
# Sustainable Investments

**Newsletter of J. Safra Sarasin Asset Management | 2nd Quarter 2019**

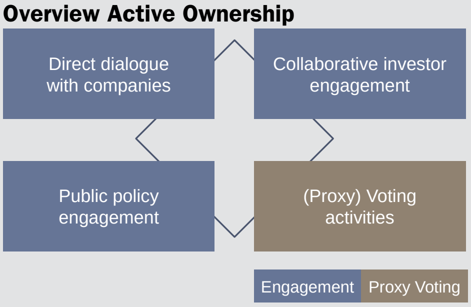
Editorial

## Active Ownership is making an impact!

**Dear reader**

When it comes to the concept of sustainable investments, many investors still only think of exclusions for the time being. However, the range of instruments has been greatly expanded over the years. Meanwhile, a best-in-class approach, ESG integration, sustainable thematic and impact-oriented investing complement the number of available instruments. Active Ownership is an instrument that has so far found less use in continental Europe, but is now enjoying increasing popularity.

**Overview Active Ownership**




Source: J. Safra Sarasin Annual Report, 2018

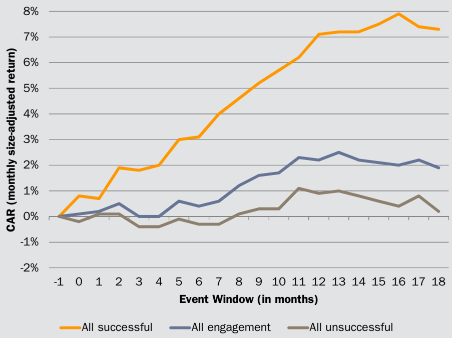
**Active owners improve the governance**

Active Ownership comprises all activities of investors with the aim of exerting influence on the business of companies. As the previous chart shows, this can be done (1) in direct dialogue with the management of a company, (2) by contentiously examining controversial issues together with other investors (collaborative engagement), (3) by discussing potential regulations with political authorities and, of course, (4) by voting on agenda items at shareholder meetings. An important goal of Active Ownership is to improve corporate governance. This also tends to lead to better share performance and reduces the negative external effects of business practices on the environment and society.

**Engagement increases performance**

In an academic study based on data from sustainable engagements conducted in the USA between 1999 and 2009, it was possible to find a correlation with the performance of equities. Successful engagements were associated with positive abnormal returns, while unsuccessful engagements were not associated with additional returns. The study also found that companies with weaker governance were more likely to be the target of engagements. Successful engagements were again more likely if the company was struggling with reputational problems but had a higher willingness to change. Such changes improved not only environmental and social management plans, but also accounting issues. Collaborative engagement was identified as a clear success factor.

**Active Ownership: studies show a noticeable impact**




Source: Dimson, Karakas, Li (2015): Active Ownership

**Regulatory pressure is rising**

Following the introduction of the Stewardship Code in the UK in 2010 and the Swiss Ordinance on Excessive Compensation in 2014, both of which require a vote on the fiduciary duty of pension funds, the EU is now taking action as well. The recently adopted Shareholder Rights Directive (SRD) imposes far-reaching obligations on institutional investors. However, surveys show that institutional investors in EU member states are not yet sufficiently prepared to comply with the Directive. In this newsletter, we explain what we do in the area of Active Ownership and also describe what investors can do to prepare for it.

Best wishes,
**Jan Amrit Poser**
Chief Strategist and Head Sustainability

# Our Active Ownership Activities in 2018

**As far as our investors are concerned, Bank J. Safra Sarasin sees its role as a sustainable asset manager with a long-term perspective. Part of our fiduciary duty is to make investment decisions in the best interests of our clients and to try to maximise the value of their investments. Active Ownership, which involves effective dialogue (engagement) and the exercising of voting rights (proxy voting) is a key component of this process. This approach is not only designed to encourage robust corporate governance structures, but to ensure that the rights of shareholders are protected. In the same vein, we aim to encourage forceful initiatives in the environmental and social domain, together with greater transparency, in order to produce a positive impact.**

