



## Sparinvest UNPRI Policy

Responsible investment in Sparinvest

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# 1. Introduction

As UN PRI signatories, we view the formal integration of ESG issues into our investment process as something that will enhance our already risk-focused approach to investing. Our primary driver is the delivery of added value. We believe ESG analysis will facilitate this, resulting in better-informed investment decisions and thus higher long-term returns and lower risk for our investors.

Our mission is to offer our investors the best possible relationship between risk and long-term returns. Experience tells us that the more thoroughly we investigate risk factors, the more likely it is that we will deliver superior returns for our investors. Therefore, risk is also our primary consideration when analyzing potential investment targets and we always assess the downside risk before the upside potential.

One of our core beliefs is that we invest in companies and not just pieces of paper. Accordingly, risk considerations are more than just a matter of figures and charts to us. We have never looked at financial ratios in isolation when analyzing prospective target companies. Instead, our approach has been to scrutinize all threats to the viability of a potential investment. Consequently, factors like governance and corporate integrity have always played a natural role in our decision-making process.

For that reason, we have signed up to the UN Principles of Responsible Investment, the UN PRI. This United Nations programme is an industry wide initiative targeting professional investors, encouraging them to advocate and incorporate responsible behavior in their investment decisions.

The UN PRI consists of six investment principles designed to focus the attention on environmental, social and governance issues - the so-called ESG risk factors - as an embedded part of the investment process.

## 2. UN Principles of Responsible Investment (UNPRI)

The overall framework for responsible investing in Sparinvest is governed by the United Nations' PRI, the UN's six principles for responsible investment. The principles lay down a number of best practices for the incorporation of environmental, social and governance issues - the so-called ESG risk factors - into the investment analysis and decision-making.

### 2.1. The six Principles for Responsible Investment

As an institutional investor, Sparinvest has a duty to act in the best long-term interests of our investors. In this fiduciary role, we believe that environmental, social, and corporate governance issues can affect the performance of investment portfolios. We also recognize that applying these principles may better align investors with the broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes

2. We will be active owners and incorporate ESG issues into our ownership policies and practices
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest
4. We will promote acceptance and implementation of the principles within the investment industry
5. We will work together to enhance our effectiveness in implementing the Principles
6. We will report on our activities and progress towards implementing the Principles

### 3. ESG in the Investment Process

The focus on environmental, social and governance-related (ESG) company risk factors is an important component of our value-based approach, and extra-financial risks have always played a key role, albeit informal, in our meticulous way of assessing investment upside. In deciding to become a UN PRI signatory, however, we have now formalized the analysis and integration of ESG factors in the investment process.

We see the formal integration of ESG research as an important element of the assessment of non-financial risks which, combined with company dialogue, can serve as a driver for the reduction of portfolio tail risk. Specifically, the formal integration of ESG risk factors in the analysis facilitates:

- The information needed for the investment teams to be able to assess the ESG risks in a specific company
- Information about the potential for company dialogue, i.e. what will it take for the company to improve on ESG matters and 'blind spots' when compared to industry leaders.

To ensure high-quality ESG research, Sparinvest has entered into an agreement with an internationally acknowledged research provider, offering up-to-date and relevant information on target companies. In addition, Sparinvest uses a combination of company reports, sector reports and customized bespoke research reports as the basis for well-informed investment decisions.

#### 3.1 ESG and Actively Managed Equities

The formal consideration of ESG risk factors is fully integrated into the investment process of the Group's actively-managed equity portfolios. Specifically, ESG risk considerations have been formally implemented in the analysis phase of the investment process, designed to strengthen decision-making and securing further downside protection.

Essentially, ESG factors are included in the investment process on an equal footing with traditional financial data, and as with the financial key metrics, environmental, social and governance issues are part of the investment process 'check list'. All potential target companies must meet the criteria of the check list before becoming eligible for investing.

To ensure the best possible overview of the ESG risks related to a company, offering the required level of detail in the company ESG portrait, Sparinvest has set up an information platform com-

prising research input from internationally acknowledged ESG research providers, which is accompanied by our proprietary Company ESG Questionnaires.

The systematic approach to ESG information gathering and analysis is an add-on to our methodical investment process, designed to contribute favorably to investment performance over the longer term.

