Capital Partners
your partner for alternative investments

ESG Report 2023

"With increasing ESG regulations in various markets across the globe, this is an opportune moment to do a regulatory deep dive in our ESG Report."

Front cover: Production of lithium-ion batteries, Kion AG, Germany, LGT CP sustainable equity portfolio

Contents

Introduction

As we reflect on the state of environmental, social and governance (ESG) factors in our portfolios this year, we do so at a time of great flux in the field. The last 12 months have seen a surge of criticism around ESG, including notable voices across media and politics. Certain US states have even passed legislation that restricts the application of ESG standards. Critics have called out ESG practitioners for being unclear about their goals, using inadequate measurement tools, increasing costs and even lowering returns. Accusations fly about managers engaging in "greenwashing" or practicing "woke capitalism."

LGT Capital Partners (LGT CP) recognizes the challenges the industry is facing with ESG integration, and we agree that existing frameworks require better terminology specification and measurement. We are convinced, however, that ESG is an essential framework, when practiced with integrity and rigor, for identifying long-terms risks and opportunities that affect investors' bottom line, as well as people and planet.

As the debate about current ESG practices continues, regulators around the world are stepping in to demand greater clarity in defining and applying ESG concepts. The European Union (EU) has been an early mover in these efforts, introducing the Sustainable Finance Disclosure Regulation (SFDR) in 2021 and initiating the build-out of a comprehensive framework to define what is "green" in the EU Taxonomy. These efforts are designed to support the move towards a more sustainable economy and financial system. Close on the EU's heels is the UK Financial Conduct Authority (FCA), with its own Sustainability Disclosure Requirements (SDR) framework, which is slated to start implementation in 2024.

Meanwhile, the Securities and Exchange Commission (SEC) in the US has announced a proposal to enhance sustainable disclosures for funds, investment advisers and companies, where we expect further communication and finalization in the course of 2023. We anticipate seeing similar far-reaching ESG frameworks in various Asian countries in the coming years, building on existing ESG legislation already in effect in the region. A recent study found "a two-fold increase in the number of ESG policies in the region over the past five years, which has translated into increased corporate ESG disclosure across most APAC markets."[1]

With increasing focus on ESG regulations in various markets across the globe, we consider this an opportune moment to do a regulatory "deep dive" in our ESG Report. Whereas past reports have focused mainly on ESG outcomes, this year we continue to do so, but with an emphasis on how we are meeting regulatory requirements. Given that the SFDR is the most wide-reaching ESG regulatory framework currently implemented, setting the bar for ESG investing for all investors with EU exposure, it has global reach. We believe that showing how LGT CP complies with EU requirements illustrates our broader approach to implementing ESG and meeting regulatory requirements as they arise.

In each of our offerings – private equity, private debt, insurance-linked securities (ILS), hedge fund and long-only multi-manager strategies, direct equity and fixed income – we look at the various ESG approaches we apply and how these align with EU requirements. In doing so, we reveal complexity as well as the rigor of different ESG frameworks, as each asset class has its own challenges to overcome in achieving compliance.

We recognize that we are in the early innings of having truly global regulatory standards on sustainability, but the clear steps taken by regional actors, especially the EU, is setting the tone for things to come. As these developments are new to each market participant, professional investors are working to implement new standards in the best way possible. We expect this area to evolve further over time, as additional parts of the sustainability regulations come into force and as practitioners gain more experience in implementation.

We hope you find this report insightful and, as always, we welcome your feedback.

On behalf of LGT Capital Partners,

Tycho Sneyers
Chairman of the ESG Committee
Member of the UN PRI Board

[1] GS SUSTAIN: APAC ESG Regulation, February 2022.

Facts and figures

381
MANAGERS
ASSESSED ON ESG

70%
OF PRIVATE DEBT PORTFOLIO
COMPANIES TRACK THEIR WATER
OR ENERGY CONSUMPTION

55%
OF PRIVATE EQUITY MANAGERS
ASSESS AND MEASURE CLIMATE
CHANGE FACTORS

81%
OF PRIVATE DEBT PORTFOLIO
COMPANIES TRACK CARBON EMISSIONS

69%
OF PRIVATE EQUITY MANAGERS
HAVE A DEI POLICY IN PLACE

Private equity

Over the last year, we have stepped up our focus on the application of SFDR within our private equity investments, in line with growing regulatory demands. These efforts have enabled us to align all new investment offerings – including primaries, secondaries and directs – with Article 8 requirements under SFDR, which "promote environmental and/or social (E&S) characteristics." This is in addition to aligning our impact private equity offering with Article 9 requirements because of its explicit sustainable investment objective and impact focus. In total, eight LGT CP private equity offerings now align with Article 8 requirements under SFDR and one with Article 9 requirements.

Our SFDR Article 8 strategies "promote E&S characteristics" by taking into account ESG-related factors in their:

- asset selection process, by considering the commitments and policies on ESG integration by the investments themselves or the managers with whom we partner
- investment monitoring process, by performing regular ESG assessments of the investments and managers with whom we partner

The core of our strategy for measuring whether our primary, secondary and direct investments promote environmental or social characteristics is our proprietary ESG rating system (described in detail on page 7). Within this system, we rate managers on their ESG practices in the areas of manager commitment to ESG, investment process, ownership and reporting. Managers receive a score of 1 to 4 (where 1 = excellent, 2 = good, 3 = fair, 4 = poor) on each of the four areas, resulting in an overall rating for each manager. This is subsequently documented in our monitoring system. The assessments are a key part of the investment books prepared for each deal, which the Investment Committee (IC) uses in reaching a decision. Managers with a rating of 4 are typically excluded from new investments. The team also uses the rating for post-investment monitoring and engagement, and will often work with 3-rated managers to provide advice and encouragement on developing their approach to ESG.

Data enhancement efforts to address Principle Adverse Impacts

LGT CP is committed to considering the Principle Adverse Impacts (PAI) of investments in relevant portfolios on a best-effort basis.[2] For many investments in the public markets, this is possible due to the availability of large data sets reported by public companies. However, the availability and quality of relevant data in the private equity industry is still limited. This is due to both the lack of common reporting standards on one hand, and the lack of non-financial reporting obligations for private companies on the other.

In light of these challenges, a group of leading private equity investors and managers, including LGT CP, joined forces in the ESG Data Convergence Initiative (EDCI). The initiative aims to streamline the private investment industry's historically fragmented approach to collecting and reporting on ESG data. Participating firms agree to report on a core set of clearly defined, business relevant, comparable ESG metrics drawn from existing frameworks. The advantage of these metrics is that they are material for practically any private equity-owned business, regardless of the size or industry. They also cover a good share of the mandatory (and some voluntary) PAIs, so they can be used for SFDR disclosure.

In addition, this initiative allows managers and portfolio companies to benchmark their ESG performance against peers and work toward improvements in a transparent way. At the time of publication of this report, more than 275 investors have joined the EDCI. Within LGT CP's portfolios, so far 35% of managers have begun reporting in line with the EDCI, which is a good start, but shows that there is much more work to be done.

As part of LGT CP's participation in EDCI, we expect to receive detailed key performance indicator (KPI) information for at least one-third of our portfolio, and this is expected to grow over time. This will allow us to improve our reporting on PAI indicators and provide better insight into the carbon footprint of our portfolios, which we have committed to reducing as part of our broader commitment to net zero. We are confident that we can build a meaningful data set over time, as many of our managers are already active in ESG data collection and reporting. One example of this is GHO Capital, one of Europe's leading private equity investors in the healthcare industry, which we have highlighted in a case study on page 9 of this report.

[2] All product-level specifications on PAIs, including whether a product considers such PAIs, is provided for in the associated pre-contractual documentation. Only products which have opted-in are considered in the reported outcomes.

ESG assessment of managers – how we do it

Each year, we conduct an assessment of managers, which forms part of the firm's larger ESG due diligence, monitoring and manager engagement process. The assessment serves a two-fold purpose. First, it shows our investors the extent to which managers are considering ESG factors in their investment, ownership and reporting practices. Second, the assessment facilitates our engagement with managers on ESG, highlighting excellence in implementation and flagging areas for improvement.

In the assessment, we evaluate managers on four key areas of ESG practice:

- Manager commitment – the extent to which they have demonstrated their commitment to ESG through actions such as defining a policy, committing to an industry initiative like the Principles for Responsible Investment (PRI) and engaging with their portfolio companies
- Investment process – the extent to which they have formally integrated ESG into their investment processes, using it as a framework for evaluating investments and identifying areas for improvement
- Ownership – the extent to which they have exhibited active ownership through activities like defining ESG guidelines, establishing KPIs or assigning ESG responsibilities for portfolio companies
- Reporting – the extent to which they have provided regular and relevant reporting on ESG on a portfolio company level and on the aggregate fund level

Managers receive a score of 1 to 4 (where 1 = excellent and 4 = poor) on each of the four areas, resulting in an overall rating for each manager, which is then documented in our monitoring system. Managers who receive low scores (3 or 4) on specific indicators are encouraged to improve over time.

Rating	Description
1	The manager is genuinely committed to ESG with institutional processes in place. It applies ESG criteria in investment decision-making, is an active owner and reports on ESG. Examples include: strong responsible investment framework, strong independent oversight on ESG, extensive ESG integration in investment process and comprehensive reporting on ESG.
2	The manager takes concrete steps to integrate ESG considerations into its approach and investment process. The ESG process is systematic, institutionalized and largely satisfactory, but LGT CP may have identified shortcomings in certain areas. Examples include: good responsible investment policy, carbon footprint monitoring, clear internal oversight on ESG topics and a good level of reporting on ESG.
3	The manager demonstrates some commitment to ESG and recognizes sustainability-related risks, but lacks fully institutionalized processes. Examples include: application of negative exclusions, signatory of established ESG standards other than UN PRI and maintains an ESG policy.
4	The manager fails to meet the minimum systematic ESG criteria of LGT CP. Examples include: not being a signatory of global responsible investment standards, little to no consideration for ESG in investment process or policy and not an active shareholder in ESG.

Source: LGT Capital Partners

Leveraging existing and innovative data sources

This year's ESG assessment of private equity managers in our portfolios shows that our managers are at various stages of development in their ESG data collection practices relating to SFDR, as 27% have begun tracking PAI indicators. Given this, we continue to leverage alternative data sources in line with our commitment to considering PAIs on a best-efforts basis. An important instrument for this is our ESG Cockpit, a proprietary tool that draws on publicly available ESG data to generate ESG scores for individual listed securities. It analyzes the ESG attributes of a company's operations, ESG controversies and the impact of the company's products and services on the Sustainable Development Goals (SDGs). While we build up our private equity database, we use the ESG Cockpit to conduct proxy analyses for certain PAI indicators within our private equity portfolios, based on averages of public market companies in the same industry. We believe that this approach provides meaningful insights at portfolio level, as potential deviations for individual companies would balance each other out.

In addition, this sector-based approach to PAI analysis enables us to respond to client requests related to the European ESG Template (EET) under SFDR and other data-driven ESG disclosures.

Figure 1: ESG metrics tracked by the ESG Data Convergence Initiative

GHG Emissions	Renewable energy	Work-related injuries	Net new hires	Diversity	Employee engagement
Scope 1	% Renewable energy use	Injuries	New hires	% women on board	Employee survey (Y/N)
Scope 2		Fatalities	Turnover	% under-represented groups* (optional)	Employee survey response (optional)
Scope 3 (optional)		Days lost due to injury		% LGBTQ (optional)	
				% women in C-suite (optional)	

*required for US only in 2021/2022 cycle, optional for rest of world, optional for LGBTQ

Source: ESG Data Convergence Initiative

GHO Capital leverages ESG data insights to create value

GHO Capital is a European specialist investor in global healthcare with approximately EUR 6 billion of assets under management.[3] The firm was founded in 2014 with the purpose of investing to deliver "Better, Faster and More Accessible" healthcare for society. GHO Capital is headquartered in London, UK, and comprises a team of 43 members.[4]

Embedding ESG in the investment process

GHO Capital has made significant progress in embedding material ESG considerations into each stage of its investment process to help mitigate risk, make better-informed investment decisions and build more sustainable businesses. The firm follows a structured approach along the investment cycle, from deal sourcing to exit. Each platform investment undergoes ESG due diligence by a third-party specialist, informed by an initial materiality-based assessment by GHO Capital, to identify key risks and opportunities. These findings are transparently presented at Investment Committee meetings.