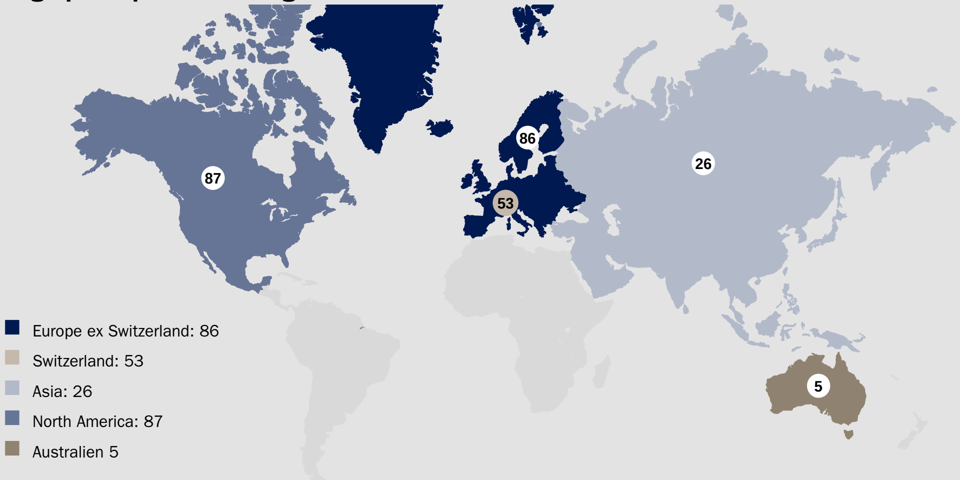
**Proxy Voting at Bank J. Safra Sarasin**
Bank J. Safra Sarasin exercises voting rights for its sustainable investment funds on behalf of its clients. The bank has its own operating guidelines for exercising voting rights, and these are fully aligned with our sustainable investment strategy. These guidelines contain our specific understanding of various themes, such as the structure and experience of the board of directors or compensation packages for executives, as well as certain environmental and social aspects.

**Overview of our Voting Activities**
Proxy Voting is the practice of exercising our voting rights at companies' annual general meetings (AGMs). Investors exercise their right to vote for various agenda items.
Our Active Ownership activities are coordinated and implemented primarily by our Sustainable Investment Research team, with the support of other parties, such as Portfolio Management. This integrated structure allows us to apply our in-depth company and sector knowledge, as well as our thematic know-how, to our engagement as effectively as possible.

| | 2018 | 2017 |
|---|---|---|
| Number of AGMs | 263 | 227 |
| Number of Proposals | 4'031 | 3'346 |
| Against Management | 25% | 24% |
| Proposals on environmental and social themes | 36 | 21 |

In 2018, we further enlarged our proxy voting footprint and can show a 14% increase in our activities in terms of absolute numbers of annual general meetings where we have casted our voting rights.

**Geographic Spread of Voting in 2018**




Source: Bank J. Safra Sarasin, 2019

**Overview of our engagement activities**
Bank J. Safra Sarasin actively pursues three different forms of engagement:
- Direct dialogue with companies
- Collaborative engagement
- Engagement for the common good

Different areas of impact are associated with each form of engagement. In our direct dialogue with companies we strive to put forward our investment arguments, while in the case of collaborative engagement the focus is more on systemic environmental, social and governance (ESG) aspects.

**Direct Dialogue Engagement Activities**
In 2018 the bank's sustainable investment professionals had approximately 500 management interactions to discuss investment cases, including ESG themes. We also conducted in-depth dialogues with 45 companies. We managed to achieve satisfactory outcomes with over half of these engagements, which focused on various topics and ESG themes (see table below). We also expressed reservations about a number of controversial aspects.

| | 2018 | 2017 |
|---|---|---|
| **Management interactions** | **>500** | **>470** |
| **Intensive company dialogues** | **45** | **70** |
| **Status** | | |
| Initiated | 1 | 2 |
| Ongoing | 3 | 8 |
| Completed | 41 | 60 |
| **Sucess rates** | | |
| Successful | 24 | 37 |
| Partly successful | 15 | 4 |
| Unsucessful | 3 | 19 |
| Pending | 3 | 10 |

**Thematic Split of Engagement Dialogues in 2018**


Source: Bank J. Safra Sarasin, 2019

**Our Commitments**

We are committed to various initiatives, playing a leading role in many, in order to foster the sustainability agenda. We live and breathe sustainability.

Source: Bank J. Safra Sarasin, 2019

**Dedicated Engagement Project on the Impact of Natural Disaster Risks for Real Estate Holdings**

ESG data availability increased significantly in recent years. For specific sustainable investment analysis needs however, company engagement is required in order to get meaningful insights in company's risk exposure and management skills.

