



ESG Engagement Report

Second quarter 2019

Nordea 1 – European Stars Equity Fund

The aim of this document is to describe some of the ESG (Environmental, Social and Governance) and engagement activities of the Responsible Investment (RI) and Fundamental Equities (FE) teams that work in collaboration on the European Stars fund. This is not meant to be fully comprehensive, but should allow investors to get insights into the main ESG and engagement activities that the integrated team has focused on.

Introduction to the STARS concept

Nordea's STARS funds proactively select high-quality ESG companies with the objective to identify tomorrow's winners, which, we believe, will have sustainable business models and the ability to conduct their businesses responsibly in relation to their stakeholders – employees, suppliers, customers, investors and society at large. Nordea's RI team works together with the fund's financial analysts and portfolio managers in order to deliver a solution that is able to:

- **Outperform the benchmark:** creating added value by enhanced long-term returns.¹
- **Meet Nordea's ESG standards:** analysing each individual stock to ensure that the fund invests only in companies that follow certain ESG standards.
- **Active ownership:** proactively engaging with companies and encouraging them to improve their management systems, their ESG performance or their reporting, as well as exercising formal rights in the voting resolutions.

Engagement is key for active ownership

Being part of Nordea's responsible investment policy, the fund excludes companies involved in the production of nuclear weapons and cluster munitions as well as companies with large exposure to coal mining (>30% revenues). However, excluding a company from our portfolios is always a last resort: the **STARS concept aims for positive selection** with the objective to influence companies to improve their ESG

profiles. **Engagement therefore takes a new dimension with the STARS.** It does not only consist of the traditional forms of engagement, like the exercise of voting rights or entering into a dialogue to encourage companies to improve their management systems, their ESG performance or their reporting. When assessing a company's ESG risk profile we also focus on specific themes utilising UN Sustainable Development Goals. Thus, we distinguish two types of engagement:

- **Risk Engagement:** if a company is not managing its material ESG risks well, the RI team engages with the company on the issue. The ESG risks can be company specific or stem from the country in which the company operates or its industry. Violations of international norms and conventions are also addressed under Risk Engagement.
- **SDG Engagement:** conducted with a specific focus on companies' exposure to certain themes, which might represent a significant material risk for the company. **Nordea believes that companies that align their strategies with the UN Sustainable Development Goals (SDGs) will be successful** in the long-term, because they are adjusting to global society's future needs.

The UN Sustainable Development Goals (SDGs) cover a broad range of social and economic development issues as part of the 2030 Agenda. In this edition of the quarterly report we have highlighted 4 UN goals; Those goals have been the focus of the engagement activities described in the coming pages.



These are the UN Sustainable Development Goals (SDGs) our ESG analysts focused on – during the period covered – when engaging with the companies. The complete list of SDGs can be seen on page 3.

¹) There can be no guarantee that this strategy and process will produce the intended results and no guarantee that the strategy will achieve its investment objective. The value of your investment can go up and down, and you could lose some or all of your invested money. ²) ESG rating scale

Top 4 ESG activities over the quarter

Holding	Current Rating	Proxy Voting ²	Relevant SDGs	Nordea ESG Area	Activity
Nestle	B+	✓	12 13 15	Climate change governance	Research/Call, Meeting
NMC Health	A+	✓	N/A	ESG reporting	Research/Call
Delivery Hero	B	–	8	Corp. Gov, Strategy, Labour rights	Meeting
BMW	A	✓	12 13	Climate change policy, transparency, lobbying	Research, call, meeting

² Proxy voting refers to the last 12 month-period. Generally we vote in annual reports and most of the Annual General Meetings (AGM) which occurs once a year. If there is no vote, it is generally because the fund was not invested at the time when the AGM happened. Please find out more on nordea.com/sustainability or access directly the [voting portal](#).

ESG rating distribution (from best to worst) applicable to this fund:



Sustainable Development Goals (SDG) utilised in this report:



Rating changes

There were no rating changes during the quarter.

Main highlights of the ESG activities over the quarter

The following activities have been selected to share with investors some of the highlights of the period. Please note that when engaging with companies, the processes might last several quarters, as such we might not necessarily report on the final decisions.

