one of the 6 environmental objectives
Substantial Contribution	Economic activity meets the technical screening criteria threshold for substantial contribution
Do No Significant Harm	Economic activity does not do significant harm to any of the other 5 environmental objectives
Minimum Social Safeguards	Does not breach social safeguards set out in OECD multinational guidelines

The EU Taxonomy is operationalized through two distinct disclosure requirements:

- Firstly, large, listed companies that currently report under the Non-Financial Reporting Directive will be required to disclose the percentage of revenues, CapEx and/or OpEx that complies with the Taxonomy criteria
- Secondly, ESG products classified as Article 8 or Article 9 that invest in Taxonomy-aligned investments will also be required to disclose the share of investments that are Taxonomy-aligned as part of the SFDR disclosures

Disclosures relating to climate change entered into effect at the end of 2021, whereas disclosures relating to the four other environmental objectives will only begin at the end of 2022.

5.2. EU Taxonomy and Data Availability

Invesco has access to EU Taxonomy data, based on best currently available disclosures and business activity data, which it can match against portfolio holdings in our proprietary analytics tool to assess the alignment of a given portfolio with EU Taxonomy. Invesco notes, however, that current market data availability challenges could create volatility when companies begin to fully report their taxonomy alignment in 2023, thereby reducing the value of establishing EU Taxonomy alignment targets at this time. This will be monitored and revisited as data availability improves, with climate-focused funds anticipated to form the first tranche of commitments.

6. Local initiatives

In addition to the EU-level framework set out above, a number of local markets across Europe have introduced local requirements for ESG-labelled products or approaches to MiFID sustainability preferences, most notably in France and Germany.

Germany:
In Germany, the local market has set out an approach to categorizing sustainable products that includes additional requirements compared with the EU framework outlined above.

Germany's Additional Requirements

Germany's Categorisation of Products which may be addressed to customers with **sustainability preferences**	**EU Framework**		**Germany's Additional Requirements**		Invesco's Luxembourg SICAV Implementation of ESG Characteristics
PAIs (Consideration of significant adverse impacts, Art. 2 No. 7 lit. c) MiFID II Regulation)	Dedicated ESG strategy with consideration of standard PAIs on environmental and/ or social issues	+	Minimum exclusions[1]	Product manufacturer takes into account a recognised industry standard	As described on Page 4.
Sustainable investments as defined by the SFDR (ES, Art. 2 No. 7 lit. b MiFID II Regulation)	ESG strategy with a proportion of sustainable investments pursuant to SFDR: specific percentages	+	No serious violations of the UN Global Compact and democracy/human rights	Product manufacturer takes into account a recognised industry standard	**Art. 8 Responsible** **Art. 8 Sustainable** **Art. 9 Sustainable** **Art. 9 Impact**
Ecologically sustainableinvestments within the meaning of the Taxonomy(Art. 2 No. 7 lit. a) MiFID II Regulation)	ESG strategy with a proportion of sustainable investments pursuant to the Taxonomy Regulation: specific percentages	+	No serious violations of the UN Global Compact and democracy/human rights	Product manufacturer takes into account a recognised industry standard	
Germany's Categorisation of 'Other Products' outside of MiFID target market					
ESG Strategy Product			Product pursues dedicated ESG strategy	Product manufacturer takes into account recognised industry standard	**Art. 8 Screened / Exclusionary**

[1] Including enhanced military and defence-related exclusions.

Invesco is considering Germany's local market's additional requirements in our approach to Sustainability Preferences. As of 2 August 2022, our Article 8 Responsible and Sustainable, and Article 9 products that have an allocation to sustainable investments meet the Sustainable Investments additional requirements. Invesco's Article 8 Screened/Exclusionary products would fall under Germany's ESG strategy product (i.e., outside of the MiFID target market and those products which may be addressed to customers with sustainability preferences).

France:
In France, the local regulator, the Autorité des marchés financiers (AMF), has introduced requirements in relation to the marketing of ESG-labelled products. The regime requires that only ESG-labelled products where the ESG strategy is considered material can make ESG a central part of their marketing communications, including any ESG-related terminology in the fund name. ESG funds that fail to meet this requirement can only make limited references to ESG in their marketing communications.

AMF's Marketing Rules for ESG-labelled Products

Approach	Marketing Rule	
Approaches based on a significantly engaging methodology	The investment product must present a minimum of information such as the definition of significant measurable objectives, and main methodological limits of the approach.	The investment product may refer to the consideration of non-financial characteristics in the strategy's name and in its marketing documents and other materials.
Non-significantly engaging approaches	The investment product must present a minimum of information such as the definition of measurable objectives, and main methodological limits of the approach.	The investment product may mention non-financial considerations in its KIID[1] in a concise and balanced manner, in its marketing material in a concise manner, but not in its name.
Approach not meeting central or limited communications standards	The investment product may present non-financial characteristics in a proportionate way in its prospectus.	The investment products may not communicate on non-financial characteristics apart from its prospectus (not in its name, KIID[1], marketing material).

[1]Key Investor Information Document (KIID)

7. Key Challenges and Solutions

Our conversations with investment teams, clients, and industry groups have revealed key challenges to implementing SFDR and achieving the regulation's intention of greater transparency for retail and institutional investors. Invesco is making significant efforts to address each of these challenges by partnering with data vendors, participating in industry-wide dialogue, and engaging with our clients.

1. **Data:** Sourcing, assessing and applying ESG data for the purposes of meeting regulation is an industry wide challenge. In particular, there is a **sequencing** issue, where reporting obligations on asset managers kick in before all the data is available. There is a challenge of **geographical scope**, as reporting by corporates only applies in EU, therefore leaving global portfolios exposed to data gaps. Invesco's sophisticated approach, using multiple data-providers and secondary indicators to supplement PAI data gaps, enables our investment teams to tailor the methodology to their specific strategies and asset classes.
2. **Regulatory:** There is a mismatch between different **jurisdictional requirements (as shown by the examples above)** and different players (corporates, asset managers, pension schemes), creating overlaps/inconsistencies.
3. **Investor Dialogue and Understanding:** Clear information and dialogue with clients will be key in understanding their preferences, since the reliance on regulatory defined frameworks such as the EU Taxonomy might not be enough to ensure that investors understand what is and isn't included in their portfolio.

8. Conclusion

Invesco is committed to implementing the SFDR regulation and delivering transparency around the sustainability of our products, to enable investors to align their investment decisions with their ESG values.

Appendix

1. Principal Adverse Impact (PAI) indicators for Corporates and Sovereigns

1. GHG emissions

2. Carbon footprint

3. GHG intensity of investee companies

4. Exposure to companies active in the fossil fuel sector

5. Share of non-renewable energy consumption and production

6. Energy consumption intensity per high impact climate sector

7. Activities negatively affecting biodiversity areas

8. Tonnes of emissions to water generated

9. Hazardous waste and radioactive waste ratio

10. Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises

11. Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises

12. Unadjusted gender pay gap

13. Board gender diversity

14. Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)

Sovereign

15. GHG Intensity

16. Investee countries subject to social violations

Optional Indicators

1. Lack of Carbon Emission Reduction initiatives

2. Lack of Human Rights Policy

2. Direct Real Estate PAIs

1. Exposure to fossil fuels through real estate assets

2. Exposure to energy-insufficient real estate assets

Optional Indicators

1. GHG Emissions

2. Resource Consumption

Source: SFDR RTS Annex 1, Table 1

For more information on the Principal Adverse Impact (PAI) indicators, please read Invesco's Principal Adverse Impact Statement (published in June 2021).

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

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