Signatory of:

Responsible Investment Review
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RI Mission Statement

We believe that investing responsibly goes to the heart of our fiduciary duty to clients to generate strong long-term investment returns

Prudent Investments – our DNA

Certain characteristics of Sparinvest's corporate DNA dictate our approach to investment. These include a long-term horizon, a bias towards academically proven strategies that work repeatedly over complete economic cycles and, most importantly, a prudent attitude to risk – the lens through which we analyse potential returns. Indeed, Sparinvest's Danish motto/strapline (conceived in the late 1990s) is: 'investering med omtanke' which translates as 'Prudent investments'.

With this in mind, it is no surprise that Sparinvest has long considered itself to be a responsible investment house. For our actively-managed funds, being responsible is about analysing the ESG characteristics of a company alongside all its other fundamentals to assess their potential impact on the investment case. Our aim is to follow strategies that we believe will deliver the best returns for clients, whilst helping our investee companies to recognise that a focus on sustainability matters can boost long term corporate value – a win/win for all concerned.

UN PRI Assessment Scores 2017

PRI Scoring Modules	Sparinvest 2017	Median Score 2017	Sparinvest 2016
Strategy & Governance	A+	A	A+
Listed Equity Incorporation	A+	A	A+
Listed Equity Active Ownership	A	B	A
Fixed Income SSA (Gov Bonds)	B	B	B
Fixed Income Corporates	A	B	B
Fixed Income Corporates	A	B	B
Fixed Income Securitized	B	B	C
Property (Indirect SAM)	A	C	A+

Source Sparinvest: The 2017 PRI Assessment scores shown are extracts from the full UN PRI Assessment Report 2016-7 for Sparinvest Group which, available at Sparinvest.eu.

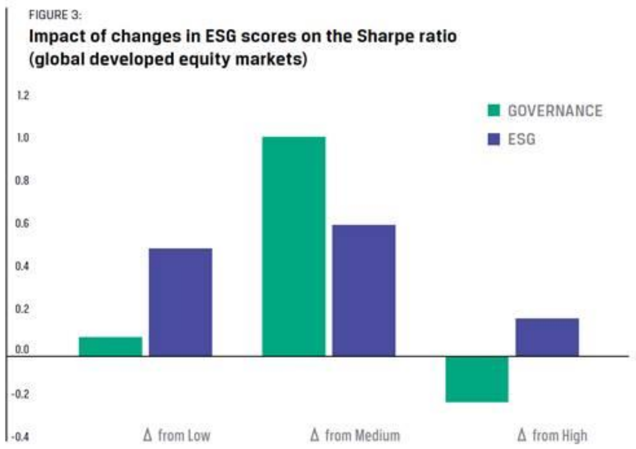
The UN PRI has now completed the process of peer-assessing signatories' transparency reports, and we are pleased to inform clients that Sparinvest has again scored satisfactory marks in most categories. For the third year in a row, we have achieved the top mark possible – A+ – in Strategy and Governance and Listed Equity Incorporation.

Above, we give our 2017 'summary scorecard', with 2016 scores for comparison. Full versions of both our Transparency Report and the PRI Assessment Report for 2017 are now available from our website, or from the new PRI Data Portal.

ESG Improvement Momentum

As we have stated many times, Sparinvest does not operate with a 'best in class' ESG strategy. We don't necessarily invest in perfect companies: often, it's about good companies with room to improve. We think that often the strongest gains can be made by investors who participate as a company gets better: whether it's improving profit margins, boosting sales, reducing its carbon footprint, improving labour relations, or bolstering board independence, improvement in ESG or other fundamentals can be significant share price drivers in the long-term.

Impact of ESG improvement on Sharpe ratio



Sources: NN Investment Partners and the European Centre for Corporate Engagement

For this reason, we were very interested to read a CFA Institute article, quoting research from NN Investment Partners and the European Centre for Corporate Engagement. This shows the improvement in Sharpe ratios resulting from in companies with positive ESG momentum. Interestingly, the biggest improvement can be seen in companies with ESG scores that are average but improving. ESG momentum has the least positive effect in companies that already score high on ESG factors. Indeed the article goes so far as to say that: 'investing in the companies with the highest ESG scores, adjusted for market cap, actually hampers investment performance because these ESG qualifications are usually already widely known and reflected in the share price'.

What excites us most about this research, is that it shows the potential for securing potentially greater returns though investment in those companies that have a tailwind of ESG improvement momentum. It also shows the merit of engaging with investee companies to encourage them to take action to improve their ESG profiles.