In 2018, we conducted a specific engagement project where a number of portfolio real estate holdings were assessed on their physical risk exposure related to rising sea levels and extreme weather events. Due to a broad set of geospatial data, we know which regions and cities are most prone to the described risks. Unfortunately, we do not have access to singe building location data for the overall portfolio of a real estate company. Questionnaires were sent out to companies to obtain the necessary data basis. The goal was to get an indication of investment implications of rising sea levels and other extreme weather events for selected investee real estate holdings with long-term assets in their portfolio.

By engaging with companies we have learned that:

- Certain sub-industries are more exposed than others (e.g. Hotel REITs)
- Geographic diversification is the most important mitigation factor
- Real estate companies have a number of mitigation tools available (ranging from pre-deal analysis to insurance)
- Building prices in flood-prone regions most likely won't crash in the coming years, but there is a tail risk for buyers.

Such engagement projects allow us to build relationships with companies and to gain in-depth insights which can be directly incorporated into our investment decisions. We came to the conclusion that our portfolio holding companies will likely not be adversely affected by natural disaster risks in the shorter time horizon and will further monitor this topic.

**Public Policy Engagement**

Bank J. Safra Sarasin continues to actively participate in political dialogue in various ways. Through involvement in leading sustainable investment initiatives and organisations such as Eurosif and Swiss Sustainable Finance (SSF), the Bank fosters contacts with politics and other stakeholders to promote the integration of relevant ESG themes on a regulatory level. The Bank is also committed to promoting a better understanding of sustainable investments.

*2018 Global Investor Statement to Governments on Climate Change*

Bank J. Safra Sarasin signed the "2018 Global Investor Statement to Governments on Climate Change" developed by the Asia Investor Group on Climate Change, CDP, Ceres, Investor Group on Climate Change, Institutional Investors Group on Climate Change, Principles for Responsible Investment, and the UN Environment Finance Initiative. The aim of the statement is to reiterate the full support for the Paris agreement and strongly urge all governments to implement the actions that are needed to achieve the goals of the Agreement, with the utmost urgency. In the statement all signatories call on global leaders to:

1) Achieve the Paris Agreement's goals;
2) Accelerate private sector investment into the low carbon transition; and
3) Commit to improve climate-related financial reporting.

Bank J. Safra Sarasin is part of the annual sustainability meeting with the financial industry on "Sustainable Finance" organized by the Swiss State Secretariat for International Financial Matters (SIF).

More detailed insights, e.g. detailed company examples, with regards to our Active Ownership activities are shared in our dedicated "Active Ownership Report 2018" publication.

For more information on our Active Ownership strategy and policy, please contact: sustainableinvestments@jsafrasarasin.com.

**Agnes Neher**
Corporate Sustainability Manager

**Andrea Weber**
Sustainable Investment Analyst

Sustainable Investment Spotlight

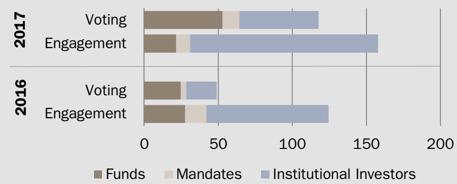
# Breaking new records in 2018

**Assets under management for investment strategies relating to engagement and proxy voting are continuously growing. While the remuneration figures for management personnel in Switzerland remain stable, the correlation between long-term performance and remuneration is not always apparent. Institutional investors are increasingly beginning to participate in climate-related engagement initiatives and investee companies are showing a pro-active approach to promoting a common exchange on ecological, social and governance matters.**

**Remarkable growth in active ownership market segment**

Active ownership is one of the fastest-growing sustainable investment strategies in Switzerland, with growth rates ranging from 27% to 140% in 2017 according to the Swiss Sustainable Finance (SSF) market report for 2018.

**Latest active ownership AuM figures for Switzerland (CHF bn)**




Source: Swiss Sustainable Finance (SSF), 2018

ESG engagement ranks third amongst all sustainable investment strategies and is applied to 40% of all sustainably managed assets in Switzerland. Proxy voting is the fastest-growing sustainable investment strategy, representing a total share of 30% in all sustainable assets in Switzerland. This may be attributable to the obligatory exercising of voting rights in Swiss pension funds in accordance with the Swiss ordinance against excessive remuneration in public corporations ("Verordnung gegen übermässige Entschädigung in börsenkotierten Unternehmen", VegüV).

