



NRW.BANK
Promoting Ideas

January 2024

NRW.BANK.ESG Investment Framework



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Foreword

Michael Stölting,
Gabriela Pantring,
Eckhard Forst and
Claudia Hillenherms
(from left to right)



Dear Readers,

Sustainability is a central guiding principle and a key criterion for NRW.BANK's decisions on business policy. It is reflected in all phases of NRW.BANK's corporate activities, starting from its strategic and business policy decisions to the shaping of its range of products and services down to the implementation of specific financings, its capital market activities and the advisory services it provides. This is also evidenced by our Sustainability Strategy, which reflects our commitment to the goals of the Paris Agreement on Climate Change and create transparency about the corporate approach applied across the entire organisational structure.

In implementing the Sustainability Strategy, we are aware of our responsibility as an investor in the capital investment business, e.g. to support the transformation of society towards a climate-neutral economy. At the same time, sustainability risks and opportunities are becoming ever more relevant for portfolio and risk management. Sustainability criteria have been taken into account in our investment portfolio since 2017 and we are continuously developing them further. As an experienced issuer of Green and Social Bonds, we have since also invested specifically in sustainable bonds ourselves. Signing the Principles for Responsible Investment of the United Nations (UN PRI) in 2020 was a logical step, followed by the publication of this ESG Investment Framework in 2023. In addition to the Sustainability Strategy and sustainability reporting, the framework

creates further transparency about the integration of ESG criteria into our investment portfolio. It provides information about our objectives and further developments with regard to the six PRIs and the expectations of our stakeholders. In addition to the general integration of sustainability risks and opportunities, our goal is to achieve a climate-neutral capital market investment portfolio by no later than 2045. We also want our investments to play a part in supporting the limitation of the temperature rise to 1.5°C.

NRW.BANK supports the necessary transformation towards a low-emission and climate-resilient economy – sustainable investments have the potential to serve as an important lever in this process. We are pleased to disclose the path we are choosing in this dynamic environment transparently by publishing the ESG Investment Framework.

January 2024

The Managing Board of NRW.BANK

Eckhard Forst *Claudia Hillenherms* *Gabriela Pantring* *Michael Stölting*
Eckhard Forst Claudia Hillenherms Gabriele Pantring Michael Stölting

Integration of Sustainability Criteria in the Investment Portfolio

In the context of its capital market business, NRW.BANK pursues a conservative investment strategy to generate necessary surpluses. These are used to finance the promotional business, to secure the viability of the Bank, also with regard to the creation of its own, non-interest-bearing provisions, and to finance the banking operations in accordance with the quantitative budget. To exclude material ESG (Environment, Social, Governance) risks of the total portfolio and to ensure that the share of the portfolio that has a positive sustainability impact is as high as possible, NRW.BANK incorporates ESG issues into the analysis and decision-making processes for its investment portfolio. The reference values of the total portfolio are the securities business and the surrogate loan business in connection with public, corporate and financial investments as well as municipal financing.

In accordance with the [PRI definition](#), NRW.BANK has been relying on a mix of thematic investing, norm-based exclusions, Best- & Worst-in-Class Screening and portfolio management aligned with the Paris climate goals. The final achievement of a climate-neutral investment portfolio by no later than 2045 to support the limitation of the temperature rise to 1.5°C is the overarching objective.

The six UN Principles for Responsible Investment (PRI)

1. We will incorporate ESG issues into the investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

Norm-based Exclusions

NRW.BANK is committed to international standards and supports the 10 Principles of the UN Global Compact as a signatory. To avoid investments in issuers with serious violations of international standards, NRW.BANK takes into account MSCI ESG Controversies research. It signals corresponding violations in the form of controversy flags. The set of values comprises some 50 generally applicable global standards, such as the UN Global Compact and the ILO Core Labour Standards. The analysis covers, for example, the violation of international agreements and company policies with respect to the handling of controversies. Flags ranging from green to red indicate the severity of the violations. Red flags indicate very serious violations. In order to avoid securities with substantial controversies, new investments in securities with a red MSCI ESG Controversies flag are excluded.