Nestlé

During the quarter we had two conversations with Nestlé: a lengthy discussion of palm oil sourcing practices and a broader conversation about general human rights performance as a part of the Corporate Human Rights Benchmark engagement. While the company has been forthcoming with information and answers, we are left with the challenge to make a judgement call on the credibility of their efforts. These efforts, when it comes to palm oil, consist of the following:

- A commitment to 100% responsibly sourced palm oil in 2020
- Mapping their supply chain in cooperation with the Earthworm NGO
- Strengthen RSPO processes through reinstated membership
- Improve traceability and verification, also through the use of satellite technology (Starling)

A notable exception from this list is replacing palm oil where possible with different vegetable fats. We did not get the sense that this is a solution that Nestlé plans on adopting to a significant extent. As palm oil produces 6-10 times more per hectare than any other vegetable oil crop, the company views it as efficient, and believes switching to other oils might shift pressures to other parts of the world.

I believe it would be worthwhile to examine that argument closer. In particular, I would be interested to know whether other crops such as rapeseed and sunflower might not carry lower risk of deforestation, as these can presumably be produced on already exploited land in regions such as Europe and US, rather than on newly cleared land in Indonesia. A potential goal of future engagement could be to push for a more critical examination of the comparable resource intensity of vegetable oil crops beyond just yield per hectare.

It would also be crucial to monitor developments in 2020: Nestlé is planning to achieve 100% responsible sourcing from a baseline of 64% responsibly sourced and 60% certified deforestation free of palm oil within a year. This is a big leap, and we need to better understand what challenges these targets might face.

Where Nestlé did seem credible is its use of monitoring technology and engagement with smallholders. The resource directed into these efforts is significant and understanding the situation on the ground is a genuine priority. The call on the Corporate Human Rights benchmark showcased these strengths in other contexts as well. The RI overall view is that the company is unlikely to transcend the limitations inherent in its sourcing model without outside pressure. The efforts it puts in managing its impacts is substantial but appears mainly reactive, so close scrutiny by investors and other stakeholders is probably essential to keep up progress.

NMC Health

We continued to have strong interactions with NMC Health during the quarter. The market continues to look extremely closely at the company's practices, as the concentrated supply chain, the high level of related party transactions, and the ownership structure carry higher than usual governance risk for a UK listed company. NMC Health provided us with some assurance regarding the chair of its audit committee, and other aspects of its disclosure. We were also pleased to see that the company has delivered on its promise to expand its ESG reporting. This has almost tripled in length and provides well-explained data on issues material to the company. We will continue the dialogue and as we feel this contributes to mitigating the governance risks of its setup.

Delivery Hero

Delivery Hero is not part of the portfolio but is part of the investment universe. We met with the company to continue our push for more transparency around its management of labour risks and their effect on the business model. Currently, our assessment regarding the company's suitability for the STARS portfolios remains unchanged. It's difficult to get a good grasp of its global exposure to litigation risk inherent to its business model. Local operations remain decentralised, and in our views, there is a significant risk of oversight gaps. Recent court judgements regarding the classification of riders as contractors versus employees have largely been unfavourable, and so far, the company has few mitigation strategies which are different than exiting the countries in question. We will continue our dialogue with the company as we feel the stock could be an interesting candidate for investment should it provide better transparency around its labour risk. We hope our feedback will contribute to move the company in the right direction.

BMW

BMW is not part of the portfolio but is part of the investment universe. We had two discussions with its sustainability team to better understand its positioning on Electric Vehicle batteries and climate policy. With regards to EV batteries, the aim of the dialogue was to understand whether their positioning on electromobility is strong enough to become a profit driver in place of diesel. We believe the pace of change could be quicker, although there is evidence that significant resources go into engineering the battery away from cobalt and minimising supply chain risks. The contract for the iNext batteries is still with an external supplier.

We also requested more transparency on the company's lobbying activities and climate policy positioning. In particular we asked for a full list of association memberships, and for reporting on climate according to TCFD guidelines. We did not get a commitment that this will happen within the next reporting period, but we acknowledged the company moving in the right direction. We will follow up at a later stage during the year to monitor such developments.

Complete list of SDGs:



Source: un.org/development/desa/en/news/sustainable/sustainable-development-goals.html

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