



Risk Control Policy

Introduction

This risk control policy is applicable to all portfolios managed by Covéa Finance and involves:

- Listing the main risks to which portfolios are potentially exposed
- Identifying the main monitoring indicators used in-house, and any measures put in place to mitigate or eliminate these risks
- Assessing the magnitude of these risks and their impact on investments
- Specifying the permanent risk control function, describing its governance and scope, and technical and human resources.

The policy is reviewed on an annual basis. Nonetheless, the policy can be updated during the year, depending on changes in the regulations, organisation or operations (investment in a new asset class, etc.).

The mainstays of the risk control system are:

- Independence of the risk control function (required for financial instruments under management)
- A Risk Committee (holding at least 3 meetings a year) to report to Executive Management
- Risk mapping: our main tool for managing activity.

The scope of monitoring includes all mandates, UCITS and alternative investment funds (AIFs) managed by Covéa Finance.

Transparent analyses can be carried out when a fund invests in an in-house fund or third-party fund.

This policy concerns monitoring the following financial risk categories:

- Market risks
- Counterparty risk
- Liquidity risk
- Valuation risk

First-level monitoring of these risks is performed by management or research teams.

Operational and non-compliance risks (asset management company (AMC)'s failure to respect its professional obligations) are controlled by the Compliance and Internal Control Officers.

1. Market risks

Market risk is defined as *“the risk of loss for the collective investment scheme or the individual portfolio resulting from fluctuation in the market value of positions in the portfolio attributable to changes in market variables such as interest rates, foreign exchange rates, equity and commodity prices, or an issuer’s creditworthiness”*.

This risk category can be divided into different sub-categories:

1.1. Equity risk

Equity risk can be defined as the risk of losses due to unfavourable movements in equity markets. This concerns all assets whose market value is sensitive to changes in the price of equities (equity or diversified funds or funds of funds, exchange-traded funds (ETFs), equity structured products, equity derivative products, derivative products based on the volatility of equities, convertible bonds, convertible bond undertakings for collective investment (UCIs), warrants, unlisted equity funds, etc.).

Risk indicators used in-house: Exposures, volatility, betas, ratios (Sharpe, information, etc.), deltas

Level of risk: Equity risk is deemed **STRONG** because the impact on invested capital can be **significant** (upward or downward fluctuations).

Save for structured products (subject to conditions), no guarantee can be given regarding the capital invested in assets exposed to this risk.

Equity risk can be hedged in part through the use of derivatives (reduction of exposure), but remains discretionary and temporary, depending on managers’ expectations.

Finally, derivative instruments based on the volatility of equities, classified as complex by the AMF (French financial market regulator) are strictly limited to certain portfolios and are not currently expected to become major performance drivers.

1.2. Interest rate risk

Interest rate risk can be defined as the risk of losses due to unfavourable movements in interest rates. This concerns all assets that are sensitive to yield curve volatility (bonds; money market instruments; money market, bond or diversified UCIs; interest rate derivatives; structured products; convertible bonds; etc.).

Risk indicators used in-house: Exposure, Sensitivity, Convexity, Deltas

Level of risk: Interest rate risk is deemed **STRONG** because the impact on the capital invested is significant with regard to our overall exposure on this asset class and to current very low interest rates.

Interest rate risk can be hedged in part through the use of derivatives (reduction of sensitivity to interest rates with futures or swaps), but remains discretionary and temporary, depending on managers' expectations.

1.3. Foreign exchange risk

Foreign exchange risk can be defined as the risk of losses due to unfavourable movements in foreign exchange risk. This risk concerns financial instruments, all asset classes combined, denominated in a currency other than euros, the base currency of our portfolios.

Risk indicators used in-house: Exposures, Foreign Exchange Effect on performance of funds

Level of risk: Foreign exchange risk is deemed **STRONG** because the impact on invested capital can be **significant** (upward or downward fluctuations).

Foreign exchange risk is not hedged systematically. Foreign exchange hedging agreements (total or partial) in order to mitigate or eliminate this risk can, however, be put in place. These hedges remain discretionary and temporary, depending on managers' expectations.

1.4. Concentration risk

Concentration risk can be defined as the risk of losses due to high exposure to an asset class, sectoral activity, currency, geographical area, issuer, etc.

Risk indicators used in-house: Exposures (sectoral, geographical areas, companies/issuers, etc.), number of issues, average weights, standard deviations of weights, weights of main positions, etc.