Best- & Worst-in-Class Screening

To integrate ESG criteria into the selection of the investments and the management of the portfolio, NRW.BANK has developed its own sustainability traffic light system. This is monitored via a daily report and ensures ESG integration of well over 95% of the total portfolio. The rating system is based on the MSCI ESG rating for companies and countries and can be categorised as positive (Best-in-Class) screening. The MSCI ESG rating is based on benchmarking within individual industries. Criteria in the areas of “environment”, “social affairs and society” and “governance” are assessed according to industry relevance and subjected to a “Best-in-Class” analysis within a sector or peer group defined by MSCI ESG Research. In the country risk category, exposure to and management of environmental, social and governance risk factors are assessed and rated. Here, the comparison is made on a global level.

NRW.BANK’s sustainability portfolio (as a part of the total portfolio) consists of investments with an MSCI ESG Research investment rating of AAA to BBB (or ratings transferred to it). The sustainability traffic light indicates the share of the portfolio in the total portfolio by means of the colours red, yellow and green and defines any necessary responses. The latter include, in a first step, the information of the Managing Board’s Asset Liability Committee (ALCO) and, if necessary, the adjustment of the total portfolio in subsequent steps.

New corporate portfolio investments in “laggards” as defined by the MSCI ESG Rating (B and CCC) are also prohibited.

Thematic Investment

In accordance with its investment policy NRW.BANK invests in selected sustainable bonds (green, social and sustainability bonds) thereby promoting the development of the thematic investing segment not only as an experienced issuer but also as an investor.

Having considered the dynamic development of market standards such as the CSRD and the EU taxonomy as well as established performance indicators and impact indicators, NRW.BANK has decided it will in future focus more strongly on an entire portfolio approach. The previous allocation to a separate sustainable bond investment portfolio will therefore be discontinued as of 31 December 2023.

Thematic bonds as assets with the highest possible sustainable impact – both socially and ecologically – will remain a key lever for making the investment business more sustainable in terms of the established (total portfolio) performance indicators.

Portfolio Management considering Climate Risks and Opportunities

In addition to the general integration of ESG aspects through norm-based exclusions and Best- & Worst-in-Class Screening, the consideration of transformation opportunities/risks and the Paris climate goals plays a key role in managing the portfolio.

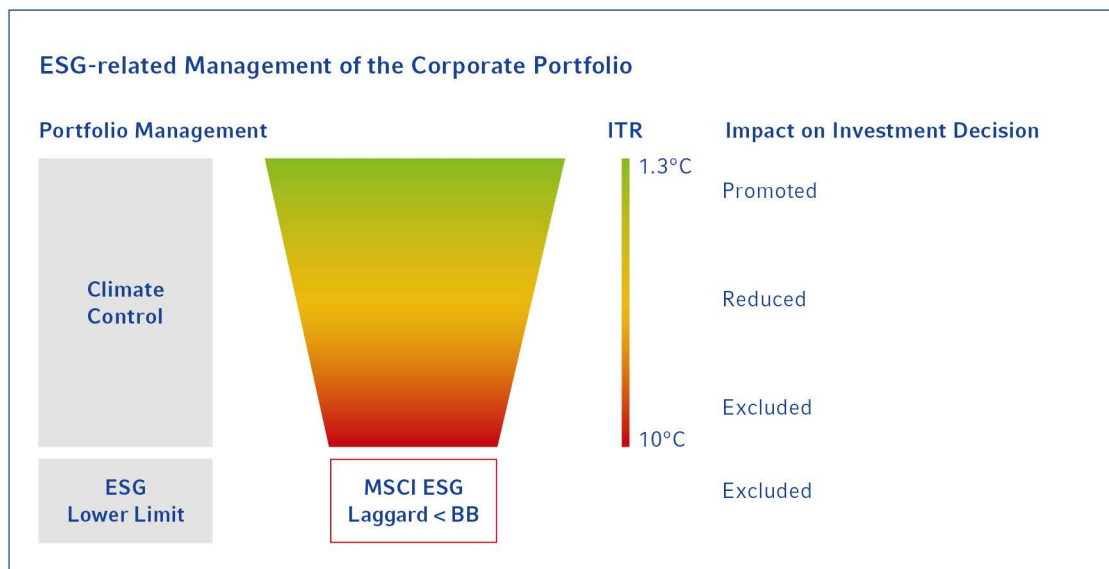
The consideration of transformation opportunities/risks and the Paris climate goals based on the Implied Temperature Rise (ITR) is a key component of the achievement of the sustainability objective in NRW.BANK's capital investments. The overarching objective is the achievement of a climate-neutral investment portfolio by no later than 2045 to support the limitation of the temperature rise to 1.5°C.