### **3.2 ESG and Corporate Bonds**

The formal consideration of environmental, social and governance (ESG) risk factors has been fully integrated into the investment process of the Group's Corporate Value Bonds Team. Specifically, ESG risk considerations are included in the analysis phase of the Value Bonds investment process. This is designed to strengthen portfolios by minimizing exposure to potential non-financial downside risks.

Essentially, ESG factors are incorporated into the investment process on an equal footing with traditional financial data; and, as with the financial key metrics, environmental, social and governance issues are part of the investment process 'check list'. All potential target companies must meet the criteria of the check list before becoming eligible for investment.

Given the nature of Corporate Bonds, where the maximum investment period is known and defined as the time to maturity, i.e. a typical time-horizon of 2-5 years, the portfolio managers consider that the ESG issues in corporate bonds are best addressed by requesting high governance standards. However, in some sectors environmental risks are fundamental in the evaluation of the investment case. Consequently, the relative importance of ESG issues may differ substantially from case to case, and it is up to the portfolio managers to assess this.

To ensure the best possible overview of the ESG risks related to a company, and to obtain the required level of detail of the target company's ESG portrait, Sparinvest has setup an information platform comprising research input from internationally-acknowledged ESG research providers; bespoke reports, whereby Sparinvest specifically commissions a full ESG analysis of a given company and information provided by companies on our proprietary Company ESG Questionnaires.

The ESG information platform serves as input to Sparinvest's Corporate Bonds Team in the investment process.

The systematic approach to ESG information gathering and analysis is an add-on to our methodical investment process, designed to contribute favourably to investment performance over the longer term.

### **3.3 ESG and Quantitatively Managed Equities**

When investing using quantitative strategies, emphasis is on overall portfolio characteristics rather than on the individual holdings. Accordingly, consideration of ESG-factors is integrated in the investment process at the total portfolio level.

Using external research providers, an ESG score is applied to every member of the investment universe, to the extent that such scores are available.

When rebalancing or adjusting the portfolio, the fund managers - with due consideration of the general investment strategy - strive to select holdings that improve the overall portfolio ESG score. The ESG score of the portfolio is monitored and logged, to keep track of the development.

The ambition, with the introduction of the ESG strategy for the quantitatively managed funds, is gradually and consistently to improve the ESG score of the portfolio over time. In the event of a conflict between the general quantitative investment strategy and the desire to improve the overall ESG score, priority must be given to the investment strategy, in accordance with Sparinvest's fiduciary duty. However, in this event, the decline in the ESG score will be disclosed and explained as a natural consequence of Sparinvest's desire to achieve transparency in its ESG investment process.

### 3.4 ESG and Passively Managed Equities

The raison d'être for passive funds is to track - according to tracking error constraints - a specified benchmark at the lowest cost possible. This means that environmental, social and governance (ESG) factors cannot be introduced in the portfolio construction procedures without altering the essence of the product and potentially changing its investment characteristics away from those promoted to and understood by investors.

Essentially this means that:

- 1) In the case of passive investment strategies, Sparinvest applies only Principle 2 of the UN PRI i.e. active ownership activities. This is entirely in line with UN PRI guidance which states that passive management is consistent with the Principles and passive managers responsibilities are largely exercised through active ownership activities rather than the incorporation of ESG factors in the portfolio construction process (i.e. Principle 1). This was stated when the UN PRI was launched in 2006, and Sparinvest fully concurs with this interpretation<sup>1</sup>.
- 2) ESG considerations in a passive portfolio can only apply if the benchmark being followed is constructed according to ESG criteria.

A report from UNEP Financial Initiative, "*Responsible investment in passive management strategies*" reaffirms the above understanding of the eligibility of principle 1. Sparinvest's passive investment strategies are fully aligned with the UNEP Financial Initiative's recommendations and

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<sup>1</sup> From the Frequently Asked Questions section of the UN PRI website: How can passive managers interpret Principle 1? The Principles were drafted by large, mostly public, pension schemes, many of which apply passive management to a large proportion of their funds. Principle 1 of the PRI, relating to the incorporation of ESG issues into investment decision making was not meant to apply to passively managed funds in their stock selection processes. During the drafting process, it was made clear that passive management is consistent with the Principles, and that passive managers' responsibilities are largely exercised through active ownership activities.

include the passive funds in the active ownership strategy, i.e. the passive funds are included in the Voting Policy, the Company Dialogue and in the Supra Company Dialogue (the latter being extremely relevant in the case of the passive funds). Specifically Sparinvest engages systematically with companies in breach with the UN Global Compact principles, in collaboration with other institutional investors.