**Our forecasts for 2018 proved correct**

In our last Sustainability Spotlight on active ownership (October 2017), we highlighted the issues of diversity and remuneration practices for management personnel, which we expected to attract greater attention in 2018. Our forecasts for both proved to be correct. The drive for greater diversity has become more prominent, while debates about appropriate remuneration principles and frameworks as well as the disclosure of remuneration rates have continued.

These aspects have become a focus of interest both globally and in Switzerland. According to Ethos (2018), remuneration is not always correlated to long-term performance. However, there was a visible "stabilisation of overall remuneration in SPI companies and a slight decrease in the largest listed companies" in 2018. Remuneration at Switzerland's 100 largest companies declined in all sectors last year, except the financial sector.

**Promotion of active ownership in Switzerland**

Active ownership AuM figures are not the only ones to climb sharply in recent times, as other observations show that there has been an increase in awareness of ESG engagement and proxy voting activities. This has been driven by factors including better collaboration between investors and companies, which are stepping up their interaction with investors accordingly.

<u>Swiss investors increasingly participating in collaborative initiatives</u>

While institutional investors in Switzerland are currently less involved in engagement activities compared to their UK counterparts, for example, since 2018 a number of Swiss investors have pledged their commitment to sustainability initiatives, such as the Global Investor Statement to Governments on Climate Change, which was signed by 319 investors worldwide (including Bank J. Safra Sarasin).

<u>Pro-active efforts by investee companies</u>

Furthermore, companies are increasingly engaging with their investors and major voting proxies to conduct a dialogue on corporate governance issues. The Sustainable Investment Research Team at Bank J. Safra Sarasin was approached by various Swiss companies in 2018 to discuss remuneration plans for management personnel and their correlation to long-term performance or proposals for executive committee candidates.

**Hot topics in 2019**

In light of the regulatory developments in other countries, we expect to see increasing numbers of shareholder suggestions regarding gender diversity and cyber security practices as well as the disclosure of related information in the foreseeable future. Use of social media and compliance with securities legislation may be other areas of current interest to investors that will attract greater attention going forward.


**Agnes Neher**
Corporate Sustainability Manager

**Andrea Weber**
Sustainable Investment Analyst

# Hazardous chemicals – or the new carbon

**Chemicals are increasingly present in our daily lives and create major health and environmental risks. Concern among stakeholders is growing, while regulatory momentum is mounting, thus creating an immediate business risk for companies. Similarly to carbon a few years ago, and despite the scarcity of information, investors need to grasp the implications of this evolution to con-tribute to and thrive in a more sustainable future.**

### Chemicals are everywhere…

Chemicals are increasingly present in everyday consumer products: from plastics and clothes to flame retardants in mattresses and couches, through to food and shampoos. This universal trend is even stronger in developing countries where regulation is generally less advanced, thus adding to the challenge of improving global chemical safety.

### …and their consequences are now well understood…

Over the last twenty years, the scientific community has built up a substantial body of evidence demonstrating the adverse health consequences and negative environmental impact of some chemical components such as phthalates and perfluorinated compounds (PFCs). According to a study[1] commissioned by the United Nations Environmental Program, industrial and agricultural chemicals are indeed among the top five leading causes of death globally. Regulation has evolved in response, and some controversial chemicals have been banned by various national bodies.

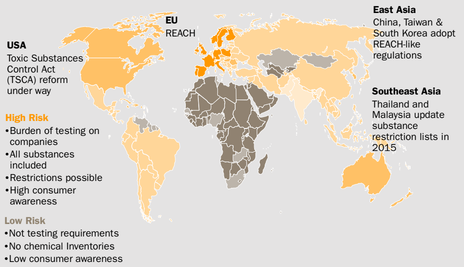
### …with action needed at all levels

In the face of growing public awareness and concern, reflected in initiatives such as the Detox Outdoor Campaign and supported by specialised NGOs like ChemSec, the European Union took a key step in 2007 and launched a vast initiative, called REACH (Registration, Evaluation, Authorisation and Restriction of Chemicals). It targets over 10,000 chemicals to date, 300 of which could potentially be banned in the coming years.

