

Vontobel

# ESG Guidelines

MTX Equities, Conviction Equities Boutique

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## 1. Introduction

These mtX ESG guidelines address the increased demand for transparency from our clients, prospects, and financial market participants in general.

It details how environmental, social and governance (ESG) considerations are integrated into the investment decisions of the strategies of the mtX franchise within Vontobel Asset Management. It explains mtX's ESG objectives, exclusion criteria as well as mtX's ESG Integration Process.

These guidelines reflect our current approach, and we expect that it will evolve over time to reflect changes in investment practices, technology, and regulation. The guidelines and the subsequent ESG research methodology are reviewed on an ongoing basis.

These guidelines are subject to and build upon the group wide ESG Investing and Advisory Policy, which details Vontobel's general approach to ESG investing, governance structure and general implementation of ESG Investing.

These guidelines are applicable to the following funds and its respective sub-funds:

- Vontobel Fund – mtX Sustainable Emerging Markets Leaders
- Vontobel Fund II – mtX Emerging Markets Sustainability Champions
- Vontobel Fund – mtX Sustainable Asian (ex. Japan) Leaders
- Vontobel Fund II – mtX China A-Shares Leaders
- Vontobel Fund – mtX Emerging Markets Leaders ex China, and
- all segregated client mandates, unless specifically varied by separate agreement.

### 1.1 ESG objective

ESG is one of the four pillars of the mtX investment process and therefore a fundamental part of the process.

The world is facing powerful trends involving major economic, environmental, and social changes. These trends result in risks and opportunities for investors. The importance of ESG cuts two ways: our investee companies have the potential to significantly impact society and the environment, and our investee companies are impacted by society and the environment.

Attention to ESG topics ensures that we build resilient solutions to meet our clients' needs and is part of our fiduciary duty. Businesses which actively engage on ESG issues tend to have better risk management, enabling more sustainable return on invested capital (ROIC) and shareholder returns.

Integrating sustainability indicators is a central pillar in the investment process with the aim of improving the long-term risk-return characteristics of our portfolios and supporting elevated social or environmental practices by the investee companies.

MtX's sustainability approach avoids investments in companies who demonstrate, through various criteria, that they are underprepared to avoid material sustainability risks and identifies companies that seek to include environmental or social characteristics in their economic activities (as have been evaluated to be most material according to the company's principal business sector). As such, both the risk profile of the sub-funds' are enhanced and the sub-funds include only companies who are better at managing their real-world impacts.

The ESG analysis is fully integrated into company evaluation and enables the analysts to reach decisions based on a holistic understanding of each company. We strongly believe an effective identification of material ESG risks and opportunities requires thorough analysis.

### 1.2 How our ESG approach developed over time

We started in 2009 with a screening approach where we used ESG exclusion criteria to pre-filter and therefore define the investable universe. This approach was more aligned with a best-in-class approach where stock selection was limited to a pool of what we qualified as "top ESG performers". We found this approach excluded too many sub-sectors and was too restrictive from a portfolio construction point of view (resulting in a too high tracking error). In 2010, we

decided to integrate the ESG analysis into the evaluation of the companies we consider investing in. Our ESG framework was then developed and over time has evolved and been finessed. Since then, we have found that having in-team ESG expertise (and having it integral to the holistic company evaluation process) provides an important value added for investors. We believe the main reason is that the ESG knowledge is anchored within the mtx team and not in a separate unit. Consequently, the analysts develop a deeper and more comprehensive understanding of a company and the potential negative impact specific ESG factors might have. Our ESG frameworks have naturally evolved and enhanced over time. Periodically, our sector deep dive papers are reviewed and refreshed, and our MSF framework is revised to keep up to date with developing themes, academic studies, and other practitioner studies on ESG and sustainability.

## 2. Responsibilities

While firmly believing in a team approach, as described below, ESG research is conducted by a team of ESG specialists dedicated to the Conviction Equities boutique and the franchises within it. These ESG analysts work collaboratively with mtx's financial analysts and portfolio managers. The ultimate responsibility for mtx's 4-pillar investment process is the Co-Heads of MTX Franchise. The responsibility for the ESG Process is the Head Sustainability, Conviction Equities.

## 3. Exclusions

Mtx has a set of exclusion criteria as described in Appendices 1 and 4. We use third party data to screen companies and conduct individual company assessment to determine whether the companies are excluded.

As described further in Appendix 1, we exclude (subject to certain de minimis revenue thresholds) companies involved in Weapons, Tobacco, Coal, and companies with a breach of UN Global Compact standards from our investment universe. We have a range of additional policies applied through detailed company research rather than screening – these are described in detail in Appendix 2. We exclude these controversial sectors because we do not believe in the long-term economic success of these areas or because they violate international norms.

The Vontobel fund II - mtx Emerging Markets Sustainability Champions (EMSC) has several additional exclusions (see Appendix 4) most notably relating to fossil fuels. This responds to investor interest in higher climate ambition scenarios and stricter thresholds on other controversial topics for greater values alignment with some clients.

## 4. ESG Integration Process

Outlined below is an overview of our ESG Integration process.

### 4.1 ESG Research Methodology

#### 4.1.1 Guiding frameworks

Core to our ESG Integration approach is our sector-specific, proprietary ESG framework, our Minimum Standards Framework (MSFs), which supports a rigorous assessment of companies on their most material ESG issues. These are in turn based on our sectoral ESG assessments. In total, we have 11 sector papers and 14 MSFs.<sup>1</sup>

The sector papers are designed as a practitioners' guide, highlighting the key ESG issues that the sector faces and mtx's approach towards these risks. These sector papers explain the rationale behind our ESG approach for each sector. These sector papers form the base for our proprietary industry-specific MSFs. The MSFs bring consistency and rigor to the decision-making process. The mtx ESG assessment is done on each of our investments before being eligible for investment. The sector papers and the MSFs are subject to periodic review to update with current knowhow, evolving trends, and best practice.

The MSFs are a framework to guide detailed, systematic qualitative and quantitative analysis of a potential investee's Sustainability Risks and Sustainability Factors (defined below). These structured assessments guide a deep evaluation of companies' preparedness and performance on the 20-25 most important, sector specific ESG indicators. These

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<sup>1</sup> To protect our proprietary ESG research methodology these documents are available on clients request only.

indicators, with defined performance thresholds, focus on material ESG issues that might have a significant impact on future cash flows. The E, S and G pillars are weighted according to the relevance for each sector. To be eligible as an investment, a company must achieve an overall minimum score. Ultimately, we seek to identify and exclude companies that are worst prepared to meet and manage idiosyncratic shocks to which their sector is uniquely exposed or whose operational practices or products pose too great a risk to society or the environment.

**Sustainability Risk(s)** means an environmental, social or governance event or condition that, if it occurs, could cause an actual or potential material negative impact on the value of the investment. Such risks include: climate-related and environmental risks (such as environmental product stewardship, carbon footprint, natural resource management, alignment with local and international targets and laws, effects of climate change); social risks evaluated as material for the sector (such as welfare and development of employees, supply chain management, data security and privacy, business ethics, or human rights violations); governance risks (including rights of minority shareholders, board and ownership structures, strength of independent oversight, related party transactions, executive pay, and audit and accounting oversight); severe sustainability controversies, and violations of international norms.

**Sustainability Factor(s)** mean a company's material impact on environmental, social and employee/labor matters, which includes, *inter alia*, respect for human rights, anti-corruption, and anti-bribery matters.

#### 4.1.2 Analysis and Resources

At mtX the ESG analysis is fully integrated into company evaluations. To maximize efficiency and expertise, the ESG analysis is conducted by mtX's ESG analysts in collaboration with the financial analyst for the sector.

A prospective investment will initially be subject to an initial view to assess if it is likely to pass the MSF and therefore warrant more detailed financial modelling. Before investment, a full MSF must be completed, and the company must attain a passing score. Our focus is not to maximize the MSF score, nor to perfect the scoring, but rather to focus on any critical issues that warrant deeper investigation and/or company engagement.

The team has access to various resources and data sets to complete their reviews. mtX subscribes to a wide range of ESG resources including: Sustainalytics, MSCI, ISS (governance/voting), Syntao Green Finance (focused on China A Shares), Bloomberg, Alpha Sense, WIND, and RepRisk as well as many 'sell side' analysts with strong ESG insights.

We find that active investors, with in-house ESG expertise can add real value in differentiating what is financially relevant from irrelevant ESG noise. Critical too is a direct dialogue with companies to overcome information gaps, particularly so in Emerging Markets.

#### 4.1.3 ESG Thresholds & Scoring

The pass mark to qualify for investment in the MSF is 2.4 for all funds except Vontobel Fund II- mtX China A Share Leaders, where the pass threshold is 2.0. Our overall objective is to avoid the worst in class companies on ESG performance. Our scoring approach is focused on identifying ESG risks. This means a score 3 meets expectations and has no material risks. Score 4 is hard to earn as it signals that the good performance is expected to deliver financial upside (such as companies with leading data protection systems are seen to suffer lower data-related drawdowns). Score 5 is rarely given as it signals industry leadership on a topic, which is seen as distinguishing a unique selling point or other value. For example, companies that rely on star talent and are widely regarded as the pre-eminent employer in the field have a clear advantage in terms of star talent recruitment and retention and hence productivity gains. A score 2 signals underperformance on a topic that poses some financial risk and score 1 signals notable risks on that topic. On any topic an overriding 'fail score' (see below) may be evaluated.

The MSF is intended to guide a rigorous, structured, and objective assessment. However, we accept there is no perfection in ESG scoring and subjectivity cannot be fully overcome. Critical for us is the extremely high caliber of our ESG analysts with rich and diverse experience, clarity on common objectives of ESG research, oversight systems and the utter transparency of the process. The outcome of each MSF deep dive is summarized in a dedicated document, in which key findings and flaws are noted. These findings form part of the company full view. The case will have been discussed between the sector dedicated ESG and financial analysts and, where necessary, further tested in cluster and Portfolio Manager meetings. In more challenging cases a four eyes principle within the wider ESG team is employed.

We believe this approach of ESG research being conducted by dedicated ESG specialists who are embedded in the team achieves the right balance of independence and integration of ESG findings. Independence because the view is formed uninfluenced by the financial analyst's view of the strength of the investment case. Integrated by being fully embedded in the team's investment process, way of thinking and dedicated to the market and asset class of the team.

#### 4.1.4 F-Score and F-Score Framework

In addition to the threshold described above, mtX applies an over-riding "**F-Score**" whereby the company fails the assessment on any Sustainability Indicator(s) even if the company would otherwise attain a pass mark. These are typically given for high level controversies that pose a material risk to the ongoing outlook of the business or which pose a highly negative impact on society or the environment even where the business case is unaffected.

A severe ESG controversy will trigger deep research into the event. The **F-Score Framework** was designed to provide a clear decision tree to assess the real-world impact of incidents on both, A) impact on society/ environment (assessments on scale and nature of impact, and culpability), and B) financial impact – the business resilience to withstand the financial impacts of the controversy. The framework provides clear assessment approach for categorizing the controversy and the impact on business and hard rules for whether the finding leads to divestment or engagement. Appendix 6 gives more detail about the F-Score Framework.

