



Since 2001, ING has used the 'Non-Financial Indicator' (Nfi). This indicator, that was developed in-house, provides investors with an estimate of the sustainability awareness of a certain company. But the Nfi is just one part of the sustainability assessment of a company. We also assess the actual conduct of a company and the impact of its products. This publication explains how we determine the Nfi and what this indicator means.

Measuring sustainability

In recent decades, SRI has evolved from a strategy based on excluding certain unsustainable activities (such as weapons, tobacco, and fur) to a strategy that focuses on inclusion; investing in companies that contribute positively to sustainability. To measure that positive contribution, of course, you need data. In the early 2000s, investors still had to collect these data themselves, but later dedicated data providers became active. At ING, since the start, we have been using Sustainalytics (now part of Morningstar), one of the largest providers of sustainability data. We combine the data needed to measure sustainability into one metric, the Nfi. This score, amongst others, is used to select companies for our sustainability portfolios. Because sustainability is a concept that continuously develops; and at the Investment Office we want to determine autonomously how we assess sustainability. In this way, our investment decisions fit well with our client's expectations and the principles of the Investment Office. It must be noted that some companies don't have a complete ESG dataset available. In that case we'll make estimates.

Best-in-class approach

The Nfi provides insight on how a company takes its key stakeholders into account. If that awareness is high, then it's easier for the company to sense what is going on in society and respond to it. We therefore expect that a high level of sustainability awareness will translate into a lower risk profile for the company in the longer term. That company will be better able to respond to opportunities that arise. This assessment of sustainability awareness exists alongside our test for controversial behavior or controversial products. Companies with controversial products or behavior are not eligible for the ING portfolios that follow the Sustainable investing approach, no matter the level of sophistication of their sustainability awareness. More about the negative test can be found in this publication: [Activities in which we do not invest](#).

Sustainability awareness

To measure sustainability awareness, we look at the way in which the company takes account of its stakeholders. This includes not only shareholders and bondholders, but all parties with whom a company has direct or indirect interactions. The diagram below provides a sense of the wide variety of possible stakeholders.



We consider companies sustainable if they act responsibly in all ways possible. The Non-Financial Indicator is a good tool to give us a clear understanding of what that means.

The elements of the Nfi

To measure sustainability awareness, we look at five elements, shown in the diagram below.



The element with the greatest weight (40%) is the **ESG Risk Management score**. This score, compiled by Sustainalytics, measures the extent to which a company manages sustainability risks. For this, we look at six to nine key sustainability issues. These range from greenhouse gas emissions and corporate governance to employee relations. The topics used to measure ESG Risk Management may differ per company, as you can imagine a utility company has to deal with different ESG issues than an employment agency. Given the large number of subjects that contribute to this score, we give this measurement the highest weight in the Nfi methodology.

The second element, the **ESG Momentum score**, we give a weight of 10%. This element looks at the development of a company's exposure to- and management of sustainability risks over the past twelve months. We believe it is important that companies do stay stationary and continue to develop their awareness of sustainability. In that case, we show our appreciation by means of a higher Nfi score. Moreover, research shows that "momentum" has a positive correlation with the company's share price.

The third and newest element, the **Product score**, is also given a weight of 10%. The score is related to the degree the company makes products that contribute positively to one of the Sustainable Development Goals (SDGs). These are seventeen goals initiated by the United Nations, to make improvements in the areas of planet, people, and prosperity. In the end, impactful products are an important vehicle for achieving those goals.

The fourth and fifth elements are both related to PAI indicators. These are indicators that reflect a company's (**Principal Adverse Impact**) on sustainability. These indicators were created by the European Union with the aim of creating transparency in the field of sustainability. And also, to reduce the negative impact of companies. For example, a company may already have a good score on greenhouse gas emissions. That's great, but ultimately, we'd like to see those emissions disappear time over time. The PAI scores are the key indicator of that.