The REACH process has come a long way since 2007 and has inspired many ongoing regulatory evolutions around the world. Similarly to the carbon issue in recent years, momentum around chemical safety is growing and material implications for companies are becoming clearer.

Such regulatory developments indeed have a direct business impact, in addition to potential operational constraints linked to the handling of hazardous chemicals. Not just for chemicals companies manufacturing the targeted components – known as Substances of Very High Concern or SVHCs – but also for a wide range of consumer goods and industrial companies whose products contain SVHCs.

### Chemical safety regulations around the world




Source: Bank J. Safra Sarasin, MSCI, 2018

Therefore companies need to take action. This starts with assessing the hazard of chemicals they use and ultimately finding sustainable alternatives, which requires extensive investigation. Indeed, inappropriate replacements can have a cost impact of \$5-\$10 million for just one substance (among hundreds or even thousands in certain businesses) according to estimates from the technology company HP, which uses chemicals in its printing products and batteries.

### Implications for investors

Professionalised carbon-tracking and reporting allows investors to evaluate companies' efforts to tackle climate change and fulfil their fiduciary duty. When it comes to chemicals, however, assessing financial risks or investing in progressive leaders is far from easy, despite the growing need for a clear understanding of companies' chemical footprint.

Chemical safety appears on the investment radar as it becomes a material risk for companies, but information and methods to assess companies' preparedness are only just emerging. Besides, adopting a risk perspective provides merely a partial view on the evolution it implies.

Phasing out hazardous chemicals from everyday products indeed calls for alternatives which might not exist today. Research efforts and a change of mindset are required to find suitable solutions. The challenge is to substitute the idea of acceptable hazard with actual chemicals and products thought to be safe from inception.

Furthermore, chemicals have the potential to contribute to addressing environmental challenges from pollution control (water treatment, soil decontamination, emissions abatement) to energy management (biofuels, power storage, solar equipment), thus opening a new field of opportunities.

### The smart way to go

At Bank J. Safra Sarasin, the assessment of chemical safety exposure and management is integral to a company's assessment. As a result, we avoid companies carrying major business and operational risks, as well as those with negative impacts on human health and the environment. On the other hand, companies fostering change and providing alternatives to SVHCs or developing relevant chemicals to address environmental challenges are likely to benefit from strong business opportunities and are identified along the investment process.

**Guillaume Krepper**
Sustainable
Investment Analyst

[1] UNEP - Global Chemicals Outlook - 2013

# Examples of recent Engagements

**LVMH – Assessing water risks in agricultural supply chains.**
As part of the PRI-coordinated collaborative engagement initiative on “Water Risks in Agricultural Supply Chains”, we have been engaging with the luxury goods company LVMH over the past three years. In a first step, we received convincing evidence that the company is aware of potential supply chain disruption issues stemming from highly water-stressed areas. For LVMH, this is mainly relevant for the grapes of vineyards in California and Chile. LVMH shared a number of mitigation measures and examples with us. LVMH works in collaboration with farmers in order to avoid water shortages. Our main engagement focus is on disclosure now. The latest water-related figures will be released shortly. In the context of our next scheduled interaction and in the spirit of “what gets measured, gets managed”, we will focus on those results and propose selected context-based water metrics to LVMH for future measuring of risks. This will put us in a better position to judge the effectivity of LVMH’s water-related efforts.

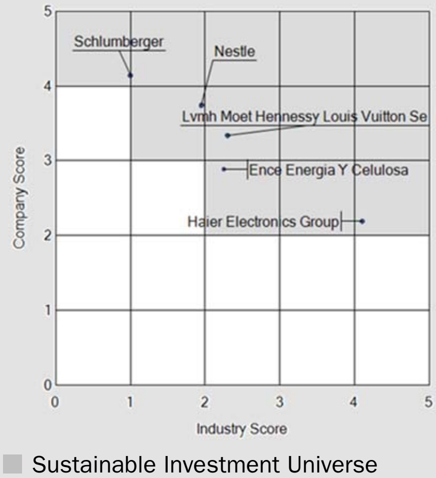
**Ence – A sustainable forest manager with further improvement potential.**
Ence is a Spanish forest and paper company with energy production (for own consumption). It displays a balanced and above average approach to sustainability issues. Potential environmental liabilities and operational disruption risks related to procurement are mitigated through adequate measures and validated by third parties (e.g FSC). Likewise the environmental footprint of direct operations is consistently handled across the company’s sites. However, trends in emissions and waste release suggest potential for improvement and the company lacks clear targets in this area. On the opportunity side, biomass energy production positions the company for megatrends. From a social and governance perspective, Ence’s practices are in line with sustainability standards and address relevant operational and business risks. Therefore, Ence is eligible to the sustainable investment universe.

