The EFG Approach to ESG and Sustainability

1. Introduction

At EFG, we recognize the rising demand for more responsible and sustainable investments, propelled by both regulatory shifts and evolving consumer behaviours, particularly influenced by the next generation. As an investment firm and asset allocator, we believe in the value of Environmental, Social, and Governance (**ESG**) factors in guiding informed investment decisions.

To better address these specific investment preferences concerning responsible and sustainable investments, we have designed a dedicated investment universe - available in Switzerland.

This paper provides information on how the universe has been designed with respect to sourcing relevant information on ESG Factors and using this information and our internal analysis to classify direct investments, mutual funds and exchange-traded funds into sustainable, responsible, or neutral investments which may be included as part of our transition approach.

This document:

- Describes our ESG Investment Approach and how we evaluate the ESG score of direct investments, mutual funds, and exchange traded funds;
- Provides more information on our transition universe;
- Provides more information on the three categories of investments which may be offered as part of our transition Universe, which are Sustainable Investments, Responsible Investments, and Neutral Investments.

2. The ESG Investment Approach

To perform our ESG analysis of Direct Investments, Equities and Fixed Income securities, EFG designed an internal framework, the **Global Responsible Investment Platform (GRIP).** GRIP integrates up to 400 data points for each company from several data providers and aggregates them into 18 thematic ESG Key Performance Indicators (KPIs) covering water consumption, air pollution, business integrity or employee health and safety, that can be regrouped into three main themes: Environment, Society and Governance (ESG).

These KPIs allow to better understand how a company manages environmental, social or governance factors in its activities, and, when aggregated and weighted according to their industry-specific importance, they provide a final ESG score that can be used to estimate a company's ability to respond to sustainability challenges.

Since we launched GRIP in 2012, we have regularly reviewed its methodology, which is based on the principle of materiality (see below section on the topic for more information) and expanded its data and investment coverage, as we adapt to new emerging sustainability challenges and changes in the regulatory landscape. The GRIP process has also been reviewed twice over the years from independent advisors.

Data Sources

The GRIP is fed with data obtained from several data providers including:

- Sustainalytics
- Refinitiv
- RepRisk
- CDP and other NGOs
- Analysts' inputs

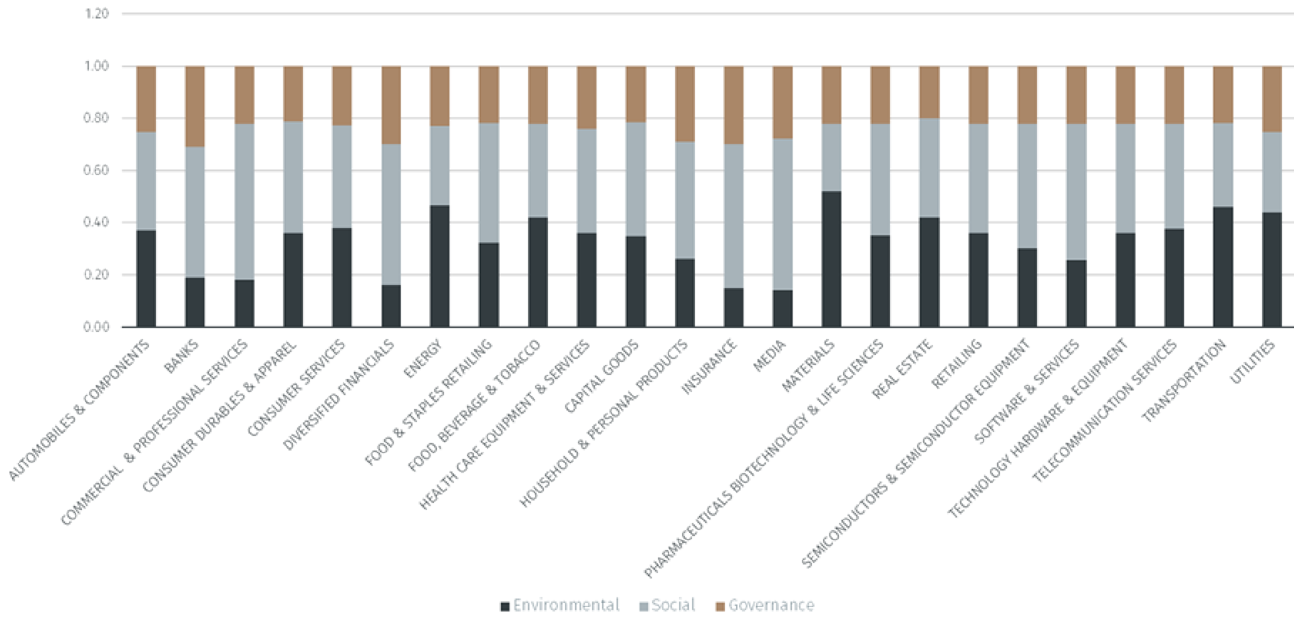
GRIP uses Refinitiv and Sustainalytics as main data providers, RepRisk as the main controversy -incidents- data supplier and information from NGOs such as CDP (Carbon Disclosure Project) for specific data points. Finally, our data approach can be enriched with some interactions we may have through our asset management firm EFG Asset Management (EFGAM) and its engagement with some companies into which we may consider investing client money or investor funds.