Once invested, ESG diligence findings are also used to highlight areas for improvement, detailed in the portfolio company's 100- or 180-day plans. Progress on ESG topics is monitored through regular meetings, and targets are addressed with portfolio companies at board meetings. When nearing the exit phase, GHO Capital's deal team can assess a portfolio company's ESG progress since acquisition, using, when available, the pre-investment ESG review as a benchmark. Where appropriate, ESG vendor due diligence is completed by third-party providers. This information is incorporated into exit documentation to demonstrate the value of ESG integration to prospective buyers.

Collecting and reporting ESG data

In 2022, GHO Capital rolled out a non-financial reporting program across the companies in its portfolio. The program allows the firm to understand where portfolio companies stand vis-à-vis a set of ESG indicators. The indicator set covers, for example, greenhouse gas emissions, diversity metrics, employee engagement statistics, and employee attrition. GHO Capital reports all ESG metrics on a voluntary basis at portfolio company-level on an annual basis. The first reporting took place as part of the firm's Annual Report for the financial year 2022.

Creating value

This big effort contributes to increased transparency along the capital value chain. It enables investors such as LGT CP to improve portfolio insights and comply with their own reporting obligations. In addition, according to GHO Capital, the program helps the manager deepen its evidence-based ESG picture of the portfolio and enables the firm to track progress. In a word, the data helps to inform the value creation process.

For example, on the back of this data, the portfolio company Sterling Pharma took steps to reduce climate risk and deliver energy savings in close collaboration with GHO Capital. This included investing in an anaerobic digester that converts waste – both Sterling's and that processed for third parties for a fee – into biomethane. The gas can then be used in Sterling's production facility or sold into the UK's gas grid. This resulted in energy savings of GBP 2 million in 2022, with another GBP 4 million in savings expected for 2023, as well as expected additional revenues of GBP 6.5 million from waste conversion activities.

[3] Based on commitments as of 31 December 2022.
[4] As of 31 December 2022.
Source: GHO Capital

ESG ratings show portfolio developments over ten years

Our ESG rating framework provides a long lens for assessing how our managers have progressed on ESG over the years, which helps to cultivate high ESG standards in our portfolios. These ratings further enable us to better fulfill our commitment to "promoting E&S characteristics." For example, in ten years of assessing our global group of buyout managers on ESG, which today includes 309 managers, we have observed steady progress in improving ESG practices. Starting from a low base in 2014, only 27% of managers had robust systems in place – as indicated by ratings of 1 or 2 – for managing ESG issues, but now a significant majority do. As of 2023, 70% of managers have achieved ESG ratings of 1 or 2.

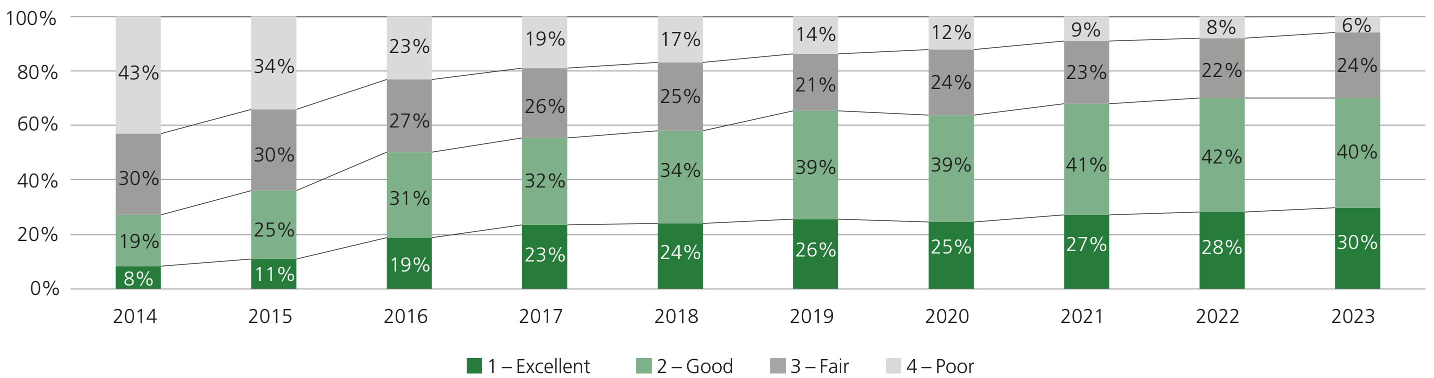
The breakdown in ratings has remained relatively stable over the last few years, but we continue to see ESG improvements by managers. Over the last 12 months, 17 managers have improved their ESG ratings as a result of concrete steps taken to enhance their approach.

In one example, a European buyout manager earned a 1 rating, after it enhanced the way the team incorporates ESG issues into value creation plans for companies. Shortly after acquisition, the team engages an external partner to carry out a comprehensive ESG review based on the manager's "7 ESG Pillars," which range from reducing the environmental footprint to improving working conditions and promoting diversity. Based on the review, the manager then develops an ESG action plan with a number of KPIs that it tracks throughout the holding period. The action plans are aimed at mitigating any ESG risks discovered during the initial review as well as identifying opportunities for creating value.

Ratings also show continued regional variation in ESG practices

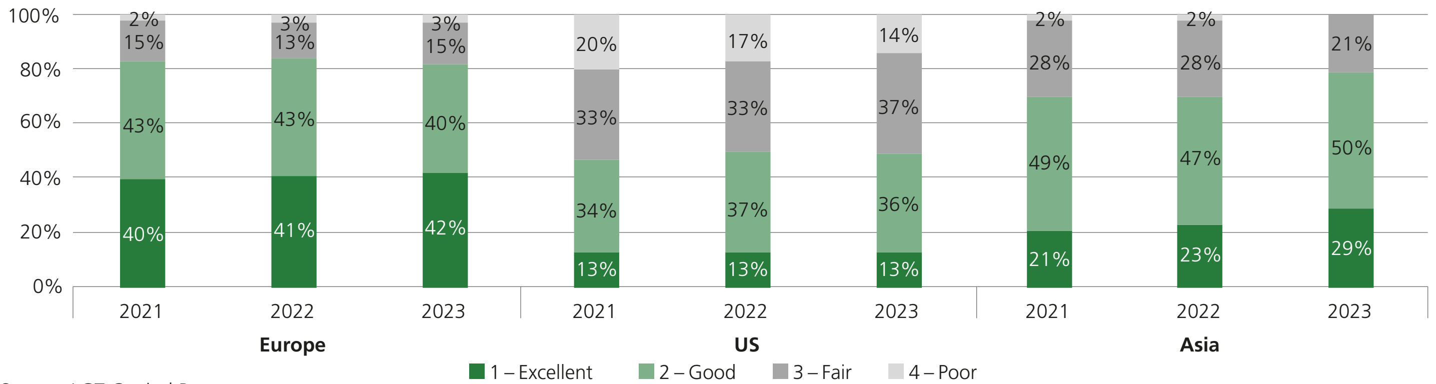
Our ESG rating system also reveals significant regional variation in ESG practices, with Europe in the lead, followed by Asia and the US. As of 2023, 82% of European managers have achieved ESG ratings of 1 or 2, while 79% of Asian managers have, with the US trailing at 49%. The most noticeable difference between the three regions is the fact that the overwhelming majority of managers in both Europe and Asia hold these top ratings, while in the US just under half of the managers do. Furthermore, the data from Asia suggests a slight improving trend over the last three years, while practices in Europe and the US have remained relatively stable.

Figure 2: ESG ratings globally

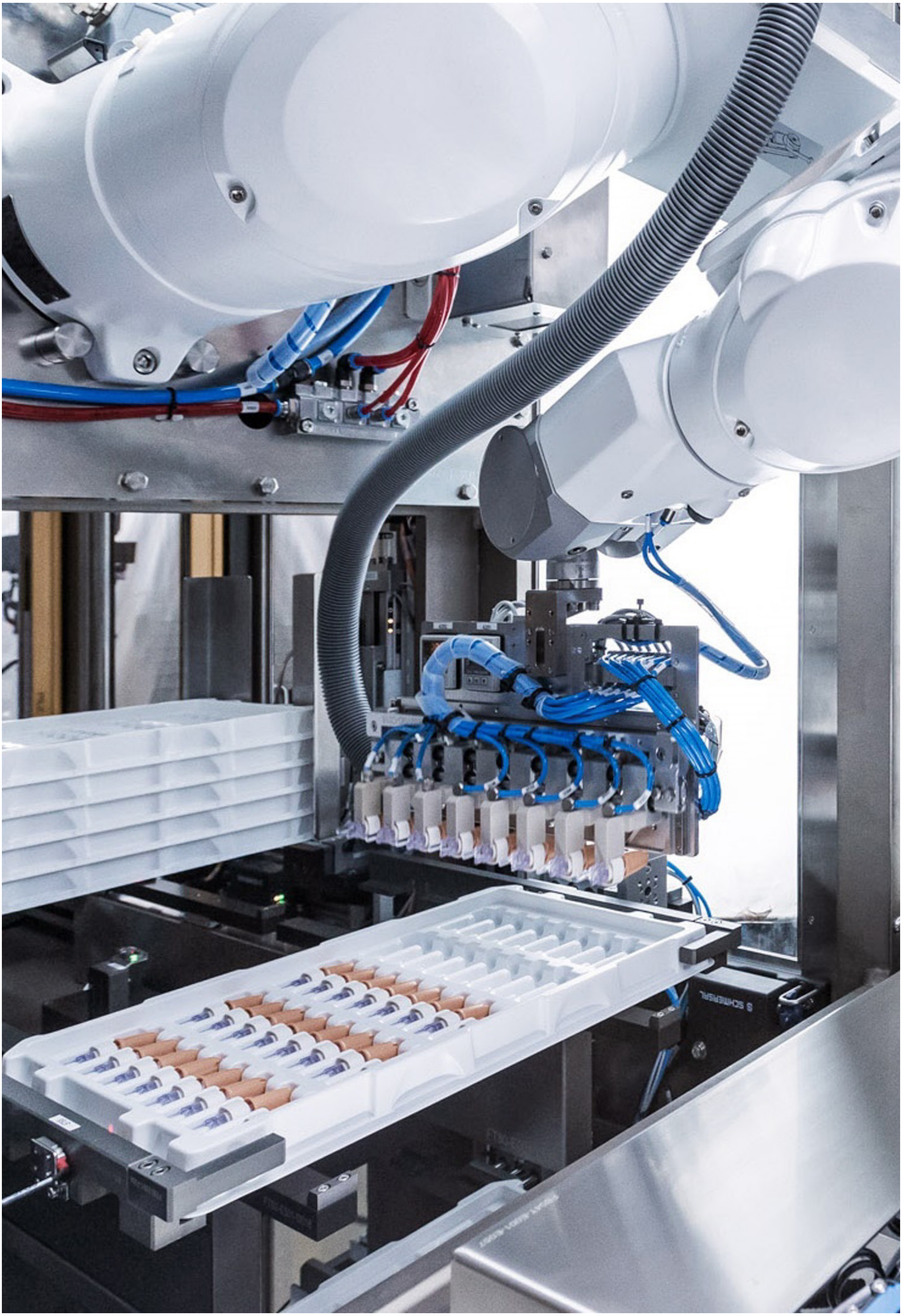


Source: LGT Capital Partners

Figure 3: ESG ratings by region



Source: LGT Capital Partners



Autoinjector manufacturing, SHL Medical, Switzerland, LGT CP private equity portfolio

ESG assessments also show how managers are performing on climate action and DEI

The ESG assessments we carry out each year enable us to look at particular aspects of managers' ESG practices, such as climate action and diversity, equity and inclusion (DEI). These topics have attracted greater investor concern in recent years, so we require managers to report on their efforts in these areas. They also provide a lens for assessing how managers "promote E&S characteristics" in their portfolio.