To this end NRW.BANK has used since 2023 the Implied Temperature Rise (ITR) in degrees as a further management parameter for limiting concentration risks in the corporate portfolio. Specifically, new investments in companies without transformation ambitions will be excluded in the future, while investments in companies with transformation ambitions with regard to the Paris climate goals will be actively promoted.

Portfolio management using the ITR parameter enables interim targets and necessary adjustments for achieving the desired management effect. The first interim operational target is to improve the ITR management parameter of the corporate portfolio by about 0.5°C by 2026. NRW.BANK will report on this in the context of sustainability reporting.

While NRW.BANK is aware that the Implied Temperature Rise (ITR) is a new and evolving indicator that is based on many assumptions, the Bank is convinced of the potential of the ITR indicator. It may become a market standard for forward-looking portfolio management considering climate risks and opportunities, especially due to the recommendation of the Task Force on Climate-related Financial Disclosures (TCFD).

NRW.BANK uses the ITR indicator as a starting point on the way to quantitative portfolio management (weighted sub-portfolio or total portfolio level) with regard to the Paris climate goals, including the consideration of interim targets, and examines further development options and offers of other leading providers of ESG data.



ITR im ESG Investment Framework

There are several climate assessment models for future-oriented portfolio management and assessment on the market. These models are based on different methods and assumptions. There is currently no standard. In this context, the internationally recognised Task Force on Climate-related Financial Disclosures (TCFD)¹, which strives for greater transparency and standardisation, has commissioned an independent group of experts, the Portfolio Alignment Team (PAT)², to examine these approaches. Following public consultation, the TCFD finally published recommendations for future-oriented portfolio management³ in 2021. The Implied Temperature Rise model, which is based on a budget approach, was recommended.

ITR Model

The remaining global carbon budget that may be emitted to keep the global temperature rise to a maximum of 2°C is compared with the projected carbon emissions, taking into account companies' concrete targets.