Given coverage from our external data providers varies in terms of data availability, approach and depth of coverage, we have created an internal weighting scheme that can cater for all these differences and adjusted the weights according to each firm's data coverage.

Summary methodology explanation

The GRIP ESG score is based on the principle of materiality, meaning that a stronger weight is assigned to those KPIs that are believed to be more important to each company depending on its industry group. For example, the importance of water consumption can significantly vary between industries and sectors. Therefore, the thematic KPI "water" is much more relevant (i.e., has a much larger weight in the final ESG score) for a mining company than for a media one. Similarly, as per the table below, the full set of Environmental KPIs is more heavily weighted for energy firms than for companies in the financial sector.

Relevance of E, S, G KPIs for different industry groups



Source: EFG GRIP, June 2024.

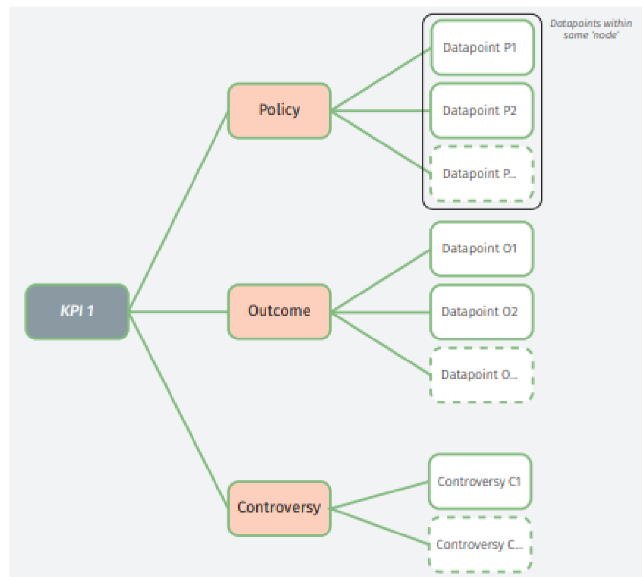
These KPIs are at the centre of our analysis and have an ever more important role in defining whether we consider a company Responsible, as we further explain below.

As outlined before, they are evaluated through multiple data sources that help us to understand:

- Policies: what are the policies, rules and targets a company has in place to manage key issues related to the respective KPI.
- Outcomes: the measurable effects of companies' activities such as tons of CO_2 emissions or the number of accidents.
- Controversies: the controversies related to companies' activities and operations to evaluate if they are "walking the talk" and behaving in the interest of all their stakeholders.

Once the KPIs for a specific company have been calculated, they are weighted and summed according to their relevance to each company, to obtain a final ESG score, expressed with a 0 to 100% scale, with 100% being the best score, that provides a simple and synthetic summary of the ESG characteristics of a company. We of course must be aware of its limitations as it is indeed very challenging to represent the complexity of a company as well as all its relations with multiple stakeholders and the external environment in one single score.

KPI Mapping



Source: EFG. January 2025.

Alignment with Sustainable Development Goals (SDGs) – Corporates

Source: United Nations, 2015.

The 2030 Agenda for Sustainable Development, adopted by all United Nations Member States in 2015, provides a shared blueprint to improve human life and protect the planet by 2030. At its heart are the 17 Sustainable Development Goals (SDGs), which are an urgent call to action for a global partnership between developed and developing countries aiming to end poverty and hunger, improve health and education, reduce inequality, strengthen justice and institutions, ensure clean water, promote circular ways of production, expand clean energy, and spur economic growth, all while tackling climate change and working to preserve our oceans and forests. Every SDG contains multiple actions or targets that can contribute to its accomplishment. These goals have been primarily drafted to be a framework for government action, but the spirit of these goals can be followed by everyone, companies included.

