



# 2018 Active Ownership Report

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# EUR 382 Billion

Assets under engagement

# 240

Number of engagement cases

# 214

Number of companies engaged

# 65%

Number of cases closed successfully

# 21

Number of engagement themes

# EUR 70 Billion

Assets under voting

# 5,291

Number of shareholder meetings voted

# 69

Number of markets voted

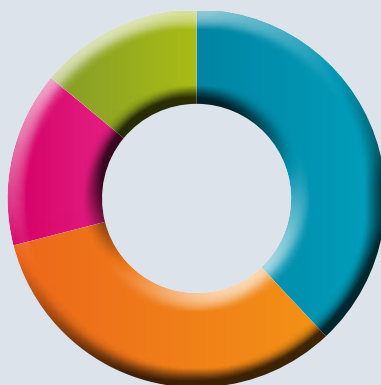
# 56%

% Meetings with votes against management

# 56,109

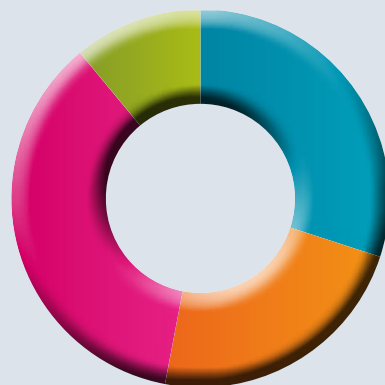
Number of proposals voted on

Engagement activities by region



North America	38%
Europe	33%
Emerging Markets	15%
Pacific	14%

Shareholder meetings voted by region



North America	30%
Europe	23%
Emerging Markets	36%
Pacific	11%

### Contents

In our 2018 Active Ownership Report we provide an update on all engagement themes run by Robeco's Active Ownership team during the year:

#### Voting Highlights P4

Robeco's voting team outlines some interesting trends from this year's proxy season, including the rising use of non-financial metrics in executive pay, our approach to scrutinizing executive pay, and the alignment of our voting practices with the SDG's.

#### Environmental Focussed Engagement P8

Carbon was the defining theme of our 2018 engagements focussed on the environment. With climate change projected to have widespread, costly effects on agriculture, water resources, human health, and on ecosystems on land and in the oceans our engagement specialists look across several sectors to ask the question: what impact do these changes have for investors?

#### Social Focussed Engagement P30

How can society solve the global obesity crisis? And what impacts will this have for companies operating the beverage industry? We look deeper into this issue, as well as providing updates on our other social engagements including around data privacy, food security, and reducing global waste.

#### Governance Focussed Engagements P48

Robeco's governance engagements span across markets, from South Korea to closer to home. Linking them all is a push for better governance practices across the board. From Culture and Risk Oversight in the Banking Sector, to Corporate Governance Standards in Asia, and Cyber Security, here we provide an update on our governance engagements from the year.

#### Public Policy P64

Robeco's Public Policy engagement span a range of subjects, sectors and markets. From our participation in the Roundtable of Sustainable Palm Oil (RSPO), to climate related policy work, we engage policy makers with the view to driving change forward in sustainable finance.

### Introduction

Active Ownership forms a central part of Robeco's Sustainability Investing approach, and we've enjoyed some notable achievements in the past year. From climate change, to food security and good corporate governance, we focus in those areas where we believe that as investors, we can create tangible impact. In engagement cases such as our ongoing engagement with Royal Dutch Shell, we are seeing tangible results.

During 2018 we started five new engagement themes, varying from engaging the world's biggest carbon emitters about climate change, to cyber security, food security and reducing global waste. As part of these efforts, we enjoyed success in spearheading engagement on behalf of Climate Action 100+ that persuaded Shell to link cuts in its carbon footprint to executive pay. This commitment of Shell was the first of its kind in the oil and gas industry. This achievement received global attention and provides a framework with which to guide our engagement with other companies in the oil and gas sector.

Collaborations such as the one with Climate Action 100+ are becoming increasingly important. Last year, we joined several investor collaborations in addition to the many initiatives we are already part of. Amongst other we became steering committee members of the Investor Alliance for Human Rights in the US, the Brazilian engagement platform AMEC, and closer to home, the Dutch Living Wage Financials platform.

In our active ownership approach, we are keen to vote at shareholder meetings in a consistent manner. During 2018 we have casted our votes on behalf of clients at more than 5,200 shareholder meetings. And this is by no means 'rubber-stamping' –, we voted against at least one agenda item in over half the meetings at which we voted.

Robeco also places great value on the external perspective on the quality of our active ownership approach. We are proud that the Principles for Responsible Investment awarded us again its top A+ score for Active Ownership in 2018, and named our active ownership work a 'best practice' in their 2018 Guide to Active Ownership in listed equity.

We look forward to achieving even more impact with our engagement and voting in 2019.