Environmental PAI indicators constitute 20% of the final score. This includes the following indicators:

- Carbon footprint (relative to enterprise value)
- Carbon intensity (relative to revenue)
- Exposure to revenues from fossil fuels
- Extent of consumption or production of renewable energy
- Intensity of energy use compared to sectors with high climate impact
- Being active in biodiversity sensitive areas
- Amount of wastewater



- Amount of hazardous waste
- Greenhouse gas reduction policy

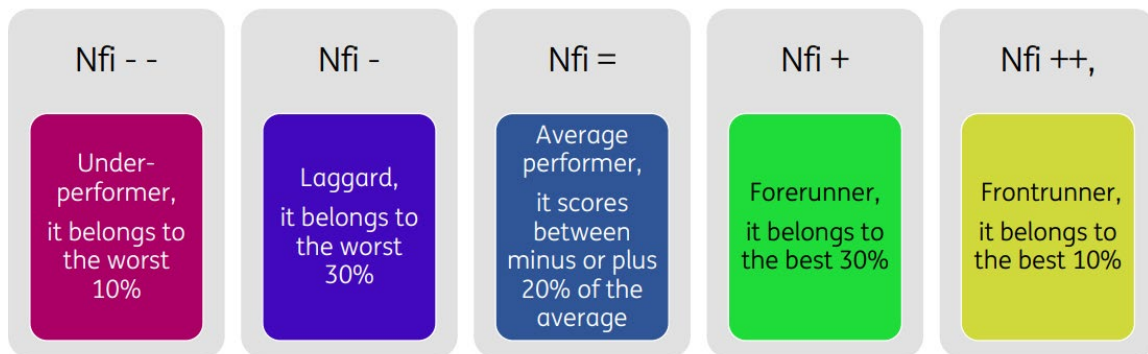
Social PAI indicators determine the last 20% of the Nfi score. This group includes the following indicators:

- Processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises
- Violations of these principles of the Global Compact
- The gender pay gap
- Board gender diversity

The calculation method

Once we have determined which data we need for each of the five elements, we calculate the individual score per indicator and per company.

- We determine the ranking between zero and one for each company per indicator. Companies that score the worst on an indicator get a zero. Companies that score the best get a 1. This is how each company determines where it stands in relation to other companies in its sector. We do this for all companies in all sectors.
- After this calculation, we add up the rankings for each indicator, per element, for each company and divide them by the number of indicators of each element. In this way we end up with a ranking for all companies for each of the five elements.
- As mentioned earlier, the four elements have their own specific weight. This leads to an overall score.
- We rank this score again so that we can classify all companies by sector into deciles.
- With these deciles we can classify companies into the categories that are distinctive for the Nfi. These can be found in the table below.



At the Investment Office we calculate the Nfi once a year. More than once is possible, but not required. The underlying data comes from annual reports, company websites and annual questionnaires, so this data does only change sporadically.

Representational

Because we are comparing companies by sector, it is important that enough companies are represented within each sector. Therefore, we calculate the Nfi score for 5000 companies. This selection includes the following companies:

- All companies that we monitor as part of our equity and bond portfolios (approximately 600 companies)
- All Benelux companies of which we have sustainability data available (approximately 225)
- International companies that have a market capitalization of at least USD 2 billion, until we have 5000 in total

For the Nfi, as already mentioned, we compare companies with other companies within the same sector. In fact, we should use the term 'industry'. In investing, we are usually talking about the eleven sectors of the official GICS classification, the Global Industry Classification System. However, a comparison within the official GICS sectors does not always provide a good result, as some sectors are very diverse. For example, in the industrial goods sector you will find both aircraft manufacturers and employment agencies. We instead use a fine-grained classification in which we group companies into 41 industry groups. That way we have groups of similar companies with sufficient size to do a representative ranking.



New developments

The Nfi has been continuously adapting over the years, to new developments in society, but also to the availability of new data. Due to the increased interest of investors, but also due to new laws and regulations in the field of sustainable investment, developments have accelerated in recent years. As a result, we radically had to change the calculations of the Nfi in 2022. Previously, the Nfi was based on a dataset of 127 different indicators about the sustainability of companies that we divided into the themes of Environment, Social and Governance. We still use most of these indicators, but only indirectly as we now use the ESG Risk Management score instead, which is based on the 127 indicators to a greater or lesser extent. We complete this Nfi score with momentum and the possible negative impact of companies on sustainability (the PAI indicators). In 2023 we refined the methodology. Furthermore, we introduce one new element: the Product score. Which we have given a weight of 10% at the cost of the weight for the ESG management momentum element. We find it important that the Nfi, the sustainability awareness indicator, is relevant for the longer term. At a recalculation with the 2022 methodology, we ended up with a relatively large number of Nfi categorization changes. The cause of this was the relatively volatility of the ESG management score. The introduction of a more stable element (impactful revenues) and the decrease in the weight for momentum, should lead to a more stable Nfi-rating. For the upcoming years, we expect a lot of changes and developments in the field of sustainable investing. With our experience and knowledge, we can adapt to these developments and make changes to our ESG investing approach when necessary.

Want to know more?



See [ING.nl/beursnieuws](https://www.ing.nl/beursnieuws)

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