

# Positioning statement on Sovereign exposure

LGT Sustainable Funds

## 1. Introduction

This positioning statement explains our sustainable investment approach for sovereigns and shall apply to LGT Capital Partners Developed Markets Sustainable Fixed Income Products (LGT CP DM SFI).

We at LGT CP DM SFI apply an integrated sustainability investment process that considers environmental, social and governance (ESG) criteria in all investment decisions. With our integrated approach, we not only take into account – to the best of our knowledge – the external effects that economic activity financed by our investments have on society and the environment. We are also convinced that we improve the overall risk/reward assessment of our investments. Our investment strategies are a reflection of relevant laws, our values and internationally recognized standards such as the UN Global Compact principles. Through our sustainable investing approach, we therefore invest in issuers that have an outstanding track record meeting our ESG criteria, thus contributing to the 2030 UN Agenda for Sustainable Development while also creating value and financial returns in the long-term. In 2021 LGT Capital Partners joined the Net Zero Asset Manager Initiative, an international group of asset managers committed to supporting the goal of net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius.

For sovereign issuers in particular the implementation of the Paris Agreement in 2015 requires economic and social transformation in order to achieve the sovereign goals committed to substantially reduce global greenhouse gas emissions. We support this transformation process and in order to achieve greater impact, we place great focus on proceed bonds within our investment strategy for sustainable funds.

Overall, our ESG assessment is as fundamental as our traditional risk assessment in the investment decision-making process. Based on this assessment, the resulting sustainability country rating helps us as the main framework in addition to the traditional credit metrics to identify risks and opportunities. For instance, CO<sub>2</sub> intensity, corruption levels or public spending for education are indicators in our country sustainability rating.

The sustainability assessment for countries is divided into two steps:

**Step 1:** We apply exclusion criteria as described in Section 2

**Step 2:** within the remaining universe we focus on positive investment opportunities as described in Section 4 of this document.

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## Exclusions and ESG factors – sovereigns

### Sustainability assessment for countries

Exclusion criteria	
<b>Human and political rights:</b>	
• Freedom (Freedom House Index)	Not free
• Reporters Without Borders press freedom	< 50.0
• Eight fundamental conventions identified in the International Labour Organization's declaration	Not ratified all eight
• 18 core international human rights treaties	Less than half
<b>UN sanctions and armaments treaties<sup>1</sup>:</b>	
• UN sanctions	
• Treaty on the non-proliferation of nuclear weapons	Yes
• Comprehensive nuclear-test-ban treaty	Not signed
• Convention on the prohibition of the development, production, stockpiling and use of chemical weapons and on their destruction	Not signed
• Convention on the prohibition of the development, production and stockpiling of bacteriological (biological) and toxin weapons and on their destruction	Not signed
• Convention on cluster munitions	Not signed
• Anti-personnel landmines convention	Not signed
• Paris agreement	Not signed
• UN convention on biological diversity	Not signed
<b>Additional criteria:</b>	
• Transparency International Corruption Perception Index	
• Military budgets	< 40.0
• Jurisdictions with strategic AML/CFT deficiencies defined by the FATF	> 4% GDP
• Evaluation using the six Worldwide Governance Indicators (WGI) <sup>2</sup>	< -0.59, < -1.00

1 Overwrite of exclusions from NPT (Treaty on the Non-Proliferation of Nuclear Weapons), CTBT (Comprehensive Nuclear-Test-Ban Treaty), CCM (Convention on Cluster Munitions) and APLC (Anti-Personnel Landmines Convention) possible based on functioning democratic controls criteria and qualitative assessment approved by ESG analytics team. 2 Any country where the arithmetic average of all six WGI does not exceed -0.59 or any single WGI is smaller than -1.00 is excluded. Source: LGT Capital Partners, Inrate