#### Peter Ferket

Head of Investments and  
Member of Robeco's Executive Committee





# Voting Highlights

**Laura Bosch**  
Active Ownership Analyst

**Cedric Hille**  
Active Ownership Analyst



**Proxy voting is an integral part of Active Ownership. The aim of our voting activities is to encourage good governance and sustainable corporate practices, which contribute to long-term shareholder value creation. In 2018, we voted upon 56,000 proposals at over 5,000 shareholder meetings across 72 countries, voting against at least one agenda item in 56% of meetings. Below we provide an update on three themes we observed during last year's proxy season.**

## Codes of conduct

- ICGN Global Governance Principles

## Corporate Governance: Proxy Voting

Our voting policy is based on the widely accepted principles of the International Corporate Governance Network (ICGN), which provide a broad framework for assessing company's corporate governance practices. We constantly monitor the consistency of our general voting policy with the ICGN principles, with laws and governance codes and systems as well as client specific voting policies. Our voting policy is formally reviewed at least once a year. We also take into account company specific circumstances and best practices when casting our votes.

## The Link Between SDGs and Voting on Shareholder Resolutions

The Sustainable Development Goals (SDGs) define global sustainable development priorities for 2030 and seek to mobilize global efforts to achieve these goals, contributing to connecting business strategies with global priorities. The SDGs can be a business opportunity for listed companies, providing them with a future competitive advantage by being a source of innovation, process improvements and operational efficiencies.

Impact assessments of climate change and emission reduction targets are

the most common subjects among environmental shareholder resolutions filed in 2018. Proponents mainly target companies operating in the utilities, oil and gas sectors. The scope of these resolutions ranges from requesting concrete greenhouse or methane emission target reductions, to asking the board to evaluate the long-term portfolio impacts of scenarios consistent with the goal of limiting the global increase in temperature to two degrees Celsius. Supporting these resolutions would positively contribute to SDG 13 'Climate Action' as it calls for integrating climate change measures into corporate strategies and planning, while fostering climate resilience by lowering emissions. However, some



are contributing to achieve SDG 5 'Gender Equality', as these support women's full and effective participation and equal opportunities for leadership at different levels of corporate decision-making roles, while advocating to end gender discrimination in the workplace.

While the number of environmental and social (E&S) proposals decreased in 2018 compared to last year, the average level of votes in favour rose in many E&S categories. Few of the resolutions discussed in this article received majority support from shareholders, however companies are becoming more aware of investors' scrutiny regarding their non-financial impact on society and the environment. In turn, this trend contributes to enhancing the relevance of positive contributions from corporations to achieve the SDGs.

### Remuneration Escalation: Scrutinizing Executive Pay

The escalation of executive compensation has been an ongoing contentious topic in the Corporate Governance arena throughout several markets. According to Bloomberg, two main developments contributed to explain this trend: replacing cash awards with equity and the accessibility to data concerning CEO pay packages, allowing executives to compare their remuneration with peers. The ultimate purpose of executive pay packages is to appropriately incentivize management to deliver long-term shareholder value, thus aligning pay and performance. Moreover, with executive pay on the rise, it remains important to ensure an acceptable pay gap between management and the company's wider workforce.

Acknowledging that executive compensation can be one of the most complex proposals up for vote at the shareholder meetings, over the recent years Robeco developed a

framework aimed to standardize our voting approach for a wide variety of remuneration plans. The framework sets clear limits on the boundaries of acceptable pay plans, whilst also allowing for a balance between the positive and negative aspects of the pay package within such limits. It focuses on the structure of the remuneration plan, overall level of disclosure, use of non-financial metrics and relative quantum of the plan.

We expect that companies facing severe shareholder opposition address these concerns by implementing amendments to their executive package up for vote at their next shareholder meeting. In fact, we recognize that a large level of shareholder opposition can be a catalyst for positive change and increased shareholder engagement.

### The Rise of Non-Financial Performance Metrics

One of the greatest challenges of any remuneration policy is to ensure that executive pay and performance are firmly aligned. This measurement involves the use of performance metrics that strike a balance between short and long-term variable pay, reflecting the interests of both management and shareholders. Corporate performance is being scrutinized beyond solely financial achievements, also taking into account the company's environmental and societal impact. As companies are increasingly asked to respond to a wider approach to shareholder value creation, remuneration packages are gradually changing to reflect such trends.

In the last couple of years there has been a growing trend in companies incorporating non-financial criteria into remuneration packages across Europe and the US, according to Morgan Stanley. Investors are increasingly asking companies to demonstrate how

proposals call for drastic emission reductions, which would come at the expense of value creation. In these instances, the shareholder proposal is likely voted against.

Board and employee diversity-related shareholder proposals were the most common resolutions filed on the social front in 2018. We recognize the importance of corporate diversity and inclusiveness as it adds value to the business whilst improving human capital management. Shareholder support on these resolutions increased from 24.5% in 2017 to 36.6% in 2018 due to amplified governance focus and media attention on the topic. By supporting these resolutions, investors

financially material environmental and social topics are embedded into their corporate strategy and how management is being incentivized to deliver on such topics. As a result, remuneration committees have been including non-financial metrics such as employee satisfaction, carbon reduction targets and gender diversity targets within their compensation schemes.

These non-financial metrics can capture less traditional performance criteria, such as a company's societal or environmental impact. This allows shareholders to hold executives accountable on the execution of a strategy that incorporates ESG considerations and encourages companies to take a broader perspective on shareholder value creation.

If implemented correctly, non-financial measures can improve compensation plans while playing a pivotal role in enhancing ESG integration in companies' strategies. For shareholders, they serve as a means to hold management accountable for shareholder value creation. For companies, they can be used to better reflect the performance and value of their executives.







