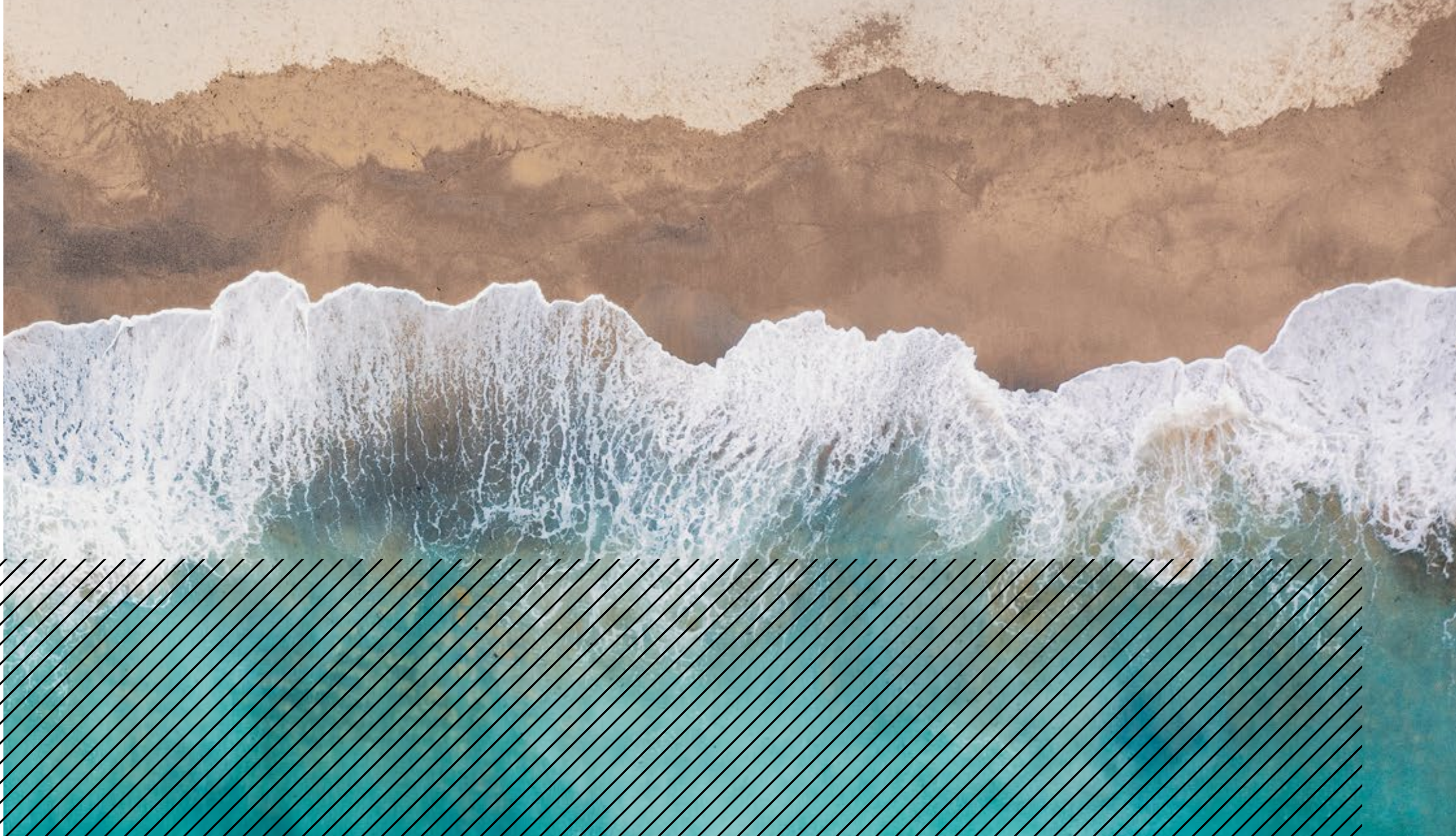
Vontobel

# Sustainable investing under the new EU regulatory framework

## Information for EU/EEA clients with discretionary and advisory mandates



August 2022

Wealth Management

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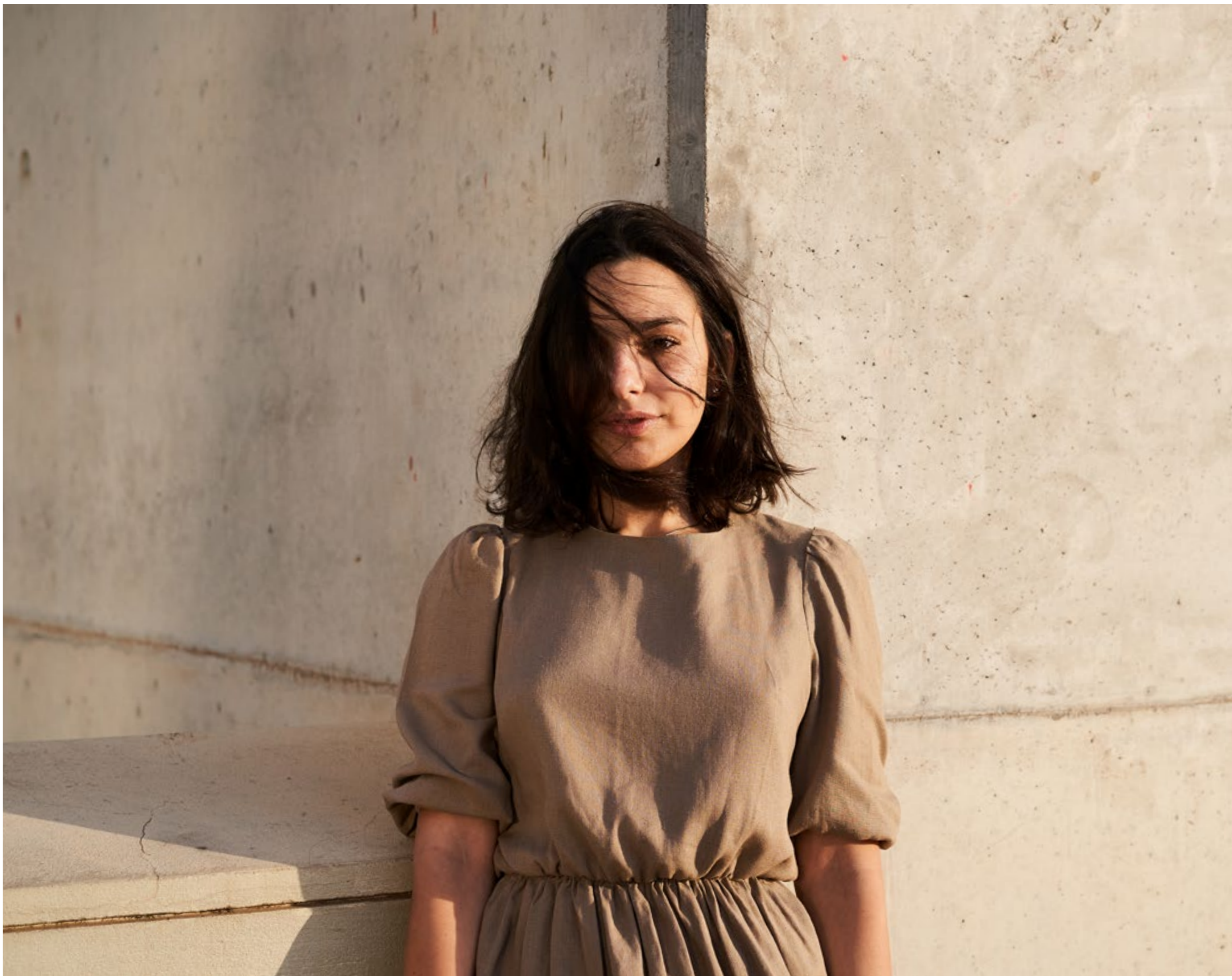
Further information: vontobel.com/sustainability

# What is it about?

As an EU/EEA client governed by the EU's regulatory regime, beginning on August 2, 2022, you will be offered an opportunity to express your sustainability preferences. This regulatory change is being introduced as a consequence of the European Union's Sustainable Finance Action Plan's legislative agenda.