Our F-Score approach is to fail the most severe incidents as research shows that avoiding the worst incidents is most beneficial to performance. Our research found that major ESG incidents typically take 2- 5 years to wash out – during which time the company tends to underperform. Controversies that are assessed as critical are failed and should be divested within 3 months. The F-Score Framework also helps to evaluate grey areas where a decision between divest vs engagement is needed to uphold our fiduciary duty. Engagement needs to have realistic expectations of change and within a reasonable timeframe.

#### 4.1.5 On-going monitoring and re-evaluation

Each company in the portfolio is monitored for ESG events on an ongoing basis by the ESG specialist for the respective sector. We benefit from specialist AI tools that capture and evaluate close to real-time ESG news in multiple languages and so turning ESG noise into actionable insights.

In addition to controversy reviews, the MSF of each investee company are all periodically re-evaluated – typically on a one-year timeframe.

## 4.2 Governance of Critical ESG Events (CEE)

Critical ESG events represent the most severe ESG related controversies or breaches of international norms (primarily UNGC). CEE can signal insufficient management of sustainability risks and excessive harm to society or the environment by a company, which is beyond the tolerance of many of our investors and stakeholders. Examples include significant negative impact on the environment, forced labor or child labor.

To identify and monitor Potential Critical ESG Events (PCEE), Vontobel investment teams are informed by ESG data and assessment methodologies provided by external ESG data providers such as MSCI or Sustainalytics. The ESG assessment methodology of such providers typically considers the UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises, the International Labor Organization (ILO) Declaration on Fundamental Principles and Rights at Work, the ILO Core Conventions, and the UN Global Compact.<sup>2</sup>

This process is initially based on the utilization of ESG Raters' evaluation and subsequently entails a comprehensive structured review conducted by the affected team's ESG specialists. Data obtained from third-party providers may be incomplete, inaccurate and categorization are subjective assessments. To properly understand the impact and validity of critical ESG events, Vontobel's ESG specialists conduct their own research to assess their impact on the relevant portfolios and on wider stakeholders. This research is presented to Vontobel's Delegated Group of the Investment

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<sup>2</sup> A full description of the respective ESG rater's methodology can be found on their webpages.

Management Committee – a group comprising Boutique Heads and Head of Risk. This group has final decision on how a PCEE is finally categorized: a) denied, b) watchlist or c) confirmed.

Securities of issuers with confirmed CEE are excluded. This is where the Investment Manager's Delegated Group has concluded that they (i) violate the norms and standards promoted by the relevant product or (ii) are involved in critical controversies, including those related to governance matters.

However, the Investment Manager recognizes that excluding such issuers from the Investment Manager's investments may not always be the best approach to mitigate the adverse effects of their activities if there is belief that reasonable progress can be attained, for example, through active ownership activities. In these cases, a watchlist status may be given. For watchlist cases, the Delegated Group will agree on presented milestones required in the research documentation of a PCEE and establish a reasonable timeframe within which tangible progress against those milestones must be achieved.

More information about this process and its scope can be found in our ESG Investing and Advisory policy under [www.vontobel.com/esg-library](http://www.vontobel.com/esg-library).

## 5. Sustainable Investments

### 5.1 Low carbon objective

The SFDR Article 8 strategies of mtx<sup>3</sup> have a 15% sustainable investment objective to support climate change mitigation and the transition to the low-carbon economy through identifying issuers that are in the top 30% of carbon footprint (Scope 1 and 2/EVIC) relative to their reference benchmark and maintaining a carbon footprint that is at least 20% lower than the Sub-Fund's reference benchmark. The methodology for this approach is more comprehensively described in the funds' prospectus.

### 5.2 SDGs

Vontobel Fund II – mtx Emerging Markets Sustainability Champions (EMSC) is an SFDR Article 9 fund comprising only Sustainable Investments.

The EMSC fund aims to contribute to the United Nations Sustainable Development Goals (UN SDGs) by investing in emerging market securities that the Investment Manager identifies as Sustainability Champions. The 17 UN SDGs are a universal call to action to address the world's most pressing long-term challenges. The UN SDGs provide a shared blueprint for peace and prosperity for people and the planet, now and into the future. The UN SDGs recognize that ending poverty and other deprivations must go hand-in-hand with strategies that improve health and education, reduce inequality, and spur economic growth – all while tackling climate change and working to preserve our oceans and forests. The private sector can play an important role in advancing the UN SDGs' agenda. Additionally, the identification of Sustainability Champions offers an attractive investment proposition by preserving and enhancing the long-term value of their assets.

We define Sustainability Champions as companies that:

- (i) Contribute significantly (at least 50% revenues aligned) to at least one of the UN SDGs;
- (ii) Pass a detailed evaluation of their environment, social and governance (ESG) operational performance; and
- (iii) Comply with extensive exclusion criteria (Appendix 4) set to avoid economic activities that are harmful to society or the environment.

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<sup>3</sup>Vontobel Fund – mtx Sustainable Emerging Markets Leaders, mtx Sustainable Asian (ex. Japan) Leaders, mtx Emerging Markets Leaders ex China.



### 5.3 Do No Significant Harm (DNSH)

In respect of any company considered to be a Sustainable Investment, in addition to meeting the fund's defined thresholds for social /environmental objectives, they must pass two additional tests: DNSH and Good Governance.

The DNSH test requires that the business activities of the investee companies shall do no significant harm to any other sustainable objective, this is assessed from the perspective of economic activities that have a material negative impact on the environment or society. This aspect is flagged via an extensive screening using all mandatory and multiple additional Principle adverse impact indicators (PAI)<sup>4</sup> are considered.

Recognizing the multifaceted nature of sustainability, we have structured our approach around four distinct impact areas: climate and energy efficiency, nature, basic needs, and empowerment. This segmentation allows us to holistically assess the impact of investments on key sustainability dimensions. Our assessment is based on a two-step approach. In an initial step, we identify potential negative impacts associated with an investment. If these impacts can be mitigated, we proceed with a second step in which we conduct a rigorous analysis of mitigation measures implemented by the companies in question.

If a company is flagged for potential negative impacts and lacks appropriate mitigation measures, it does not pass the DNSH test. Consequently, such companies are excluded from being considered sustainable investments. Notably, an exception is made for the empowerment area, where we integrate aspects relating to diversity into our active ownership activities, particularly in our voting policy.

To facilitate our assessments, we rely on a combination of reputable data sources. MSCI ESG and Sustainalytics provide valuable insights into a company's ESG performance. Additionally, our own research efforts are employed to gain a deeper understanding of the nuanced aspects of sustainability specific to each industry and company.<sup>5</sup>

An overview of Vontobel's DNSH approach can be found in Appendix 5.

### 5.4 Good Governance

While 'Good Governance' is a regulatory requirement for Sustainable Investments, mtx applies this criteria to all investments. Good governance is essential as it is the bedrock for management of ESG issues in generally. Mtx uses the MSF to assess good governance practices of the investee companies – including human capital management, supply chain management, business ethics and corporate governance structures. Corporate governance evaluation includes sound management structures, such as board independence, quality and diversity, employee ownership, executive remuneration, rights of minority shareholders, as well as audit and accounting oversight. Mtx further ensures good governance of the investee companies via active ownership (as further described in the following section).

## 6. Active ownership and engagement

At mtx, we believe that voting and engagement is core to our fiduciary responsibilities to clients and central to ESG and sustainable investing. Material ESG issues can impact the future success of a company and therefore its investment potential. As long-term investors we see these as important tools to help steer companies towards internationally accepted norms and practices, which is ultimately for the long-term benefit of the company as well as its wider stakeholders. We understand this is an iterative process of on-going dialogue and we regularly work with outside partners to leverage our voice with other shareholders to elicit positive change.

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<sup>4</sup> This approach is based on the Principal Adverse Sustainability Impacts indicators (SFDR RTS Annex I) and the minimum social safeguards of SFDR.

<sup>5</sup> We acknowledge the variability in data availability across different impact areas. For instance, carbon emissions metrics enjoy more comprehensive coverage compared to nature-related metrics. Proxy data may be used in case of data limitations. Recognizing this disparity, we have identified areas for improvement and are committed to progressively exploring alternative data sources. Our goal is to enhance the depth and breadth of our assessments, ensuring a more nuanced and comprehensive understanding of the sustainability performance of potential investments.

### 6.1.1 Voting

We believe that actively exercising our voting rights is in the best interests of our clients and therefore part of our fiduciary duty, it is also an important lever in promoting more sustainable behavior. Since 2011, we have been partnering with expert external advisors to improve the quality of our voting decisions and the breadth of our engagement activities. This role is currently provided by Columbia Threadneedle's Responsible Engagement Overlay (REO). Reo was selected, following a comprehensive search process, as the solution that best fit our aims and methodology.

Mtx has a dedicated process in place to ensure it reviews and reacts to all company meeting ballots. For each ballot, analysts receive REO's voting recommendations and supporting research as well as that of ISS. These are then reviewed by the ESG team and relevant financial analyst, and a deliberate decision is made whether to support the voting recommendations or not based on their in-depth knowledge of the company and its management. In more challenging cases, the internal view is communicated to the portfolio managers who have the final decision. Unless overruled by this process of deliberation, voting is based on standardized policies agreed by REO and Vontobel. Mtx's voting policies accord with Vontobel Asset Management Voting and Engagement Policy. Vontobel Asset Management publishes our voting records on a yearly basis – latest reports can be found: <https://www.vontobel.com/esg-library/>. This process ensures that we execute all our voting obligations and retains the authority for analysts and portfolio managers to personally make decisions in the interest of our investors.

### 6.1.2 Engagement

Mtx have a comprehensive engagement strategy that enables us to use our role as shareholders to support companies in becoming more sustainable. We have both direct engagements, which are undertaken by our analysts (ESG & financial) and portfolio managers, and indirect engagements through our partnership with REO.

#### 6.1.2.1 Direct engagement

Mtx aims to achieve two goals through our direct engagements- to help investee companies mitigate financial risks from ESG issues, and to encourage investee companies reduce negative impact or improve positive impact. The engagement is through collaborative efforts among ESG analysts, financial analysts, and portfolio managers. Engagement can be characterized in two ways: fact-finding research and longer-term objective driven.

Fact-finding, typically one-off, engagements are frequently conducted as part of our structured ESG research process – either due to data gaps or to better understand a company's performance and policies towards material ESG issues.

Mtx has established a longer-term engagement plan with a selection of investee companies. With these companies, mtX arranges more regular interactions and establishes objectives and milestones of the engagement. The plan is dynamic and periodically updated. We aim to cover typically 30-50% of our ongoing investments in this plan.

We select companies into engagement plan based on our in-depth MSF research as well as other screening factors. The selection criteria are based both on ESG issues that are financially material to the company ('Single materiality') as well as high externalities of the company on society /the environment ("double materiality" perspective). Serious or repetitive controversies are a common trigger for engagement. We also use our DNSH screen based on principle adverse impact (PAI). We have proprietary screening tools for climate, biodiversity and human rights and highly exposed companies will be added to our engagement plan.

Typical engagement topics include climate transition, environmental impacts, labor practices, corporate governance, reporting and disclosure, and biodiversity. Through these consultations, we encourage companies to improve their risk management practices and ESG disclosure. We reference specific areas of improvement where these are needed.