# Climate Action

**Sylvia van Waveren**  
Senior Engagement Specialist

**Cristina Cedillo**  
Engagement Specialist



**Climate change is projected to have widespread, costly effects on agriculture, water resources and human health, and on ecosystems on land and in the oceans. Soil degradation, local water stress and extreme weather events are likely to affect the macroeconomic performance of countries, sectors and companies. Engagement Specialists Cristina Cedillo and Sylvia van Waveren explore the impacts of climate change for investors.**

## Codes of conduct

- UN Global Compact Principles 7-9
- Rio Declaration on Environment and Development
- OECD Guidelines for Multinational Enterprises, Chapter VI
- SDG 7: Affordable and Clean Energy

## Environmental Management: Environmental Policy & Performance

An environmental management policy is a set of restrictions or standards designed to protect and conserve environmental resources. An effective environmental policy clearly outlines rules and expectations for companies to follow regarding preventing negative impact on the environment. Furthermore it should be equipped to calculate the environmental performance of a company as well.

Under the Paris Climate Accord adopted in 2015, world leaders committed to limit global warming to between 1.5°C and 2°C. In order to achieve this, the world must transition to a low-carbon economy over the coming decades, with the aim of becoming carbon neutral before the end of the century. Achieving this goal requires a global effort to shift investments from carbon-intensive industries to renewable energy and more efficient technologies.

## Climate change is high on investors' agendas

Investors are concerned about two key areas: transition and physical risks. Transition risks are linked to the

implications of climate-related policies requiring the reduction of greenhouse gas emissions and the adoption of clean technology. For example, a tax on carbon would disincentivize an electric utility company from generating energy from coal, and instead encourage energy generation from renewables. This could potentially lead to stranded assets. This term is used to describe situations where man-made capital – such as coal plants – has to be retired prematurely due to direct or indirect climate policies, or to the falling costs of alternative, cleaner technologies. Fossil fuels are at most risk of becoming stranded if they cannot be burned in order to limit global warming. Those





companies that are not prepared for the energy transition will face significant financial challenges as regulations change and energy priorities shift.

Coal plants in the US are a case in point for carbon-intensive energy sources which are losing competitiveness against lower-emitting sources. For decades, coal has been the dominant energy source for generating electricity in the US. However, in 2016, natural gas-fired generation surpassed coal generation in the country on an annual basis for the first time. The shift was primarily market-driven due to the large amounts of cheap natural gas available. Environmental regulations

played a secondary role in driving coal's declining generation, according to the US Energy Information Agency. Energy suppliers in some states made investments to shift generation towards natural gas, at least partly for environmental reasons. Natural gas emits about half the amount of CO<sub>2</sub> per megawatt-hour of electricity than coal, and is therefore considered by many to be a 'bridge fuel' that can help transition to a low-carbon economy. Moreover, the share of coal in the US energy mix has also been reduced by the expansion of renewables such as wind and solar. This growth has been driven by state and federal policies supporting greater investment in renewable energy technologies and the adoption of them.

Physical risks are linked to extreme weather events such as floods, droughts or hurricanes. Although they can be hard to predict as global weather patterns become more unstable, these risks can also have a significant financial impact. The costs of California's drought between 2012 and 2016 raised electricity costs by USD 2 billion. Electric utilities companies saw a steep reduction in their low-cost hydroelectric power generation, some of them by as much as half. As a result, energy demand had to be compensated with other, more costly sources of fuel. Some companies reported replacement costs of as much as USD 200 million in a single year.

### Understanding climate change impacts at company level is key

The financial industry is becoming increasingly aware of climate-related risks. There is a growing sense of urgency to understand how investee companies, and the economy in general, will be impacted by climate change, and to what extent they are seizing emerging opportunities. The recommendations of the Task-Force Climate-related Financial Disclosures

(TCFD) issued in the summer of 2017 are expected to contribute to this. The TCFD's voluntary disclosure framework recommends that financial and non-financial organizations provide climate-related financial disclosures in their annual financial filings, including scenario analyses that assess the business impacts of climate risks. Robeco supports this initiative, as we believe that such disclosures will help us make better-informed decisions on the climate risks and opportunities of our investments.

### Engaging with the world's top emitters

December 2017 saw the launch of Climate Action 100+, an investor-led initiative to engage with the world's largest corporate greenhouse gas emitters. It aims to improve governance on climate change, curb emissions and strengthen climate-related financial disclosures. This initiative has already attracted 256 signatory investors with a total of USD 28 trillion in assets under management.

Robeco is proactively participating in this initiative and launched a three-year engagement theme on climate action in the first quarter of 2018. Robeco will be co-leading engagements with three companies, and will engage on both an individual and collaborative basis with a total of 13 companies. We will be focusing our efforts on three key sectors: utilities, chemicals and oil & gas.

Our engagement has four key objectives, which are also in line with those of the Climate Action 100+ initiative. These are to:

1. Implement a strong governance framework which clearly articulates the board's accountability and oversight of climate change risk and opportunities.
2. Take action to reduce greenhouse gas emissions across their value

chain, consistent with the Paris Agreement's goal of limiting global average temperature increase to well below 2-degrees Celsius above pre-industrial levels.