Level of risk: Concentration risk is deemed **STRONG** because the impact on invested capital can be **significant** regarding funds invested in specific stocks or funds (small caps, growth stocks, green funds, convertible bond funds, technological breakthrough funds, emerging market funds, property funds, high-yield bond funds (speculative financial instruments), bond funds, private equity funds of funds, etc.), which can suffer greater losses than generalist funds.

To reduce concentration risk, a diversity of instruments is used in the construction of portfolios. This diversification is key in the subsequent monitoring of portfolios.

1.5. Credit risk

Credit risk can be defined as the risk of losses due to a deterioration in an issuer's creditworthiness, or the risk of losses due to an issuer defaulting on part or all of its commitments (failure to pay coupons or to repay nominal amount).

Risk indicators used in-house: Credit ratings of issues or issuers, spreads between the debt instrument and equivalent sovereign debt (depending on availability of data).

Level of risk: Credit risk is deemed **STRONG** because the impact on invested capital can be **significant**, especially in the event of an increase in the issuer's credit spread, or the issuer defaulting or failing to pay the coupons.

Rating agencies used are S&P, Moody's and Fitch Ratings. The lowest rating awarded by the three agencies is used. An in-house rating table has also been put in place to have an independent rating (based on a given list of issuers).

1.6. Commodity risk

Commodity risk can be defined as the risk of losses due to unfavourable movements in commodity prices. It concerns all financial instruments that are sensitive to changes in the price of commodities (gold, silver, oil, copper, corn, etc.) and only concerns specific portfolios mentioned in their prospectuses.

Risk indicators used in-house: Exposures

Level of risk: Commodity risk is deemed **VERY STRONG** because the impact on invested capital can be **very significant** (upward or downward fluctuations) and because this asset class is classified as non-traditional by the AMF.

This asset class, classified as complex by the AMF since 2019, can experience movements that are very different from those of traditional markets (equities, interest rates, currencies) and can be a major performance driver, even if its weight remains relatively small.

Finally, this asset class exposes portfolios to foreign exchange risk because most commodities contracts are denominated in US dollars (margin calls).

2. Liquidity risk

Liquidity risk is defined as *"the risk that a position in the portfolio cannot be sold, liquidated or closed out at limited cost in an adequately short time frame and that the ability of the UCITS or the AIF to comply at any time with issue and redemption requirements at the request of investors, or the ability of the AMC to liquidate*

positions in an individual portfolio in accordance with the contractual requirements of the portfolio management mandate, is thereby compromised”.

Indicator used in-house: percentage of the portfolio that can be liquidated in x days, number of days to liquidate x% of the portfolio (risk under liabilities)

Level of risk: Liquidity risk is deemed **STRONG** because the impact on invested capital can be **significant** in the event of turbulence in the markets and impossibility of cashing out positions at reasonable prices.

Liquidity risk is reflected in the assets and liabilities. Under liabilities, the risk is measured based on the portfolio’s stability, investment type and concentration. Under assets, the risk is measured on the portfolio’s ability to liquidate its assets in a defined time interval. This measure varies according to the types of instruments; the methods used include the following:

- For equities: percentage of the volume exchanged during the past three months.
- For fixed income: liquidity score determined based on geographical area, type of debt, etc. A liquidable amount is associated to each of these scores.

The other methods are shown in the liquidity stress tests policy.

It is worth noting that certain specific asset classes (private equity, loans, private placements, etc.) are, by nature, quasi-illiquid because they are difficult to sell in a short period of time and without costs. Management and legal teams carry out specific analysis on these assets before any investments are made. Should portfolios invest in these assets, managers monitor the assets after the investments have been made through meetings with counterparties or management companies, and reports received periodically.

3. Counterparty risk

Counterparty risk is defined as “the risk of loss for the collective investment scheme or the individual portfolio from the fact that the counterparty to the transaction or to a contract may default on its obligations prior to the final settlement of the transaction’s cash flow”.

Post-transaction counterparty risk concerns financial contracts traded directly on a regulated market or over the counter (futures, forwards, swaps), but also securities using forward financial instruments with a counterparty such as synthetic trackers or securitisation special purpose vehicles (SPVs).

Indicators used in-house: Exposures by counterparty, amounts of margin calls (and available liquidities), total risk (leverage).

Level of risks: Counterparty risk is deemed **STRONG** because the impact on invested capital can be **significant** in the event of the counterparty defaulting prior to the final settlement of the contract.

This risk is, nonetheless, mitigated, depending on each case, by cash collateral agreements (concerning over-the-counter contracts), deposits requested by clearing houses and daily margin calls (concerning listed contracts) or by the basket of investments pledged as security within synthetic trackers.