This brochure provides you with information about the topic of sustainability preferences and their impact on you as an investor. It is intended to help you with all the information you need to be able to decide whether you will integrate sustainability preferences in your investments, and if so to what extent.



# How you are affected by the EU Sustainable Finance Action Plan

Major investments are needed to transform the EU economy to deliver on climate, environmental, and social sustainability goals, including the Paris Agreement[1] and the UN Sustainable Development Goals[2]. For this reason, the EU introduced the "EU Sustainable Finance Action Plan[3]" entailing the following objectives:

- "Re-orient capital flows towards sustainable investment, in order to achieve sustainable and inclusive growth
- Manage financial risks stemming from climate change, natural disasters, environmental degradation and social issues; and
- Foster transparency and long-termism in financial and economic activity."

To implement the EU Action Plan, several key regulations have been enacted and will be gradually implemented. These regulations have the following impact on you as an investor:

- The amendment of the ***MiFID II Regulation***[4], in force as of August 2, 2022, requires financial providers to ask you if you want to consider sustainable criteria in the form of sustainable preferences in your investments. If you choose to do so, you must communicate your preferences to your Relationship Manager, who is required to consider them in the advisory process. Without feedback from your side, we are not allowed to advise you as of August 2, 2022.
- With the ***EU Taxonomy Regulation***[5], in force since July 12, 2020, a classification system for economic activities was introduced, leading to a common understanding of the definition of environmental activities. This classification system serves as a basis for the definition of the above-mentioned preferences. Based on this regulation, you can define what proportion of revenues in sustainable, especially environmental, activities your portfolio should aim to encompass.
- The EU is gradually implementing the ***Sustainable Finance Disclosure Regulation (SFDR)***[6]. Its focus is on information asymmetries between financial services providers and you as an investor, as regards the consideration of sustainability risks, the marketing of environmental and social characteristics, regarding sustainable investments, and the consideration of adverse sustainability impacts. Principal adverse impacts are indicators measuring the negative external impact of economic activities on sustainability factors ("negative externalities").

The SFDR regulation also introduces a classification system for financial products, categorizing them into three categories leading to greater transparency:

- Article 6 products (considering negative impacts on sustainability factors)
- Article 8 products (promoting environmental or social characteristics) and
- Article 9 products (targeting a sustainable objective)

1 unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement
2 sdgs.un.org/goals
3 ec.europa.eu/info/publications/sustainable-finance-renewed-strategy_de#action-plan
4 MiFID II amendment, see eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021R1253
5 EU Taxonomy, see eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32020R0852&qid=1651821886945
6 Sustainable Finance Disclosure Regulation (SFDR), see eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32019R2088