3. Implement a risk management system that identifies, assesses and manages key climate risks.
4. Provide enhanced corporate disclosure in line with the final recommendations of the TCFD to enable investors to assess the robustness of companies' business plans against a range of climate scenarios, including well below the 2-degrees Celsius scenario, and to improve investment decision-making.

The new Climate Action theme builds upon Robeco's previous climate change-related engagement programs. Robeco has been engaging with companies in the real estate, utilities, automotive and oil & gas sectors over the past five years to encourage them to reduce their greenhouse gas emissions.

## SPOTLIGHT ON



Marian Pavlus  
Credits Analyst

### Investors' views on climate-related risks in utilities companies

**Electric utilities is a sector in flux, facing an onslaught of fundamental changes including more stringent government regulations, decarbonization, greenhouse gases reduction concerns, the availability of cheaper renewable alternatives, and changing power grid dynamics, writes Marian Pavlus, Credits Analyst.**

The once-oligopolistic utilities operators are under threat from new market entrants offering energy alongside other conveniently-bundled technologies and services. The energy mix of an independent power producer determines the company's level of risk or opportunity related to carbon. In the post-COP21 environment, with the adoption of the Paris Agreement, strong policy headwinds to limit greenhouse gas emissions mean companies with a fossil-fuel heavy energy mix face increased compliance costs in a number of jurisdictions that employ carbon pricing mechanisms. Utilities companies that rely more on coal-based power generation are more likely to experience public and investor scrutiny as well as regulatory and compliance costs due to more stringent environmental policies. Those with the most efficient renewable energy systems are likely to compete successfully for government renewables subsidies. Best practice involves proactive management of greenhouse gas risks and a simultaneous increase in investments in renewable technologies for power generation.

Next to carbon, the air pollution emanating from other chemicals released from burning fossil fuels also poses risks. The combustion of fossil fuels such as coal, oil and natural gas creates by-products such as SO<sub>x</sub>, NO<sub>x</sub>, dust, dioxins, particulate matter, fly ash and mercury along with other heavy metals and toxins. These contribute to air pollution if released into the air, and they threaten soil and underwater contamination if they are not properly disposed of. Non-compliance with relevant regulations has resulted in penalties for companies, including clean-up costs and fines, as well as the cost of installing flue-gas desulfurization or 'scrubbers', which cost hundreds of millions of dollars. Industry best practice includes certifying environmental management systems to external standards (such as the ISO 14001 series), and measuring and reporting on air, water and waste emissions, along with setting time-based reduction targets.







# Climate Change and Well-being in the Office Real Estate Sector

Sylvia van Waveren  
Senior Engagement Specialist



The real estate sector as a whole accounts for nearly 40% of the world's energy consumption and 33% of global greenhouse gas (GHG) emissions. As the sector is facing major challenges to reduce its carbon footprint, it is a key focus of our carbon-related engagements. Over the last four years, we have successfully engaged on carbon management with retail Real Estate Investment Trusts (REITs). In Q4 2017, we expanded our engagements from retail businesses such as shopping malls to office spaces. Due to this expansion, we now also address 'health and well-being' (H&WB) in our dialogue with these companies.

## Codes of conduct

- UN Global Compact Principles 7-9
- Rio Declaration on Environment and Development
- SDG 11: Sustainable cities and communities
- SDG 13: Climate Action

## Environmental Impact: Climate Change

Together with the limited availability of natural resources such as water, climate change is the biggest environmental issue affecting companies. Climate change currently affects both government policy and consumer behavior. Climate change increases the risk to companies and sectors but also offers opportunities. In order to address the risks arising from climate change, companies will have to develop strategies to manage the financial, operational and organizational impact. It is also important that companies set targets, measure performance and report progress. Opportunities will arise in new and existing markets, through process improvements and technological innovation from companies at the cutting edge.

## Using the assessments of GRESB

The research underpinning this engagement program comes from the Global Real Estate Sustainability Benchmark (GRESB) Assessment, and its Health & Well-Being Module supplement. The GRESB is an industry-driven organization committed to assessing the sustainability performance of real estate assets globally. Robeco uses the GRESB's dynamic benchmark to engage with the companies in which we invest, aiming to improve the sustainability performance of the real estate sector.

## Focusing on five engagement objectives

As investors, we are not only looking for real estate companies that seek to reduce costs. We also value those companies that integrate sustainability into their business models to ensure the long-term value creation of the properties in their portfolios. We have defined the following five engagement objectives for which we seek improvements at companies:

1. Having a climate change policy, and integrating sustainability into the overall business strategy. This includes their response to the various risks and opportunities presented by climate change, the



## CLIMATE CHANGE AND WELL-BEING IN THE OFFICE REAL ESTATE SECTOR

integration of sustainability in their respective corporate strategies, and the development of programs and targets aimed at increasing investments in green buildings and facilitating green renovations.