Sustainability Movement Gathers Pace

When the history of the sustainability movement is written, the year 2015 may be seen as a 'tipping point' for two reasons. First came the UN Sustainable Development Summit in New York, where more than 150 world leaders formally adopted the 2030 Agenda for Sustainable Development, and its 17 ambitious 'Sustainable Development Goals' (SDGs or 'Global Goals)', which are now feeding through into international policies on development cooperation. Then came December's Paris Climate Agreement which committed its 195 signatories (minus one since the advent of 'The Donald') to undertake 'nationally determined contributions' and established mechanisms to hold them accountable to a future 2°C (or less)-compliant economy, making this target a financial imperative for all sectors of industry.

In 2017, we have seen a raft of legislation enhancements and policy initiatives, designed to enshrine these commitments in EU law and ensure that companies increase their focus on delivering a sustainable financial future. These include:

- **Shareholder Rights Directive** revised to hold companies more accountable to shareholders' long-term interests.
- **Non-Financial Reporting Directive**, new guidelines for companies to report on the social and environmental impacts of their activities.
- **Capital Markets Union Action Plan** integrating sustainability in the EU's investment plan for Europe and directing private capital towards the UN 2030 Agenda and the SDGs
- **High level expert group on Sustainable Finance** recommending reform of EU rules and financial policies to facilitate green and sustainable investment.

As we can see, the sustainability train has well and truly left the station in the EU. And this is mirrored in other jurisdictions, such as Japan where sustainability seems to be developing at bullet train speed, urged on its way by GPIF, the nation's largest asset owner. GPIF has joined the UN PRI and publicly stated that it wishes to see its asset managers integrating and engaging on ESG issues.

Inevitably, the build-up of political and financial momentum behind the 2030 Agenda, the Paris Agreement and sustainability in general will offer ESG opportunities and risks to companies and their investors. This can only strengthen the argument for why the integration of ESG information in investment analysis is absolutely essential to discover long-term value or any threats to it.

Engagement – Case Studies

In our previous RI Review, we promised to look at some of our 2016 engagements in a bit more depth. Given that our average equity investment holding period is 3-5 years, engagement case studies seldom have a beginning, middle and end that slots neatly into a single calendar year. However, the three examples below give an indication of some of the types of issues that led us to engage during 2016 and how we went about it. Sparinvest's policy is to maintain the anonymity of target companies in ongoing engagements in the belief that confidentiality is more conducive to positive outcomes.

Case 1 – Environmental and Governance issues at a South African retailer

We were attracted by the prospects for investment in a South African retailer. However our pre-investment ESG analysis had identified two issues of moderate concern. In terms of risk/reward ratio, these concerns did not diminish the investment case sufficiently to prevent investment. However, we considered it important to address them from the perspective of long-term value. We therefore chose to engage with the company. Initial contact was via telephone, but followed up by more detailed email correspondence.

Concern 1 - Carbon: South Africa has been one of the first movers in proposing carbon tax legislation designed to speed up transition to the low-carbon economy that it sees as a great opportunity. The target date for the introduction of carbon taxation was 1st Jan 2017 and, although legislation has been delayed, investors in South African businesses ignore the potential impact of the tax at their peril. For this reason, we sought information from our investee company regarding the potential impact on its operations, and its strategy.

Our aim was to enter a dialogue with a view to supporting the development of a coherent long-term strategy to address both direct emissions from stores and logistics, and upstream emissions in the production of private label goods.

Concern 2 – CEO Remuneration: while generally satisfied with the fundamental performance of the company and its senior management, we had concern over the CEO's remuneration package, and specifically the payment of a sizeable discretionary bonus which was cash-only and immediately vesting, without any transparent performance criteria.

Our aim here was to supplement our voting activity relating to this issue by directly conveying our concern to management, and seeking a commitment to a more transparent remuneration based on quantifiable performance criteria.

Outcomes: We have found the company to be generally responsive to dialogue – although more forthcoming on some issues than on others. There has been a change of CEO which we hope will have impact on future remuneration policy. Engagement continues.

Case 2 Alleged violation of union rights in U.S.

During 2016, one of our portfolio companies merged with another in the Food Retail sector. Our original investment had passed both our fundamental analysis process for actively-managed equities (incorporating ESG considerations) as well as an independent ethical screening process. It was therefore held in both responsible *and* ethical fund ranges. However, two US subsidiaries of the other merger company had historically faced accusations of undermining workers' union rights and of anti-union discrimination. This resulted in a norms-based ethical screening alert for the newly-merged entity.

Our service provider for collaborative engagements had been involved in dialogue with the company concerned over this issue for some time, trying to clarify its approach to US labour relations. However, as our portfolios inherited the situation via the merger, we decided to supplement this service provider engagement with our own direct engagement, both to fact-find, but also as we saw greater opportunity for impact.

Our aims were to encourage the clear communication of the merged entity's labour policy, and to ensure respect of certain specific rights such as that of union representatives to access the workplace. On the whole, the company had a record of strong labour relations, and we were keen that this should not be damaged by weaker practices at a minority of subsidiaries.