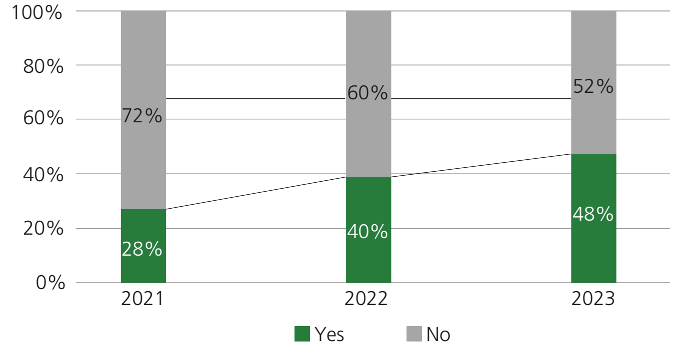
Responding to the challenge of climate change

We observe a positive three-year trend in the proportion of managers that assess and measure climate change-related risks and opportunities, as 55% of managers do so today versus 32% two years ago. As with most ESG metrics, Europe and Asia are ahead, with 62% and 60%, respectively, actively managing climate change risks, while 43% of US managers do.

We also see a positive trendline for managers who monitor greenhouse gas (GHG) emissions, as 48% do so today, versus 28% two years ago. We take this as an encouraging sign, as it suggests that initial risk assessments are generally followed up with ongoing monitoring.

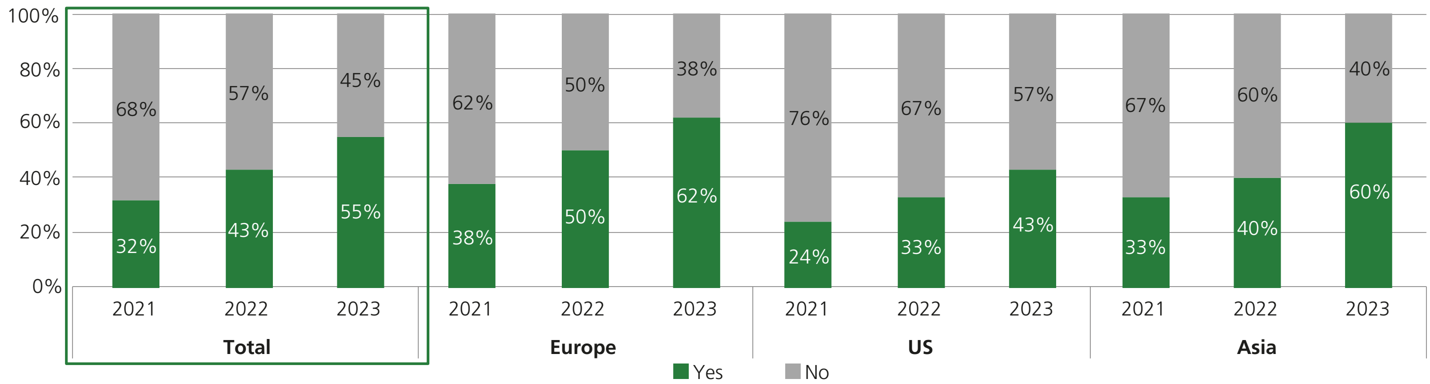
One US buyout manager illustrates how firms are working to integrate climate change-related metrics into their investment and ownership processes. The manager has begun collecting Scope 1 and Scope 2 GHG emissions data in line with EDCI guidelines, which the team uses to inform ESG priorities and actions for each portfolio company. The manager initially launched a pilot program for data collection at one company in 2021 and is now in the process of rolling it out for the rest of the portfolio companies in the firm's latest fund.

Figure 5: Proportion of managers that monitor greenhouse gas of portfolio companies



Source: LGT Capital Partners

Figure 4: Proportion of managers that assess and measure climate change-related risks and opportunities in their portfolios



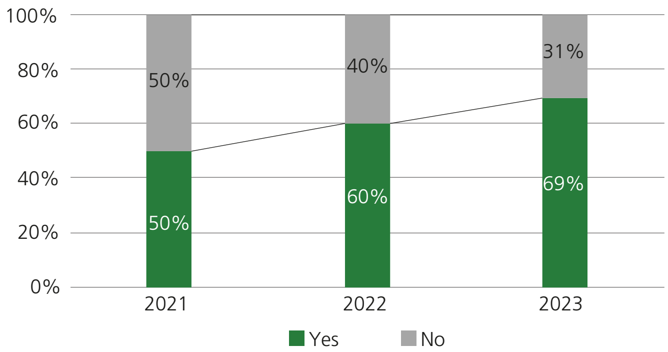
Source: LGT Capital Partners

Taking action on DEI

Like with climate change, manager efforts on DEI have again increased over the last year, and we see a similar positive three-year trend. The proportion of managers with a DEI policy in place has risen to 69%, up from 50% two years ago. Manager DEI policies vary greatly, from those that focus only on the manager's own firm to policies that also include provisions related to investment decision-making and portfolio companies.

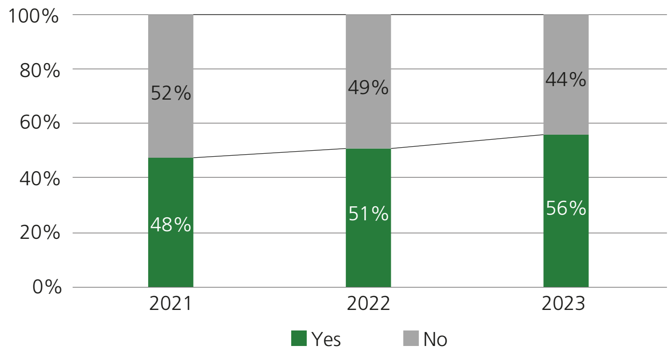
Alongside having a DEI policy, we also observe an uptick of five percentage points in the share of managers that consider DEI when selecting investments, from 51% last year to 56% today.

Figure 6: Proportion of managers that have a DEI policy in place



Source: LGT Capital Partners

Figure 7: Proportion of managers that consider DEI in their investment decisions



Source: LGT Capital Partners

How we meet Article 9 requirements

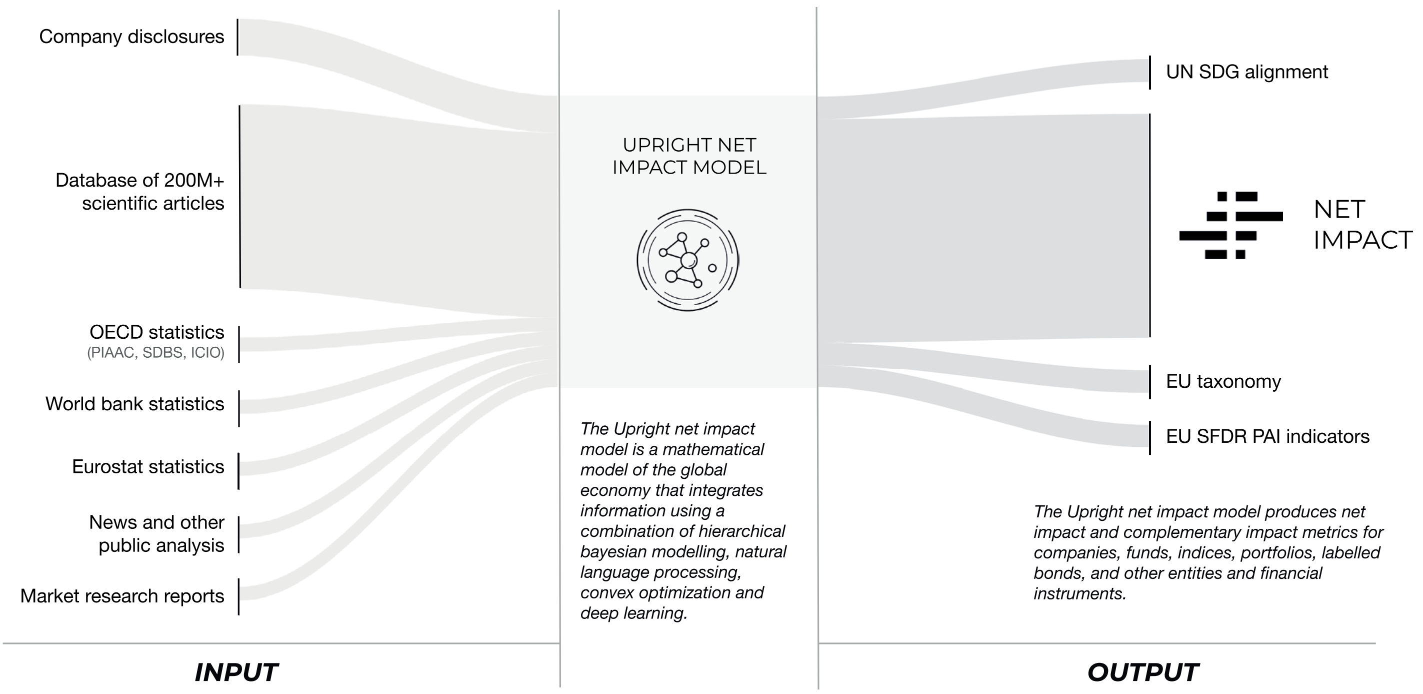
In addition to our Article 8 funds under SFDR, we strive to grow our impact offering over time. In 2022, we closed our flagship private equity impact strategy and are currently investing the fund. In early 2023, we launched our private debt impact strategy with a similar impact approach. These strategies align with Article 9 requirements under SFDR because they have sustainable investment as an explicit objective, backed by binding quantitative commitments on ESG and sustainability. There is also an expectation that all investments comply with certain minimum environmental and social safeguards. The regulation allows a degree of flexibility in defining the impact objectives to be targeted by a fund, but it requires financial market participants to be transparent about the indicators used to measure attainment of the goals. Managers are also required to commit to quantitative thresholds and to disclose progress in an annual report.

Sustainability objectives and substantial contribution

Our impact strategies broadly invest into three themes: climate action, healthcare and inclusive growth, which includes investments in education and financial inclusion. Every new investment opportunity is vetted comprehensively to determine whether it fits with our impact strategy, by applying a proprietary impact framework that is based on best practices. For impact monitoring, we collect investment-specific performance indicators from our managers and investee companies. These metrics are communicated to investors as part of quarterly and annual reports. However, given the broad thematic scope, it is challenging to define sustainability objectives and related metrics that can be applied across the entire portfolio. In response, we explored ways to measure our investee companies' contribution to sustainability objectives in a comparable way, which led us to partner with the Helsinki-based technology company Upright.

This partnership enables us to leverage an innovative, data-driven quantification model that measures both the positive and negative impact created by the underlying portfolio companies, which are summarized into comparable "net impact profiles." The model is based on machine learning, open-source science and information on the products and services provided by the underlying companies. Using Natural Language Processing (NLP) techniques, the model can assess the content of scientific articles and summarize their findings about how various company products and services impact the environment, human health and society along their entire value chain.

Figure 8: Data-driven model for impact measurement



Source: Upright and LGT Capital Partners

The analysis results in a net impact ratio, which allows the LGT CP team to determine whether a company's contribution to environmental and social objectives clearly outweighs any possible environmental and social costs. In doing so, we can assess whether a company makes a "substantial contribution to sustainability" outcomes as required by SFDR.