2. Being transparent in order to earn a license to operate. Companies should be sufficiently transparent about their sustainability activities, thereby earning and strengthening their license to operate. This encompasses aspects such as proactive communication, the level and depth of sustainability reporting, and their participation in relevant initiatives such as the GRESB and Carbon Disclosure Project (CDP), along with certification schemes such as the Building Research Establishment Environmental Assessment Method (BREEAM) and Leadership in Energy and Environmental Design (LEED).
3. In order to provide a framework for the efficient measurement and reduction of their overall environmental impact, we believe that companies should have an Environmental Management

System (EMS) in place. This EMS should cover energy consumption and carbon reduction metrics, and ideally be externally certified according to international standards, such as ISO 14001.

4. Reducing energy consumption and carbon emissions. Under this objective, we review and look for reductions in the companies' periodic disclosures. We focus on absolute and relative reductions year on year, and across the last three years. The companies' performance will also be evaluated in relation to their peers.
5. Focusing on promoting health and well-being for employees. It is increasingly recognized that office spaces can influence this. These issues are progressively viewed as being important areas of opportunity for the real estate industry because they are a driver for workers' productivity.

### Improving health and well-being in offices

For this latter engagement issue, it is widely recognized that having green and healthy office buildings can bring about various economic benefits for real estate companies. First, the proactive management of buildings' environmental performance and carbon emissions can lead to lower energy costs. Second, landlords can charge premium rents for environmentally friendly, healthy buildings because of tenants' lower energy costs, and the increased productivity of happier and healthier employees. Third, it is also easier to market and lease out such buildings, as their occupancy rates are higher on average. Fourth, a climate change strategy reduces the risk related to the potential implementation of stricter environmental legislation by governments.

Therefore, we believe that the objective "Health and well-being" (H&WB) is financially material to our investments. A company's staff is one of its most

valuable resources. Critically, employees typically account for 90% of a business' operating costs. Companies that improve their productivity gains can enjoy significant financial and competitive advantages. In fact, according to a recent study, businesses with elaborate employee H&WB programs significantly outperform the S&P 500. Furthermore, in a survey of 200 Canadian building owners, 38% of those reported that healthy buildings were worth at least 7% more than normal ones, while 46% said they were easier to lease out, and 28% said that these buildings commanded higher rents.

According to the World Green Building Council, there are various different elements of a healthy office that can lead to happier, healthier and more productive employees. These are indoor air quality and ventilation, thermal comfort, the availability of natural light, noise reduction, interior layout and design, the look and feel, location, and access to local amenities.

Another way that companies can invest in their employees' H&WB is through corporate wellness programs. More than 75% of large companies in the US routinely offer such programs, which can consist of a range of activities such as improving fitness, and encouraging weight loss and smoking cessation. In general, an amalgamation of strategies is employed to improve employees' and tenants' H&WB.

### Reporting on progress

In relation to the health and well-being objective, all the companies under engagement have introduced an employee satisfaction survey. Most have also implemented programs to improve the satisfaction levels. The biggest challenge for the companies now is to collect all the data, and to connect the dots to gain a higher labor productivity. We will disclose our results in the regular engagement updates and reports.





# Environmental Challenges in the European Electric Utilities Sector

Cristina Cedillo  
Engagement Specialist



**Energy generation is the most carbon-intensive economic sector, responsible for approximately 25% of global greenhouse gas emissions. As the world strives to limit global warming to less than 2 degrees Celsius by the end of the century, it is essential that the sector shifts away from fossil fuels and moves towards low-carbon and renewable energy sources.**

## Codes of conduct

- UN Global Compact Principles 7-9
- Rio Declaration on Environment and Development
- OECD Guidelines for Multinational Enterprises Chapter IV
- SDG 7: Clean and Affordable Energy

## Environmental Impact: Climate Change

Together with the limited availability of natural resources such as water, climate change is the biggest environmental issue affecting companies. Climate change currently affects both government policy and consumer behavior. Climate change increases the risk to companies and sectors but also offers opportunities. In order to address the risks arising from climate change, companies will have to develop strategies to manage the financial, operational and organizational impact. It is also important that companies set targets, measure performance and report progress. Opportunities will arise in new and existing markets, through process improvements and technological innovation from companies at the cutting edge.

## Recent developments

This energy transition poses a fundamental challenge to electric utilities. Renewable energies are intermittent in that they do not provide a constant, reliable supply of energy. In the medium term, utilities will continue to invest in conventional power plants that can be fired up on demand when the wind is not blowing or the sun is not shining. This means that electric utilities must find the right balance between security of supply, the environmental impact and costs.

As investors, it is important to understand how these companies

are coping with the challenge of transitioning to a low-carbon economy. In 2015, we initiated an engagement program with eleven European electric utilities to encourage companies to (1) adopt a clear decarbonization trend, shifting from coal to gas to renewables; (2) take steps to enhance the thermal efficiency of existing coal-fired plants; (3) focus on business model innovation, to facilitate the integration of renewable energies into the grid; and (4) increase transparency on their position with regard to climate-related policies and their relationships with trade associations.





### The net-zero emissions challenge

The scientific community has identified a 'carbon budget', or the amount of carbon dioxide that the world can emit if we are to limit the temperature rise to well below 2 degrees Celsius. It is estimated that by 2011 the world had already burned through 52% of this carbon budget. To stay within this budget and achieve a 2-degree scenario, global emissions would have to start decreasing by 2020 and become nearly carbon-neutral by 2050.

