

Value Bonds – Global Ethical High Yield

FIXED INCOME

Teva Case Study and LGX Green Exchange

Fund Update

LUXFLAG: We are proud to announce that we have received the ESG LUXFLAG Label for our Global Ethical High Yield fund. The Label reassures investors that we incorporate ESG strategies throughout our investment process through an annual review of our compliance with our ESG strategy.

The ESG LUXFLAG label also enables our presence on a leading platform for instruments dedicated to sustainable finance, LGX. We are the first and only pure High Yield fund on the LGX – Green exchange.

As we mentioned last quarter, we are working on our carbon thematic engagement which is our most ambitious responsible investing endeavor yet. The initiative is well underway. By the end of the quarter we had heard back from 46 companies which represent 40% of the funds' AuM. We pursue replies from the remaining companies and are developing targeted engagement letters for the 46 issuers to address specific objectives.

Also as part of our commitment of pursuing lowering the carbon footprint of the fund is our participation in the Climate Action 100 initiative. This collaborative engagement initiative entails engagements with companies to take into account climate risk and reduce their greenhouse gas emissions. We are collaborating with other investors on engaging with a utility portfolio company, which by its nature is prone to high emissions. The company is one of the 46 issuers that have replied to our carbon engagement initial letter.

Furthermore, we currently have three engagement dialogues that are open with companies that we hold in the fund. As stated in previous updates, the companies have responded to our inquiries constructively but we continue to monitor the cases, should we see it valuable to pursue further dialogue.

On the topic of ESG integration, we are working to improve how we integrate ESG data in our fundamental analysis and to expand our framework to a more granular model. There has been significant growth in available ESG data which enables us to better assess how companies fare on ESG in contrast to peers and their own history.

Teva case study: Last, but certainly not least, we would like to highlight that we are publishing the first case study of our first norm related engagement. The case involved Teva Pharmaceutical Industries Ltd. and a potential breach of human rights international norms. Please note that as a rule we do not disclose the name of companies involved in ongoing engagements, however this case has been closed and there have been no news to warrant re-opening the dialogue. Therefore, we are glad to share with investors details about the engagement in the case study on Page 2 of this report. We would like to clarify that currently we do not hold Teva bonds in the fund.

Group Engagements

As a member of the advisory group of the Sustainable Stock Exchanges initiative, Sparinvest has provided input into a newly-published SSE Report comprising an action plan for securities regulators wishing to support the Sustainable Development Goals. The report: "How securities regulators can support the Sustainable Development Goals" is available [here](#).

Responsible Investments at Sparinvest

At Sparinvest, analysts and portfolio managers will engage directly with selected portfolio companies. Furthermore, we work with ISS-Ethix, a service provider of ethical screening and collaborative engagements. Via ISS-Ethix, we participated in pooled engagements, targeting companies in confirmed or alleged breach of international norms. In addition to ISS-Ethix, we use ESG research, ratings and analysis as well as carbon footprinting services from MSCI. The development and implementation of responsible investment practices are driven by our Responsible Investment Committee, which includes representatives from Equity and Fixed Income investment teams, and reports to both the Investment Committee and the Board of Directors.

**We do not disclose the name of portfolio companies involved in neither our direct nor our service provider engagements.*

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Engagement Case Study

Sparinvest and Teva Pharmaceutical Industries Limited

A direct engagement by our Credit team on a human rights norms issue.

In 2016, Sparinvest's Responsible Investment Committee introduced a policy whereby companies assessed as being in potential breach of international norms could only be held in ethical portfolios if there was engagement with the company to understand, and mitigate, the risk of breach. As a result, our Fixed Income team undertook its first direct norms based engagement on a human rights issue.

Objectives of the Engagement

Teva Pharmaceutical Industries Limited faced allegations that three of its drugs were in danger of being used for capital punishment by lethal injection in the USA. The company had previously gained widespread praise after acting decisively to control distribution of an anaesthetic, Propofol, after learning that it was potentially being used in capital punishment.

ISS-Ethix, Sparinvest's ethical screening and engagement service provider, had already been in dialogue with Teva on this issue but had failed to secure sufficient assurance about the robustness of Teva's distribution models across all 'at risk' products. This meant that they still viewed the company at risk of breaching international human right norms.

Sparinvest's credit team held Teva bonds in our ethical high yield fund. Therefore, we began direct engagement to seek assurance that Teva was committed to doing its utmost – via robust distribution models and contracts – to prevent the use of its products for capital punishment purposes.

Sparinvest and Teva

Sparinvest wrote to Teva in September 2016, introducing ourselves as bondholders, confirming our relationship with ISS-Ethix and explaining our interest – as responsible investors – in mitigating norms risk in our investee companies. We then we requested more information from Teva about its distribution controls and the language used in distribution contracts to prevent compounding pharmacies and other third parties from using Teva products for capital punishment purposes.

Teva responded. Amongst other things, they confirmed that all applicable distribution contracts had, for some time contained language designed to prevent onward selling to state penitentiaries for the capital punishment purposes. Sparinvest pursued further disclosures from the company as the team believed that public disclosures would lead to stronger commitment on this issue.

Sparinvest continued to monitor the news on this topic and was reassured to hear that a UK-based anti-death penalty campaigning NGO that had been investigating the provenance of lethal injection drugs could find no new evidence of Teva's products being used.

In February 2017 ISS-Ethix reviewed the case and reassessed Teva as having responded solidly and effectively to mitigate this norms risk. The case was closed.

A Successful Dialogue

Sparinvest considers its engagement with Teva on this issue was successful, based on the acknowledgment of our concerns, a constructive dialogue with answers to many of our inquiries and the positive development of a case of potential breach of international human rights norms.

Conclusion

From this case Sparinvest learned that companies are willing to respond to the legitimate concerns of bondholders and that direct engagement can be a powerful approach in addressing ESG risks in corporate bond issuers.

As a general rule, Sparinvest does not comment on ongoing engagements because we believe that public disclosure is not conducive to constructive dialogue. However, once a case is closed and there has been no new information to warrant an re-opening of dialogue on the same issue, we feel it is appropriate to share with investors the details of the case.