



QUINTET  
FUND SUSTAINABILITY ASSESSMENT SUMMARY



When we assess the level of sustainability within funds and ETFs, we don't just rely on the self-proclaimed EU Sustainable Finance Disclosure Regulation (SFDR) classification. We also apply our analysis to give a more nuanced indication of how much a fund has incorporated environmental, social and governance (ESG) factors. Funds that themselves claim to have a relatively high sustainable profile are assessed against a range of factors to make sure they meet our high standards.

#### What you need to know

- SFDR requires funds to classify themselves according to the following three categories:
- **Article 6:** No Environmental or Social factors taken into account.
- **Article 8:** Promoting Environmental or Social characteristics.
- **Article 9:** Having sustainable investments as their objective.
- We've developed a rating system to give a more nuanced opinion on funds and ETFs on top of the SFDR classification.
- We use a three-step process to assess the level of incorporation of ESG factors. This process comprises interviews, questionnaires, and holdings analysis.

#### Assessing funds

The Quintet investment universe includes funds and ETFs with Article 6, 8 and 9 classifications. Before selecting a fund, we conduct due diligence on various elements, including:

- the robustness of the investment process,
- the individuals running the strategy,
- the risk-adjusted return characteristics,
- the asset manager, and
- the fund's ESG practices.

All funds – regardless of their SFDR classification – have to demonstrate basic responsible practices, such as using a minimum set of exclusions, including a process to avoid exposure to cluster munitions, and a willingness to engage with the companies they invest in. SFDR article 8 and 9 funds must fulfil not only investment risk-adjusted return criteria but also a more rigorous assessment of the level of incorporation of ESG factors. We have developed a rating system to give further insight into the ESG characteristics of funds and ETFs.

#### Why this rating system?

We consider the SFDR classification as a solid step in the right direction. However, we also recognise the desire for more granularity in this classification. We want to make the decision of which fund or ETF is most suitable for a portfolio easy when looking through an ESG lens. This rating system takes the regulatory boundaries into account and also looks at other, less prominently featured characteristics regarding ESG integration.

#### Principal Adverse Impacts (PAIs)

Principal Adverse Impacts (PAIs) are material (or likely to be material) adverse impacts on sustainable factors caused by the activities or decisions of a company. SFDR has recognised many PAIs, and we consider whether a fund or ETF takes these PAIs into consideration in their investment process.

## Sustainable Investments

In order for an investment to be recognised as sustainable it has to invest in an economic activity that contributes to an environmental or social objective. The investment also has to pass a test showing that it does not significantly harm any of those same objectives as well as follow the principles of good governance.

### How does this rules based system work?

#### Good Governance

SFDR Article 6 funds for instance are only suitable for portfolios claiming environmental or social characteristics (such as our flagship portfolios) if the underlying instruments have been checked for good governance (e.g. involvement in tax evasion, bribery etc.). Article 6 funds which have passed a good governance test therefore receive a (low) rating while other article 6 funds receive no rating.

#### Promoting environmental or social characteristics

SFDR Article 8 funds promote environmental or social characteristics, they have incorporated a form of ESG screening into their process and have a process to check their investments for good governance (if applicable). However, Quintet sees a large variety in ESG profiles within this article.

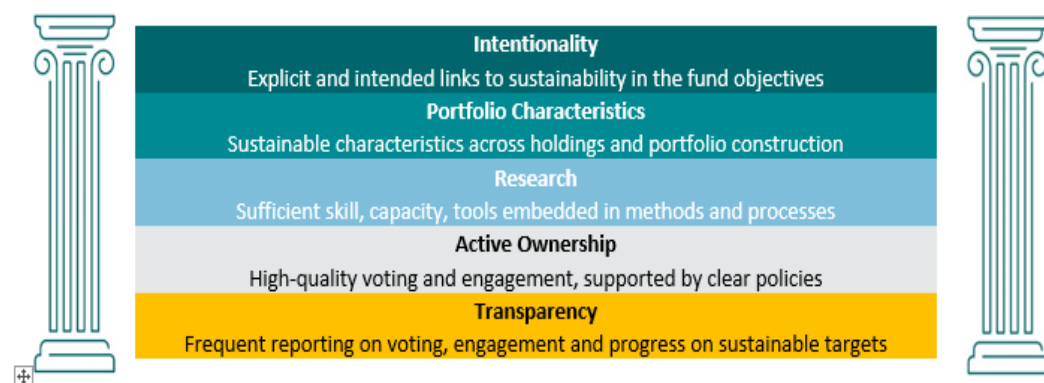
If an article 8 fund does not consider the PAI's we score it low because we believe that the incorporation of PAI's into the investment process enhances the quality of ESG integration. We also give article 8 funds a higher rating if they have committed to a minimum % of sustainable instruments. For an article 8 fund to qualify for the second highest rating it has to pass a robust assessment of their ESG characteristics based on five key pillars (figure 1).

The highest rating is reserved for article 9 funds which have the vast majority in sustainable investments. Examples of these are funds with a focus on purely environmental sustainable themes funds with a reduction in carbon emissions as their objective, or funds with a focus on social sustainable themes.

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### Figure 1: Quintet utilizes five key pillars in ESG fund selection

Quintet's proprietary framework



Source Quintet

## Why these five pillars?

These five pillars help us determine whether a fund can qualify for the highest ratings. Quintet firmly believes that material ESG factors influence investment returns. We believe that for a fund to have strong ESG characteristics it is not enough to partly show its intentions by classifying itself as SFDR article 8 with a minimum % in sustainable investments. The fund's holdings and its portfolio construction methods have to demonstrate clearly that its ESG characteristics align with the manager's intentions.

To achieve environmental and social portfolio characteristics and fulfil intent, the manager has to have adequate resources and methods in place to make sure that sustainability can be fully embedded.

Furthermore, taking sustainability into account doesn't stop when a security is purchased. We believe engagement and proxy voting for equity funds are crucial elements to assess and influence the behaviour of investee entities. Finally, we urge these funds to be transparent about the way they have implemented sustainability into their portfolios and how they have executed their sustainable fiduciary responsibilities.

## How do we assess these pillars?

To assess the five key pillars, we operate a three-step process comprising interviews, questionnaires and holdings analysis.

This process generates a multi-dimensional analysis. It provides both depth and flexibility and enables a full assessment of a fund's environmental and social characteristics. This detailed analysis, in our view, is a superior investment process than relying on a single third-party indicator – often derived solely from holdings analysis.

**Interview:** an interview with the fund manager enables us to understand how sustainability is embedded in the fund.

**Questionnaire:** asset managers answer a questionnaire about sustainability. There are dozens of questions on subjects such as United Nations (UN) Global Compact compliance, the fund's investment process, the use of exclusions, the availability of resources and transparency of reporting.

**Holdings:** we analyse the fund holdings using both quantitative and qualitative methods. Considerations include whether the holdings have links to the UN Sustainable Development Goals (SDGs) or are exposed to substantial sustainability risks, controversies and carbon intensity.

With passive funds or exchange-traded-funds there is no need to interview the manager as the fund is following a specified index. The questionnaire is partly answered by the asset manager and partly by the underlying index provider.

## Change log

Version	Publication date	Details
1.0	31/12/2022	Initial version
2.0	31/12/2023	Updated process to consider funds' SFDR disclosures