During our engagement, all companies have acknowledged the need to curb their emissions, and have adopted

strategies with an increased focus on natural gas and renewable energies. However, the level of ambition of these strategies varies. Overall, most companies are shifting their energy mix towards natural gas and renewables, as well as investments in smart grids that facilitate the integration of renewables into the energy distribution system. The most ambitious four companies have committed to reduce their carbon emissions in line with a 2-degree scenario and become carbon-neutral by 2050.

Others, acknowledging the challenge of investing in clean energies, have restructured their organizations. In Germany, electric utilities are separating their green energy businesses from their fossil fuel assets. As investors, we have welcomed this move, and believe that the new companies focusing on clean energies can promote the necessary investments in generation and distribution networks.

### Security of supply lies at the crux of the energy transition

Coal is the most carbon-intensive energy source, emitting twice as much greenhouse gases as natural gas. Continued investment in coal plants implies significant technological and emissions lock-in in the long-term. According to the UN Environment Program, between 80% and 90% of coal reserves worldwide will need to remain in the ground if the goals of the Paris Agreement are to be met.

Several EU countries have announced plans to phase out inefficient coal plants over the next two decades, and only allow the operation of those plants that are retrofitted with carbon capture and storage technologies.

As a result, the majority of companies that we engaged with have publicly committed to not developing new coal

assets; have disposed of some of their old coal plants; and are considering to either phasing out or upgrading the remaining ones.

Despite these commitments from both companies and regulators, throughout our engagement we have seen that concerns about the security of energy supply have slowed down the process of phasing out coal in some parts of Europe. For example, in November 2017 the Spanish government rejected a Spanish utilities application to shut down its last two Spanish coal-fired power plants. This move triggered a political debate in the country about the extent to which coal plants are needed to secure energy supply.

### Corporate public advocacy efforts remain opaque

We have been engaging with electric utilities to encourage them to become more transparent on the positions they hold with regard to climate-related regulations. Overall, we have seen that companies are supportive of the high-level goals of the Paris Agreement. Also, all companies show a strong support for carbon pricing policies and the reform of the EU Emissions Trade Scheme (ETS) to reduce surplus emissions allowances and therefore increase their price. However, other policies on emissions-reduction targets and renewable energy have received mixed levels of support among companies.

One of the most challenging concerns to address with companies is their involvement with trade associations that are unsupportive of climate policies. It is a concern when companies express support for a policy, but at the same time is a member of a trade association that is lobbying against that same policy. We would ideally like to learn to what extent they are able to influence the associations towards taking a more supportive

position. In our engagement, only one company committed to conducting annual audits to assess the policy positioning of the trade associations it belongs to, and to identify potential misalignments.

### End of our three-year engagement

We see that the European utilities sector is making progress on its decarbonization, and that most companies are taking significant steps to transition to a low-carbon economy. However, much more needs to be done if we are to achieve the climate goals. As companies have laid out their ambitions to curb emissions by 2050, the next step for them is to develop a roadmap with key milestones of how they plan to achieve this, and communicate to investors how they are addressing the challenges ahead. We believe that the adoption of the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) will facilitate this process, and we are pleased that six of the companies under engagement have already committed to them.





# Environmental Challenges in the Oil and Gas Sector

Sylvia van Waveren  
Senior Engagement Specialist



With the publication of the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations in the summer of 2017, a new reporting benchmark has been set for companies operating in the oil and gas sector, says Sylvia van Waveren.

## Codes of conduct

- UN Global Compact principles 7-9
- Rio Declaration on Environment and Development
- OECD Guidelines for Multinational Enterprises Chapter VI
- SDG 13: Climate Action

## Environmental Impact: Environmental Policy & Performance

An environmental management policy is a set of restrictions or standards designed to protect and conserve environmental resources. An effective environmental policy clearly outlines rules and expectations for companies to follow regarding preventing negative impact on the environment. Furthermore it should be equipped to calculate the environmental performance of a company as well.

## TCFD recommendations strengthen our engagement approach

The TCFD seeks to develop recommendations for voluntary climate-related financial disclosures that are consistent, comparable, reliable, clear and efficient, and provide useful information to lenders, insurers and investors. This initiative is strongly backed by Robeco, which we signalled publicly in 2017 by signing a statement of support of the principles. Subsequently, our engagements with the companies under our 'Environmental challenges in the oil and gas sector' theme have increasingly focused on requesting companies within the peer group to use

this reporting framework in their public disclosures.

## Reliable data forms the bedrock of future decisions

As investors, it is of paramount important that the data disclosed by companies provides a reliable base upon which long-term investment decisions can be made. Data must therefore be consistent, accurate and comparable to allow an assessment to be made of the companies' long-term sustainability performance, and the companies' subsequent potential to create value for stakeholders in the long term. How a company responds to the challenges presented by climate change now and in the future will



## ENVIRONMENTAL CHALLENGES IN THE OIL AND GAS SECTOR

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sustainability report will make use of the TCFD recommendations. We are particularly pleased with these commitments from a majority state-owned company, since for us, this is a way of indirectly approaching national governments on these matters.