Single and double materiality perspectives may or may not be immediately aligned. For example, we engage with companies that lack disclosure or show weak management of tailing dams so that we can ensure the company can properly manage and mitigate ensuant financial risks. At the same time, this pressure helps to mitigate negative impact on environment and society. In contrast, we know some companies do not face high financial risks from large

carbon emissions in the short term. Nevertheless, we engage with such companies to encourage them to think long-term and develop their emissions reduction strategy which also mitigates horizon risks.

In our engagement plan we maintain a list of main objectives and topics we plan to engage for individual companies. As we start engaging with companies, we might adjust or add objectives and topics accordingly after each round of engagement as we often gain deeper understanding of the company and could decide if we are satisfied with certain topic or need to ask more or encourage the company to spend more efforts. In this way we stay agile and effective. We believe this approach helps us build realistic expectations and achieve plausible steady progress, whilst pursuing the driving longer-term goal(s).

We maintain an engagement log to document all engagement activities. We summarize the key findings for each engagement and identify follow-up steps. Examples of these engagements are provided to clients in Vontobel Asset Management's yearly voting and engagement report<sup>6</sup> and in the client quarterly reporting.

#### **6.1.2.2 Escalation**

Where an investee company is flagged for serious controversies, we maintain a regular review of the evolving situation, ever vigilant of the potential need to divest if the situation is not remedied. Engagement could be escalated through additional meetings with the management and dialogue with the board chairman and non-executive directors. Where these engagements do not progress in the direction that we believe is in the best long-term interests of shareholders, the environment or society, other options are considered, including, but not limited to: Voting against resolutions at shareholder meetings, Collaborating with other institutional investors; and/or Divesting.

#### **6.1.2.3 Indirect engagement**

Columbia Threadneedle REO is our partner for indirect engagement. Such collaborative engagements allow us to exercise greater influence than the size of our holdings would otherwise permit and benefit from REO's specialist resources and experience. An additional major benefit is that REO will establish a long-term engagement plan with objectives and milestones, and this persists irrespective of investment inflows and outflows by REO clients. i.e., it can take a truly long-term perspective and will maintain regular pressure throughout the life of the issue engagement. We regularly observe that the type of engagement which helps drive structural changes is most effective in the context of long-established dialogue and a relationship of trust. REO conducts engagement activities based around three approaches: i) Bottom-up approach – they engage with companies that have exceptionally poor ESG practices or severe ESG controversies ("priority companies"). ii) Top-down approach – they select companies for which practices should be improved based on thematic focus areas (e.g., climate risk management). And iii) Continuous risk management – they engage in response to controversies and breaches in global norms.

#### **6.1.3 Reporting**

We acknowledge that material ESG factors are often of medium to long-term nature and difficult to quantify. For this reason, we emphasize the importance of transparent communication if, and how, material ESG considerations influence the decision making of our investment managers. We therefore provide our clients with quarterly reporting for our funds. ESG is an integral part of this quarterly publication. This reporting includes: 1) Summary of ESG profile of new investments and of ESG annual reviews, 2) ESG profile of the fund, 3) Summary of the proxy voting, 4) Summary of the collaborative engagement activities, 5) Summary of our own engagement activities.

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<sup>6</sup> <https://www.vontobel.com/esg-library/>

### Appendix I: Exclusion criteria for mtX funds except EMSC

The following critical activities are screened and monitored during the ESG Investment Process. Such an evaluation includes the entire enterprise and all entities that are financially consolidated. The following screens and policies apply to all mtX Vontobel funds and respective sub-funds ("MtX funds") listed in the introduction, save as amended/ augmented in Appendix 4 in respect of MtX's Emerging Markets Sustainable Champions fund.

Exclusion	Criteria (% of revenues permitted)	Exceptions applied?
<b>Sector/business activity-based exclusions</b>		
Adult entertainment	Production: 10% Distribution: 10%	None.
Coal	Production: 10%	None.
Coal powered electricity	Production: 10%	
Nuclear power	Production: 10%	None.
Nuclear weapons	Production: 0%	None.
Oil sands	Production: 10%	None.
Palm Oil	Production: 0% Distribution: 0%	None.
Tobacco <sup>7</sup>	Production: 0% Retail: 10%	None.
Controversial weapons <sup>8</sup>	Production: 0%	None.
Military Contracting <sup>9</sup>	Production: 10%	None.
All other weapons & Firearms <sup>8</sup>	Production: 0%	
<b>Sovereign exclusions</b>		
UN Sanctions	UN Sanctions list	Applies to new investments and may not be applicable to pre-existing investments
<b>Norms based exclusions</b>		
UN Global Compact ("UNGC") and Global Norms Violation <sup>10</sup>	Violation	Yes – see section 4.2
Critical ESG Controversy	Red flag (MSCI) or Category 5 (Sustainalytics)	Yes – see section 4.2

<sup>7</sup> Production of Next Generation products (e.g., vaping, e-cigarettes) have 5% revenue tolerance.

<sup>8</sup> The weapons related exclusions includes zero tolerance (including: a) tailor-made and essential, b) non tailor-made or non-essential, and c) significant ownership (defined as 10-50% shareholding)) for: i) Controversial weapons; ii) Nuclear weapons; iii) Biological and Chemical, iv) Cluster Weapons, v) Depleted Uranium; vi) White Phosphorus; vii) Small Arms (including, civilian assault and non-assault weapons and retail/distribution thereof; military/ law enforcement customers; and key components).

<sup>9</sup> Military Contracting comprises companies that manufacture weapons or weapon components and parts (other than those excluded in i to vii of the policy above) or provide tailor-made products or services that support military weapons or non-weapons related products/services provided to the military or defense industry. Weapons in this category include handguns, guns, ammunitions, missiles, military aircrafts, tanks, warships, nuclear warheads, defense components and systems, training/combat simulators, etc. Tailor-made products include, for example, special fabrics for bulletproof vests, electronic systems for military aircrafts, etc.

<sup>10</sup> The Investment Manager uses screens from Sustainalytics and MSCI for global norms and standards that are enshrined in: i) the UN Global Compact, ii) the Organization for Economic Co-operation and Development Guidelines for Multinational Enterprises (OECD MNE Guidelines), iii) the United Nations Guiding Principles on Business and Human Rights (UNGPs), as well as iv) their underlying conventions and treaties, and v) the International Labor Organization's fundamental principles.

### 1) **Violation of UN Global Compact and other international norms**

Compliance of companies with international global norms and standards is a critical part of the ESG due diligence assessment and is governed through the Critical ESG Events process described in section 4.2.

### 2) **Controversial Weapons**

#### **Group Level exclusions on controversial weapons**

Vontobel prohibits investments in manufacturers / producers of controversial weapons. In addition, Vontobel will not provide any investment advice on the securities of these companies to clients. Vontobel considers the following weapon types as controversial weapons:

- Anti-personnel mines (Ottawa Treaty (1997)),
- Cluster munitions (Convention on Cluster Munitions (2008)),
- Chemical weapons (Chemical Weapons Convention (1997)),
- Biological weapons (Biological Weapons Convention (1975)),
- Non-Detectable Fragments (Protocol I of the Convention on Certain Conventional Weapons (1980)),
- Incendiary Weapons (Protocol III of the Convention on Certain Conventional Weapons (1980)), and
- Blinding Laser weapons (Protocol IV of the Convention on Certain Conventional Weapons (1980)).

This exclusion category is part of our approach to the consideration of Principal Adverse Sustainability Impacts indicators related to social matters.

### 3) **Conventional and Nuclear Weapons**

All Mtx funds exclude nuclear weapons. Accordingly, it focuses on manufacturers of warheads and missiles, including assembly and integration; manufacturers of exclusive delivery platforms; producers and storers of fissile materials; and component manufacturers for nuclear delivery platforms, based on a 0% revenue threshold.

The Mtx franchise maintains an additional screen relating to other weapons. Companies that derive revenue from the manufacturing of weapons or weapon components or from providing tailor-made products or services to the defense industry<sup>11</sup> are excluded subject to a de minimis threshold of 10% revenues. Mtx has made this exception to Vontobel's Level 2 exclusion approach because of its sole focus on emerging markets.

### 4) **Tobacco**

The adverse health consequences of using tobacco products are well documented. The World Health Organization considers tobacco consumption one of the biggest public health threats (tobacco is one of the main risk factors for several chronic diseases including lung cancer and cardiovascular diseases) and the major reason for premature deaths. Experts estimate that tobacco consumption causes direct and indirect social costs of 1.8% of GDP globally<sup>12</sup>. Therefore, the tobacco industry must comply with multiple regulatory standards and frameworks related to health impacts, advertising, labeling, distribution, and product ingredients. Furthermore, many states, cities, and municipalities have banned or limited smoking in public places, which may reduce the number of users, or the volume of products used. Over the past few decades, tobacco product manufacturers have faced lawsuits from individuals, governments, corporations, and other groups given the link of tobacco use and cancer as well as other diseases. In some cases, this has resulted in multi-billion-dollar settlements. Several class action lawsuits are currently still pending in the US and Canada that could have severe financial consequences. The rising popularity of new generation "vapor"

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<sup>11</sup> This comprises companies that manufacture weapons or weapon components and parts (but not raw materials) or provide tailor-made products or services that support military weapons or non-weapons related products/services provided to the military or defense industry. It does **not** include companies that provide dual use products and services or products of strict civilian use. Weapons in this category include handguns, guns, ammunitions, missiles, military aircrafts, tanks, warships, nuclear warheads, defense components and systems, training/combat simulators, etc. Tailor-made products include, for example, special fabrics for bulletproof vests, electronic systems for military aircrafts, etc.

<sup>12</sup> Goodchild M, Nargis N, Tursan d'Espaignet E. Tob Control 2018; 27 :58–64. Doi: doi:10.1136/tobaccocontrol-2016-053305

and “heat-not-burn” products (NGPs) also involves litigation risks. Vapor products (e.g., Juul) face criticism over allegedly causing addiction, especially in teenagers, due to high levels of nicotine.

Tobacco producers are typically pure play providers; however, it is possible to see unrelated businesses with unmeaningful tobacco exposure. Therefore, tobacco producers are excluded and retailers/wholesalers distributing tobacco products are excluded with a threshold of 10% of tobacco revenues.

#### 5) **Coal (extraction and power)**

Based on a lifecycle approach, thermal coal is the most carbon intensive fossil fuel source and therefore carries a disproportionate danger to the climate (as well as to public health), while from an energy generation perspective it is easily substitutable. Coal is the fossil fuel bearing the most financial and regulatory risk and therefore poses greatest investment risk. Thermal coal is mainly used in power generation. We exclude companies with more than 10% exposure to coal mining or coal power generation from our universe.<sup>13</sup> Implicitly this also means we do not have any coal companies with expansion plans in our portfolio. Normally only companies with a focus and major activities in coal undertake further coal investments.

#### 6) **Oil Sands**

Oil sands are extremely carbon intensive and harmful to the environment. There are two main ways of extraction: surface mining is done to extract bitumen that lies close to the surface and creates large open-pit mines. Oil sands deposits that are greater than 75 meters below the ground surface are usually extracted without removing the overlying rock and dirt and require an in-situ method of extraction where steam is injected into a horizontal well, sending heat to reduce the bitumen’s viscosity. A 10% revenue threshold is applied for oil sands.