The translation of the SDGs into corporate life comes with some complexities, as many of the targets go beyond the daily duties of people and corporations. For example, the SDG 1 "Poverty eradication" is mainly linked to legislative measures of a country. A corporation can of course support this goal through external philanthropic activities or charities. However, these types of actions are difficult to be clearly linked to the company's operations and can therefore be seen as a type of "social greenwashing".

EFG distinguishes between transversal and more activity-specific SDGs. Transversal SDGs could potentially be attributed to all companies such as SDG 5 on "Gender Equality", SDG 11 "Sustainable Cities and Communities" and SGD 16 "Peace, Justice and Strong Institutions". Other ones such as the SDG 6 on "Clean Water and Sanitation" is much more industry specific. For instance, SDG 6 is not assigned to companies in the software or banking industries, since water consumption is not a material (important) topic for them, whereas for mining or consumer goods companies it is indeed.

The approach implemented by EFG mainly relies on its internal GRIP engine which, as previously explained, defines a number of high-level KPIs to score ESG performance across multiple domains such as Water, Waste, Employment Quality etc. These KPIs are translated into SDG alignment, meaning a company with great management of employment practices, and hence a very high KPI score related to Employment Quality, can be said to align to the SDG 8 "Decent Work and Economic growth" and a company with a good Water KPI score can be said to align with the SDG 6 "Clean Water and Sanitation", if water consumption is material for the specific industry the company belongs to.

In some instances, the SDG alignment can be attributed through a qualitative assessment based on revenues derived from specific activities (e.g., a solar panel company with limited ESG disclosures) or following a more qualitative assessment of company practices. In other cases, it can be attributed through sectorial selection, e.g., SDG 3 Good Health and Well-being can be, under certain conditions, assigned to companies in the Healthcare or Pharmaceutical sectors. Finally, SDG 7 Clean and Affordable Energy can also be attributed to companies on the basis of their involvement in renewable energy production or consumption. As an additional control SDGs attributions go through a final controversy check: if we deem a company is exposed to too

many litigations or controversies referred to the SDG in focus, the attribution of the SDG will be neglected.

Alignment with Sustainable Development Goals (SDGs) - Sovereign

The process to assign an SDG to a Sovereign entity combines two steps:

The first one consists of a negative screening and has the aim to replicate the UN Global Compact assessment that focuses on respect of human rights, environmental protection, and anti-corruption practices. It excludes all the countries that have a normalized score below 50% in one of the following three key indicators: Human Rights, Carbon Emissions Intensity, and Control of Corruption according to the internal methodology.

The second step consists of a positive screening and leverages the Sustainable Development Report (https://dashboards.sdgindex.org/), which evaluates the approach of countries towards the 17 Sustainable Development Goals (SDGs). If a country is considered by the report to have achieved one SDG or is progressing towards that goal, it can be said to be aligned with the specific SDG.

To receive the final SDG attribution, a Sovereign issuer must pass both mentioned screenings: if it is considered aligned with the requirements of the second assessment (SDG index) but does not meet the negative test, the SDG is not assigned. With respect to sovereign investments EFG assesses all the 17 SDGs.

GRIP light

GRIP is highly dependent on the inputs from the various data feeds. When they are missing or only available in very limited quantity, the analysis becomes more complex. As such we developed a “GRIP light” approach to cover companies where limited data availability makes a full ESG analysis less meaningful. This complementary approach mainly exploits external data obtained from RepRisk and Sustainalytics “core” frameworks. It is based on a smaller set of data and is also used for supranational or government agencies, but also for holding companies, not reporting at holding level. Clearly, given the lack of precise details, this approach can only provide a high-level estimate of the ESG riskiness of a firm.

Mutual Funds and ETFs ESG assessment

The process to assess the ESG characteristics of Mutual Funds and ETFs is completely separated from the process used to score direct securities. This approach mainly focuses on the investment process of the third-party collective investment scheme. Our Fund Selection team assigns ESG ratings by combining different approaches that allow the classification of such investments within the following scale, which we have defined, ordered by perceived strength of ESG integration (high to low):

- **ESG Sustainable**
- **ESG Responsible**
- **ESG Neutral**
- **Non-ESG**

The process to reach these classifications is slightly different between mutual funds and ETFs.