### Focus on positive investment opportunities

#### ESG scorings we look at

<b>Environmental</b>	<ul style="list-style-type: none"> <li>Air pollution</li> <li>Agriculture</li> <li>Biodiversity and resources</li> <li>Water</li> </ul>	<ul style="list-style-type: none"> <li>Waste</li> <li>Energy</li> <li>Climate change</li> <li>Multilateral environmental treaties</li> </ul>
<b>Social</b>	<ul style="list-style-type: none"> <li>Standard of living</li> <li>Health</li> <li>Security</li> <li>Education</li> </ul>	<ul style="list-style-type: none"> <li>Equality</li> <li>Labor</li> <li>Human rights</li> </ul>
<b>Governance</b>	<ul style="list-style-type: none"> <li>Strength of institutions</li> <li>Corruption and business climate</li> <li>Stability and security</li> </ul>	<ul style="list-style-type: none"> <li>Democracy</li> <li>Multilateral treaties</li> <li>International sanctions</li> </ul>

## 2. Position on applied exclusions

### 2.1 Human and political rights

Sovereigns are above all responsible for ensuring the well-being for their populations. As responsible investors, we hold sovereign Issuers responsible when they are involved in severe and systematic violations of human rights. Therefore, LGT CP DM SFI will not invest in any sovereigns i.e. oppressive regimes that fail to uphold and protect the most basic of human and political rights. Our assessment on Oppressive Regimes is supported by SDG 16 – to promote peaceful and inclusive societies for sustainable development and is based on the criteria as outlined below:

#### 2.1.1 Freedom status

Any country that is classified as ‘not free’ using the Freedom House assessment<sup>1</sup> is excluded from the investment universe.

#### 2.1.2 Press freedom

Any country with a World Press Freedom Index<sup>2</sup> reading above 50 is excluded from the investment universe.

#### 2.1.3 Human rights

Any country that has not ratified or implemented in equivalent national legislation at least half of the core International Human Rights Treaties according to the OHCHR<sup>3</sup> is excluded from the investment universe.

### 2.2 UN sanctions

The use of mandatory sanctions is intended to apply pressure on a State or entity to comply with the objectives set by the Security Council without resorting to the use of force. The UN sanctions list is maintained by the United Nations member countries and organizations to eliminate terrorism and weapons proliferation, oppose human rights violations or violations of international treaties, money laundering and deliberate destabilization of sovereign countries, and drug trafficking, etc.

Countries that are subject to sanctions under Article 41 of the UN security council shall be excluded from the investment universe.

### 2.3 Corruption

Any country with a Transparency International Corruption Perception Index<sup>4</sup> reading below 40 shall be excluded from the investment universe.

### 2.4 International cooperation

Any country that is considered a “Jurisdiction with strategic AML/CFT deficiencies” by the FATF<sup>5</sup> or is not a signatory of the

- Paris Agreement<sup>6</sup>
- UN convention on Biological Diversity<sup>7</sup>
- The eight fundamental conventions identified in the International Labour Organisation’s declaration on Fundamental Rights and Principles at Work<sup>8</sup>

is excluded from the investment universe.

<sup>1</sup> <https://freedomhouse.org/report/freedom-world>

<sup>2</sup> <https://rsf.org/en/ranking>

<sup>3</sup> <https://www.ohchr.org/en/core-international-human-rights-instruments-and-their-monitoring-bodies>

<sup>4</sup> <https://www.transparency.org/en/cpi/2021>

<sup>5</sup> <https://www.fatf-gafi.org/>

<sup>6</sup> <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>

<sup>7</sup> [cbd.int](https://www.cbd.int)

<sup>8</sup> <https://www.ilo.org/global/standards/introduction-to-international-labour-standards/conventions-and-recommendations/lang--en/index.htm>

## 2.5 Armaments

Any country where the military budgets exceeds 4% of GDP, or that is not a signatory to the following international conventions or treaties regarding certain types of military weapons is excluded:

- Treaty on the Non-Proliferation of Nuclear Weapons
- Comprehensive Nuclear-Test-Ban Treaty
- Convention on the Prohibition of the Development, Production, Stockpiling and use of Chemical Weapons and on their Destruction
- Convention on the Prohibition of the Development, Production and Stockpiling of Bacteriological (Biological) and Toxin Weapons and on their Destruction
- Convention on Cluster Munitions
- Anti-Personnel Landmines Convention

## 2.6 Governance

Good governance is crucial for countries to foster economic growth and helping to create open and socially cohesive societies. We therefore screen countries using the six Worldwide Governance Indicators (WGI) developed and maintained by the World Bank<sup>9</sup>. The individual indicators are Voice and Accountability, Political Stability and Absence of Violence/Terrorism, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption.

Any country where the arithmetic average of all six WGIs does not exceed -0.59 or any single WGI is smaller than -1.00 is excluded.

## 3. Considerations on sovereigns using death penalty

The death penalty, also known as capital punishment, is a controversial and widely debated topic. According to the Death Penalty Information Center, more than 70% of the world's countries have abolished capital punishment in law or practice. In recent years there has been a clear trend away from capital punishment. The U.S remains an outlier among its close allies and other democracies in its continued application of the death penalty. It is worth mentioning that international law does not prohibit the death penalty, however, most countries consider it a violation of human rights.

Countries using death penalty are not excluded. Having not abolished death penalty nevertheless results in a negative impact on a country's sustainability rating, depending on the prevalence of the use of it.

## 4. Position on positive screening

For the investable universe that remains LGT CP has developed a positive screening methodology for countries. It considers the political stability and institutional framework as well as aspects related to social development, the preservation of natural resources and equally weights the environmental and social dimensions.

We apply 20 KPIs focusing on fundamental issues with E, S&G factors. Each KPI is assigned a score based on LGT CP's propriety scoring algorithm. The performance is assessed against the closest peer group for most KPIs, with the exception of governance, which is measured against the whole universe. The KPI scores are then aggregated into overall scores for E, S and G themes separately. These are then further combined to form an overall ESG score for the security. The sustainability country rating helps us as the main indicator in addition to the traditional credit metrics (debt levels) to identify risks and opportunities that are not yet factored in the current prices and are expected to impact tax income, solvency and in the end spreads negatively.

## 5. Position on use of proceeds instruments

Use of proceeds instruments such as Green, Social and Sustainable Bonds are assigned for investments in projects with a positive environmental or social impact. We invest actively in such instruments and have developed a dedicated methodology for assessing and evaluating this asset class. We firstly assign an ESG score to the issuer and then apply specific eligibility criteria to the use of proceeds instrument.

The eligibility criteria for inclusion entails the compliance with an appropriate framework such as the ICMA Green Bonds principles for Green Bonds as well as the requirement for a second party opinion. In addition, we evaluate for each Sustainable Bond framework the ESG aspects of the underlying project.

<sup>9</sup> <https://www.worldbank.org/en/publication/worldwide-governance-indicators>

If the criteria are met the investment may receive an uplift to its ESG score. The sovereign' exclusions criteria mentioned in Section 3 also apply for use of proceeds instruments.

#### **6. Position on sustainable-linked instruments**

Sustainable linked bonds as opposed to green, social and sustainable bonds do not focus on the use of proceeds but on the issuer's ESG strategy and therefore require a separate assessment. Whilst issuers of such bonds commit explicitly to future improvements in sustainability outcomes within a predefined timeline proceeds are intended to be used for general purposes. We actively invest in such instruments and have developed a methodology similar to our sustainable bond assessment where we apply an uplift on the internal ESG rating, however the uplift is assessed on the bond and not on the issuer. Our assessment requires a second party opinion, credible sustainability related targets (KPIs) and identifies whether the issuer's products and services meet on ore more of the 6 environmental objectives in line with the EU Taxonomy.

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