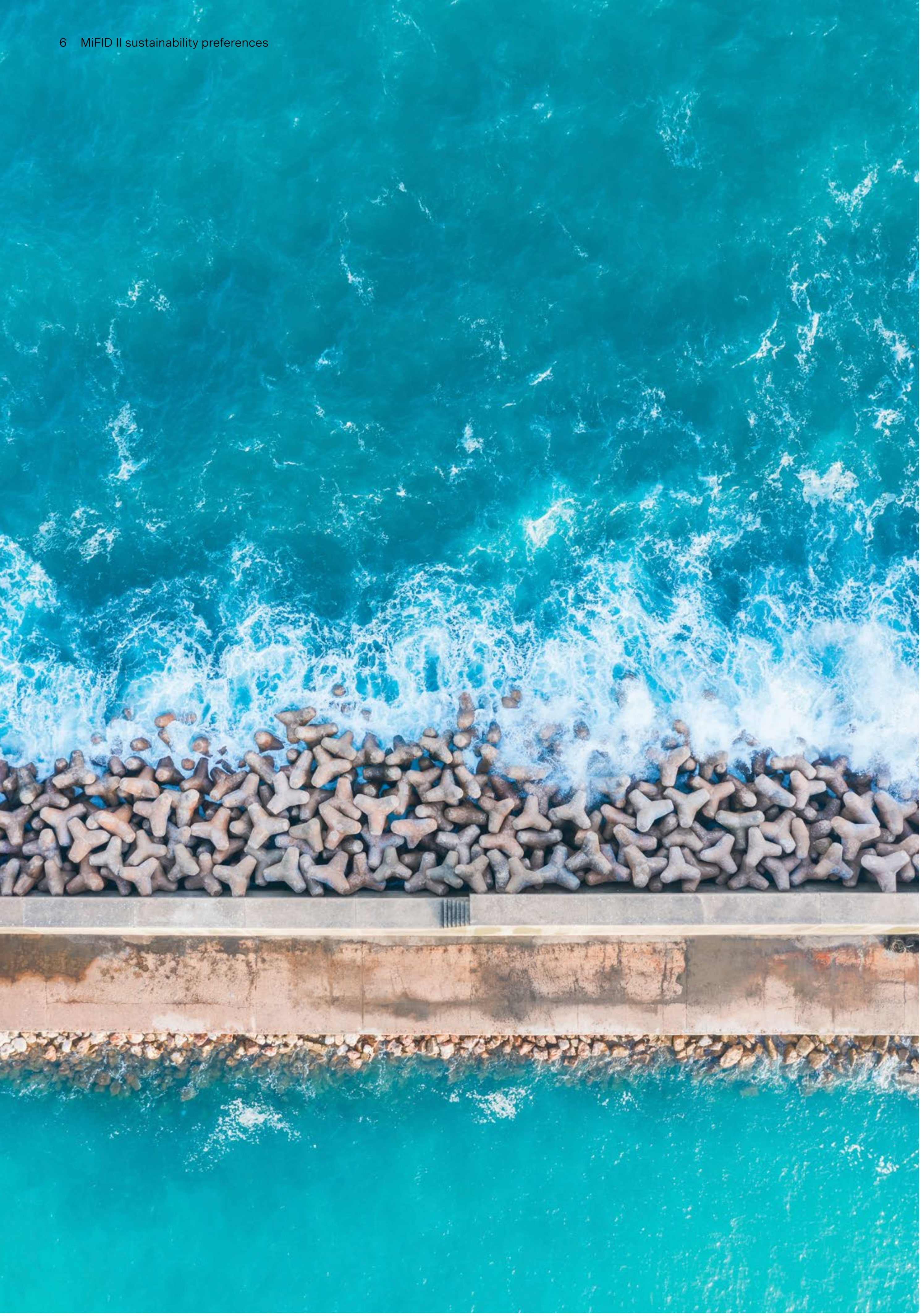
# Defining your sustainable investing preferences

## What you need to do

The regulation provides that investors can choose from among three preferences, which are shown in the table below. On pages 8 – 10 of this document, the three preferences are explained in more detail. ***If you want to invest sustainably*** according to the regulations summarized on page 4, ***you need to choose your preferred combination from the list below***. Your Relationship Manager will be happy to provide you any further information you need.

This is an overview of the preferences; for details see pages 8 – 10.

| PREFERENCE | PRINCIPAL ADVERSE IMPACTS (PAI) | SUSTAINABLE INVESTMENTS (SFDR) | ENVIRONMENTALLY SUSTAINABLE INVESTMENTS (EU TAXONOMY) |
|---|---|---|---|
| Description of the preference | Exclusion of companies with defined negative impacts from their economic activities on environmental and / or social aspects | – The company's activities must contribute to sustainable goals,<br>– should not significantly harm any sustainable goal, and<br>– the company should follow good governance practices | – The company's activities must contribute to environmentally sustainable goals,<br>– should not significantly harm any environmentally sustainable goals,<br>– should fulfill (EU Taxonomy) criteria defined by the EU and<br>– the company should comply with certain international standards |
| What to define if you want to consider this preference | Choose<br>– if you want to consider PAI according to Vontobel's definition and<br>– what proportion of your portfolio should be aligned | Choose what proportion of revenue of all investee companies in your portfolio should fulfill the above criteria. | Choose what proportion of revenue of all investee companies in your portfolio should fulfill the above criteria. |



# How this affects you as an investor

If you delegate the management of your assets within a discretionary mandate to Vontobel, we aim to ensure that the portfolio will always be aligned with your chosen preferences. In case you opt for an advisory mandate, the system will check before any transaction whether the financial product to be acquired is aligned with your preferences. You can change your preferences at any time if you think that the thresholds as defined are too strict or too lenient. You will be informed about your actual preferences and to what extent your portfolio is in line with your preferences.