Do no significant harm

We also use the net impact ratio analysis to determine whether an investment passes the "do no significant harm" (DNSH) test. Since the net impact ratio captures both positive and adverse impacts on society, health and the environment, the separate elements of the ratio can also be used to assess the DNSH requirement. We do that by setting a minimum threshold score for each element, below which an investment does not pass the DNSH test and is therefore uninvestable. In addition, we consider the PAI indicators. Where available, we use disclosed PAI data from our investee companies, otherwise we leverage Upright's quantification model to fill in the gaps.

Minimum safeguards

In addition to the DNSH test, we introduced additional safeguards to ensure no sustainability objectives are harmed. We use a news-based controversy check, both pre-investment and during the ownership phase. Each investee company is monitored by external data provider RepRisk, which screens over 100,000 publication channels in more than 20 languages worldwide. The issues monitored are aligned with global corporate sustainability frameworks, such as the UN Global Compact, the OECD Guidelines for Multinational Enterprises, and the UN Guiding Principles on Business and Human Rights. Investments in companies that were involved in at least one significant and material risk incident in the last five calendar years are excluded from the investment universe.

Good governance

Finally, we ensure that all investee companies follow good governance standards by vetting new opportunities for this criterion as part of the regular ESG due diligence process. This check includes, among other topics, an assessment of management structures, good employee relations, remuneration of staff and tax compliance. The good governance criterion is tested through the manager rating and specific details related to governance. If any of these details (or indicators) show a specific weak score, the good governance criterion is not met and the investment cannot be considered sustainable.

Bringing all of these elements together, along with the regular ESG engagement we have with managers and companies, we are able to fulfil the requirements of SFDR Article 9.

SFDR and EU Taxonomy at a glance

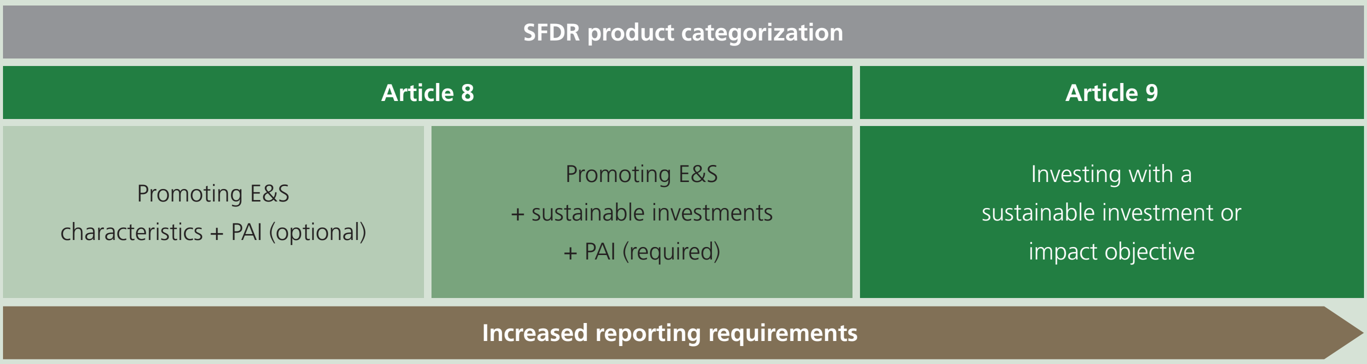
The SFDR is part of the EU Action Plan on Sustainable Finance, and ultimately the European Green Deal, with the specific aim to support the move toward a more sustainable financial system. The SFDR's aim is to provide transparency to investors about the environmental and social characteristics of financial products. The regulation introduces a core set of requirements for asset managers:

- Transparency – asset managers must disclose ESG features of investment programs (including risks) in pre-contractual documentation, on their websites and in periodic reporting
- Standardization – PAI, a set of standard indicators to measure negative effects
- Comparability – a common, clear and comparable set of rules for defining sustainability, which utilizes templates, making it easier for investors to compare the ESG features of products

Aside from reorienting further capital flows towards sustainable outcomes, the goal of the EU is to prevent asset managers from "greenwashing." Under SFDR, investment managers need to clearly spell out for each investment program how they consider sustainability factors, with specific disclosures required, depending on the type of fund:

- "Article 8" includes offerings that promote social and/or environmental characteristics. Such strategies give binding ESG-related commitments, for example, to sustainable investments or other ESG features, and they may consider PAIs
- "Article 9" includes offerings that have an outright sustainable investment objective and a (high) binding sustainable investment commitment. These strategies also consider PAIs
- "Article 6" includes offerings that do not meet the criteria of Article 8 or 9, but still have a reporting and consider sustainability-related risks

Figure 9: Overview of SFDR product types



Source: LGT Capital Partners

The EU Taxonomy and its challenges

One of the major building blocks of the EU Action Plan on Sustainable Finance is the EU Taxonomy, which in its initial iteration creates a classification system for environmentally sustainable economic activities. The goal is to create a common understanding of what activities are "sustainable." The framework is directly linked to the SFDR regulation, as the EU Taxonomy effectively defines green or environmentally sustainable investments in an SFDR context.

The EU Taxonomy is still a work in progress, as only two of the six defined environmental objectives – climate change mitigation and adaptation – have been worked out in detail. The remaining four objectives are currently in draft form and are expected to apply as of January 2024. We look forward to seeing the Taxonomy develop into a fully fleshed out framework that we can integrate into our investment processes, which includes all six environmental objectives alongside a Social Taxonomy. In the meantime, there are two key challenges that prevent us from doing so at the current time:

1. Lack of reliable, relevant company-level data
   The EU Taxonomy defines a set of economic activities that could be considered sustainable, if they meet certain criteria that are also defined by the Taxonomy. The challenge is that there are almost no reported disclosures available from companies that correspond to the defined activities or the criteria for determining Taxonomy alignment. Data vendors have made creative attempts to overcome this hurdle by using estimates and producing assessments such as "likely aligned" or "potentially aligned," but we still find it challenging to work with an incomplete set of regulations. As a result, we do not currently apply the EU Taxonomy screening criteria and do not make any claims on the level of Taxonomy-aligned investments in our direct equity and fixed income portfolios.

2. Limited coverage of economic activities
   At the moment, the EU Taxonomy only meaningfully incorporates the themes of climate change adaptation and mitigation. Using the data we sourced on the Taxonomy from one of our vendors, we were able to classify approximately 10% of company revenues from the MSCI World index as eligible for the Taxonomy alignment, resulting in around 2% of company revenues actually aligned with the Taxonomy. While such coverage may be suitable for certain investment strategies or specific securities that are focused exclusively on climate change, it is not well suited to diversified portfolios.

Private debt

ESG integration in private debt

Our flagship private debt strategy aligns with Article 8 requirements under SFDR, based on the comprehensive ESG assessment that is an integral part of the investment process. The ESG assessment enables deal teams to select assets with a positive ESG profile and helps the strategy to "promote E&S characteristics."

We developed a process for asset selection and monitoring that includes six different ESG and sustainability factors, which we assess using a combination of proprietary tools and commonly used industry frameworks. Each of the six factors is assigned a score on a scale of 1 to 4 (where 1 is the best and 4 is the worst), with the final ESG risk score calculated as a weighted average of all six factors. Pre-investment, the assessment guides investment decision-making, enabling deal teams to identify companies that "promote E&S" as well as those that fall short. Post-investment, reassessing each investee company annually enables us to engage productively with companies on ESG as well as fulfill our reporting requirements under SFDR.

In assessing companies on ESG, deal teams look at:

1. **ESG controversy check** – we consider any ESG controversies identified by our risk monitoring solution, flagging controversial ESG issues. We also take into account any ESG sensitivities identified, typically related to the business model of the company or the market in which it operates.

2. **Sponsor rating** – we assess the sponsor's overall approach to ESG, leveraging existing due diligence material where available. This includes any ESG assessments of the manager, which may have been prepared as part of our private markets ESG efforts. Insights gained from this review are documented in an assessment template in which we rate the manager on various aspects of ESG practice. This culminates in an overall ESG rating for the manager, based on a scale of 1 to 4. If there is no ESG rating produced internally on the sponsor, we carry out a qualitative assessment of the manager's ESG practices based on publicly available information and our own due diligence on the manager.

3. **SDG impact assessment** – using the company's industry sector as a proxy, we use our proprietary ESG assessment tool, the ESG Cockpit, to determine whether the company is likely to have any positive or negative impacts on the SDGs. The deal team also engage with management, the private equity sponsor and the deal diligence provider to evaluate the deal more broadly against the SDGs.

4. **PAIs** – where possible, we assess investee companies against the PAI indicators to ensure we consider all ESG sustainability risks at asset level.

5. **Climate resilience** – we systematically consider risks related to climate change while assessing the materiality of these risks for any given business. Towards this end, we developed our own Climate Resilience Framework, which aligns with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The framework enables us to analyze a company's climate resilience to physical risks (related to climate change itself) and transition risks (related to the transition to a lower carbon economy). On the back of our analysis, we rate the materiality of such climate risks. This allows for informed asset selection based on climate change considerations and for the subsequent monitoring of the portfolio's composition according to the risks identified. Furthermore, we assess the carbon footprint of the investment opportunity under review, using actual data when available and public market sub-industry averages as a proxy for the company's actual footprint.

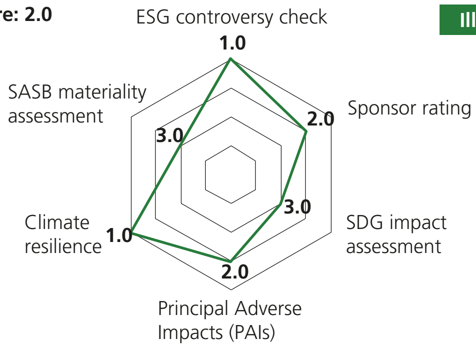
6. **Materiality assessment** – we carry out a review of the various ESG factors that are defined as material for the given industry by the Sustainability Accounting Standards Board (SASB). If applicable, the deal team will work with the sponsor and management to consider whether any of these ESG factors should be monitored in the company reporting and management information for better comparisons with sector best practice.

The culmination of this assessment is a quantitative output of the investment's overall ESG profile. This score is produced across the portfolio and monitored annually when our investee companies return their annual ESG surveys. While the scoring has an element of subjective analysis, it also allows the team to track portfolio trends on specific factors and in aggregate. An example output is shown in Figure 10.

Figure 10: Example ESG score for a portfolio company

Total score: 2.0

Illustrative



Source: LGT Capital Partners

Restored prairie land, Roeslein Alternative Energy, Missouri, LGT CP private equity portfolio

ESG throughout the investment process

The six-factor assessment enables the deal team to establish an ESG profile of the prospective company at the very beginning of the investment process. The deal team will approach the ESG Committee for advice and guidance if there are any concerns from an ESG perspective. Generally, when the team identifies a material ESG issue that they believe is too serious or cannot be addressed or mitigated by the sponsor, they decline the investment at this early stage. Assuming the deal passes this initial check, the deal team will present their ESG analysis (based on the ESG scoring model) to the IC, including a comprehensive summary of the findings from the six-factor analysis. The IC considers any relevant risks or noteworthy outputs from the ESG analysis in reaching an investment decision. Post-investment, the team tracks a set of 16 ESG-related KPIs on the companies in the private debt portfolio, which provide insights on how companies are responding to ESG challenges and opportunities.

Portfolio company KPIs

In Figure 11, we aggregate the KPIs from our portfolio of 40 companies to provide a snapshot of how our private debt portfolio overall is performing on ESG.[5] The portfolio comprises small and mid-sized European companies, with a tilt towards those in the service, technology and light industrial sectors.