4. Valuation risk

Valuation risk can be defined as the risk of losses due to a poor or lack of valuation of a financial instrument.

All asset management companies should have a method for accurately and independently valuing the instruments held in the portfolios they manage.

Each financial instrument is valued using market prices provided by multiple sources mentioned in Covéa Finance's Price Policy and information provided by the issuer or independent expert.

Risk Control procedures are carried out beforehand when the valuation model used is validated, by ensuring that the model is consistent with the parameters proposed by the research or management teams.

They are also carried out where there are differences in the valuations. That is to say, if a difference exists between the value produced using the in-house model or the valuations provided by our outside providers (in particular regarding complex products and over-the-counter financial contracts) and that of the counterparties. The procedures consist of revaluing the instrument and identifying the source of the difference.

The scope of the products potentially posing a valuation risk has been defined based on the following two criteria:

- An absence of price; or
- A potentially unreliable valuation (in particular due to a single contribution by a counterparty or complex valuation method).

However, once an instrument has one of the sources of contribution mentioned in the Price Policy, or at least two independent contributors, its valuation is deemed reliable.

In addition, Covéa Finance has put in place an in-house valuation process for several categories of financial instruments:

- Transferable debt securities (following the reform of money-market funds in 2019);
- Illiquid instruments traded on Euronext Growth (formerly Alternext)
- Private equity funds for which we may need to calculate adjusted net asset values.

The models used in-house and outside providers are reviewed on an annual basis by the Risk Control team.

Finally, valuation committees hold periodic meetings around Front Office, Research, Control and Instrument Chain teams to monitor identified products.

5. Risk mapping

Pursuant to the AMF's guide to the organisation of the risk management system within asset management companies – DOC-2014-06, risk control periodically assesses the risk levels to which collective investment schemes and managed portfolios are exposed.

Risk Control has established a structured mapping for each type of instrument held in the portfolios that associates the risks inherent in each of them.

A risk mapping has then been produced for each portfolio, using the mapping for each type of instrument, ensuring that for a given portfolio all the risks inherent in the instruments held in the portfolio are monitored. This mapping is Risk Control's main tool and is contained within a table, providing an instant reading of the levels of exposure to the risks. The different risk profiles of the portfolios are measured thanks to this mapping, and alerts are triggered when threshold exposures are reached.

6. Stress tests

The Management Company has put in place an overall process of stress tests to apply to the portfolios, which are of two types:

- Market stress tests
- Liquidity stress tests

These stress tests measure the impact of a disruption in the markets and/or a disruption of the liquidity of the markets on the value and structure of the portfolios.

The models used are adapted to the type, size and complexity of the funds, and have been produced based on the risk factors inherent in each portfolio.

The types of scenarios chosen are of different sorts: historical, hypothetical or a mix of the two. For liquidity stress tests, we have also used the so-called reverse scenario.

The indicators used are those commonly monitored as part of our permanent risk control (loss in stock market price by instrument and by portfolio, fall in unrealised capital gain, reserves, breakeven points, impact on liquidation of portfolios, etc.).

The frequency of these stress tests is adapted to each fund, but is at least quarterly. Models, scenarios and assumptions are reviewed on an annual basis, at least.

The results of the stress tests are communicated to the management board and presented to the risk committee, with an action plan if vulnerabilities are detected. They are also communicated to the regulator as part of regulatory reports (AIFM, MMF) and also presented to the board of directors of SICAVs (open-ended investment companies) (MMF).

7. Risk committee

The risk committee's main responsibility is to analyse current exposures of portfolios under management. The analysis is performed on exposures to countries, geographical areas, sectors, currencies, ratings, issuers, maturity classes, etc. The committee also explains any changes in exposures occurring between two meetings of the committee, in order to raise the alarm should there be significant changes.

Once identified, these changes can lead to decisions being taken in the various management committees set up for this purpose, in order to anticipate the potential consequences of any such changes.

This also helps to measure the impact of the choices made in the various management committees concerning the market risks to which the portfolios are exposed.

Finally, the performance and different risk indicators of the portfolios we manage are presented.