Mutual Funds

For Mutual Funds, “top down” and “bottom up” analysis is conducted on each internally approved mutual fund, assessing ESG credentials with a view to assigning an ESG rating according to EFG’s own proprietary rating system. If a client is flagged as ESG-interested and has a discretionary/advisory mandate, then they can invest only in Transition universe approved securities.

“Top-down” analysis:

- Consider asset manager’s PRI (Principles for Responsible Investments association) score.
- Consider whether the asset manager has signed up to the UN Global Compact initiative.
- Assign a score for Investment Process, based on qualitative analysis, to denote how well-embedded ESG analysis is into the investment process.
- Where an exclusion list exists, assess the appropriateness and stringency.

“Bottom-up” analysis:

- For Fixed Income products, we use the MSCI ESG rating.
- For Equity products, we use the Morningstar Globe score.

Scores from the top-down and bottom-up approaches are combined to form a holistic ESG score for the fund. This score will then influence the ESG rating that the fund analyst assigns to the fund.

ETFs

Only passively managed (index-tracking) ETFs can be constituents of EFG’s Approved ETF List. Since these products are designed to replicate the behaviour of an underlying index, assessing ESG integration into the ETF’s investment process, in the same way that we do for funds, would not be relevant. Our ESG rating process focuses on the construction of the underlying index that the ETF tracks, and the construction methodology being used. Factors considered include the stringency of any exclusion lists compared with the broad market, whether there are any sustainability-linked objectives (e.g., Paris-Aligned Benchmark), whether the index targets a particular thematic linked to ESG (e.g., gender diversity or climate transition).

For both Mutual Funds and ETFs, the approach defines the ESG features of securities that, as better explained further

below, allow the classification of Mutual Funds/ETFs into "Sustainable", "Responsible" or "Neutral" from an ESG point of view.

3. The EFG Transition Universe

The above methodologies are used in our **EFG Transition Universe**, which aims to capture investment opportunities and reduce risks of investing in securities that may be unable to transition to a more sustainable economy. The objective of the EFG Transition Universe is not to sacrifice return but to pair financial performance with environmental or social considerations.

EFG believes the transformation to a more sustainable economy is underway as new consumer behaviors and changing business models are affecting investor demand creating new investment opportunities which can be tapped into.

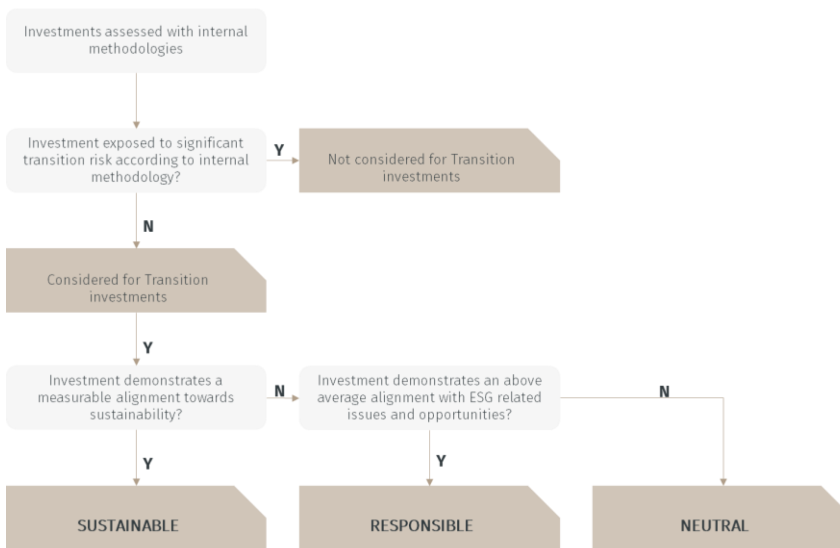
Within our Transition Universe we decided to remove investments that present significant transition risk due to their products, behaviour, or approach to market. Additionally, the Transition Universe classifies investments into the following three characteristics: "**Sustainable"**, "**Responsible"** and "**Neutral"** investments, using the internal methodologies previously described. The process to assign those ESG characteristics is slightly different across the multiple asset classes and investment vehicles and better explained in the following chapters.