Engagement was initiated in late 2016 via email. This was followed up with a detailed and constructive conference call with the Investor Relations department in early 2017.

Outcomes: Having clarified the company's clear policy that all employees are free to unionise and that any historic issues had been addressed, we were reassured. We therefore encouraged the company to give the same information directly to our ethical screening services provider in order to counter the norms alert appearing in their ethical assessment. In April 2017 our ethical screening services provider issued a new assessment for the company, effectively clearing it of the allegation of anti-union discrimination.

Case 3 - Human Rights in the Extractive Industries (collaborative engagement)

This final case is part of a PRI-coordinated collaborative engagement with various prominent companies within extractive sectors, with the aim of improving human rights policies, practices and performance. Key background resources are the UN Guiding Principles on Business and Human Rights, and the UNGC/PRI Guidance on Responsible Business in High-Risk and Conflict-Affected Areas.

Sparinvest has been acting as co-lead investor, along with two other institutional investors, in engaging with a Japanese oil and gas company held in actively-managed portfolios. This company had typically been involved in projects in various locations as a non-operator, but prior to the start of the engagement, it had taken steps to become an operator, most prominently through a major LNG project in Australia.

At this key juncture, the objective of engagement was to secure improvement in human rights policies, frameworks and practices. Initial work started in late 2015 and continued in the first half of 2016, consisting of research and fact-finding dialogue (via email and telephone conferences) to determine the precise issues on which to engage. From July 2016, the engagement moved to more concrete proposals, made via telephone conference and face-to-face meetings, and supplemented by more detailed email follow-ups. Four focus areas were chosen:

- Overall governance, management and reporting structures relating to human rights

- Grievance mechanisms: structures for processing and monitoring grievances, and ensuring the effectiveness of the grievance mechanism
- Employee training, and monitoring training effectiveness.
- Business partners (suppliers, contractors, JV partners, etc) and how human rights issues& processes can be addressed in that context.

Most concretely, we aimed to encourage the company to create a standalone, overarching Human Rights Policy which would be supplemented by more detailed disclosures on implementation, and annual monitoring and reporting.

Outcomes: Having made a clear and concrete proposal for the company in 2016, engagement has continued in 2017 with a face-to-face meeting. We are pleased to report that the company has now introduced an overarching human rights policy which was one of our key engagement objectives.

New PRI Collaborative Engagement on Cyber Security

Sparinvests's ongoing and future engagements are discussed at regular stewardship meetings. In this forum, we had long identified cyber security as significant risk to corporate value across a number of sectors, and thus a relevant theme for us to engage on. For this reason and, in the aftermath of recent high profile cases of cyber security breaches, we have committed to join the UN PRI co-ordinated engagement on Cyber Security which begins this month.

This engagement will focus on companies' policies and governance for effective cyber risk management across large cap companies mainly operating in the financial, consumer and healthcare sectors.

New Fixed Income Engagement Policy

Over the past year, Sparinvest's Responsible Investment Committee has worked closely with our Fixed Income management teams to strengthen RI policies and procedures. We have now introduced a new Fixed Income Engagement Policy covering all the asset classes. This is also available to view on our website.

In respect of our Corporate Bond strategies – we have started direct dialogues with a number of portfolio companies – particularly those where there have been allegations of potential Norms-breaching behaviour. As creditors, we are very encouraged by the willingness of our investee companies to enter into dialogue with us and share information about how they are working to mitigate the ESG risks that we have raised with them.

During 2016, we asked our screening services provider to run an ethical screen on the entire investable universe of our Covered Bonds strategies. This exercise did not uncover any unexpected ESG issues, but we will continue screening companies in this universe so that our portfolio managers will henceforward be alerted if any norms or sector-based issues arise.

Whenever there is discussion about how bonds can be used to drive forward the sustainability agenda, it is Green and Social Bonds that seem to hog the limelight, despite the fact that the value of issuance is less than 1% of the value of the corporate bond market.

We would like to argue the case for responsible Fixed Income strategies that integrate ESG considerations into investment decisions and use their influence as creditors to press companies for ESG risk mitigation.

Consider, for example, Sparinvest Ethical High Yield Value Bonds fund – a High Yield fund that has strong ESG credentials for the following reasons:

- It builds ESG considerations into a value investment strategy that looks for mispriced bonds,
- It undergoes a norms- and sector-based ethical screening,
- The portfolio managers engage directly with portfolio companies on ESG risks,
- It is carbon footprinted under the Montreal Carbon Pledge.

Such strategies perhaps do not get the recognition they deserve for their role in driving forward the sustainability agenda within the mainstream bond universe.

Yours faithfully,

Sparinvest Responsible Investment Committee