**Schlumberger – A cooperative oil giant.**
Schlumberger is an energy equipment and services company that experienced some deterioration in regard to some Key Performance Indicators. Bank J. Safra Sarasin had an open and successful engagement dialogue with the oil giant about its ESG-management in general, and about specific critical indicators. Especially in the field of biodiversity and toxic emissions we had some critical discussions with the company which we conducted on the phone and in direct exchange in Switzerland. The company provided us with further information about their strategy and future efforts to tackle the decline performance. The result was an increase in our in-house sustainability rating of the company. Our lead was followed by one of the large rating agencies.

**Nestlé – Monitoring the sourcing of controversial raw materials.**
Nestlé purchased 425’000 tons of palm oil in 2018, which makes the company one of the largest buyers of this commodity globally. We approached the company to better understand how the supply chain is monitored and how Nestlé collaborates with relevant stakeholders. In particular, our controversy monitoring signaled allegations of land-grabbing related to a well-known palm-oil supplier. However, Nestlé could confirm that this supplier did not deliver palm oil to them. In 2018, Nestlé increased transparency and released a list with all tier-one suppliers. Ten suppliers, which did not comply with the agreed action points were publicly disclosed and removed from the supply chain. Because effective risk management and anti-deforestation efforts require industry-wide change, Nestlé puts emphasis on innovation. Nestlé, together with partners, established a satellite-based service that allows for constant monitoring of the palm oil supply chain with the goal of stopping deforestation. Overall, the company remains committed to using 100% responsibly sourced palm oil by 2020 (currently: 64%).

**Haier – On the way to better environmental emissions disclosure.**
Haier is a major Chinese household appliances manufacturer operating globally. The company displays an above average management quality of environmental challenges in relation with electronic waste thereby mitigating related risks including unexpected operational expenses. Following the collaborative engagement conducted with the Carbon Disclosure Project (CDP), Haier will start to report on its greenhouse gas emissions which is a key information to assess companies’ climate change impact. This is becoming increasingly relevant in China where the government has planned the implementation of an emissions trading scheme. On social issues, Haier ranks at the same level as most of its peers, although it performs better on Supply Chain Labor Standards thus reducing associated risks such as operational disruption. Corporate governance at Haier is in line with industry standards. Overall, Haier displays an average sustainability profile and is therefore eligible to the investment universe.

**Sarasin Sustainability-Matrix®**

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Sustainable Investment Research

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**Sustainability Rating Methodology**

The environmental, social and governance (ESG) analysis of companies is based on a proprietary assessment methodology developed by the Sustainable Investment Research Department of BJSS. All ratings are conducted by in-house sustainability analysts. The sustainability rating incorporates two dimensions which are combined in the Sarasin Sustainability-Matrix® :

Sector Rating: Comparative assessment of industries based upon their impacts on environment and society.

Company Rating: Comparative assessment of companies within their industry based upon their performance to manage their environmental, social and governance risks and opportunities.

Investment Universe: Only companies with a sufficiently high Company Rating (shaded area) qualify for Bank J. Safra Sarasin sustainability funds.

Key issues

When doing a sustainability rating, the analysts in the Sustainable Investment Research Department assess how well companies manage their main stakeholders' expectations (e.g. employees, suppliers, customers) and how well they manage related general and industry-specific environmental, social and governance risks and opportunities. The company's management quality with respect to ESG risks and opportunities is compared with its industry peers.

Controversial activities (exclusions)

Certain business activities which are not deemed to be compatible with sustainable development (e.g. armaments, nuclear power, tobacco, pornography) can lead to the exclusion of companies from the Bank J. Safra Sarasin sustainable investment universe.

Data sources

The Sustainable Investment Research Department uses a variety of data sources which are publicly available (e.g. company reports, press, internet search) and data/information provided by service providers which are collecting financial, environmental, social, governance and reputational risk data on behalf of the Sustainable Investment Research Department.



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