With respect to companies the two prerequisites to be considered as either Responsible, Sustainable or Neutral is to belong to the bank's Approved List and to comply with basic international norms and our internal rules. Before assigning such characteristics, we screen companies to ensure they respect the following "Standards" based on international or internal rules:

- Main standards such as United Nations Global Compact principles (UNGC), ILO Core Labour Conventions, UN Guiding Principles on Business and Human Rights or OECD Guidelines for Multinational Enterprises.
- No production or involvement in controversial weapons.
- Issuers deriving more than 20% of their gross revenues from the extraction, production and/or sale of thermal coal or oil, unless they have published a clear and credible exit/reduction/net-zero strategy.
- Exposure to Gambling or Tobacco exceeding 5% of gross revenues.
- Very weak ESG profile, high reputational risk, or exposure to significant controversies in multiple domains according to our list.

Companies found to be breaching those external norms and internal rules are excluded from the Transition Universe. To screen and monitor that companies which are part of such investment universe comply with those standards, EFG uses data sourced from Sustainalytics, Urgewald, Swiss Association for Responsible Investments, RepRisk and internal analysis.

Transition Universe



Source: EFG.

With respect to Mutual funds and ETF the selection is embedded in the due diligence process and informs the analysts when they assign the different characteristics.

4. Sustainable Investments

Generally speaking, direct investments in companies or in collective investment schemes that demonstrate a measurable alignment with sustainability or have ESG integration at the core of their product design, according to EFG's screening methodology and are therefore at the forefront of the "transition" towards a more sustainable economy are considered "Sustainable".

a) Direct investments - Equities / Fixed Income Corporates

EFG defines certain companies as being "Sustainable" if they meet specific criteria. These are companies that, in addition to respecting the "standards" defined above in section 3 for being included in the Transition Universe, help the economy transitioning to an economic model that reduces the negative footprint on our society and the environment due to their sustainable practices or products. The definition of "Sustainable" focuses on absolute and measurable criteria.

Environmentally Sustainable Investments

At EFG a security could be considered Environmentally Sustainable through:

1. Meaningful exposure to EU Taxonomy activities
2. Measurable contribution to an Environmental Objective
3. Net-Zero Alignment
4. Green Financing

The first approach to attribute the "Sustainable" characteristic exploits the EU Taxonomy of environmentally sustainable activities. In order to meet the EU's climate and energy targets for 2030 and to achieve the objectives of the European Green Deal, the EU Commission defined some requirements that any activity must respect to be considered Taxonomy aligned.

The activities must contribute to at least one of the following six environmental objectives:

1. Climate change mitigation
2. Climate change adaptation
3. The sustainable use and protection of water and marine resources
4. The transition to a circular economy
5. Pollution prevention and control
6. The protection and restoration of biodiversity and ecosystems

In addition, they should not significantly harm any of the other objectives, must respect basic human rights, labour standards and finally stringent technical criteria. Under the EU taxonomy rules any activity not respecting any one of the above criteria cannot be considered taxonomy aligned.

All these requirements ensure high-quality standards and EFG qualifies any company that has more than 25% of revenues or capex linked to Taxonomy aligned activities as "Sustainable".

The second approach to qualify an investment as "Sustainable" includes investments that have a positive effect on the environment. This is the case when the majority of revenues are obtained from specific activities related to renewable energy, environmental restoration, sustainable mobility, water or waste management, circular economy etc. For a company to be considered "Sustainable", the exposure to those activities must represent more than 50% of its revenues. In addition, the company must not significantly harm the above highlighted objectives.

A third approach to qualify an investment as "Sustainable" focuses on efforts to reduce emissions. Companies with Net Zero commitments and targets and a credible and demonstrable approach to reduce Green House Gas (GHG) emissions in line with the Net Zero goal set out by the Paris Agreement of limiting global warming well below 2°C, are also considered sustainable. To assess the alignment to Net Zero EFG combines different methodologies with a leading role played by its "Climate Engine" that forecasts future company emissions and compares them with reference sectorial pathways to measure the alignment with Net Zero objectives and represent our main approach to define whether a company is Net Zero or not. More details can be found in the already published document "Climate Engine: an overview".

Finally, the **fourth approach** focuses on labelled bonds that are covered by ICMA, Green Bonds Standards, or in the future by the EU Green bonds standards. Such bonds when issued with a clear commitment on the use of proceeds, can be considered "Sustainable" investments, even if they are issued by companies that are not considered sustainable. Other investments such as Sustainability-linked bonds with sustainable characteristics can also be considered "Sustainable" after a manual assessment. We believe that financing non-sustainable companies to decarbonise and improve their sustainability profile is a fundamental step in achieving climate goals and societal needs.