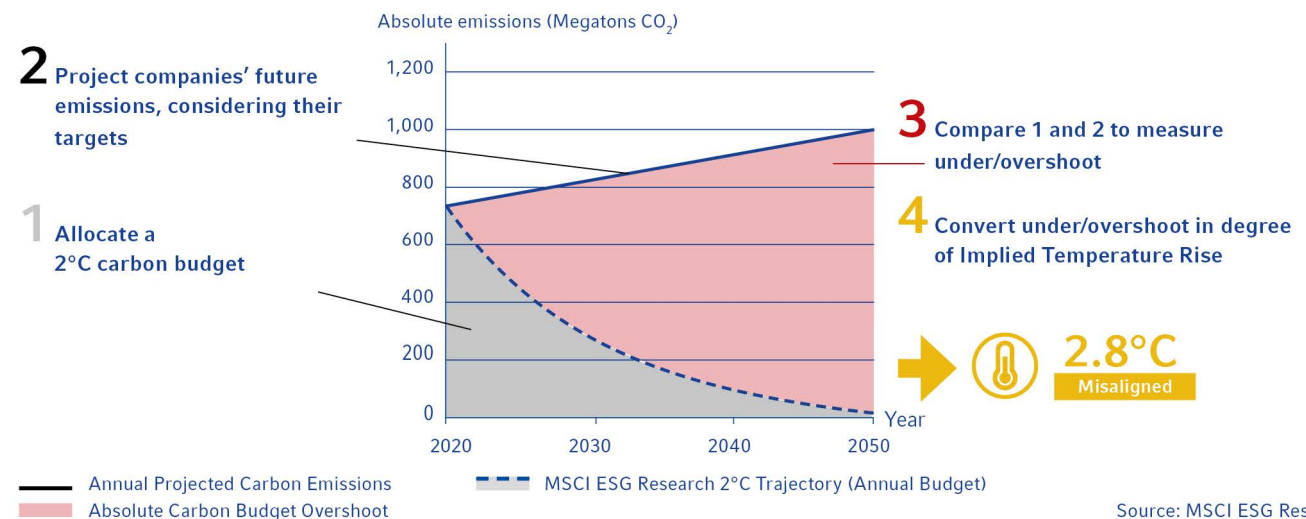
1. The underlying carbon budget is based on calculations of the Intergovernmental Panel on Climate Change (IPCC)⁴. A share of the budget is allocated to a company based on its sector, location and business activities.

2. Based on the companies' reported emissions and reduction targets, company-specific emission time series are simultaneously determined and compared with the allocated budget.
3. The comparison of the values results in an overshoot or undershoot of the available budget.

4. Using the scientifically based Transient Climate Response to Cumulative Emission (TCRE) approach, the determined overshoot or undershoot can be converted into a warming potential.

To obtain the portfolio temperature, the company-specific budget of all companies included in the portfolio is determined together with the projected emissions on a pro rata basis. For this purpose, the market value is set in relation to the Enterprise Value Including Cash (EVIC). The budgets and emissions of all positions in the portfolio result in the portfolio budget, which is set in relation to the determined emission time series. This results in an overshoot or undershoot, which is converted into the corresponding portfolio temperature using the TCRE approach.

Calculation Basis of MSCI ESG Research's ITR Indicator



¹ <https://www.fsb.org/wp-content/uploads/P141021-2.pdf>

² https://assets.bbhub.io/company/sites/60/2021/05/2021-TCFD-Portfolio_Alignment_Technical_Supplement.pdf

³ https://www.tcfhub.org/wp-content/uploads/2021/10/PAT_Measuring_Portfolio_Alignment_Technical_Considerations.pdf

⁴ https://www.ipcc.ch/report/ar6/wg1/downloads/report/IPCC_AR6_WGI_SPM_final.pdf

Significance of the ITR Indicator

The ITR indicator used by MSCI ESG Research is determined using a model and current findings as well as some underlying assumptions of a company's future development. MSCI ESG Research uses the recommendations of the TCFD and GFANZ as a basis, exchanges information with these initiatives and continuously develops the model further. Due to different methods, data basis, time horizons and emission scopes, the comparable management parameters of different providers of ESG data deviate from each other:

- So far, there has been neither a generally accepted method nor a generally valid data set for calculating the ITR indicator.
- There is no generally accepted method for entering calculations. Depending on the asset category, there are currently large differences in the availability of the data required for the calculation. As the availability and the accuracy of the data improve, the method for calculating the ITR indicator should also evolve and lead to other results.
- If no data are available and/or the data change, different estimation methods are used, especially with regard to companies' future emissions.