Moreover Sparinvest also operates passive funds tracking benchmarks tailored to accommodate ESG factors.

### **3.4 ESG and Danish Mortgage Bonds**

The Danish covered (Mortgage) bond market was established in 1797 when the first mortgage bank was founded. The idea was that by pooling loans, borrowers would be able to achieve a better deal from lenders than they would be able to negotiate on individual basis. This bank would provide loans secured by a mortgage on real property (and with joint and separate liability for borrowers) by issuing negotiable debt securities.

Over the course of more than 200 years no mortgage bank has defaulted in Denmark.

Mortgage lending has been regulated in Denmark by special mortgage legislation since 1850. The issuance of mortgage bonds is regulated by the Danish Financial Business Act and Executive Orders and the Danish Mortgage Credit Loans and Mortgage Credit Bonds Act. From a societal point of view, the aim of the legislation is to provide mortgage lending to homeowners at reasonable costs and to protect mortgage bond investors.

History has shown that the Danish mortgage system offers transparent, cost-efficient financing for homeowners and the continuing lack of defaults during crises show its resilience and attractiveness for investors.

Danish Mortgage Bonds is a uniform asset class with high ESG standards (or alternatively low ESG related risks), and consequently Sparinvest considers allocating investments to Danish Mortgage Bonds as a very prudent action in terms of dealing with ESG risks.

Additionally, Sparinvest has consulted UN PRI Secretariat on the application of Active Ownership (Principle 2) in the context of Danish Mortgage Bonds. The Secretariat confirms Sparinvest's understanding that, given the transparent nature of the Danish mortgage system, active ownership does not apply towards Danish Mortgage Banks.

### **3.5 ESG and Sovereigns**

The formal consideration of sovereign ESG risk factors is integrated in the investment process of those Sparinvest funds that invest in sovereigns, using World Governance Indicators as input. More than 200 countries are analysed annually on key metrics, focusing on government/regulatory governance and human rights in particular. Specifically countries are ranked according to:

- **Voice and accountability.** This metric captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as enjoy freedom of expression, freedom of association, and a free media.
- **Political stability and absence of violence.** This metric measures the perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including domestic violence and terrorism.
- **Government effectiveness.** This metric captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.
- **Regulatory quality.** This metric captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.
- **Rule of law.** This metric captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.
- **Control of corruption.** This metric captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.

Sparinvest operates a proprietary risk regression model where the factors listed above are included alongside other relevant risk measures when evaluating the credit spread. Consequently, World Governance Indicators are systematically included in the investment process and decision.

Where serious ESG risks are identified, Sparinvest's Sovereign Bonds Investment Team prefers to look for alternative bond issues. Accordingly, engagement and intervention with States/Governments is done in collaboration with other institutional investors through e.g. the Clearinghouse, a UNPRI initiative to support cooperation between institutional investors in the effort to increase awareness on ESG issues and improve the standards in dealing with ESG risks. Other forums for engaging with States/Governments include Eurosif - where Sparinvest is a member of the Lobbying Advisory Group.

### 3.6 ESG and Property

Property investments in the Sparinvest Group are the responsibility of the daughter company Sparinvest Property Investors.

Generally Sparinvest Property Investors is committed to implementing responsible principles in the investment and portfolio management process while upholding our fiduciary duty to our investors.

Sparinvest Property Investors manages indirect real estate investments. Indirect real estate investment has fundamental attributes that affect the ability to include ESG-factors in the investment process. Specifically:



- Managing funds of funds involves no direct control of the ultimate asset invested in.
- Investment in a real estate fund is typically entered into for a defined period of time.