The data required for the implementation of the EU Taxonomy Regulation is only partly available at present but will evolve over time. If your choice requires that a high proportion of your portfolio is aligned with sustainable revenues, there might only be a limited number of financial products available. In the case of discretionary mandates, there could even be no products currently available at all.

The percentages depicted in the table reflect the strictness of the three preferences. The preference "Environmentally Sustainable Investments (EU Taxonomy)" in particular leads to a significant reduction of the potential investment universe; for example, in the case of the broad MSCI World Index, only 5 percent of the index is currently aligned with EU Taxonomy criteria.

**Examples**
The following table shows the extent to which different ETFs on well-known indices meet the criteria set out in the three preferences PAI, SFDR, and EU Taxonomy:

| INDEX | PAI | SFDR | EU TAXONOMY |
|---|---:|---:|---:|
| MSCI World | 97% | 6% | 5% |
| MSCI World ESG Leaders | 100% | 8% | 8% |
| MSCI World SRI Select red. Fossil Fuel | 100% | 11% | 10% |
| SPI | 100% | 8% | 1% |
| SPI ESG Multi Premia | 100% | 6% | 2% |

# Details and explanations about the preferences

The following sections provide further information about the sustainability preferences.
Vontobel implements the defined criteria based on data provided by a well-known external data provider.

## Principal adverse impacts (PAI)

SFDR's implementing regulation ("RTS") provides a comprehensive list of "adverse sustainability indicators". These indicators are essentially a set of environmental, social, and governance indicators and metrics, ranging from carbon emissions and fossil fuel exposure to biodiversity impacts, social violations, or gender parity on the company's board. They show in which areas and to what extent a company might have a negative impact on its environment (also known as "negative externalities"). With the enactment of Level 2 of the regulation (not expected before 2023), entities will have to disclose at least the 18 mandatory PAI.

Until then, if this sustainability preference is chosen, Vontobel will apply the criteria shown in the adjacent table. You can decide if you would like us to consider these in your portfolio. If you decide to do so, you need to indicate the minimum fraction of the portfolio value to which this preference should be applied. As mentioned, indicators can change and will evolve over time, as this approach is only provisional and will be replaced by a more elaborated approach in 2023.

**Thematic exclusions**
- Armaments and controversial weapons
- Tobacco
- Thermal coal
- Government bonds:
  consideration of human rights, climate, sanctions

+

**10 Principles of the UN Global Compact**[7]
Monitoring of serious violations of the 10 Principles of the UN Global Compact, especially in the following areas:
- Human and labor rights
- Environment
- Business practices

+

**Exclusion of controversies**
Exclusion of companies where the overall controversy assessment signals that a company is involved in a severe controversy related to its operations and / or products, with regard to an environmental or social impact.

[7] UN Global Compact: see unglobalcompact.org/

## Sustainable investments (SFDR)

SFDR defines sustainable investment[8] as an investment in an economic activity that a) contributes to an environmental or social objective, provided that b) the investment does not significantly harm any environmental or social objective and that c) the investee companies follow good governance practices (the full definition can be found in the regulation mentioned in footnote 6).

**Contributes to environmental or social objective**
An economic activity that contributes to
- an environmental objective as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or
- a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labor relations, or an investment in human capital or economically or socially disadvantaged communities (SFDR Art. 2[17])

+

**Does no significant harm**
None of the mentioned objectives should be significantly harmed.

+

**Adheres to good governance practices**
The following practices are defined:
- Sound management structures
- Tax compliance
- Respectful employee relations
- Fair renumeration of staff

[8] Definition based on regulation 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR), Art. 2 No. 17

## Environmentally sustainable investments (EU Taxonomy)

The EU Taxonomy Regulation defines an environmentally sustainable investment[9] as an investment that a) makes a significant contribution to one or more of six environmental objectives, b) does not significantly harm resp. negatively impact any of the other defined environmental objectives, c) complies with minimum social safeguards, and d) fulfills the technical evaluation criteria defined by the EU Taxonomy.