#### 7) **Nuclear Power**

We exclude companies with exposure to nuclear power (threshold 10% of revenue/ capacity) from our investment universe. This exclusion is based on our evaluation of the fundamental economics – particularly as the structural clean energy transition poses challenges to Nuclear (falling electricity price, shrinking profit spreads, need for government under writing) which leads to weak industry positioning and declining returns on invested capital.

#### 8) **Palm Oil (production and distribution)**

Palm oil production raises environmental and human health concerns. It is associated with the clearing and burning of forest lands (particularly virgin or primary forests) releasing high levels of carbon and methane with high climate impact, as well as impacting human health from fire particulates and displacing local communities, as well as causing loss of biodiversity. While the Responsible Palm Oil Certification offers assurances to minimize the negative impacts of palm oil cultivation on the environment and communities, we felt that excluding the sector entirely (both production and distribution of palm oil) would not materially impact portfolio construction or choice and be more clear-cut.

#### 9) **Adult Entertainment**

Exclusion of Adult Entertainment (production and distribution) offers alignment with some investors’ values and does not cause any material restriction on mtv portfolio construction as this sector is very unlikely to anyway fall into our investment criteria. We can therefore simply exclude it (subject to 10% revenue threshold) to make the position clear.

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<sup>13</sup> In some cases, % revenues from a particular energy source are not reported, in this case we use % of total power generated or failing that, % installed capacity.

## Appendix 2: Additional policies that are managed through MSF assessments rather than screening.

### 1) Carbon and Climate related risks

Please see Appendix 3 for a thorough overview of how mtX assesses these risks and integrates findings into investment process.

### 2) Oil and Gas (conventional and unconventional production)

We do not outright exclude fossil fuels either in energy extraction industries or in power production (except in EMSC – see Appendix 4). However, they are carefully evaluated as part of our ESG MSF assessment. Other unconventional oil and gas sources include shale oil and gas, extraction in the Arctic or liquefied natural gas (LNG). These sources are assessed on a case-by-case basis comparing them with the state-of-the-art technologies, environmental protection, and safety measures. Thus, when investing in such oil and gas companies, we pay close attention to the design, operational implementation and legal compatibility of a comprehensive environmental management systems and a clear climate strategy. It is important to us that companies commit themselves to progress in reducing GHG emissions and to report them transparently. In some cases, we collaborate with REO who conduct an engagement dialogue with affected companies and support them to potentially further reduce GHG emissions.<sup>14</sup>

### 3) Electricity Generation / Utilities

The ESG issues of the power generation sector are explicitly assessed in the sector paper for utilities and reflected in the utilities MSF<sup>15</sup>. The ESG metrics for the utility sector comprises several forward-looking issues such as climate strategy, expansion and investment strategy for renewable energies and reduction of carbon emissions. Current low carbon emissions levels per kWh generated and a steep reduction path for the future are key positive ESG criteria. Overall, companies with a clear strategy and concrete goals for reducing their environmental impacts, score higher in the MSF evaluation. Companies with high inventories of fossil-fuel based power plants are clearly more vulnerable to new climate regulation and carbon pricing. They may fail as an investment case, especially if they lack a clear climate strategy and continue to invest into conventional power generation capacity that may not deliver the necessary return on invested capital.

Regarding the energy mix of a power generator, strict thresholds were defined for coal (<10% revenues). With these low thresholds, we indirectly avoid any utility company that focuses on coal or nuclear expansion plans. In the utility sector, we focus on gas, water and multi-utility companies or grid operators that do not own any generation plants. These companies generally have a lower environmental impact than power generating companies.

### 4) Alcohol

A prime target of regulators and tax authorities due to its addictive potential and negative effect on public health. High consumption of alcohol can cause serious disease and premature death. Alcohol taxes are already relatively high in many countries could increase further.

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<sup>14</sup> Academic studies have shown that engagement can be more effective than divestment. Climate change is a major engagement theme of REO, particularly on extractive industries, financial services, transportation, utilities, and consumer goods. Key topics include alignment with Paris Agreement, net-zero by 2050 strategy, board ownership, and full disclosure of all relevant risks and opportunities. REO has a separate engagement stream with the oil and gas sector with a specific focus on climate change, net zero, as well as specific engagement projects (e.g., Coal phase out, Climate Action 100+ etc.). While our own engagements are less systematic these are topics and themes we too pick up in our conversations with relevant companies.

<sup>15</sup> The top material issues in our Utilities sector MSF are in summary: i) GHG emissions/ energy mix (% fossil fuels, climate/energy transition strategy, energy efficient infrastructure); ii) Community relations (robust stakeholder project management and low related controversies); iii) grid resilience (against natural disasters and cyber-attacks, grid outages/reliability); iv) operational safety / emergency preparedness; v) water sourcing / management.

In September 2020, following an in-depth review of the topic<sup>16</sup>, mtX decided to update its policy towards alcohol producers. We made the move towards more engagement with laggards. Companies who do not have policies or practices on responsible drinking won't receive an F score outright but will be engaged with (but their low score may mean they fail to pass our MSF threshold score for investment). We believe such an approach is better suited to change their behavior, especially if other asset managers and owners do similarly. Following our industry research, we updated the MSF scoring indicator to better capture best practice. Top scoring companies will have: a strategic focus on responsible consumption (focus on underage and harmful drinking); a clear policy on responsible marketing; and strong implementing initiatives (such as direct awareness campaigns for customers and suppliers and educational partnerships that discourage irresponsible drinking). Where the company receives a score 1 (*no disclosure/information*) or Score 2 (*generic statement on responsible marketing policies - no clear evidence of initiatives. No breach of law nor controversies*), we will engage with the company on the issue. An F-Score will still be given if there are significant or recurring controversies surrounding irresponsible marketing, or significant breaches of applicable legislation. Our general approach to ESG issues is not to fail a company for lack of policies (or disclosure) but for gross misdeeds in practice. This also recognizes that Emerging Market companies are less likely to have public policies on the issue and may not yet have cultural pressure to formulate one.

#### 5) **Gender, Diversity, and Inclusion**

**Board Gender Diversity:** We believe in the importance of board gender diversity as a vital aspect of corporate governance. Our stance is rooted in the recognition that diverse boards enhance decision-making, bring varied perspectives, and foster a more inclusive corporate culture. We advocate for increased representation of women on boards to reflect the diverse makeup of stakeholders and society at large. Rather than pursuing exclusions or quotas, we prefer a strategy of voting and engagement. Voting allows us to use our shareholder influence to support board candidates and resolutions that align with our diversity values. Engagement, on the other hand, enables constructive dialogue with companies, promoting awareness about the benefits of gender diversity and encouraging voluntary improvements. Our voting policy with REO means a recommended vote AGAINST Nomination Committee Chair (or next appropriate director) if less than 13.5% Women on Board in Emerging Markets and 27% in Developed Markets (further racial diversity criteria and other gender standards apply according to local corporate governance/ listing rule requirements).

**Workforce Diversity & Discrimination:** We recognize the importance of ethnic and gender diversity and inclusion as a critical issue of social justice, and we recognize its real value to our business and the businesses we invest in. We expect our investee companies to address systemic racism and gender bias and the lack of inclusion in the workforce of under-represented groups. Diversity at leadership and board levels is particularly important as we believe that a suitably diverse mix of skills and perspectives is critical to the long-term effectiveness of the board and the strategic direction of the company. Diversity & Inclusion are integrated into our MSF company assessments of human capital management and board composition. Under these factors we consider metrics (to extent available) such as policies on diversity, inclusion and discrimination, gender & minority breakdown of workforce, pay details, females in leadership roles and percentage of women on the board. Additionally, our DNSH screen will flag any company that has severe controversies related to Discrimination & Workforce Diversity Assessment.

#### 6) **Biodiversity / Natural Capital<sup>17</sup>**

Although the world's 7.6 billion people represent only 0.01% of all living things by weight, humanity has already caused the loss of 83% of all wild mammals and half of all plants. The current rate of extinction is tens to hundreds of times

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<sup>16</sup> We investigated global variations in problems from alcohol abuse, and how regulators and by alcohol producers address them. We looked in depth at asset owners' and asset managers' handling of the issue, particularly of those with sustainable investment policies. We examined five options ranging from total inclusion to total exclusion.

<sup>17</sup> **Natural capital** represents the world's stock of natural assets (renewable and non-renewable resources), which includes soil, air, water, grasslands, forests, wetlands, rocks, and minerals, and all living things from mammals and fish to plants and microbes. **Biodiversity** can be understood as the variety of life on earth, or the variation that exists in the natural world, such as the genetic



higher than the average over the past 10 million years – and it is accelerating.<sup>18</sup> The World Economic Forum’s annual Global Risks Report has, for the past five years, identified biodiversity loss and ecosystem collapse as a mid to high level global risk in terms of impact and likelihood. The Intergovernmental Platform on Biodiversity and Ecosystem Services carried out a global assessment of biodiversity and ecosystem services and found a significant loss of species and plant diversity over the past 50 years, including one million species already face extinction.<sup>19</sup> It is estimated that ecosystem services are worth c.\$125-140 trillion every year, and more than half (c.\$44 trillion) of global GDP is highly or moderately dependent on nature<sup>20</sup> and the cost of inaction in the face of biodiversity loss is estimated to rise to at least \$14 trillion, 7% of global GDP by 2050<sup>21</sup>. As nature loses its capacity to provide natural capital and ecosystem services (such as healthy soils, clean water, pollination, and a stable climate), sectors that are highly dependent on nature could suffer significant losses. The importance of Biodiversity to human security and well-being is reflected in their prominence in the Sustainable Development Goals (SDGs), 14 out of 17 of which have biodiversity elements. However, the negative trends are undermining progress towards 80% of SDG targets on poverty, hunger, health, water, cities, climate, oceans, and land.<sup>22</sup>

The sectors that have the highest impact on natural capital from an impact perspective are Consumer Staples (food and beverage, agricultural products, fisheries, farming especially palm oil, soy, and cattle), Materials (forests, mining, metals, transportation, construction), and Energy (Oil and Gas). The sectors with highest nature dependency overlap with the impact sectors but added to this are: Consumer Discretionary (textiles, apparel, and luxury goods) and Utilities (heat and power), while others (especially Real Estate and Tourism) are mostly impacted via their supply chains.<sup>23</sup>

Mtx’s Natural capital assessment framework is being beta tested and we are currently working with specialist third parties to develop our framework and draw on independent datasets dedicated to this topic. The fundamental elements of a Natural Capital risk framework include:

- First, mapping impact (direct and indirect): focus on where company (and supply chain) sites are located, conservation value of sites, habitat loss indicators, type of commercial activity and its impact on natural environment.
- Second: mapping dependence – understanding the extent to which a business relies on nature (resources and ecosystem services) to generate revenue.
- Third, evaluating governance – i.e., efforts to reduce nature loss throughout their value chain. This can be broken down to, i) commitments and targets (oversight structures, policy strength, strategy ambition and robust risk-management process to assess nature-based risks), ii) implementation measures (scope, depth, ecoefficiency of technology and implementation structures, training, and incentives), and iii) performance / results (nature-based metrics and targets, KPI performance, controversy assessments). Evaluating a company’s policies and procedures is crucial; it shows proactive sustainability efforts beyond past controversies. Strong policies reflect a company’s awareness of potential impact and steps toward mitigation, aligning commitment with action.