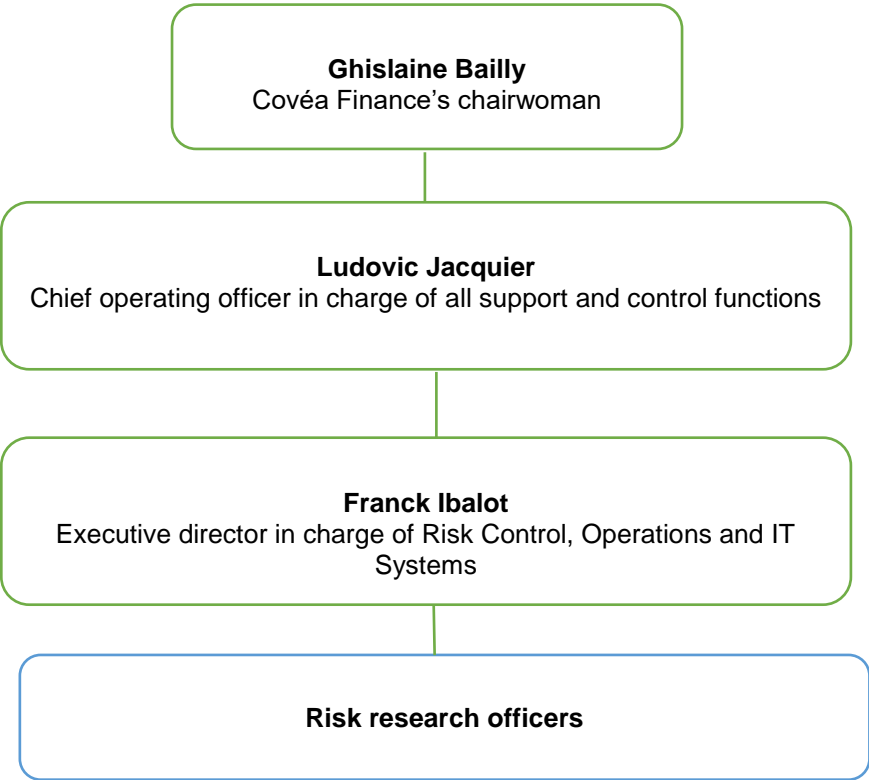
8. Organisation of the permanent risk control function

8.1. Organisation and scope

Pursuant to the provisions of Article 313-53-4 of the AMF General Regulation and as stipulated in AMF Instruction No 2012-01, *"the permanent risk control function should be independent of the operational units in terms of both hierarchy and function"*.

The risk control team is under the responsibility of the executive director in charge of Risk Control, Operations and IT Systems, Franck Ibalot, who is a member of the Executive Committee.

The organisation ensures the independence of the function vis-à-vis the operational units in charge of the management. It informs the management decisions in the value chain and risk chain.



Risk research officers monitor exposure to the risks by carrying out formal checks and conducting analyses from time to time. They produce risk indicators on a regular basis to analyse changes. Their role, therefore, is to measure the effectiveness of management decisions and to communicate their analyses to the members of the Risk Committee.

8.2. Attributions and alert system

The role of the risk control team is to alert executive management and fund managers.

These alerts are issued:

- **From time to time:** through analysis documents when requested or when certain ratios are controlled.
- **Periodically:** through **risk committees**, **risk mapping** and **stress tests**.

The risk monitoring system is based on in-house alert thresholds. These thresholds can trigger alerts and/or actions depending on the observed level of exposure. Thanks to this monitoring, executive management and fund managers can be alerted of when thresholds are reached in order that they can take measures they consider needed. The alerts sent are the subject of a quarterly report that is presented to the executive management.

8.3. Supervision

The risk management system is supervised by the executive management through the Risk Committees, which hold meetings in their presence.

Permanent Internal Control also has access to the whole of this system and carries out formal controls based on sampling of work carried out by Risk Control.