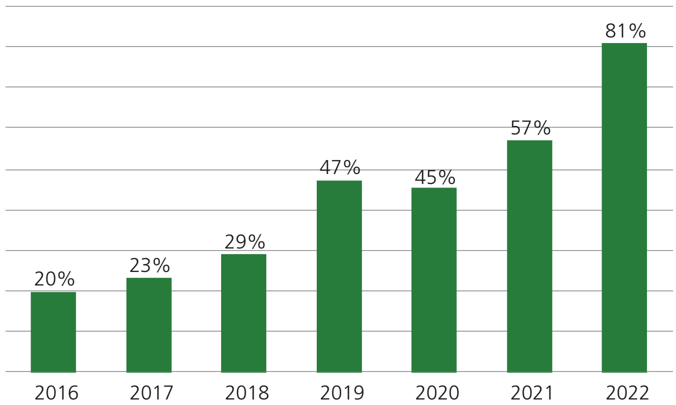
For one key indicator, assessing carbon emissions, we observe a positive long-term trend (Figure 12), as the proportion of companies disclosing this information has grown significantly since 2016. Currently, 81% of portfolio companies report on CO_2 emissions, which is a significant increase over the last year. It shows that tracking carbon emissions has become mainstream for our direct private debt portfolio companies.

Figure 11: ESG KPIs

ESG metric		Portfolio score
General	Implemented an ESG policy	78%
	Track ESG initiatives with KPIs and reports	70%
	No ESG-related litigation	100%
Environment	Implemented an environmental policy	62%
	Assess carbon footprint	81%
	Track water or energy consumption	70%
	Track waste volumes, cost and % recycled	54%
Social	Net job creation (increase in staff over last 12 months)	73%
	Provide training opportunities	95%
	Company-wide profit sharing	49%
	Proportion of women in executive management committees	28%
	Proportion of female employees in the portfolio	44%
Governance	One or more independent board member(s)	70%
	Average number of board meetings per year	10
	Adhere to a corporate code of ethics	81%
	Established independent board committees (management, audit, remuneration, etc.)	59%

Source: LGT Capital Partners

Figure 12: Proportion of companies assessing their carbon emissions



Source: LGT Capital Partners

[5] Based on our survey of LGT CP private debt portfolio companies as of 31 December 2022.

Carbon footprint compared to the benchmark

We assess the carbon footprint of our private debt portfolio using a mix of industry proxies and actual company reported Scope 1 and 2 carbon emissions.[6] The portfolio's GHG emissions intensity of 8.7 metric tons of carbon equivalent (tCO_2e) per million EUR invested is considerably lower than its carbon budget of 28.4 tCO_2e per million EUR invested, which means the portfolio is well positioned to achieve net zero by 2050 or sooner.

Figure 13: LGT CP portfolio vs. net zero budget

Portfolio CO_2 intensity	8.7 tCO_2e emissions per million EUR invested
Portfolio budget for net zero by 2050 or sooner	28.4 tCO_2e emissions per million EUR invested

Source: LGT Capital Partners

LGT CP launches dedicated private debt impact strategy

LGT CP is launching a dedicated impact private debt strategy in 2023, which aligns with Article 9 requirements under SFDR. The strategy will invest in assets that directly contribute to the global challenges of social inequality ("Inclusive Growth"), climate change ("Climate Action") and inadequate healthcare ("Healthcare"). Each prospective investment will undergo a thorough impact analysis using the same impact framework established for our private equity impact strategy, which held a final close in 2022. The impact analysis is carried out alongside the usual ESG assessment. The growth in the investible impact universe across Europe is clear, so targeting investments in businesses that make measurable contributions to global social and environmental challenges was a logical next step for LGT CP's private debt platform.

[6] Based on a portfolio size of 40 companies and the share of capital invested by LGT Private Debt in relation to total enterprise value as of 31 December 2022. "Portfolio CO_2 intensity" based on a mix of top-down (industry proxies) and bottom-up (company level assessments) CO_2 footprint assessments. Budget estimations are based on our value added approach in conjunction with the Net Zero Emissions by 2050 Scenarios (NZE) developed by the International Energy Agency (IEA).

Insurance-linked strategies (ILS)

Insurance-linked strategies (ILS) focus on pure event-driven risk, with investors assuming the role of quasi-reinsurers. Investors receive premiums (investment income) in exchange for acting as a backstop to insurance and reinsurance companies in the event of a very severe catastrophe, such as a strong earthquake or a hurricane. The asset class has long attracted investors for its low correlation to financial markets, while the recent introduction of SFDR has further highlighted the sustainability dimensions of ILS.

The EU Taxonomy specifically lists non-life catastrophe insurance, LGT CP's area of ILS specialization, as a sustainable "enabling" economic activity. The EU has recognized that ILS investments act to improve the performance of wide-ranging economic activities for mitigating or adapting to climate change. For example, homeowners and business entrepreneurs choose to buy protection against climate-related perils, such as hurricanes or floods, which effectively assigns a cost to such climate-related insurance events (by charging a premium for the insurance cover). Increasing insurance premiums brought on by climate change is thought to incentivize society to invest in preventive measures, which should ultimately increase communities' resilience to natural disasters.

These dynamics mean that a large share of ILS investment activity can be considered sustainable. However, the EU Taxonomy currently focuses only on climate-related perils, such as windstorms or floods, which are considered within the framework as "enabling" activities. Non-climate related insurance risks, such as earthquakes, are not covered by the EU Taxonomy, but transactions with such risks can still be considered sustainable if the counterparty adheres to sound ESG practices and the transaction's exposure to heavy industry is no more than 5%.

From this promising starting point, LGT CP considers its ILS funds to align with Article 8 requirements under SFDR, since these investments "promote E&S characteristics." As part of the investment process, we work to ensure that both the counterparty and the underlying transaction meet the various SFDR requirements for Article 8 alignment. To this end, we have developed a two-step ESG analysis, which is described in detail further below. We first analyze whether the deal counterparty (typically an insurance or reinsurance company based in North America, Europe, Japan or Australasia) meets certain minimum standards of ESG practices as a firm. As a second step, we assess the actual risks covered by the individual transaction to ensure that such risks are climate driven and pass the DNSH test as outlined in the SFDR and the EU Taxonomy, as applicable.

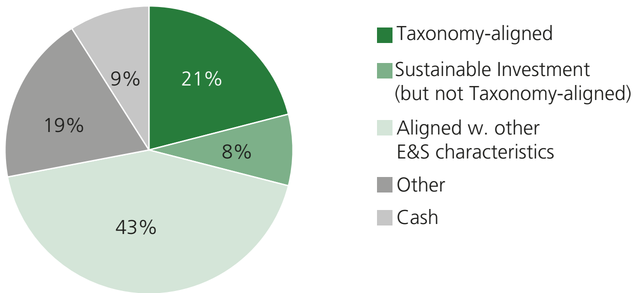
This DNSH-test aims to ensure that the risk-transfer does not provide coverage to businesses focused primarily on fossil fuel production or consumption (such as coal mines or coal-fired power plants, for example). Investments are considered to be fully Taxonomy aligned only if:

- the counterparty is in line with ESG expectations
- the transaction avoids exposure to fossil fuels
- the transaction covers climate-related perils

However, if the investment meets the first two requirements but includes an allocation to non-climate related perils (which are not yet covered by the EU Taxonomy), the deal can still still be deemed sustainable under LGT CP's SFDR sustainable investment framework.

For LGT CP's ILS strategies that are aligned with Article 8 requirements under SFDR, we have committed to allocating at least 50% of the portfolio to investments that are Taxonomy aligned, sustainable or "aligned with other E&S characteristics." Furthermore, the portfolio will allocate at least 20% of capital to Taxonomy-aligned and sustainable investments. Figure 14 shows the breakdown of a sample LGT ILS portfolio according to the EU Taxonomy, which indicates that the portfolio is well above these thresholds.

Figure 14: Investment breakdown of a representative LGT ILS fund portfolio[7]



Source: LGT Capital Partners

Step 1: Assessing ILS counterparties with the ESG Cockpit

As a first step in ESG due diligence of ILS counterparties, we assess the ESG practices of the counterparty (primary insurance or reinsurance companies), using our proprietary ESG analysis tool for companies, the ESG Cockpit. The tool draws on company-specific ESG information from well-established providers to create a set of ESG-related KPIs. Taken together, they culminate in an overall ESG score based on objective, relevant and systematic ESG information. The ESG Cockpit enables the team to check a counterparty's "alignment with E&S characteristics" and its compatibility with minimum safeguards and standards of good governance.

[7] Data as of 31 December 2022.

Step 2: Transaction-level analysis and the DNSH test

The second step is a thorough review of the risk-transfer element of the underlying ILS position. ILS investments ultimately serve to finance reconstruction after extreme natural catastrophe events. In doing so, these investments make a positive contribution to sustainable investments, according to SFDR. In particular, ILS investments support two SDGs: 11 (Sustainable Cities and Communities) and 13 (Climate Action).

Furthermore, ILS can also qualify for EU Taxonomy-aligned investments by applying the EU Taxonomy technical screening criteria (TSC) for non-life insurance and the underwriting of climate-related perils. To do so, 75% of the transaction's risk must derive from climate-related perils. Transactions that fall below this threshold may still be considered investible – as they could still qualify as "promoting E&S characteristics" – if they pass the DNSH test described earlier.

Transactions that provide reinsurance coverage to businesses involved in the extraction, storage, transport or manufacture of fossil fuels or other assets dedicated to such purposes are deemed ineligible for consideration as sustainable investments. If a transaction provides such cover, it must be excluded from the investment universe. In order to meet the requirements of this DNSH test, we carry out a thorough review of the underlying portfolio covered within the ILS investment. For example, a portfolio that only covers residential property typically meets the DNSH test because it does not have exposure to unsustainable economic activities conducted by industrial companies. By contrast, an investment that provides insurance coverage for large industrial companies – some of which could be active in the area of fossil fuel production – is unlikely to pass the test.

The chart in Figure 15 shows three examples of how our team has assessed different types of transactions in practice. Deal 1 passes all tests and qualifies as Taxonomy aligned, while Deal 2 passes as a transaction that "promotes E&S characteristics" but is not Taxonomy aligned, as the contribution from climate-related perils is too low. Deal 3 does not meet the requirements given the coverage granted for industrial companies active in the area of fossil fuel exploration.

Figure 15: Assessing ILS transactions under SFDR and the EU Taxonomy

	Deal 1	**Deal 2**	**Deal 3**
Counterparty	US residential insurance company	Global insurance company	Global reinsurance company
Country (HQ)	USA	France	Switzerland
Counterparty ESG score (0 to 100)	83	80	89
Deal description	Catastrophe reinsurance, focus on US hurricane and severe storm events	Catastrophe reinsurance, focus on European winter storm, flood and earthquake	Property reinsurance for large industrials active in the area of fossil fuel extraction
Industrial exposure (maximum 5% for Taxonomy alignment)	0%	3%	100%
Contribution from climate related perils (minimum 75% for Taxonomy alignment)	88%	56%	0%
Type of ESG investment under SFDR	Fully EU Taxonomy aligned – clear target transaction.	Meets E&S characteristics – eligible for investing.	Not eligible for investment – deal covers only industrial risks and perils related to fossil fuel extraction.
Allocation	Yes	Yes	No

Source: LGT Capital Partners

Hedge funds

One year has passed since we aligned our flagship discretionary hedge fund strategy with Article 8 requirements under SFDR. This time has allowed us to test the investment process and refine it according to the enhanced SFDR requirements, with some additional clarity provided by the regulators over the last year. Even with additional input from regulators, we believe there is still room for improvement in the SFDR framework as it applies to hedge funds, including better clarification on the treatment of specific instruments used, such as derivatives.