In Mtx’s MSF assessment, we assess the deforestation and land grabbing mainly for materials and consumer staples sectors, specifically agriculture and food, paper and pulp, and metals and mining industries. We evaluate the

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variability between a group of individuals of one species, or between that species and another in its community--or between a whole ecosystem and another.

<sup>18</sup> World Economic Forum and Price Waterhouse, Coopers and Lybrand (WEF/PwC), 2020. ‘Nature Risk Rising: Why the Crisis Engulfing Nature Matters for Business and the Economy’. And WEF 2020a. *The Future of Nature and Business*. WEF, Geneva, Switzerland.

<sup>19</sup> The IPBES found that natural ecosystems have declined by 47% on average compared to earliest estimated states. Approximately 25% of species are already threatened with extinction. Ecological communities on land have declined 23% on average and the global biomass of wild animals has fallen by 82%. IPBES (2019), *The Global Assessment Report on Biodiversity and Ecosystem Services – summary for Policy makers*.

<sup>20</sup> Op cit.

<sup>21</sup> Braat. L et al. 2008: *The Cost of Policy Inaction (COPI): The case of not meeting the 2010 biodiversity target*.

<sup>22</sup> UN Environment Management Group, 2020, *Supporting the Global Biodiversity Agenda. A United Nations System Commitment for Action to assist Member States delivering on the post-2020 global biodiversity framework*.

<sup>23</sup> UN PRI (2020). *Investor Action on Biodiversity: Discussion Paper*. Also, UNEP and Global Canopy 2020. *Beyond ‘Business as Usual’: Biodiversity targets and finance. Managing biodiversity risks across business sectors*. UNEP-WCMC, Cambridge, UK

controversies related to deforestation and land use issues for individual companies. We expect companies to have proper measures and governance in place to avoid deforestation in the supply chain of palm oil, soy, cattle, coffee, cocoa, timber, and rubber. Under-performance may lead to a 'Fail score' or engagement.

Under Vontobel's **DNSH screen** a company is flagged as "Significantly Harming" in respect of Biodiversity, water, and pollution if it fulfils at least one of these conditions:

- **Biodiversity:**
  - The company has severe/very severe controversies related to Biodiversity & Land Use.
  - The company has >5% revenues from the following activities that are considered to have significant negative impacts on biodiversity: palm oil, soy, cattle, timber, and biofuels (excluding second generation).
- **Water:** The company has severe/very severe controversies related to Water Stress.
- **Hazardous waste:** The company has controversies related to «Toxic Emissions & Waste» (severe or very severe).

Where a DNSH flag is raised a second step may then be undertaken to remove the flag if the company has policy/procedures in place allowing it to mitigate negative impacts (either in direct operation or in supply chain). When evaluating policies, we look for whether they are in line with relevant industry standards (e.g., RSPO), if externally verified; if the company dedicates sufficient resources to manage the issue; if good governance including senior management accountability; and if appropriate remediation measures have been taken in event of controversies.

#### 10) Wood and pulp / Deforestation

Deforestation is a material risk for companies as illegal logging can trigger legal and reputational risks, including for companies further up the value chain. As investors we assess companies in the forestry and paper industry to ensure the company is managing these risks well. In individual company assessment, we look for awareness of deforestation as a business risk, commitment to reduce or remove deforestation in the production or sourcing of materials, transparency on their exposure, actions to address deforestation in their supply chain, including monitoring suppliers or own operations in line with the commitments made and reported progress towards ending deforestation from their products and supply chain.

#### 7) Water use and Effluence

Water is one of the most precious resources on the planet. More than 1 billion people do not have access to clean drinking water. Also, for industries with high water demand, this resource becomes critical and scarce. A growing number of water users are competing for limited water supplies. The World Resource Institute identified 37 countries that already face "extremely high" levels of water stress, meaning that more than 80% of the water available to agricultural, domestic, and industrial users is withdrawn annually. Industries with high water usage that operate production sites in such areas need to set up a forward looking and robust water management. Industries that are most affected are: Energy, Materials, Industrials, Utilities, Consumer staples and parts of Communication Services. The corresponding sector papers give guidelines for assessing and weighing this topic in the overall company specific MSF process. Water related concerns frequently arise under multiple indicators per sector, such as operational eco-efficiency, community relations, biodiversity, emissions, opportunities in clean technology etc. As described above severe controversies relating to water or hazardous waste would be flagged under DNSH approach and considered for fail under the MSF.

#### 11) Animal testing (*under Product Governance indicator*)

Within the Pharma, biotech and life sciences, animal testing can be an important part of the development, manufacture and testing of medicines (although the practice is slowly decreasing). Beyond pharmaceutical use, the practice is also a risk in other industries, notably Chemicals, Food, Household and Personal Products, and Tobacco.<sup>24</sup> Best

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<sup>24</sup> A study by ISS found that 23% of companies that make up the S&P 500 are exposed to animal testing. *ISS ESG research paper, 'Cruelty-Free Portfolios: How to Approach Animal Testing in Investments?', 10 July 2021*

practice is to diligently adopt the '3R principles' (Reduce number of animals used; Refine processes to minimize stress; Replace with alternative solutions) and integrate welfare standards for the treatment of animals, such as being accredited by the Association of Assessment and Accreditation of Laboratory Animal Care International. These principles encourage alternatives to the use of animals in the testing of medicines while safeguarding scientific quality and improving animal welfare where the use of animals cannot be avoided. Various regulations in emerging and developed markets are pushing the 3R principles and 40 countries have bans on use of animal testing in cosmetics, while some require it. Overall, conflicting legal requirements globally combined with high reputational risk leads to very low transparency on this complex ethical issue.<sup>25</sup> Where companies do disclose their policies, there is low consensus on approach and types of practice.

Mtx recognizes the widespread use of animal testing across many industries, including in compliance with local regulations. We therefore do not exclude the practice by companies in both pharma and non-pharma use. However, as part of our MSF assessment (where relevant in our Healthcare and Consumer Staples MSFs), we examine exposed companies' practices on animal testing, commitments to animal welfare, initiatives for finding alternative solutions, as well as compliance with local laws and with the local Food and Drug Association's requirements (e.g., following Good Manufacturing Practices, Good Clinical Practices, Good Laboratory Practices, where applicable). The issue falls within the wider topic of product governance, under-performance on animal testing can be regarded as a red flag to the wider issue. Animal welfare is also assessed as part of our supply chain management/ agricultural production MSF assessment. Such practices and commitments would be scored in our MSF (potentially leading to a failure from low score).

Where no public policies regarding the use and treatment of laboratory animals are available, we would engage with the company to develop or disclose this information. Where there are no policies and significant or repeated controversies on the issue, we would fail the company the company was taking sufficient remediation measures.

#### 12) **Antimicrobial resistance (under Food Safety indicator)**

Antimicrobial resistance caused using antibiotics in animal husbandry is of special concern. According to estimates, 70% of all antibiotics applied in the US are used for farm animals, much of them for nontherapeutic purposes. Of the two million people that contract a disease linked to drug-resistant bacteria in the US each year, at least 23,000 die. The death toll is expected to increase fast.<sup>26</sup> There are legal restrictions on the use of antibiotics in animal husbandry, but initiatives and working groups like the Transatlantic Taskforce on Antimicrobial Resistance are pushing for a further tightening. In our MSF assessments, this issue is assessed as part of the wider topic of food safety. We look for strong quality/food safety management systems, preferably evidenced by related certifications (e.g., Global Food Safety Initiative), and supplier requirements related to food safety and antibiotics use in animal husbandry. Companies involved in major controversies (product recalls, regulators warnings, fines, product liability lawsuits) would be expected to have taken measures to strengthen quality/safety management systems and/or related supply chain monitoring systems. Engagement with companies is needed in the case of poor disclosure. If additional information is not available and we are not convinced the company meets basic standards, we would consider refraining from investing.

#### 13) **Sustainable agricultural production**

Most subsectors of the Consumer Staples industry rely heavily on agricultural raw materials. Agricultural production is associated with many environmental issues including GHG emissions, water consumption, deforestation, use of

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<sup>25</sup> ISS found that by far the majority (82%) of companies have no public policy, of the rest many have general statements only and 13% of non-pharma use states that animal testing is limited to the extent required by law (Ibid.). Our own examination of MSCI data on animal testing found that 13% of ACWI has ties to animal testing, of which 37% have some form of statement or policy addressing welfare of animals used for laboratory testing (the results were twice as high in healthcare than in chemicals or consumer staples). The results in EM were starker, 10% of MSCI EM universe have animal testing exposure but only 5.7% (8 companies) have some form of policy/statement.

<sup>26</sup> <https://www.cdc.gov/drugresistance/>

chemicals, overfishing, controversial animal husbandry practices and use of genetically modified organisms. On the social side, poor labor standards in agricultural production are of high concern. We assess companies' handling of environmental and social requirements for agricultural suppliers and their programs to implement these standards. A high proportion of certified products (organic, fair trade) is one indicator to provide evidence for this. As there is a clear trend towards "conscious consumption", companies with high supply chain standards and a certified product offering will be able to strengthen their brand reputation and benefit from market growth.

Agricultural products companies with agricultural operations of their own are expected to apply high environmental and social standards and have targets and programs in place to reduce environmental impacts, notably chemicals use, deforestation and overfishing, among others. Other subindustries in this sector that are indirectly linked to agriculture related ESG issues through their supply chains, are expected to apply high environmental and social standards for their suppliers and monitor compliance regularly. Among food producers, food retailers and cosmetics providers, we prefer companies with a substantial offering of labelled products (organic, fair trade). We do also prefer companies with a high proportion of direct purchasing in combination with programs supporting suppliers in improving environmental and social conditions.

If disclosure is poor, we engage with the company directly. If additional information is not available and we are not convinced the company meets basic standards, we would consider refraining from investing. We would not invest in companies with a history of significant labor rights violations, or companies using highly controversial chemicals in their production process. We would especially reconsider investment in the event of negative reports and rankings provided by NGOs and other public sources. Involvement in major controversies can be an indicator for weak management structures.

#### 14) **Sugar (under Product Health and Safety indicator)**

Obesity and smoking are the top drivers for the rising number of diseases and conditions such as cancer, heart attack, stroke, and diabetes. These are mainly reported in developed countries but increasingly so in developing countries. In 2016, more than 1.9 billion adults were overweight, of which over 650 million obese, according to the WHO. The World Obesity Federation expects the number of overweight individuals to increase to 2.7 billion by 2025, resulting in related health care costs of \$1.2 trillion by 2025.<sup>27</sup> Against this backdrop, high-calorie snacks, and processed foods, sugared soft drinks and other unhealthy food face rising regulatory pressure. Existing regulation includes "sugar taxes" (e.g., in Mexico, France and Belgium); restrictions on sale of snack foods (the US prohibits their sale in schools, as well as in Mexico and Australia); and limitations on the use of hydrogenated oils (e.g., US). There are also concerns about the health effects of additives such as preservatives, pigments, flavor enhancers and artificial ingredients in processed foods, (as well as in the household and personal products industries). The level of scrutiny in the nutrition and health industry is particularly high on the part of consumers and consumer-advocacy groups. Companies that fail to address such issues face reputational risks. Many have reacted by improving their products' nutritional profile or launching health and wellness product lines.