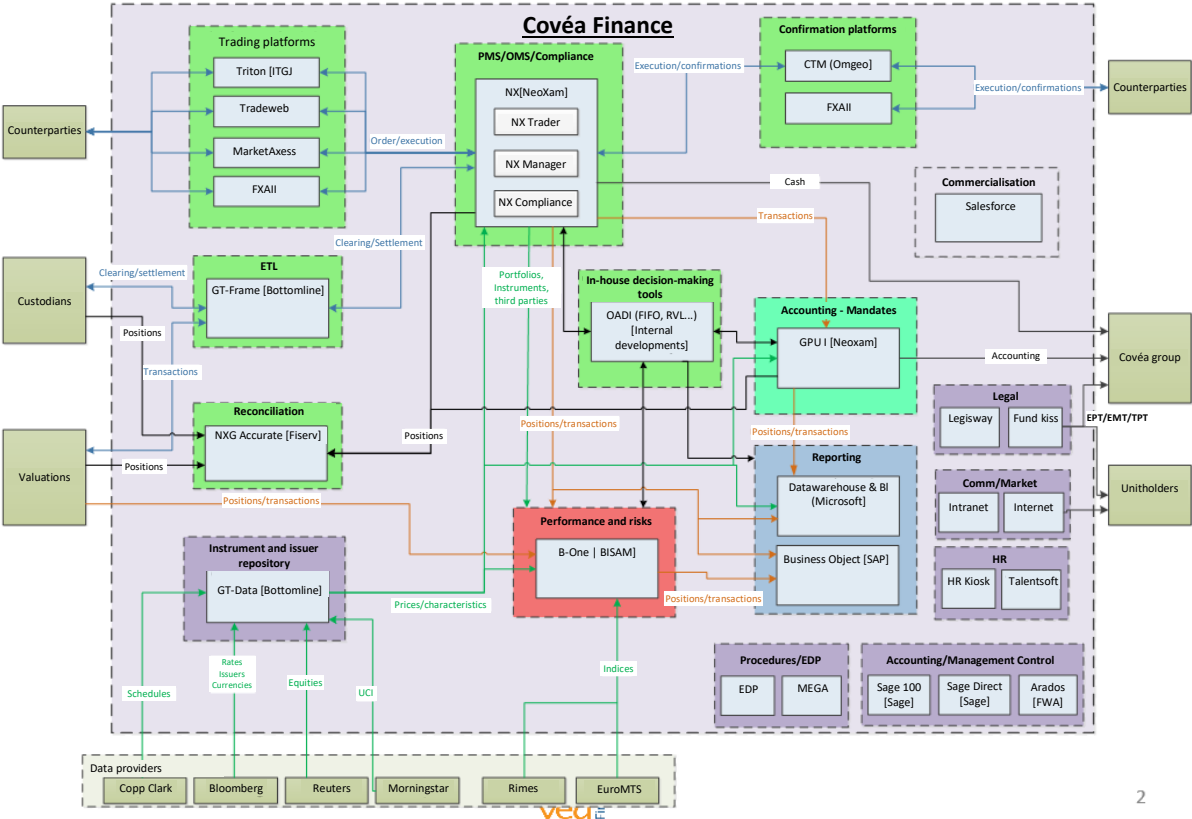
8.4. Tools and IT systems

Risk Control uses the following measurement and risk monitoring tools:

- **B-One (FACTSET)**: Tool for measuring and attributing performance and risks.
- **NX Portfolio Management System (NEOXAM)**: Tool for managing positions and transactions.
- **Business Objects (SAP)**: Reporting tool
- **Applications developed in-house**

The risk management procedures are formalised in the in-house procedure tool MEGA.

The tools are supplied with data from reliable sources and are part of the following mapping of the IT system:



The market data used are sourced from recognised contributors: Bloomberg, Thomson-Reuters, MorningStar, Six Telekurs, Markit and Rimes.

REFERENCES

- AMF General Regulation
- French Monetary and Financial Code - Article L. 533-10-1
- AMF Instruction 2014-06 -- Guide to the organisation of the risk management system within asset management companies.
- Vadémécum AFG 2013-03 -- Organisation of risk control
- AMF Instruction 2012-01 -- Risk management organisation for collective investment undertaking management activities and discretionary portfolio management investment services.
- AMF Instruction - Risk management and internal control systems.
- AMF Instruction 2011-15 -- Calculation of global exposure for collective investment schemes (CIS) and alternative investment funds (AIF).
- AMF Instruction 2008-06 -- Organisation of asset management companies (AMCs) and Investment Services Providers (ISPs) in terms of valuation of financial instruments.
- DOC-2012-19 - Position - AMF recommendation - Programme of operations guide for asset management companies and self-managed collective investments.

Appendix: Méga procedures

The procedures used by Risk Control to measure the exposures to market, liquidity and counterparty risk are modelled in the in-house tool MEGA:

- Control risks
 - Define risk categories
 - Define risk indicators regarding risk categories
 - Monitor risk indicators
 - Issue level-1 alerts
 - Issue level-2 alerts

- Manage valuation
 - Monitor valuation of complex products
 - Control valuations of structured products
 - Verify counter-valuation of complex products

- Manage the Risk Committee
 - Prepare Risk Committee presentations
 - Hold Risk Committee meetings

- Manage market stress tests
 - Prepare action plan following market stress tests
 - Define test scenarios and assumptions
 - Define risk types by portfolio

- Manage liquidity stress tests
 - Prepare action plan following liquidity stress tests
 - Define liquidity profiles by portfolio
 - Define liquidity stress test scenarios and assumptions

Updated in Paris, 23 September 2020