Subject to the above limitations, the fund screening and selection process consists of an asset and property manager quality assessment where Sparinvest Property Investors' policy regarding how to deal with ESG risks in the property portfolio is fully integrated. Consequently, since 2005 Sparinvest Property Investors has systematically required the fund investment managers under due diligence to state:

- That the investment manager is aware of the UN Global Compact Principles<sup>2</sup>
- That there have been no deliberate and repeated violations of the principles of UN Global Compact in the property management/development.
- That the investment manager has not been involved in any critical violation of national laws with no attempt to remedy the violation.
- That the investment manager will not invest in properties which are principally used for manufacturing, trading, storing or other kinds of servicing of weapons violating the international arms treaties.

The statements are mandatory for Sparinvest Property Investors to consider investment in a fund. In addition, Sparinvest Property Investors exercise active ownership, giving priority to securing impact and influence from the effort:

- Sparinvest Property Investors always seeks board representation in the funds invested in, or alternatively seeks alliances with other investors with board representation.
- Sparinvest Property Investors has identified governance issues as a key-focus area and in particular guarding the limited partners' rights.
- Sparinvest Property Investors actively monitors the portfolio and annually requests the fund managers to report any perceived violations of international norms as defined by UN Global Compact.
- Sparinvest Property Investors seeks the highest risk-adjusted return in line with its investment strategy with due consideration to environmental sustainability. The movement toward sustainable, or "green", building practices is a structural change in the commercial real estate market and Sparinvest Property Investors advocates sustainable building practices throughout the funds invested in where it is economically efficient. E.g. by encouraging fund managers/property managers to work systematically towards energy certifying the properties in the portfolios (an example is the LEED Certification in the US).

Sparinvest Property Investors actively enters into alliances with co-investors on securing common policies on ESG-risks in the property portfolios.

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<sup>2</sup> The United Nations Global Compact is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption.

## 4. Active Ownership

A driving principle behind Sparinvest's approach to responsible investment is active ownership. Therefore, Sparinvest has set up an active ownership program consisting of:

- A company dialogue program; dialogue with portfolio holdings on ESG issues.
- A supra company dialogue program; Certain issues are better addressed in a supra company level, like regulatory bodies, institutions (e.g. stock exchanges) or even country governments. Sparinvest Supra Company Dialogue focuses on collaborative engagement with other institutional investors.

Improved environmental, social and governance company practices may ultimately affect investment performance and, consequently, the primary purpose of the Active Ownership Program is to move investment portfolios towards higher ESG standards. Therefore, we generally advocate dialogue rather than exclusion.

### 4.1. Company Dialogue

By engaging in respectful two-way dialogue with management, our aim is to draw attention to the benefits that can be obtained by improving company ESG practices. Proxy voting and class action litigation are considered potential instruments to facilitate this.

Our aim, however, is not to enter into dialogue with each and every company in our portfolios. Instead, we will make an assessment of dialogue matters on a case-by-case basis. The key principle of the dialogue program is to influence standards in selected companies, entering into dialogue on issues where achieving a result is likely. We label this 'dialogue with an impact'.

Company dialogue is a key element in our investment process and, based on the premise that we know our holdings better than most, the dialogue program is handled internally by the Sparinvest fund management teams.

#### 4.1.1. *Voting Policy*

Sparinvest engages in proxy voting on all shareholder assemblies in company holdings in the actively-managed portfolios in accordance with the policies established by the investment manager and as stated herein, except where inconsistent with applicable laws and regulations or with specific client instructions.

Sparinvest recognizes that rights inherent in stock ownership, including the right to vote by proxy, are important instruments in the dialogue with companies and companies management in order to influence said company towards higher awareness on Environmental, Social and Governance issues.

The guiding principle in the voting policy of Sparinvest is that it must best serve the long-term interest of the investors. This means that Sparinvest may vote in a way inconsistent with the below stated principles if it will better serve the interest of the beneficial owners of the assets. It is the responsibility of the Sparinvest Equity Portfolio Managers to decide on a case-by-case basis the vote on shareholder resolutions so that it is consistent with the guiding principle.