In our MSF assessment of consumer staples companies, as part of the wider assessment of product health and safety, we look for companies with a range of healthy products. Among those with a high exposure to product health risks (sugar, fat, salt, potentially hazardous chemicals), we favor companies with targets and programs to analyze health effects and phase-out critical products (for retailers especially) or controversial ingredients (for food processors, beverage and household and personal products companies). Where disclosure is poor, we engage with the company directly. If additional information is not available and we are not convinced the company meets basic standards, we would consider refraining from investing.

<sup>27</sup> <https://www.theguardian.com/society/2017/oct/10/treating-obesity-related-illness-will-cost-12tn-a-year-from-2025-experts-warn>

**15) Gaming – protection of minors**

Gaming companies have specific additional indicators in the MSF with a focus on responsible content and protection of minors (focusing on strict and enforceable time and spend caps on minors).

**16) Human Rights, Forced and Child Labor, Modern Slavery**

Our Human Rights approach blends top-down exclusions (notably violation of international norms and exclusion of weapons) with bottom-up proactive due-diligence on all investment positions.

The ILO conservatively estimated that in 2016 c.40 million people were victims of modern-day slavery.<sup>28</sup> All industry sectors have some exposure to human rights abuses through forced and compulsory labor, child labor, and other forms of modern slavery, either directly in their own workforce or indirectly through their supply chain but the most exposed sectors are manufacturing, construction and agriculture, forestry, and fishing. This topic is a material issue assessed in all MSFs (assessing factors such as, commitments to this issue, policies, workforce composition, workers' freedom of association, benefits, and various metrics associated with supply chain management (including policies, oversight, training, audits).

Modern day slavery falls within the wider issue of respect for Human Rights and companies' responsibility to its wider stakeholders – this includes its workforce, customers, suppliers, and the communities impacted by its operations, products, or services. We view these various stakeholders as important drivers of long-term value for any business and companies that demonstrate awareness of this by behaving ethically and responsibly towards them are better positioned to generate stable long-term returns for their shareholders. Our MSFs are tailored to focus on the key externalities and stakeholder groups of a particular sector, but common to all assessments is to investigate how companies treat their workforce, oversee responsible principles in their supply chain, how they respect their customers with responsible product governance and manage and minimize negative their impacts on wider society.

The more severe human rights cases or incidents of modern slavery will cause a 'fail' assessment under the UNGC, UNGP, ILO or other global norms listed in screening topic 1 above, and would, by default, trigger exclusion. However, we recognize that this field is frequently not black and white – many companies go under the radar of controversy reporting or may have unclear supply chain ties to identified abuse. To complete our assessment, we rely on our varied ESG data providers for their metrics on human rights performance as well as our varied controversy sources, including media and civil society reports. In addition, where data is limited and risk exposure is high, we engage directly (or via our engagement partner) with companies to understand how they are addressing these risks and their commitments to have no forced labor in their workforce (direct and indirect). We encourage companies to map their actual and potential impacts on human rights, uphold international global norms, take account of wider interests of stakeholders and society by actively ensuring respect for human rights or mitigating other adverse societal impacts and to take appropriate remedial action in case of a breach of these principles. Our F-Score framework (described in section 4.1.4) is used to assess the salience of the human rights risks and determine whether divestment or engagement is the best course.

**17) Uyghur forced labor**

Uyghur forced labor is a specific human rights risk to which mtX is potentially exposed as an EM focused investor. It is a topic where there is often limited evidence to robustly prove the presence or absence of forced labor. Therefore, we

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<sup>28</sup> Of which 24.9 million people were victims of forced labor, which includes forced labor exploitation in the private economy (16 million), forced sexual exploitation (4.8 million), and state-imposed forced labor (4.1 million) respectively. Almost 20% of forced labor cases are children. The remainder are victims of forced marriage (15.4million) and other forms of modern slavery. Modern Slavery is an umbrella term that essentially refers to situations of exploitation that a person cannot refuse or leave because of threats, violence, coercion, deception, and/or abuse of power. International Labor Organization, Walk Free Foundation, and International Organization for Migration (IOM), Global Estimates of Modern Slavery: Force Labor and Forced Marriage in 2017 (Geneva, Switzerland: International Labor Office, pdf pg. 29, 2017), [https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/publication/wcms\\_575479.pdf](https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/publication/wcms_575479.pdf)

developed a multi-faceted framework to guide a detailed analysis, qualitatively and quantitatively, on a company's risk exposure from the financial and reputational perspective.

A company may be implicated by forced labor risk through its relationship with the Xinjiang Production & Construction Corp (XCPP), presence and operations in the Xinjiang Uyghur Autonomous Region (XUAR), involvement in the labor transfer programs of the Xinjiang Vocational & Education Training Center (VETC) and its upstream supply chain. For each scenario, we conduct thorough analysis, which includes fact-finding engagements if the company is implicated and speaking with third parties such as the company's business partners, suppliers, and brokers. We focus our desktop research and discussions on the company's hiring processes, labor working conditions, external labor audits on production facilities, supply chain traceability and raw materials policies.

We have established de-minimis thresholds on revenue at risk. We take into consideration a company's dependency on revenues generated from facilities located in the XUAR region and from exports to countries with present or upcoming forced labor trade regulations such as the United States and the EU countries. The de-minimis thresholds are set at 5% and 10% respectively. ESG team would recommend against investment into companies where revenues at risk have crossed these thresholds.

#### 18) **Mining**

We are particularly careful when assessing mining companies as mining companies face material ESG risks. We pay close attention to the following social issues: human rights, labor practice, community relations, land use, vulnerable people, indigenous people, artisanal miners, mine closure, occupational health and safety, and resettlement. The environmental risks we assess include mining waste and tailings management, hazardous substances, water management, climate risks, air, noise, energy use, biodiversity, and miner closure. We also investigate the governance issues such as legal compliance, ethics, bribery and corruption. In general, we expect companies to understand and identify priorities, have strong commitments and actions on safety, display transparency of their performance, and enhance community and regulatory relations.

#### 19) **Nuclear Power**

We see three categories of companies involved in nuclear power generation. For utilities companies operating nuclear power generation, we assess the company within the utilities MSF and consider the topics including operational safety track record, employee health and safety, location risks, environmental management, and waste management and if the location is in a high-risk zone (e.g., earthquakes) to determine if the company is investible. For uranium mining companies, we assess the companies under the mining sector MSF and consider the most material topics related to mining, (such as employee health and safety, labor practices, environmental & emissions management, etc.) to determine if the company is investible under MSF assessment. For companies providing equipment and services for nuclear power generation, we conduct MSF assessment for relevant sector, typically industrials. The ESG topics could include employee health and safety, product quality, business ethics, energy management, GHG emissions.

#### 20) **Taxation**

As multinational companies continue to face increased scrutiny in relation to their tax practices, we evaluate companies' exposure to potential earnings, governance, reputational and broader societal and macroeconomic risks. Such an assessment is conducted within the financial analysis. Where corporate disclosure is poor, we may engage with companies to encourage improvements in their publication of tax-related information to support our investment decision.

#### 21) **Oppressive regimes (government and company level)**

The UN Security Council has primary responsibility for the maintenance of international peace and security. It has 15 Members, and each Member has one vote. The use of mandatory sanctions is intended to apply pressure on a state or entity to comply with the objectives set by the Security Council without resorting to the use of force. Today, there are 14 ongoing sanctions regimes, which focus on supporting political settlement of conflicts, nuclear non-proliferation,

and counterterrorism. We adhere to the official UN list of sanctioned countries<sup>29</sup> and do not invest in companies domiciled in such a country (not applicable where later applied to pre-existing holdings). The Management Company operates a program reasonably designed to ensure compliance generally with economic and trade sanctions-related obligations applicable directly to its activities (although such obligations are not necessarily the same obligations that the Fund may be subject to).

As the funds do not invest in sovereign bonds, no position is taken on purely sovereign issues, such as existence of the death penalty, the status of political rights or civil liberties at a national level, ratification or otherwise of certain international treaties, etc.

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<sup>29</sup> [https://www.un.org/securitycouncil/sites/www.un.org.securitycouncil/files/subsidiary\\_organ\\_factsheets.pdf](https://www.un.org/securitycouncil/sites/www.un.org.securitycouncil/files/subsidiary_organ_factsheets.pdf)

### Appendix 3: Climate Assessment Framework

Mtx uses a multi-angle approach to assess companies' climate-related risks and impacts. We aim to identify companies with material financial climate risks to explicitly inform our investment risk assessment. We engage with companies who we identify as having material climate risks or impacts with the objective of reducing absolute emissions and establishing credible net zero strategies. Climate risks are integrated into the MSF for all sectors and into financial models where appropriate.

The process to identify companies with material climate related risks starts with a proprietary screening tool, to quantitatively identify companies most exposed to carbon pricing and physical risks. The second step, our **Climate Assessment Framework**, is a more qualitative and deeper assessment of Transition & Physical Risks before moving on to Impacts and Transition assessments.

#### Part 1: CLIMATE SCREENING:

- A) Transition Risks** cover legal, policy, technology, market & reputational risks related to the transition to a lower carbon economy. In the screening stage, we focus on cost of carbon as primary legal risk. To do so, we examine a shadow cost of carbon using three carbon cost scenarios (\$30, \$50 and \$100/ton) all for scope 1 emissions. We flag companies as potentially high risk where the carbon cost under these scenarios is 5% or more of net income or of revenues. While some assumptions are notably more than current carbon costs in Emerging Markets, we use this for forward looking approach to identify companies that could potentially pay a sizeable portion of their revenue or net income for their carbon emissions. Other aspects of transition risk are examined more qualitatively in the Climate assessment framework.
- B) Physical risks** examine the risk to companies' physical assets or disruption of operations from climate change models of acute and chronic climate pressures. Acute climate risks are extreme weather events such as hurricanes, floods, or cyclones, whereas chronic risks arise from long-term shifts in climate patterns such as sea level rise, extreme variability of weather & precipitation or frequency/duration of heat waves. To identify companies most exposed to these events, we first identify asset-heavy companies by calculating the ratio of net property, plants, and equipment (PPE) and inventory over revenues and over net incomes. We look to identify companies most exposed to cost of asset replacement and we flag companies whose physical assets are more than 1x revenues or 10x net income. The thresholds are adjustable to capture more companies according to analyst judgement.

#### Part 2: CLIMATE ASSESSMENT FRAMEWORK:

For companies that are flagged as having high transition or physical risk, a more detailed climate risk qualitative assessment is conducted based on detailed research of individual companies. The framework closely follows the commendations and structure of TCFD. This framework first looks at financial risks for these companies, with a focus on the short-term. The framework scope is then widened to all high emitters where climate impacts and risk management are examined.