The lack of a clear framework for hedge funds, together with the fact that many managers are domiciled outside the EU, has resulted in a relatively low number of funds adopting SFDR Article 8 or 9 in the last 12 months. The few exceptions were a small number of managers that pursue ESG-focused strategies, such as those focused on climate change and the energy transition. This reinforced our conviction on the validity of our approach, which focuses on our own ESG process and customization capabilities rather than the SFDR status of the underlying funds. Nevertheless, as part of our ongoing engagement, we are pushing the underlying managers to increase their ESG ambitions, and we expect additional improvements with the launch of the UK SDR framework.

SFDR assessment

Our flagship discretionary strategy promotes "among other characteristics, E&S characteristics" through a systematic ESG assessment, which includes three key components:

1. **ESG exclusion policy** – we make hedge fund investments mainly through a managed account structure, which enables us to maintain our ESG exclusion of exposure to controversial weapons (land mines, cluster bombs/munitions and biological, nuclear and chemical weapons) and thermal coal. For the few exceptions of investments made in commingled funds, we monitor the exposure post-investment via our managed account platform, which enables position-level transparency.

2. **Top-down ESG assessment** – we rate our managers based on a top-down ESG score, which takes into account key criteria, such as ESG policies and governance, investment process, stewardship and reporting/verification. The ratings are based on the PRI Responsible Investment Due Diligence Questionnaire for Hedge Funds, which was recently amended to better cover SFDR requirements. Since our 2020 decision to divest from managers rating poorly from an ESG perspective, we have not had any managers rated 4 (indicating no ESG processes in place) in our portfolios. Additional details related to the evolution of the portfolios' ESG ratings can be found in the next sections.

3. **ESG portfolio monitoring** – the daily portfolio transparency made possible by our managed account platform enables us to assess and monitor the ESG characteristics of the underlying portfolios through our ESG Cockpit.[8] The proprietary tool enables us to score companies on over 40 different ESG KPIs, measure their environmental footprints and SDG impacts, as well as gauge their alignment with net zero. We combine the top-down ESG assessment of the manager with the bottom-up assessment of the underlying portfolios to calculate an ESG score for the whole portfolio. For the reported period, our hedge fund portfolios had a net ESG score of 60.2, which is considered a good score for a diversified hedge fund portfolio. The portfolio generated GHG emissions of 32.9 tCO_2 equivalent per million USD invested versus a budget of 38.4 tCO_2 equivalent per million USD invested.[9] The GHG budget is revised every year according to the International Energy Agency (IEA) Net Zero 2050 sectoral pathways.

Finally, we considered the PAI indicators shown in Figure 16 in the investment management process. This is calculated with our ESG Cockpit and is part of our overall ESG Rating. This allows for enhanced insight into the adverse impacts caused by investee companies or issuers. The PAI indicators on page 25 are for the reporting period of our flagship discretionary hedge fund strategy, which focuses on long-short equity. The table shows three values for each metric:

- Portfolio exposure – how much of each metric (GHG, wastewater, pay gap, etc.) is in the portfolio.
- Portfolio coverage – the proportion of the portfolio's NAV that is covered by the reported metric. As the table shows, far more companies report GHG or carbon emissions than gender pay gap, so the coverage is higher for these metrics.
- Portfolio eligibility – the proportion of the portfolio's NAV that can possibly be measured for a given metric. In a diverse hedge fund portfolio like this one, only long positions in corporate securities and sovereign bonds are in scope, and they represent 67.7% of the portfolio. Cash, derivatives, FX forward contracts and certain commodity futures are not eligible for measuring, so they are excluded from the metric.

[8] Or, for a small number of fund investments, through at least monthly portfolio snapshots.
[9] Average score for 2022.

Figure 16: PAI indicators for flagship discretionary hedge fund strategy

Indicator	Metric	Portfolio exposure	Portfolio coverage	Portfolio eligibility
Indicators applicable to investments in investee companies				
GHG emissions	Scope 1 GHG emissions (tCO_2 eq.)	158,672.2	39.1%	67.6%
	Scope 2 GHG emissions (tCO_2 eq.)	30,758.3	39.1%	67.6%
	Scope 3 GHG emissions (tCO_2 eq.)	1,278,808.5	39.1%	67.6%
	Total GHG emissions (tCO_2 eq.)	1,468,239.0	39.1%	67.6%
Carbon footprint	Carbon footprint (Scope 1 & 2 tCO_2 eq. per mln inv)	91.8	39.1%	67.6%
	Carbon footprint (Scope 1,2 & 3 tCO_2 eq. per mln inv)	711.6	39.1%	67.6%
GHG intensity of investee companies	GHG intensity of investee companies (Scope 1 & 2 per mln sales, weighted intensity)	260.3	39.1%	67.6%
	GHG intensity of investee companies (Scope 1 ,2 & 3 per mln sales, weighted intensity)	1,735.6	39.1%	67.6%
Exposure to companies active in the fossil fuel sector	Share of investments in companies active in the fossil fuel sector	5.7%	42.2%	67.6%
Share of nonrenewable energy consumption and production	Share of non-renewable energy consumption and non-renewable energy production of investee companies from non-renewable energy sources compared to renewable energy sources, expressed as a percentage	82.1%	20.0%	67.6%
Energy consumption intensity per high impact climate sector	Energy consumption in GWh per million EUR of revenue of investee companies, per high impact climate sector	1.4	16.8%	67.6%
Emissions to water	Tonnes of emissions to water generated by investee companies per million EUR invested, expressed as a weighted average	14.0	1.8%	67.6%
Hazardous waste ratio	Tonnes of hazardous waste generated by investee companies per million EUR invested, expressed as a weighted average	6.8	9.3%	67.6%
Activities negatively affecting biodiversity-sensitive areas	Share of investments in investee companies with sites/ operations located in or near biodiversity-sensitive areas where activities of those investee companies negatively affect those areas	0.0%	42.2%	67.6%
Violations of UN Global Compact (UNGC) principles & Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises	Share of investments in investee companies that have been involved in violations of the UNGC principles or OECD Guidelines for Multinational Enterprises	0.5%	42.2%	67.6%
Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises	Share of investments in investee companies without policies to monitor compliance with the UNGC principles or OECD Guidelines for Multinational Enterprises or grievance/ complaints-handling mechanisms to address violations of the UNGC principles or OECD Guidelines for Multinational Enterprises	29.0%	42.2%	67.6%
Unadjusted gender pay gap	Average unadjusted gender pay gap of investee companies	12.1%	5.2%	67.6%
Board gender diversity	Average ratio of female to male board members in investee companies	30.4%	37.9%	67.6%
Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)	Share of investments in investee companies involved in the manufacture or selling of controversial weapons	0.0%	42.2%	67.6%
Indicators applicable to investments in sovereigns and supranationals				
GHG intensity (country's Scope 1, 2 and 3 GHG emissions per million GDP)	GHG intensity (country's Scope 1, 2 and 3 tCO_2 eq. per million EUR GDP)	405.6	1.4%	2.4%
Investee countries subject to social violations	Number of investee countries subject to social violations (absolute number and relative number divided by all investee countries), as referred to in international treaties and conventions, United Nations principles and, where applicable, national law	0.0%	1.4%	2.4%

Source: LGT Capital Partners

Current ratings and the long-term ESG development of our hedge fund universe

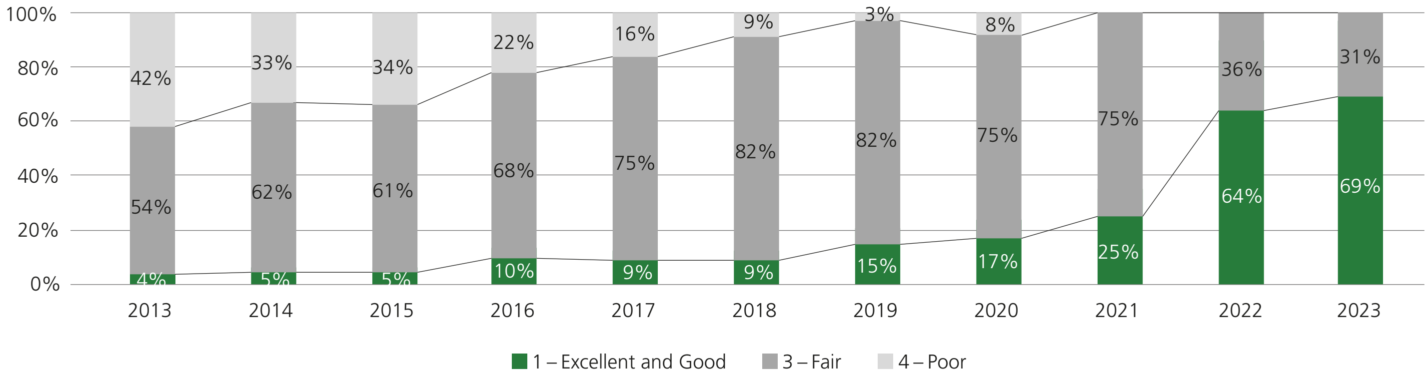
Continuing last year's trend, we see that our hedge fund managers have generally stepped up their ESG efforts, most likely driven by a mix of increasing regulatory requirements and investor demand. All the managers in our portfolios have at least demonstrated some commitment to ESG and recognize sustainability-related risks and most are familiar with SFDR.

For our hedge fund portfolios overall, we observe that the proportion of managers rated 1 or 2 increased from 64% to 69%, which is largely the result of two managers being upgraded from 3 to 2. This was driven by positive developments in their ESG practices, such as introducing ESG committees to lead on ESG governance, improved approaches to incorporating ESG considerations into portfolio construction, as well as the introduction of ESG/DEI training within their firms. In addition, we made new investments in a dedicated carbon fund manager, which achieved a top rating of 1.

We see a similarly positive picture when looking at the volume of assets managed for us by these firms, where 73% of hedge fund assets are managed by teams with an ESG score of 1 or 2, while 27% are managed by those rated 3.

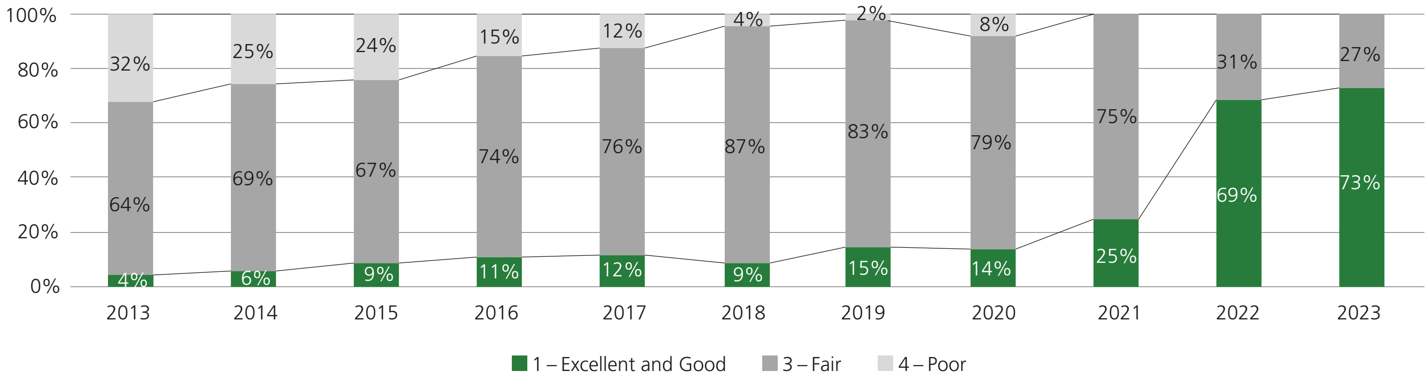
In the course of this year's assessment, we also downgraded one manager from 2 to 3, after it became clear that the firm's investments did not always reflect the principles expressed in their ESG policies. This example illustrates the importance of validating the initial manager ratings with a close look at the portfolio on an ongoing basis.

