



ESG Quarterly Report

First 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 2 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.

Top 3 ESG activities over the quarter

Holding	Current Rating	Proxy Voting ²	Relevant SDGs	Nordea ESG Area	Activity
Munich Re	A	–	13	Climate change governance	Research/Call
NMC Health	A+	–	N/A	ESG reporting	Research/Call
Ryanair	C	–	8	Corp. Gov, Strategy, Labour rights	Research/Call

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.

Munich Re

We engaged with the company to get some background on their decision to stop underwriting new coal business. The pledge to limit or exclude coal from insurance underwriting has become a new norm in the sector where AXA, Swiss Re, and several other insurers have also committed. Munich Re came as a surprise in August 2018, about a week after the CEO publicly declared the company would not consider to stop coal underwriting. Munich Re was therefore first criticised for not committing to such topic and then for having loopholes in its commitment. Our assessment was focusing on why the sector leader in climate change expertise committed so late and in a weaker way than its competitors.

We had an open and hard-hitting conversation with Renate Bleichert, Munich Re's head of sustainability, to understand the reasons behind such story in order to test the credibility of Munich Re's climate leadership at this point.

In a nutshell, the management board was hesitant to commit to exclude coal due to the size and complexity of Munich Re's energy portfolio. Ultimately, they managed to agree to the standard industry commitment of not underwriting new coal projects, with some country-based exceptions. The sustainability team has a veto right and decides exceptions on a case by case basis. The countries that can be exempt have under 10% electrification rate (based on IEA data), and an exception has only been requested three times since August 2018. It wasn't granted in any of the cases.

Munich Re also pointed out its activities to create innovative insurance products which incentivise the adoption of climate solutions and the roll-out of renewables. This is a small part of the overall product portfolio, and the RI team has yet to be persuaded that it is a sufficiently significant growth driver.

Our key takeaway is that Munich Re is probably a leading climate expert but has a problematic relationship in being a policy leader. Its superior expertise is primarily used, perhaps unsurprisingly, to sharpen premium setting, but top leadership is extremely cautious about any perceived jeopardy to returns. To some extent, the sustainability function is trying to turn very entrenched practices around. We understand external investors' voices have significant weight within the board, and therefore we need to express our views to these investors in a suitable setting. We believe this will influence Munich Re to further progress on the topic. We currently consider sending a letter as there would be a significant reputational benefit should Munich Re superior climate expertise translates into a genuine policy leadership.

NMC Health

We had a follow-up conversation with the UK listed healthcare provider NMC Health to better understand the quality of care metrics included in the ESG reporting. We therefore met with the company's risk management team, who shed some light on how data was collected, quality proofed, and used to guide care provision. We also had a fruitful discussion on how to better present this data to underline any competitive advantages NMC Health might have. We acknowledged that the data quality oversight is done according to best practice and we were impressed by the expertise of the responsible manager. We will continue monitor closely NMC Health's practices. Our impressions so far are positive but there are some outstanding governance questions that need to be addressed in the future.

Ryanair

We liaised with Ryanair to give the company an opportunity to present its case on the viability of its business model and the state of its corporate culture following the unionisation of its workforce. The company highlighted their competitive advantage which will last despite the rise in labour costs due

to efficiencies in other areas. However, the company was not able to offer enough evidence supporting any genuine culture change. They mentioned that the pilot shortage and under-capacity the industry is currently facing will weaken the negotiation power of unions, thus benefitting the cost base. This may be a true fact, but does not demonstrate a change or a willingness for a change of the corporate mindset.

We also talked through the corporate governance changes the company is experiencing, such as the changed role of founder Michael O'Leary and the board changes. This part of the conversation was particularly frustrating as Ryanair continues to ignore the root causes of investor concerns. For example,

as we questioned the potential 100 million pounds pay-out to Michael O'Leary, the counterargument was that it costs almost nothing to investors as it is granted in options. We then tried to explain that the actual issue lies elsewhere (choosing the right incentive, reputational risk) and we don't think the company agreed with our views.

We have the impression that changes are so far more cosmetic than fundamental, even if it looks significant on the paper. The corporate culture that created Ryanair's problems remains unchanged and we see no reason for a rating upgrade at this stage.

Complete list of SDGs:



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

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