When proxy voting on portfolio holdings, Sparinvest abides by the following principles:

- One-share, one-vote
- Shareholders shall be provided with reasonable opportunities to propose shareholder resolutions
- The rights of minority shareholders shall be well protected
- The board, and committees on remuneration, nomination and auditing, shall predominantly consist of independent members
- A transparent remuneration policy shall align the interests of management with those of long-term shareholders
- Companies shall generally aim to be transparent
- Decisions on capital employment and the distribution of capital shall be taken in the best interests of long-term shareholders
- 'Poison pills' and other defense measures shall generally be avoided
- Accounts shall be audited by independent external auditing firms, whose other relationships with the company cannot be considered to impair that independence
- Subject to the above principles, companies should aim to comply with local corporate governance standards, or explain non-compliance

In the cases where Sparinvest votes against the recommendation of company management and board, the proxy vote cast is accompanied by a letter to the company informing about and explaining Sparinvest's voting decision.

Sparinvest uses the service of an internationally-renowned Proxy Voting Service Provider to assist with proxy voting research and the operational matters in proxy voting on the portfolio holdings. The proxy voting is effectuated within an extensive set of guidelines derived from the voting policy.

Sparinvest will report to investors on the implementation of the voting policy on [www.sparinvest.lu](http://www.sparinvest.lu)

#### ***4.1.2. Class Action Policy***

Sparinvest acknowledges the option of participating in class action litigation against portfolio holdings involved in legal wrongdoings impacting negatively on performance and investment returns.

We believe that our investors have a right to seek fair compensation for investment damages if they have suffered financially as a result of company wrongdoing. We generally believe that companies in breach of national or international law should be held accountable for any illegal conduct. Companies should not be encouraged to believe that doing 'small amounts of harm to many' means that the risk of legal challenge from individual investors seeking justice for the harm done to them is low.

We recognize, however, that class action litigation may have adverse consequences for companies and investors, outweighing the perceived benefit to society. Consequently, we consider litigation as an instrument of last resort in the company dialogue, to be used only when all other options appear to be exhausted.

Sparinvest uses an internationally-acclaimed and recognized legal firm specializing in the prosecution of complex class action litigation for any litigation matters.

#### **4.2. Supra Company Dialogue**

While company dialogue is a cardinal element in Sparinvests approach to active ownership, we recognize that certain issues are better addressed in a supra company level, like regulatory bodies, institutions (e.g. stock exchanges) or even country governments.

Cooperation with other institutional investors significantly increases the effectiveness of the dialogue and likelihood of the dialogue being successful. Sparinvest Supra Company Dialogue focuses on collaborative engagement facilitated by:

1. Eurosif - where Sparinvest is a member of the Lobbying Advisory Group, engaging e.g. with the European Commission on ESG matters.
2. The UNPRI Engagement Clearinghouse - a central global collaborative forum for investors on a range of issues, allowing signatories to pool resources and influence and achieve greater impact with the engagements.
3. Other kinds of collaborative forums, e.g. collaborative engagement using a service provider as facilitator on companies in violation with the principles of UN Global Compact as assessed by the service provider.

Eligible issues to address through supra company dialogue can be legislation on mandatory ESG reporting, Stock Exchanges setting standards for listed companies on ESG disclosure or engaging with country FSA's on minority shareholders rights.

Specifically, the collaborative engagement - with Ethix SRI Advisors as facilitator - focuses on a systematic engagement with companies in confirmed violation with international norms, as determined by UN Global Compact.

## **5. Exclusion Policy**

We believe in dialogue rather than exclusion.

We will always seek dialogue with the ambition to influence a company to change its ways before taking other measures. Our stance is that if we leave (exclude) a company violating environmental, social or governance standards, we also renounce our right to impact on the future behavior of the company, thereby allowing it to continue its business unhampered. As a general rule, therefore, dialogue will always be our vehicle of choice when engaging with portfolio holdings.

However, occasionally a wrongdoing may be so blatant a violation of national laws or international norms that it is unjustifiable to remain invested – from both a moral and legal perspective – even while trying to influence the company into changing its ways.

Sparinvest has identified these cases to be:

- Companies in affirmed critical violations of national laws with no attempt to remedy the violations
- Companies in affirmed violations of international arms treaties with no attempt to remedy the violations

A group of key investment professionals representing Asset Management, Group Legal and Management will, on a case-by-case basis, determine whether a company will be excluded.

Sparinvest works together with an internationally-recognized screening firm to monitor portfolio holdings for violations of international laws and norms.