### An issue of collective action

However, it should be noted that climate change is an issue of collective action, and that, combined with individual company engagements, Robeco aims to encourage all stakeholders in the energy transition to take the necessary steps to achieve a warming scenario of below 2 degrees Celsius. Regulation is necessary to level the playing field, governments must take sufficient action, and industries as a whole must alter from their current course. Therefore, it is important that our engagement as a whole be much broader, and that we as investors encourage all stakeholders to take responsibility in preparing for the energy transition.

Next to our company engagements, Robeco has therefore also joined efforts by the investment community to publicly call on oil and gas producers to do more to address climate change risks. Together with 60 investment firms representing a total of more than USD 10 trillion assets under management, we sent a joint letter to the UK's Financial Times, addressing all companies in the industry. The signatories strongly encouraged all companies in this sector to clarify how they see their future in a low-carbon world.

### New business models required

In our engagement dialogs so far, we see that many of the companies in the peer group are conscious of the need for innovation and change, and that a multitude of new business models are under consideration. Renewable energy, grid management and electric

vehicles are all new developments that could offer new business opportunities for the large oil and gas players. A large majority of international oil companies have established new business units dedicated to exploring new commercial models in biofuels and renewables. However, companies are proceeding with caution, as they test how their organizations can add value to these new areas of the energy system. Most of the companies are allocating modest amounts of capex, but for those leading the transition, it is possible that we will see them commit to larger investments after the end of the decade.

### What's in a name?

It is in fact a sign of the times that one major player within the sector has gone so far as to change its name, removing any reference to the word 'oil'. Admittedly, such a step is largely anecdotal for the changes currently under way within the sector, and the pace of future change that is still required. However, it is indicative of the search for new ways to create value in a future global energy mix, with significantly less consumption of fossil fuels than is currently the case.

This, in fact, gets to the very crux of the issue. Many companies within the sector are beginning to look beyond their traditional business models and asset mixes towards a new, more sustainable future. We are strongly supportive of such steps, and can already identify a few companies within our peer group that have begun to move ahead of the curve. However, in all cases, we see significant room for improvement, particularly in the area of implementation.

### Using today to plan for tomorrow

Whilst we accept that the transition to a more sustainable energy system is a long-term journey which cannot take

have a significant effect on long-term shareholder value creation and preservation. In this regard, the TCFD is a hugely positive development.

### IOCs and NOCs diverge

Since the initial publication of the framework, most international oil companies (IOCs) have publicly committed to the TCFD. However, most state-owned companies have yet to do so. In our engagements thus far, progress has been made with one national oil company (NOC) which has recently expanded and improved its ESG activities. Following the establishment of a good relationship with this company, we encouraged its management to increase the scope of the ESG data that they provide to their stakeholders, including their participation in several of the most important questionnaires of sustainability data providers. Furthermore, the company's next



place overnight, the journey in itself must start today. A key component of this is translating this long-term ambition into an implementable and accountable plan of action. In this sense, the TCFD will be of assistance, in allowing investors to 'pick the winners' based on a reliable baseline of climate data.

Over the next 18 months, we will therefore be focusing on encouraging the companies within the peer group to clarify their levels of ambition and the alignment of their strategies with the objective of the Paris Agreement of limiting global warming to 2 degrees or less.

### SPOTLIGHT ON



Carola van Lamoen  
Head of Active Ownership

#### Engaging with Royal Dutch Shell

**Together with the Church of England Pensions Board, Robeco has been leading the investor engagement activities with Royal Dutch Shell, on behalf of Climate Action 100+, an initiative spearheaded by investors with more than USD 32 trillion in assets under management, and the Dutch corporate governance platform Eumedion.**

The Anglo-Dutch oil major has now agreed to set short-term targets for cutting carbon emissions and will link executive pay to meeting these objectives for the first time. Robeco has engaged with Shell for many years to try to reduce the impact of the company, and that of other oil majors, on climate change.

#### Introducing an ambition

Shell was already the first oil and gas company to introduce an ambition to reduce its carbon footprint, stretching out to 2050. Meeting the challenge of tackling climate change requires unprecedented collaboration and this is demonstrated by our engagements with investors," said Shell Chief Executive Officer Ben van Beurden. "We are taking important steps towards turning our Net Carbon Footprint ambition into reality by setting shorter-term targets. This ambition positions the company well for the future and seeks to ensure we thrive as the world works to meet the goals of the Paris Agreement on climate change." In a joint statement with investors, the company added: "Shell aims to reduce its Net Carbon Footprint by around half by 2050 and by around 20% by 2035 as an interim step. To operationalize this long-term ambition, Shell will start setting specific Net Carbon Footprint targets for shorter-term periods (three or five years). The target will be set each year for the next three- or five-year period. The target setting process will start from 2020 and will run to 2050."

#### Link with remuneration

"Taking into account the perspectives gained through its engagements with shareholders and other relevant stakeholders, Shell will incorporate a link between energy

transition and long-term remuneration as part of its revised Remuneration Policy, which will be subject to a shareholder vote at the 2020 Annual General Meeting (AGM)."

"If approved at the AGM, the policy will include a Net Carbon Footprint-related measure, as well as other measures, to have a balance of leading and lagging performance metrics over a three- or five-year performance period. The measures for each performance period will be set on an annual rolling basis at the time of the award and will be subject to the annual remuneration target-setting process as well as to the final plan design. The measures and targets will evolve as time progresses over the years to 2050."