Figure 17: ESG ratings by number of managers

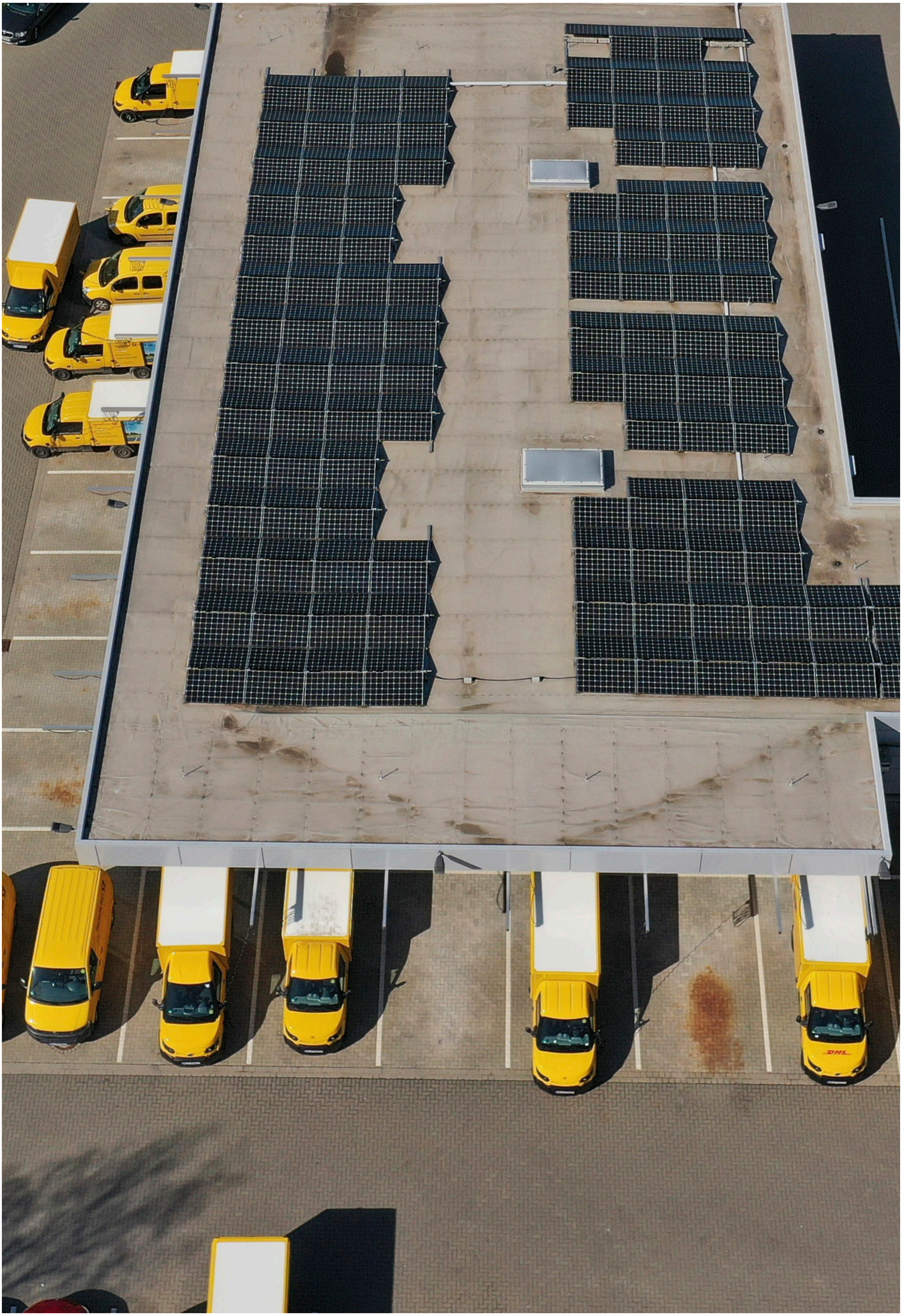


Source: LGT Capital Partners

Figure 18: ESG ratings by assets under management



Source: LGT Capital Partners



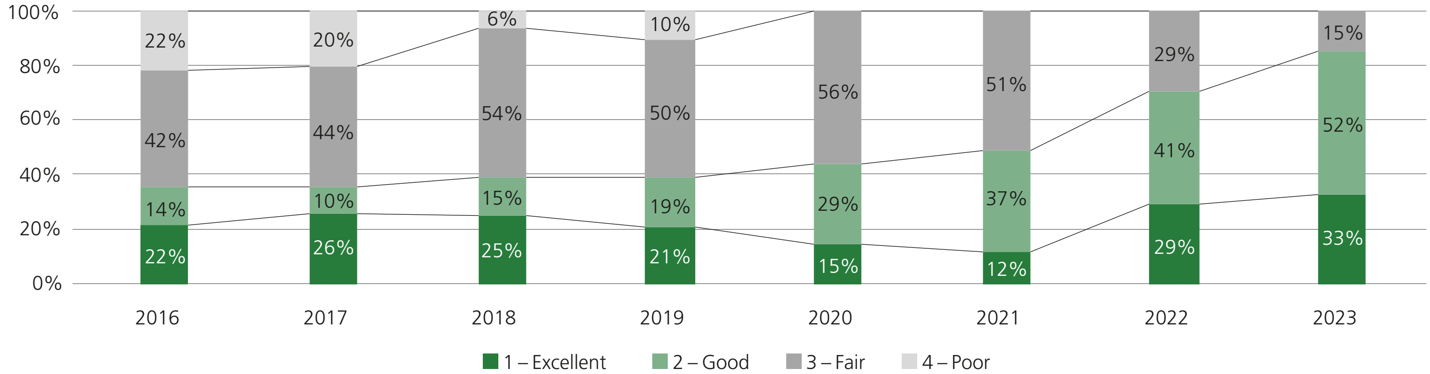
Carbon neutral distribution depot, Deutsche Post, Germany, LGT CP sustainable equity portfolio

Long-only managers

The positive developments we have seen in our long-only managers continued again this year, with one-third of the managers having received our best rating of 1, and only 15% of managers rated 3.

From an SFDR perspective, we see that most of our managers rated 1 have also aligned their underlying fund or master offering under SFDR Article 8 or 9. The only exception is a Canadian manager that does not meet the SFDR requirements for such a classification, but the team nevertheless has best-in-class ESG integration.

Figure 19: ESG ratings globally



Source: LGT Capital Partners

Case Study: Innovative micro-cap manager develops own ESG data in sector with few options

One of our managers, Otus Capital Management (OCM), which specializes in micro-cap stocks of European companies (with market caps of between EUR 50 million and EUR 250 million), made significant strides in ESG in the last year. Their efforts enabled them to transition from a fairly basic ESG approach focused on exclusions and corporate governance factors to a comprehensive ESG assessment. This work also earned them an increased ESG rating from 3 to 2. Ordinarily, we would think of this as just the normal progression for a long-only manager, where, typically, plentiful data exists on which to base an ESG analysis. But in the case of a micro-cap manager like OCM, they had to develop their own systems entirely from scratch because micro caps are not covered by the usual ESG data vendors like MSCI, ISS and others. Micro-cap companies are simply too small and too numerous to make it onto the radars of the usual ESG data providers.

Undeterred by this limitation, OCM undertook a project to identify 24 ESG factors from annual reports for each of the 40+ positions in the fund. For each company, they collected this data from the five most recent years of reporting, depending on availability. After collecting the data, the team began drilling down into the ESG materiality of individual stocks. Portfolio managers utilized their interactions with management as well as annual reports, sustainability reports and broker reports to identify the main ESG risks and opportunities that the company is exposed to. They also supplemented their understanding by drawing on the MSCI ESG Industry Materiality Map to assess the ESG materiality in the company's sector and sub-sector.

Leveraging these various data inputs, OCM's portfolio management team appraises each target company from an ESG perspective, considering the relevance, significance and resulting sustainability risk contribution of each ESG factor identified. Based on this, portfolio managers apply a traffic light system to classify each stock as:

- Green: broadly positive E, S, or G credentials have been identified
- Yellow: broadly neutral E, S or G credentials have been identified
- Red: broadly negative E, S or G credentials have been identified

In addition to scoring all companies in each of the three categories, the portfolio managers provide a commentary in which any red flags – resulting in a red classification – are explained and the specific risks are assessed and documented. Furthermore, any strong positive ESG characteristics are highlighted in the portfolio manager's commentary. This commentary ensures a full audit trail is maintained, in particular highlighting any weaknesses and key sustainability risks identified. These risks are addressed during subsequent company engagements. Portfolio managers regularly review the ESG credentials and re-affirm their selections following a meeting or call with an investee company.

We think OCM's approach of developing its own ESG data in a space where few commercially available data sources exist is a good example of proactively solving the problem of data availability.

Public equity and fixed income

Integrating ESG into the investment process for listed securities has been a core part of our philosophy since the inception of our first sustainable equity and fixed income strategies in 2009. From the outset, we were convinced that investing in companies with strong ESG practices leads to long-term outperformance. As methods and standards for ESG evolved, so did our approach to assessing companies on ESG. The introduction of SFDR added a new dimension, as it has challenged us to more clearly define the terms and processes that drive ESG integration in our sustainable equity and fixed income portfolios.

In this section, we describe how we have implemented the different parts of SFDR regulation in our direct equity and fixed income portfolios, also touching on some of the challenges. We have aligned most of our flagship sustainable strategies with Article 8 requirements under SFDR because of their strong focus on making sustainable investments and "promoting E&S characteristics." However, we have aligned two sustainable bond strategies with Article 9 because they explicitly focus on sustainable bonds with measurable positive impacts on the SDGs.

One significant aspect of the SFDR regulation is how it defines "sustainable investments" across three key dimensions, requiring sustainable investments to:

- contribute to an environmental or social objective
- not significantly harm any environmental or social objectives
- follow good governance practice

There are also areas where additional regulatory clarifications would be welcomed, such as for sovereign bonds. Under the current regulation, sovereign bonds are not often eligible for consideration as sustainable investments, with the one exception of green bonds issued by sovereigns. This is because SFDR can be interpreted as suggesting that such bonds are earmarked for economic activities, or projects, that fulfill a specific environmental or social objective.

Leveraging our ESG Cockpit to assess individual companies on ESG

In assessing the ESG and sustainability characteristics of investments, LGT CP's key tool is the the ESG Cockpit. The tool leverages a multitude of raw ESG data from a variety of providers, enabling portfolio managers to score an individual company on over 40 KPIs, as well as measure its environmental footprint, impact on the SDGs and alignment with net zero. The ESG Cockpit also enables our team to continuously monitor the ESG attributes of a security, or an entire portfolio.

With the ESG Cockpit front and center, our team is able to systematically assess companies on how they measure up on each of the three key sustainability criteria according to SFDR. The overall assessment framework is shown in Figure 20.

Figure 20: Framework for identifying sustainable investments

Starting point

Universe promoting E&S characteristics
- Exclusion of controversial activities
- Exclusion of low ESG performers
- Applying good governance check

- Application of exclusion filters
- Identification of lowest ESG score quartile

1st Step

Candidates for sustainable investments
- Positive net SDG outcomes from products and services

- Existing SDG outcomes from products & services
- Existing SDG operational outcomes

2nd Step

DNSH and minimum safeguards check
- Sustainable investments should not harm any sustainable investment objectives

- Existing controversy scoring framework

Data from the ESG Cockpit

Source: LGT Capital Partners

Defining environmental and social objectives

As a starting point, we use our SDG framework already embedded in the ESG Cockpit as guidance for what can potentially be viewed as a sustainable investment. The SDGs are a set of internationally agreed environmental and social objectives, which are widely accepted within the financial industry for assessing the sustainability of an economic activity. As such, we consider a company that makes a net positive contribution to the SDGs as a strong candidate for the "sustainable" classification. This is measured by looking at how the company's operations, products and services impact the SDGs in aggregate, netting the negative impacts from the positive.