The preference “environmentally sustainable investments” imposes greater restrictions on the investment offering compared to the preference “sustainable investments” (see the section “Examples” on page 7 for an indication of the choice of the proportion of sustainable revenues).

**Makes a significant contribution**
With its economic activities, the company makes a significant contribution to one of the following objectives:
- Climate change mitigation
- Climate change adaptation
- The sustainable use and protection of water and marine resources
- The transition to a circular economy
- Pollution prevention and control
- The protection and restoration of biodiversity and ecosystems

+

**Does no significant harm**
While the company may contribute positively to one of the objectives listed above, it should not have any negative impact on all others.

+

**Minimum social safeguards**
The following norms must be respected:
- OECD Guidelines for Multinational Enterprises
- Guiding Principles on Business and Human Rights
- Declaration of the International Labor Organization on Fundamental Principles and Rights at Work
- International Bill of Human Rights

+

**Technical evaluation criteria**
Catalogue of economic activities defined and evaluated by the EU as sustainable

[9] Definition based on regulation 2020/852 on the establishment of a framework to facilitate sustainable investment (EU Taxonomy)

## Benefits

Identifying your sustainability preferences in the advisory process helps us to tailor our investment services more precisely to your sustainability goals. In the case of an advisory mandate, if a potential investment you ask for is not in line with your preferences (i.e. too low a proportion of sustainable economic activities), our systems will identify this, and we will discuss possible courses of action with you. Investment advice from our side always fulfills your preferences. In the case of discretionary mandates, we can offer our standard sustainable mandate, which is constructed using collective investment instruments (sustainable investment funds, ETF). Or, under certain preconditions, we can tailor a discretionary mandate based on your needs, which will be aligned to your personal sustainability goals. Please contact your Relationship Manager for further details.

# Further information

Please be aware that Vontobel cannot guarantee the complete fulfillment of sustainability preferences. Vontobel undertakes to meet your sustainability preferences on a best-efforts basis but relies on data providers and third-party information that might be insufficient.

Further information on sustainable investing at Vontobel can be found at the following addresses:

**Bank Vontobel AG**
vontobel.com/en-ch/wealth-management/investing/sustainable-investing/
vontobel.com/en-ch/about-vontobel/responsibility/principles-and-policies/

**Bank Vontobel Europe AG**
vontobel.com/en-de/wealth-management/investing/sustainable-investing/
vontobel.com/en-de/about-vontobel/responsibility/principles-and-policies/

**Legal notice**

**Limitations due to data availability**
The implementation of the advisory process according to EU regulations is based on a large amount of data that must be prepared and provided by all EU investee companies. These companies are only beginning to prepare such data. Therefore, the information base is still very limited at present. Vontobel has decided to classify companies for which data is not available as not sustainable. For the time being, this will lead to a limited offering aligned with sustainability criteria according to the EU regulations. However, as more data becomes available, the offering aligned with the EU sustainability regulation will grow over time.

**Adaptation of sustainability preferences**
The higher the minimum proportion you choose, the less choice you will have of available sustainable products, which will limit your portfolio diversification, at least for the time being. In our view, a tradeoff between your preferences and the product availability is in your own interest. Of course, the definition of your sustainability preferences is fully yours to make, and we do not want to influence you in any particular direction. However, we want to ensure that when you make your decision, you are fully aware of the consequences it might have. Furthermore, we would like to point out that after you have initially defined your sustainability preferences, it is possible to adjust them at any time.

# Glossary

## Definition of key sustainable investment terms

**ESG**
Environmental considerations might include climate change mitigation and adaptation, as well as the environment more broadly, for instance the preservation of biodiversity, pollution prevention, and the circular economy. Social considerations could refer to issues of inequality, inclusiveness, labor relations, investment in human capital and communities, as well as human rights issues. The governance of public and private institutions—including management structures, employee relations, and executive remuneration—plays a fundamental role in ensuring the inclusion of social and environmental considerations in the decision-making process (source: ec.europa.eu).