Sovereign entities are never considered sustainable, but in line with the above, certain types of their labelled bonds can.

b) Mutual Funds and ETFs

Mutual funds and ETFs are classified as "Sustainable" by EFG when they have sustainability at the core of their product design or at the core of the underlying Index construction policy and are often thematic in nature (e.g., concentrating on Clean Energy, Water, etc.).

5. Responsible Investments

Differently from "Sustainable" investments, the "Responsible" characteristic generally captures investments with some relative strengths compared to others. These securities demonstrate an above-average focus on ESG-related issues and opportunities. In the case of direct investments, this means investments in companies that are achieving an above-average performance by aligning positively to at last one of the UN SDGs in accordance with EFG's methodology. For collective investment schemes, this indicates that ESG analysis is well integrated into their investment approach and has a material influence on portfolio construction and security selection. These investments don't have a clear direct effect on the transition towards a more sustainable economy, but thanks to their approach contribute creating the sound "ecosystem" that is necessary for the global efforts.

a) Direct investments - Equities / Fixed Income

Corporates

Companies which respect the "Standards" defined above in section 3 for being included in the Transition Universe, can be qualified as "Responsible" Investments if in addition they are considered aligned with at least one UN Sustainable Development Goals, which, as previously described, contain both environmental and social aspects. We believe SDGs represent a simplified but useful classification when describing and reporting ESG characteristics with a common and easy to understand framework. According to this approach a company that obtains an above-average performance in at least one KPI and is considered aligned with the corresponding SDG, is characterised as "Responsible". We believe that this approach is also financially sensible as companies that are able to better serve their stakeholders' needs and better align to real social and environmental issues are reinforcing their competitive position. Better serving the multiple stakeholders of a company can be seen as a positive step to build future success.

Sovereign Issuers

The attribution of the Responsible characteristic to Sovereign issuers is determined on the basis of the SDG attribution previously described. If a country receives at least one SDG, meaning it also passes the negative tests, it is considered as Responsible.

b) Mutual Funds and ETFs

With respect to Mutual Funds and ETFs, EFG considers them as "Responsible" when they demonstrate best in class ESG implementation, meaning ESG analysis is well-integrated into the security research process and has a tangible effect on the overall opinion on the issuer and on portfolio construction. Issuers with positive ESG credentials are actively promoted, while those with material ESG-related issues are demoted. With respect to ETFs, ESG considerations are well-integrated into the underlying index construction often with significant exclusion policy or with specific social or environmental objectives.

6. ESG Neutral Investments

Finally, the last ESG characteristic captures investments that, according to the EFG framework, have all the requisite to have financially sound performance, but are not significantly exposed to transition risks and, at the same time, do not display material positive characteristics on a par with securities considered sustainable or responsible according to EFG's methodology. With reference to collective investment schemes these are for investments where ESG factors are primarily used for risk management purposes.

a) Direct investments

Direct investments into companies are considered "Neutral" by EFG, if they respect the minimal "Standards" defined above in chapter 3 for being included in the Transition Universe, but do not show enough positive characteristics to be classified as either "Responsible" or "Sustainable".

b) Mutual Funds and ETFs

Mutual Funds are considered "ESG Neutral" when they demonstrate an awareness of ESG factors within their investment processes, even though often considering ESG analysis for the purpose of avoiding material risks only. All these funds went through our rigorous process and have been assessed in depth.

With respect to ETFs, the "Neutral" characteristic contains products where ESG analysis is lightly integrated into the underlying index through a limited set of exclusions. In a few cases, normal ETFs can be considered Neutral if a more in-depth analysis shows a limited exposure to ESG and Transition risks.

c) Commodities

With reference to Commodities, some of them are considered by EFG as "Neutral" and therefore included in the EFG Transition Universe, while others are excluded from the EFG Transition Universe, irrespective of the available avenues to invest in (e.g., ETCs, certificates, futures, options, etc.). Within the Transition Universe, and when assessed from a financial

point of view, EFG will try to invest in commodities with “responsible sourcing” certifications and otherwise will only invest in industrial metals. While we are aware that the mining of minerals is exposed to various social and environmental issues, EFG is also aware these materials are needed for the energetic transition.

On the other hand, EFG does not want to be involved in investments in soft commodities (e.g., crops and wheat) as price fluctuations can have significant and dire consequence for the life of millions of people.

Finally, EFG has decided not to invest in energy commodities. Even if some of them will still be needed for the foreseeable future, we are of the view that it is not justified to include such investments in EFG’s Transition Universe.

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