Further conditions to be met

The SFDR regulation further requires that sustainable investments "do no significant harm" to any sustainable investment objectives, which is known within the SFDR framework as the DNSH test. Such investments are also required to adhere to certain minimum safeguards. Since our ESG Cockpit assesses the net impact of a company on the SDGs, a company with a net positive contribution to the goals is likely to pass this test. However, we take the analysis one level deeper by checking whether there are any known ESG controversies associated with the company. Here, we again leverage an existing module within our ESG Cockpit, which assesses any ESG controversies surrounding a company. Businesses that have a pattern of attracting material ESG controversies related to their operations or products and services fail the DNSH test in our framework. The ESG Cockpit also enables us to maintain minimum safeguards because it checks for breaches of global corporate sustainability frameworks, such as the UN Global Compact, the OECD Guidelines for Multinational Enterprises, and the UN Guiding Principles on Business and Human Rights.

Good governance

According to SFDR, both sustainable investments and those that "promote E&S characteristics" have to follow good governance practices. To address this dimension, we added a specific pass/fail assessment of good governance to our ESG Cockpit, focusing on the items mentioned in the SFDR regulation. This includes attributes such as sound management structures, good employee relations, remuneration of staff and tax compliance. All of these factors are captured in the various KPIs tracked by the ESG Cockpit.

PAIs

Another requirement of SFDR is to determine whether a fund considers the PAIs relating to an investment. The SFDR framework defines a set of mandatory PAI indicators – such as environmental, social and employee concerns, respect for human rights, anti-corruption, and anti-bribery matters – that have to be taken into account when judging the sustainability of an investment. As we have been integrating dozens of KPIs into our ESG analysis for many years, we found that most of the mandatory PAIs were already included in our ESG framework. What is new is that we have to report on the identified PAIs in the periodic SFDR reporting.

Putting it all together, Figure 21 shows how different companies might score when assessed as potential sustainable investments. When they meet all three of the key criteria shown above, they can be considered sustainable.

Figure 21: Assessing a company as a sustainable investment

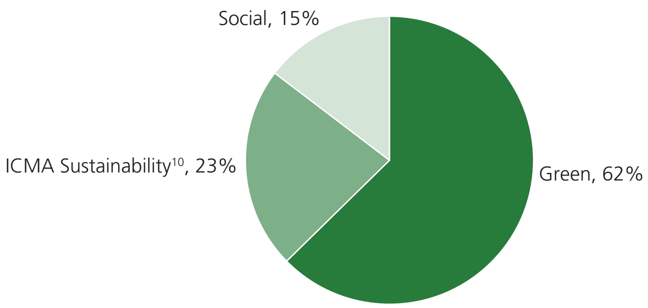
	Promoting E&S criteria	Positive net SDG outcomes	DNSH and minimum safeguards check	Sustainable investment
Company A	ESG Score 25.2			
Company B	ESG Score 46.9	Net SDG outcome: -29.0		
Company C	ESG Score 67.7	Net SDG outcome: +8.7	Severe controversies	
Company D	ESG Score 79.0	Net SDG outcome: +13.7	No major controversies	

Source: LGT Capital Partners

How sustainable bond strategies meet Article 9 requirements

One of the differences between fixed income and equity investing is that the fixed income universe includes "use of proceed bonds," which fund projects with dedicated environmental and/or social benefits. This makes a substantial difference in meeting Article 9 requirements. Our two Article 9 sustainable corporate bond strategies have clear sustainable investment objectives and have set a commitment of minimum 75% sustainable investments. In addition, the definitions of sustainable investments, PAIs and good governance described above apply to Article 9 funds as well. However, when defining sustainable investments for corporate bonds, we have the additional element of how bond proceeds are used, which require close scrutiny by the investor.

Figure 22: LGT CP sustainable bond strategy by bond type



Source: LGT Capital Partners

The first step in determining whether a bond qualifies as a sustainable investment under SFDR is to examine the various features of the security. In the case of green, social or sustainable bonds, we analyze the environmental or social objectives set out for the bond, while also considering how they fit into the issuer's overall business strategy and operations. We also check to make sure that the proceeds of the bond are linked to at least one SDG, as evidenced in the bond's Second Party Opinion (SPO) and periodic impact reporting. To complete our analysis, we regularly interact directly with the issuers themselves. Any identifiable controversies or ambiguities surrounding an impact bond's framework, or its use of proceeds, would disqualify it as a sustainable bond.

ESG controversies are grounds for declining a bond for sustainability reasons, whether they are specific to the bond or the issuer. This can occur, for example, when an issuer retroactively relabels an existing project as sustainable in a new bond issuance, instead of investing in a new project with a clear sustainability target. In other cases, the issuer may fail to explain how the bond's proceeds will help to achieve a social or environmental goal, or provide a credible way of measuring achievements. We encountered the latter situation with one recent issuance of a social bond, which focused on gender equality and female empowerment. The bond's documentation lacked a persuasive framework for showing how the proceeds would be used to achieve these worthwhile goals, so we declined the bond as an investment. Nevertheless, we continue to monitor the issuer's sustainable offering, as their measurement framework and standard of reporting evolves.

In some cases, LGT CP can also allocate capital to issuers that are not formally classified as green or sustainable, as determined by their use of proceeds. For example, a conventional bond issued by a company that itself makes a strong net positive contribution to the SDGs through its operations and products or services would be a good candidate for the "sustainable" classification. If it met the other criteria described above for corporates, it would be deemed sustainable. Prominent examples of such companies have included Brazilian biofuel producer Raizen for its clear focus on sustainable energy, and the global healthcare company Medtronic for expanding access to healthcare for underserved populations.

[10] "Use of proceed bonds" that align with the Sustainability-Linked Bond Principles of the International Capital Markets Association.

About us

LGT CP is a leading alternative investment specialist offering a wide range of investment programs focusing on private markets, liquid alternatives and multi-asset class solutions. The core team began investing in private markets in 1997, and in November 2000, they founded LGT CP, based in Pfaeffikon, Switzerland. The founding team continues to be a key part of the Firm's senior management today, ensuring stability and consistency in our culture and approach.

LGT CP has a long-held commitment to incorporating ESG considerations into its client programs and its business overall. Since 2003, many of our programs have had a responsible investment clause written into their governing documents, authorizing us to exclude investments that are substantially exposed to arms-related activities, violations of human rights, irresponsible treatment of the natural environment or other non-ethical conduct of business. Consideration of ESG issues is an integral part of our investment process, as our investment teams are responsible for taking into account ESG considerations when performing due diligence on investments. Any opportunity that is pursued will have been vetted for such issues.

LGT CP has been a signatory to the Principles for Responsible Investment (PRI) since 2008. In 2018, Tycho Sneyers, a managing partner and chairman of the firm's ESG Committee, joined the PRI board of directors. LGT CP also participates in the Net Zero Asset Managers initiative, the Institutional Investors Group on Climate Change (IIGCC), Climate Action 100+, the ESG Data Convergence Project, GIIN and the European Sustainable Investment Forum (Eurosif).

Pfaeffikon (Switzerland)
Schuetzenstrasse 6
CH-8808 Pfaeffikon
Phone +41 55 415 96 00

San Francisco
Suite 1330, Floor 13
580 California Street
San Francisco, CA 94104
Phone +1 628 201 0050

New York
30th Floor
1133 Avenue of the Americas
New York, NY 10036
Phone +1 212 336 06 50

Dublin
Third floor
30 Herbert Street
Dublin 2
Phone +353 1 433 74 20

London
1 St. James's Market
London SW1Y4AH
Phone +44 20 7484 2500

Paris
43 Avenue de Friedland
75008 Paris
Phone +33 1 81 80 5600

The Hague
Pr. Beatrixlaan 582
NL-2595 BM The Hague
Phone +353 1 433 7420

Luxembourg
21-25, Allée Scheffer
2520 Luxembourg
Phone +352 27 86 65 83

Frankfurt
Neue Mainzer Strasse 6-10
60311 Frankfurt am Main
Phone +49 69 505060 4701

Vaduz
Herrengasse 12
FL-9490 Vaduz
Phone +423 235 25 25

Dubai
Office 7, Level 3, Gate Village 10
Dubai International Financial Centre
P.O. Box 125115
Dubai, United Arab Emirates
Phone +971 4 401 9900

Beijing
Floor 61/Unit 01, China World Tower 3B
1 Jianguomenwai Ave
Chaoyang District
Beijing, P.R. China 100004
Phone +86 10 6505 8225

Hong Kong
4203 Two Exchange Square
8 Connaught Place Central
G.P.O. Box 13398
Hong Kong
Phone +852 2522 2900

Tokyo
17th Floor, Stage Building
2-7-2 Fujimi, Chiyoda-ku
Tokyo 102-0071
Phone +81 3 6272 6442

Sydney
Suite 40.04, Level 40
264 George Street
Sydney NSW 2000
Phone +61 2 7908 7777

Legal Information

This marketing material was produced by LGT Capital Partners and/or its affiliates (hereafter "LGT CP") with the greatest of care and to the best of its knowledge and belief following the principles of good faith. LGT CP provides no guarantee with regard to its content and completeness and does not accept any liability for losses which might arise from making use of this information. The opinions expressed in this document are those of LGT CP at the time of writing and are subject to change at any time without notice. If nothing is indicated to the contrary, all figures are unaudited. This document is provided for information purposes only and is for the exclusive use of the recipient. It does not constitute an offer or a recommendation to buy or sell financial instruments or services and does not release the recipient from exercising his/her own judgment. LGT CP recommends the recipient checking whether the information provided is in line with his/her own circumstances with regard to any legal, regulatory, tax or other consequences, if necessary with the help of a professional advisor. This document may not be reproduced either in part or in full without the written permission of LGT CP. It is not intended for persons who, due to their nationality, place of residence, or any other reason are not permitted access to such information under local law. Every investment involves risk, especially with regard to fluctuations in value and return.

Investments in foreign currencies involve the additional risk that the foreign currency might lose value against the investor's reference currency. It should be noted that historical returns and financial market scenarios are not a guarantee of future performance.

ESG disclosures

The strategies mentioned in this document, are considered to meet the criteria of Art. 8 or 9 strategies under EU 2019/2088. Investors should note that, relative to the expectations of the Autorité des Marchés Financiers, these strategies present disproportionate communication on the consideration of non-financial criteria in their investment policy. Further, it is considered that the names of these strategies are disproportionate to the AMF's consideration of non-financial criteria. The "do no significant harm" principle applies only to those investments underlying the strategy that take into account the EU criteria for environmentally sustainable economic activities. The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable economic activities.

For all other strategies mentioned in this document, investors should note the Investment Manager's assessment of ESG characteristics may change over time and the ESG conclusions of the Investment Manager might not reflect the ESG views of investors. There is no guarantee that a company meets the expectations in relation to ESG. LGT CP integrates an assessment of Sustainability Risks into its investment processes. The results of this assessment and the potential impact on returns may vary. LGT CP or the appointed manager may rely on third-party ESG data or research providers to produce any ESG-related analysis. Such data or research may be imprecise, incorrect or unavailable and the resulting analysis may be impacted. It is considered that the policies adopted to assess and mitigate Sustainability Risks may mitigate such risks to the strategy. The investments underlying the strategy do not take into account the EU criteria for environmentally sustainable economic activities. Further details on ESG integration and sustainability-related stewardship can be found on lgtcp.com.

LGT Capital Partners Ltd.
Schuetzenstrasse 6, CH-8808 Pfaeffikon
Phone +41 55 415 96 00, lgt.cp@lgtcp.com

www.lgtcp.com