Collaborative Engagement

In the ESG context, engagement refers to the interaction between the investor and current or potential issuers in which it may invest. Engagement is the active involvement of an investor with regard to its own principles, sustainability guidelines and the improvement of transparency for the assessment of relevant sustainability indicators. Accordingly, engagement helps support the [UN PRI 2, 3 and 5](#). In its capital markets business, NRW.BANK invests exclusively in fixed-income securities and is thus never a shareholder. Engagement as a shareholder within the meaning of UN PRI 2 is therefore not possible. Nevertheless, NRW.BANK decided in 2022 to pursue engagement together with other institutional investors via ISS ESG. Every year, ISS ESG identifies 100 companies violating international standards. Through norm-based collaborative engagement, NRW.BANK, together with other institutional investors, can engage in selected companies that show social and ecological controversies with regard to international norms and standards for responsible corporate governance. The joint influence of the investor pool increases the chance that the engagement has a greater impact. At the same time, investment opportunities and portfolio diversification increase through successful engagement, as the risk of [norm-based exclusions](#) decreases and ESG ratings can improve. The exposure to ESG risks is also reduced.

NRW.BANK reports on its engagement activities in its Sustainability Report.

Update and Outlook

The Framework describes the current implementation of the integration of ESG criteria into NRW.BANK's investment portfolio. Given the relevance, NRW.BANK attaches to this topic, but also to meet the growing regulatory, supervisory and voluntary requirements, coordination between the front office and back office units is indispensable, as is the continuous further development of the Framework. A working group set up in 2021 under the leadership of the Capital Markets unit with participation of the Risk Control and Credit Management units and the Strategy Development Department ensures the coordination between the units of the Bank that are relevant for its orientation and further development. The direct involvement of the Sustainability Committee, also established in 2021, ensures rapid decision-making processes. When further developing its ESG Investment Framework, NRW.BANK ensures the highest possible degree of congruence with its [Sustainability Strategy](#) and bank-wide objectives.

In a dynamic environment with a simultaneous lack of international standards and a heterogeneous data basis, far-sighted integration of ESG criteria is a major challenge. For the time being, NRW.BANK is convinced that the consideration of ratings, scores and analyses of renowned providers of ESG data is the most sensible approach. To analyse the key parameters of the Framework with regard to the best possible management of ESG risks and opportunities, the currently relevant management parameters, which are based on MSCI ESG Research's scores, were compared with scores from other providers of ESG data in 2022 and 2023. NRW.BANK

uses this approach to gain experience in achieving the desired management effect and examines the necessary adjustments of the method and objectives in the context of its annual strategy process. This includes expanding the integration of climate risks and opportunities to other sub-portfolios beyond the ESG rating. In addition, experience gained from this approach is also helpful when participating in surveys and consultations especially about ITR Methodology through which NRW.BANK can proactively support the further development of ESG analysis and management systems.

The plan to increase the sustainable portfolio management to cover the total portfolio remains an important goal, but is based on having market-driven, comparable and methodologically consistent management tools. This year's review of a possible expansion found that a methodology comparable to the ITR concept for corporates was in NRW.BANK's opinion not yet available. Of course, promising developments such as the ASCOR project initiated by the UN PRI will continue to be closely monitored in line with our objectives.

The Framework is updated as relevant changes of core components occur – a regular update is not planned, though. Reporting and target setting associated with the Framework are carried out in the context of NRW.BANK's [sustainability reporting](#) and are integrated into UN PRI reporting.

Abbreviations

ASCOR	The Assessing Sovereign Climate-related Opportunities and Risks Project	TCFD	Task Force on Climate-related Financial Disclosures
CBI	Climate Bonds Initiative	TCRE	Transient Climate Response to Cumulative Emission
ESG	Environment, Social, Governance	TEG	Technical Expert Group (on Sustainable Finance)
EVIC	Enterprise Value including Cash	UN	United Nations
GFANZ	Glasgow Financial Alliance for Net Zero		
GBP	Green Bond Principles		
ICMA	International Capital Market Association		
ILO	International Labour Organization		
IPCC	Intergovernmental Panel on Climate Change		
ITR	Implied Temperature Rise		
PAT	Portfolio Alignment Team		
PRI	Principles for Responsible Investment		
SBG	Sustainability Bond Guidelines		
SBP	Social Bond Principles		

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