**EU Sustainable Finance Action Plan**
This Action Plan on sustainable finance is part of a broader effort to connect finance with the specific needs of the European and global economy, for the benefit of the planet and our society. Specifically, this Action Plan aims to:

1. reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth;
2. manage financial risks stemming from climate change, resource depletion, environmental degradation, and social issues; and
3. foster transparency and long-termism in financial and economic activity.

(document from the European Commission: “Action Plan: Financing Sustainable Growth”)

**EU Taxonomy**
The EU Taxonomy is a classification system establishing a catalogue of environmentally sustainable economic activities. It should play an important role in helping the EU scale up sustainable investment and implementing the European Green Deal. The EU Taxonomy is meant to provide companies, investors, and policymakers with appropriate definitions for which economic activities can be considered environmentally sustainable. In this way, it aims to create security for investors, protect private investors from greenwashing, help companies to become more climate-friendly, mitigate market fragmentation, and help shift investments where they are most needed (based on ec.europa.eu).

**Greenwashing**
Companies giving a false impression of their environmental impact or benefits. Greenwashing misleads market actors and does not give due advantage to those companies that are making an effort to legitimately green their products and activities. It ultimately leads to a less green economy. To tackle this issue, the European Green Deal states “Companies making ‘green claims’ should substantiate these against a standard methodology to assess their impact on the environment.” (source: ec.europa.eu).

**MiFID II amendments**
The suitability assessment defined in MiFID II is amended with sustainability preferences. Investors must be asked about their sustainability preferences, which are then to be considered in every financial instrument transaction as well as when investing in a financial product (see also: Delegated Guideline (EU) 2021/1269 of the Commission).

**PAI (principal adverse impacts)**
SFDR recognizes principal adverse impacts as those impacts of investment decisions that result in negative effects on sustainability factors (Public Consultation Report on Taxonomy extension options linked to environmental objectives, July 2021).

**Paris-aligned**
Agreed at COP21 in Paris in 2015, the Paris Agreement's central aim is to strengthen the global response to the threat of climate change by keeping a global temperature rise this century well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5°C.

**SDGs (Sustainable Development Goals)**
The SDGs are 17 goals aiming to catalyze sustainable development set by the UN in 2015. They include goals such as no poverty, gender equality, decent work, sustainable consumption, climate action, and reduced inequalities (based on sdgs.un.org/goals).

**SFDR**
See Sustainable Financial Disclosure Regulation

**Sustainability factor**
Based on the definition of the EU Sustainable Finance Disclosure Regulation (SFDR): environmental, social and employee concerns, respect for human rights, and combating corruption and bribery (Regulation (EU) 2019/2088 of the European Parliament and of the Council).

**Sustainable finance**
Sustainable finance refers to the process of taking environmental, social, and governance (ESG) considerations into account when making investment decisions in the financial sector, leading to more long-term investments in sustainable economic activities and projects (source: ec.europa.eu).

**Sustainable investments**
A sustainable investment is an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labor relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff, and tax compliance (Regulation (EU) 2019/2088 of the European Parliament and of the Council).

**Sustainability risk**
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 (Regulation (EU) 2019/2088 of the European Parliament and of the Council).

**Sustainable Financial Disclosure Regulation (SFDR)**
The SFDR determines the sustainability disclosure obligations that makers of financial products and financial advisers have toward end-investors, concerning the integration of sustainability risks by financial market participants (e.g. asset managers, institutional investors, etc.), all entities offering financial products entailing the management of their clients' money, and financial advisers in all investment processes, and for financial products that pursue the objective of sustainable investment. As well, it defines disclosure obligations as regards adverse impacts on sustainability matters at entity and financial products levels, i.e. whether financial market participants and financial advisers consider negative externalities on environment and social justice of the investment decisions/advice and, if so, how this is reflected at the product level (based on ec.europa.eu).

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