##### A) Financially Material Climate Risks:

- a. **Transition Risks:**
- i) Policy/legal risks – focus of key legal risks where the company operates and sells to cover relevant climate-related/carbon regulations (with short/mid-term horizon). This can go beyond carbon pricing or caps, such as water regs, emission controls, product compliance costs, asset redundancy from policy changes, plant shut-downs/pauses for pollution controls, etc.
  - ii) Technology Risks examines asset life, age, low-carbon substitutes, IEA pathways etc. to estimate upgrading needs, additional R&D & capex requirements, asset write-off risks, or opex/production disruption of making transition.
  - iii) Market Risks include increased opex costs, market risks from shifting consumer demands, supply chain insecurity and of the competitive landscape.
  - iv) Reputation Risks: sectors with high emissions stigma are particularly exposed to shifting consumer demand, financing risk and workforce attractiveness risks.



We examine the company's strategy to prepare for and mitigate these risks. Where possible, we aim to quantify risks in terms of their main financial impact (revenues, expenses, or capex) and consider the company's financial resilience to withstand forecast risks.

**b. Physical Risks:**

For a more accurate look at Physical risks, we first try to locate flagged companies' key production or operation locations. We identify the type of assets, location clustering, and any key facility risk. We draw on the physical risk assessment of our data providers (MSCI & Bloomberg) especially for the overlay of climate risk maps but with a critical eye to cross check on other asset location data direct from the company. At this stage there is a high reliance on companies' own assessment of climatic physical risk exposure and management as a primary source. By better understanding the type and location of assets we can make more informed estimates of the potential impact in terms of disruption or asset destruction. We consider company's stated strategy to mitigate these risks. Aware of many data limitations these risks are currently categorized as low, medium, or high.

As a result of this first step, we conclude the risk level of transition risks and physicals risks for individual companies in the short term of 1-3 years and in the mid-long term. By identifying high-risk companies in the short term, we can apply the finding in our investment decision and mitigate our investment risks.

**B) CLIMATE IMPACTS**

In the next step, in addition to companies flagged under step one, we also examine high emitting companies for their emissions performance, decarbonization commitments, strategy and governance.

- i) **Emissions:** We first evaluate their current and past emissions (scopes 1 & 2 separately) on absolute and intensity basis and the three- and five-year historic trends, energy sources, percentage renewables. We compare companies to their sub-industry peer group. For scope 3 we examine the degree of company influence over its major categories.
- ii) **Targets:** Next, we examine the short, medium & long-term targets and determine if the target is clear, ambitious, and credible with scientific basis (e.g., SBTi approved) and clear implementing strategy.
- iii) **Governance & Disclosure:** We examine if the company has adequate disclosure of emissions, have quality disclosures to TCFD or CDP and have independent data assurance. We examine the governance on board and management levels, for example, we check if the responsibility for climate risks is clearly defined, if there is sufficient experience in climate risks, and if the governance has driven adequate disclosure and track history of meeting.

**Part 3: ENGAGEMENT**

Finally, we engage with companies with material climate risks and lack of measures to mitigate the risks and impacts. We use the assessment framework to tailor our dialogue with companies. Through the conversations, we can gain more information to better understand the risks and discuss the challenges and solutions with companies.

**Part 4: CLIMATE IN THE MSF ASSESSMENT**

We consider three main areas under the climate topic in the MSF.

First, we assess companies on reporting scope 1, 2 and 3 emissions, scope of emissions coverage, explanation on emissions sources, third party audit, emissions target, and actions. Depending on the company, we expect different levels of disclosure and efforts based on their amount of emission and relevance. We expect large emitters to disclose comprehensively on climate efforts and strategy. For companies with small emissions, we do not penalize them if they have limited reporting. We are skeptical of empty words and so look for evidence of credible actions and resources behind any net zero statements.

Second, we examine the historical GHG performance by looking at total emissions and emissions intensity trends over the past three and five years and compare this to its most relevant peers. We consider the large emitters as having higher risk when they have increasing emissions intensity over the past three or five years.

Third, we assess the transition risks and physical risks. On transition risks, we evaluate the current costs and potential costs from various regulations comparing to revenue and net income. We also assess the technology risk from potential capex and opex to improve technology, equipment, and innovation. For market risk, we check the potential revenue loss or margin loss. We also consider reputation risks from controversies. On physical risk, we assess if the company has large, fixed assets compared to revenue and net income, if the company discuss physical risks in a clear and meaningful manner and can demonstrate adequate measures to mitigate the physical risks. For companies that have hit the thresholds to be screened in detail in the Climate assessment framework – the result of that assessment is used here. For other companies a lighter touch assessment is used.

#### **Part 5: CLIMATE IN FINANCIAL MODELS**

Sustainability risks, including carbon pricing, stranded asset risk etc., are brought into the financial models in several ways but most importantly via the discount rate. We use a four-factor model to explain equity risk (*Size, Leverage, HOLT P/B Ratio, and HOLT Quality Factor*), of which the HOLT Price/Book ratio is highly relevant as it considers the implied market view of the company's growth outlook, tech obsolescence, the stage of the lifecycle which incorporates the energy transition theme, higher carbon costs, growth outlook in legacy businesses. Discount rates have significantly increased over the last 3 years, particularly in Energy and Utilities sectors and the cement industry. In some sectors the analyst will further reflect carbon /energy transition costs in their capex budgets where environmental upgrades are anticipated. Finally, carbon cost burdens will also be reflected in EBITDA margin forecasts, particularly over the coming years.

#### **Part 6: CLIMATE EXCLUSIONS**

As described further in Appendices 1 and 4, mtX has several exclusions directed at fossil fuels extraction and power. In the Article 8 category of funds, Mtx applies a 10% tolerance threshold to coal extraction and coal power. In our Art 9, EMSC fund, the thresholds on fossil fuels comply with the Paris Aligned Benchmark and Febelfin's 'Towards Sustainability' label.

#### **Part 6: CLIMATE IN DNSH SCREEN**

As described in section 5 and Appendix 6, all Sustainable Investments, are subject to a detailed Do No Significant Harm screening and assessment process. One pillar of that process relates to climate. In addition to strict exclusions on extraction of and power from fossil fuels, the DNSH screens for high carbon emitters in all sectors and flags as harmful the top 50 absolute emitters and the 5% worst in each industry (Scopes1+2), unless they demonstrate credible transition plans.

#### Appendix 4: Additional exclusion criteria for Vontobel Fund II- mtX Emerging Markets Sustainability Champions (EMSC)

EMSC falls into Vontobel's "Level 3" exclusion category and therefore has the tightest level of exclusions. It aligns with the exclusion requirements of the EU Paris Aligned Benchmark. Additionally, it has the Towards Sustainability Label awarded by Febelfin<sup>30</sup> (hereafter referred to as "Febelfin") and as such has additional screening requirements.

Exclusion	Criteria (% of revenues permitted)	Exceptions applied?
<b>Sector/business activity-based exclusions</b>		
Adult entertainment	Production: 0% Distribution: 5%	None.
Alcohol	Production: 0% Retail: 10%	None.
Conventional weapons, incl. firearms <sup>34</sup>	Production: 0%	None.
Coal <sup>31</sup>	Upstream: 5% Production: 0% Downstream: 5%	None.
Coal powered electricity*	Production: 5%	
Gambling	Production: 5%	None.
Games that glorify violence	Production: 10%	
Gas	Production: 0%	None.
Gas powered electricity*	Production: 5%	
Genetically Modified Organisms	Production: 5%	None.
Nuclear power	Production: 5%	None.
Nuclear weapons	Production: 0%	None.
Oil	Production: 0%	None.
Oil power*	Production: 5%	
Oil Sands	Production: 0%	None.
Palm Oil	Production: 0% Distribution: 0%	None.
Tobacco <sup>32</sup>	Production: 0% Retail: 5%	FN32.
Weapons (all including Unconventional, controversial and firearms) <sup>33</sup>	Production: 0%	None.

<sup>30</sup> <https://towardsustainability.be/>

<sup>31</sup> GICS 10 energy sector is fully excluded. Outside of this sector, coal upstream and downstream covers companies that provide tailor-made products and services that support thermal coal extraction are excluded with 5% revenue threshold, save that Transportation of thermal coal is excluded with 10% revenue threshold. This includes companies that provide storage and transportation (10%), mining, and coal refining services. Other companies in the value chain of thermal coal extraction are subject to 25% revenue limit.

<sup>32</sup> Production of Next Generation products (e.g., vaping, e-cigarettes) have 5% revenue tolerance.

<sup>33</sup> Our weapons related exclusions includes zero tolerance (including: a) tailor-made and essential, b) non tailor-made or non-essential, and c) significant ownership (defined as 10-50% shareholding)) for: i) Controversial weapons; ii) Nuclear weapons; iii) Biological

Military Contracting <sup>34</sup>	Production: 5%	None.
Predatory Lending	Production: 0%	None.
<b>Sovereign exclusions</b>		
UN Sanctions	UN Sanctions list	Applies to new investments and may not be applicable to preexisting investments
<b>Norms based exclusions</b>		
UN Global Compact ("UNGC") and Global Norms Violation <sup>35</sup>	Violation	Yes – see section 4.2
Critical ESG Controversy	Red flag (MSCI) or Category 5 (Sustainalytics)	Yes – see section 4.2

\*The Sub-Fund applies the Febelfin Towards Sustainability Label and as such follows its detailed Quality Standards 2023. These include, inter alia, the following (summarized) additional requirements that apply to power producers:

- 1) Governance Strategy to mitigate impacts & increase positive contribution. AND
- 2) Not involved in new coal fired power stations (except national legal obligations for energy security). AND
- 3) Production/ Capacity for coal-power shall not be increasing and must be <5GW. AND
- 4) The company must meet ONE of the following criteria:
  - i) have an SBTi target set at well-below 2°C or 1.5°C, or have a SBTi 'Business Ambition for 1.5°C' commitment; or
  - ii) derive more than 50% of its revenues from contributing activities (EU Taxonomy or UN SDGs); or
  - iii) have more than 50% of Capex dedicated to contributing activities; or
  - iv) have carbon intensity 1.5C aligned (e.g., TPI .348tco2e/MWh)

Phase-out. Best of peer group (i.e., Q1 ESG rated company, especially on transition) can be eligible if: a) <3% portfolio in aggregate, b) meets governance strategy and c) no expansion/new coal plants. Phase out to be 0% by June 2025.

Grandfathering: electric utilities with carbon intensity below the threshold in following table are permissible provided coal/nuclear are not structurally increasing:

	2024	2025
Max gCO2/KWh	335	315

#### **Additional remark**

The Vontobel Fund – Emerging Markets Sustainability Champions applies the Febelfin Towards Sustainability Label and as such follows its detailed Quality Standards 2023. The Febelfin label prescribes many additional rules that are not fully documented in this policy. For full details of all rules stemming from the Febelfin Towards Sustainability Label please see their website<sup>30</sup> for up-to-date information.

and Chemical, iv) Cluster Weapons, v) Depleted Uranium; vi) White Phosphorus; vii) Small Arms (including, civilian assault and non-assault weapons and retail/distribution thereof; military/ law enforcement customers; and key components).

<sup>34</sup> Military Contracting comprises companies that manufacture weapons or weapon components and parts (other than those excluded in i to vii of the policy above) or provide tailor-made products or services that support military weapons or non-weapons related products/services provided to the military or defense industry. Weapons in this category include handguns, guns, ammunitions, missiles, military aircrafts, tanks, warships, nuclear warheads, defense components and systems, training/combat simulators, etc. Tailor-made products include, for example, special fabrics for bulletproof vests, electronic systems for military aircrafts, etc.

<sup>35</sup> The Investment Manager uses screens from Sustainalytics and MSCI for global norms and standards that are enshrined in: i) the UN Global Compact, ii) the Organization for Economic Co-operation and Development Guidelines for Multinational Enterprises (OECD MNE Guidelines), iii) the United Nations Guiding Principles on Business and Human Rights (UNGPs), as well as iv) their underlying conventions and treaties, and v) the International Labor Organization's fundamental principles.

## Appendix 5: Do No Significant Harm Process

PAI <sup>36</sup>	STEP 1: DNSH TESTS	STEP 2: ANALYZING MITIGATION MEASURES
<b>CLIMATE</b>		
T1: 4	<b>Does the company have a significant exposure to fossil fuel extracting activities?</b> <ul style="list-style-type: none"> <li>– &gt; 1% coal extraction</li> <li>– &gt; 10% oil extraction</li> <li>– &gt; 50% gas extraction</li> <li>– &gt; 5% oil sands and arctic oil/gas</li> </ul>	No mitigation measures are eligible for companies with significant exposure to fossil fuel extraction activities. Accordingly, such companies will by default be considered as significantly harming.
T1: 5 T2: 4, 5	<b>Does the company have a significant exposure to power generation from fossil fuels?</b> <ul style="list-style-type: none"> <li>– &gt; 10 % coal power generation</li> <li>– &gt; 50% other sources of high carbon intensive power generation</li> </ul>	Eligible mitigation measures include credible transition plan in place (e.g., Science Based Targets, net zero targets, reduction of carbon emissions demonstrated during the past years, > 20% revenues derived from climate solutions). In name of just transition regional emission norms and longer transition pathways are considered for emerging market companies.
T1: 1, 2, 3, 6 T2: 4	<b>Is the company a high carbon emissions emitter?</b> Top 50 emitters (absolute emissions) and/or under the top 5% highest emitters within industry for companies active in high impact climate sectors (based on carbon footprint or intensity), based on scope 1 and 2 emissions.	
<b>NATURE</b>		
T1: 7 T2: 10, 11, 15	<b>Does the company have significant exposure to the production of soft commodities directly linked to deforestation? (&gt; 5% of revenues from palm oil, soy, cattle, timber)</b>	Eligible mitigation measures include initiatives, procedures and/or policies in place to develop sustainable practices within their own operations or supply chain (e.g., operating in line with relevant industry standards e.g., RSPO, externally verified operating standards, sufficient resources dedicated to managing the issue; good governance including senior management accountability. For supply chain we look for technical assistance to obtain sustainable certification, implementation of specific sustainable requirements for suppliers and robust measures to verify compliance).
T2: 7, 10, 11, 14, 15	<b>Does the company have instances of severe controversies related to biodiversity and land use?</b>	Eligible mitigation measures include initiatives, procedures and/or policies demonstrating efforts to mitigate significant negative impacts and remediation measures in event of controversies.
T1: 8 T2: 7, 8	<b>Does the company have instances of severe controversies related to water stress?</b>	
T1: 9 T2: 13	<b>Does the company have instances of severe controversies related to toxic emissions and waste?</b>	
<b>BASIC NEEDS</b>		
T1: 10, 11 T3: 1, 4, 5, 9, 10-17	<b>Does the company have instances of very severe violations of international norms (UNGC, OECD, etc.)?</b>	No mitigation measures are eligible for companies that have instanced of such violations or have exposure to controversial weapons. Accordingly, such companies will be considered as significantly harming. This assessment is conducted as part of our process to identify "Critical ESG Events". <sup>37</sup>
T1: 14	<b>Does the company have any exposure to controversial weapons?</b>	
<b>EMPOWERMENT</b>		
T1: 13	<b>Does the company have a diverse board? (Subject to regional thresholds)</b> Typically judged as <13.5% women directors in emerging markets and <27% Women in developed markets, but this is subject to further regional thresholds set by corporate governance codes, listing exchanges, etc.	In this area we believe strict thresholds are not proportionate for defining significant harm. Instead, we prefer a market nuanced approach to identifying under-performance and find active stewardship the better approach to addressing weakness. Voting allows us to use our shareholder influence to support board candidates and resolutions that promote diversity. Engagement enables constructive dialogue with companies, promoting awareness about the benefits of gender diversity and encouraging voluntary improvements. In the case of severe controversies, these will be assessed as part of our process for the identification of "Critical ESG Events". A confirmed critical ESG event will be classified as significantly harming and so be excluded from being considered sustainable investments.
T1: 12 T3: 7	<b>Does the company have instances of severe controversies related to discrimination and workforce diversity or an excessive gender pay gap?</b>	

<sup>36</sup> These "Principal Adverse Impacts" indicators are stemming from the SFDR Regulatory Technical Standards. While they may not be used as such in our methodology, for instance due to data quality and/or coverage, we consider that the test being conducted is a proxy to the area being addressed through these indicators.

<sup>37</sup> More information can be found in our ESG investing and advisory policy under <https://www.vontobel.com/esg-library/> and is described in section 4.2 in this paper.

Appendix 6: F-Score Framework

# F-score process chart

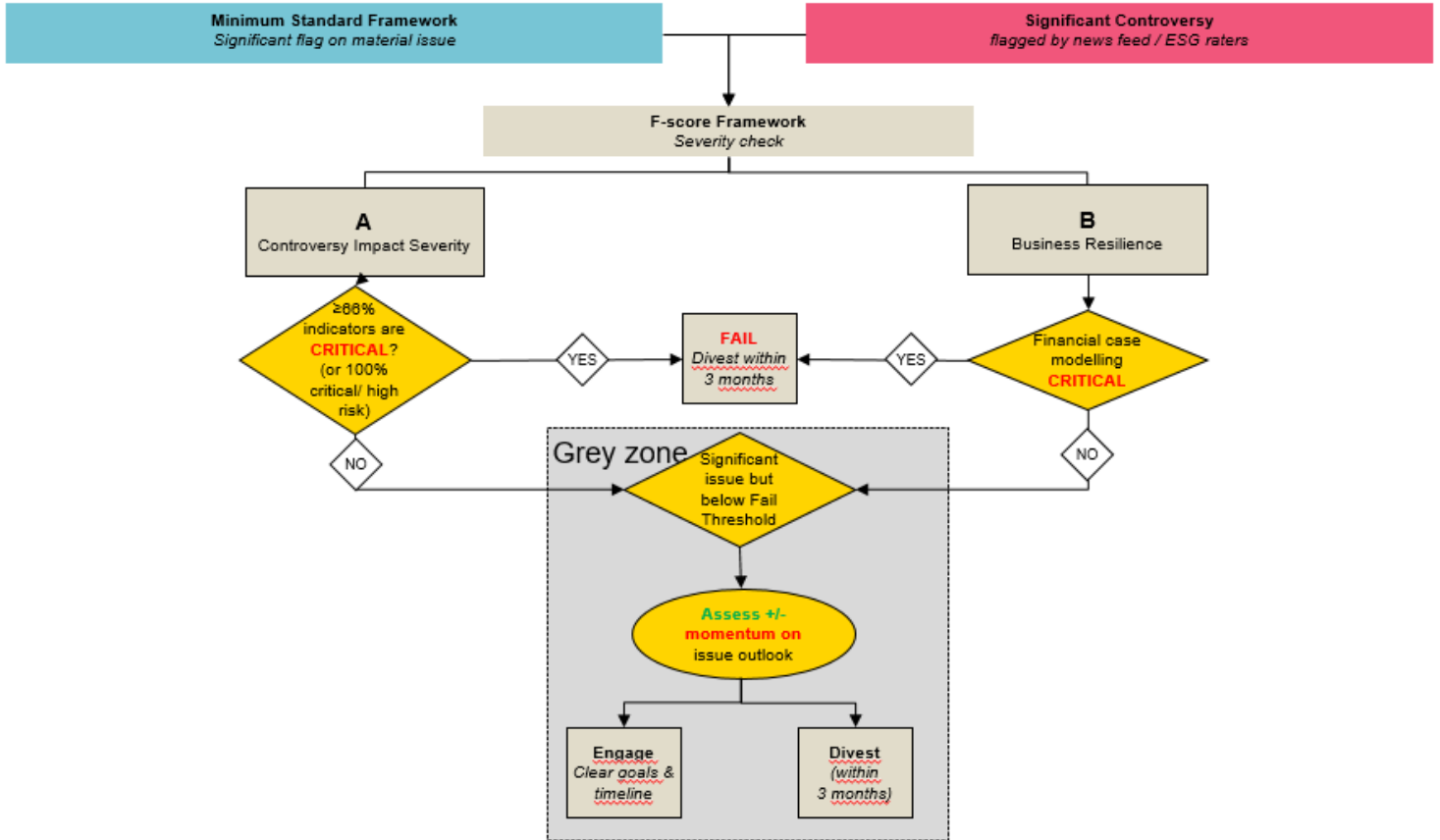


Figure 1: mtX flow chart illustration of the F-Score assessment process.

### **Appendix 7: Methodological Limits**

In assessing the eligibility of an issuer based on ESG research, there is a dependence upon information and data from third party ESG data providers, and from issuers, and on internal analyses, which may be based on certain assumptions or hypothesis. The data obtained from third-party data providers or issuers may be incomplete, inaccurate, or unavailable and the assumptions or models on which internal analysis rests may have flaws which render the internal assessment incomplete or inaccurate. As a result, there exists a risk of incorrectly assessing a security or issuer, resulting in the incorrect inclusion or exclusion of a security. Considering that ESG data providers may change the evaluation of issuers or instruments at their discretion and from time to time due to ESG or other factors, updated information on the methodology used by our current ESG data providers can be found on their websites. There is also a risk that the Investment Manager may not apply the relevant criteria of the ESG research correctly or that our portfolios could have indirect exposure to issuers who do not meet the relevant criteria. These risks pose the main methodological limits to our sustainability strategy. Neither the Fund, nor the Management Company nor the Investment Manager make any representation or warranty, express or implied, with respect to the fairness, correctness, accuracy, reasonableness, or completeness of an assessment of ESG research and the correct execution of the ESG strategy.

**CVs****Lara Kesterton**

Head of Sustainability for the Conviction Equities Boutique

Director

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Lara Kesterton joined Vontobel Asset Management in June 2017 as ESG Research Lead for mtX. In January 2024 she was elected to Head of Sustainability for the Conviction Equities Boutique. In this capacity, Lara and her team have extended their ESG research support to include the Impact & Thematic and Swiss Equities teams in addition to mtX.

Prior to joining Vontobel, Lara Kesterton worked on developing decarbonizing pathways for international hotel groups, and on a World Bank project with the Maldives government. Lara has worked with a number of private equity groups on renewable energy investments.

Lara is a lawyer by professional background, with 5 years' practice in a leading London law firm, specializing in banking and international finance.

Lara Kesterton attained her undergraduate degree (BA Politics) at the University of Durham, her legal qualifications (PGDL & LPC) at the London College of Law, and a Master of Science in Environmental Change & Management from Oxford University.

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