"The final plan design is being discussed with shareholders, including details relating to the appropriate remuneration structure and appropriate measures and metrics."

#### Long engagement activities

The moves follow engagement activities that go back as far as 2005. Earlier this year, Robeco was signatory to an appeal from 60 investment firms appearing in the Financial Times that encouraged all companies in the oil and gas sector to clarify how they see their future in a low-carbon world. Robeco also spoke at Shell's 2018 shareholder meeting on behalf of a large group of institutional investors.

"Only committing Shell to a climate scenario puts the company at a disadvantage in many respects," said Van Lamoen. "Our engagement must be much broader, so we encourage other companies in this sector to take responsibility in preparing for the energy transition."









# ESG Challenges in the Auto Sector

Cristina Cedillo  
Engagement Specialist



2016 was a record year for recalls in the US, both by the number of recall campaigns and the number of vehicles affected. As much as 20% of all cars in service in the US were subject to recalls, costing carmakers and suppliers USD22.1 billion – a 26% increase over the previous year. These recalls can be very costly, affecting an automaker's bottom line, the company's stock price, or both. This is perhaps best illustrated by Toyota's recall crisis of 2009-2013, where vehicles affected with unintended acceleration (a fault that resulted in casualties and injuries), led the company to recall 9 million cars globally and suspend production of some of its most popular models in some markets. Toyota's shares dropped 20% in a month and worldwide sales declined by almost 20%.

## Codes of conduct

- UN Global Compact Principles 7-9
- Rio Declaration on Environment and Development
- OECD Guidelines for Multinational Enterprises, Chapter VI
- SDG 9: Industry, Innovation and Infrastructure
- SDG 11: Sustainable Cities and Communities

## Environmental Management:

### Environmental Policy & Performance

An environmental management policy is a set of restrictions or standards designed to protect and conserve environmental resources. An effective environmental policy clearly outlines rules and expectations for companies to follow regarding preventing negative impact on the environment. Furthermore it should be equipped to calculate the environmental performance of a company as well.

Experts suggest that the high volume of recalls is likely to continue. Firstly, a key driver behind this trend is the growing level of complexity of vehicles and the increasing number of electronic components supplied by multiple parties in the supply chain. Secondly, cost-cutting by car manufacturers can also be said to play a role in the increase of recalls. AlixPartners estimates that global carmakers have cut between a third and a half of their employees in their quality management divisions following the financial crisis. Furthermore, staff

numbers have not reached pre-crisis levels despite observing growth in the sector, primarily because of the industry's need to invest in new technologies, like electric vehicles and self-driving capabilities.

## Opening up the black-box

We believe that understanding the quality management approach of carmakers can help investors identify those that are better equipped to prevent defects or non-compliance incidents and therefore decrease their recall liabilities. Yet, data on product



During 2018, our engagement with the automotive industry aimed at gaining a better understanding of the product quality management approach of large auto makers. Next to our dialogues with companies, we also conducted an assessment of carmakers' performance, ranking carmakers on the reliability of their vehicles. We used data on the number of defects detected in the first 200,000 kilometers of use of each vehicle model between carmakers collected during two years by Dekra, a European vehicle inspection company. These reliability scores can be used as a proxy indicator for effective product quality management. After a year of engaging with the sector, we are now able to report our initial findings.

### Getting it right the first time

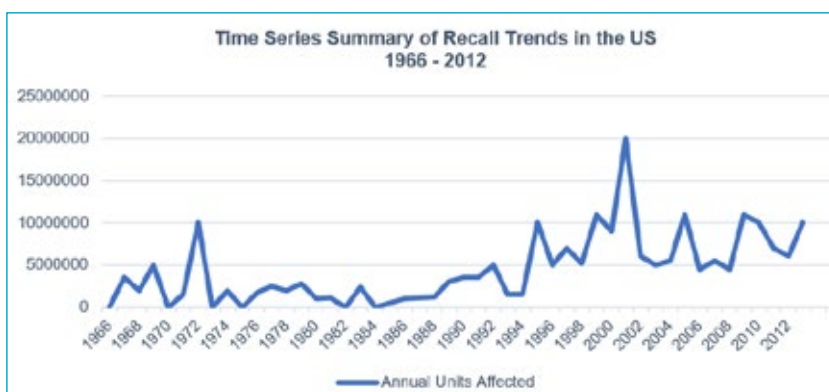
Minor defects and malfunctions are impossible to fully prevent. But a carmaker can become exposed to significant financial risk when a defect is known to endanger many people, is expensive to repair, or when the company has been aware of the defect for a long time before it was disclosed or otherwise discovered. Yet, some carmakers have product quality management based on a zero-defect ambition. Although their zero-defect ambition is not achieved in practice, these carmakers actually have an above-average performance relative to peers in terms of lower number of 'things gone wrong' during the first

200,000 kilometers driven. In our engagement, we learned that this zero-defect ambition in practice means integrating quality targets at each stage of vehicle development, from the design phase and assembly, to delivery and use by customers. While setting a zero-defect target does not translate into better performance, it may say something about the attention paid to product quality and being more successful in translating this high-level ambition into effective internal controls and processes.

### Knowing when to act

Identifying defects and non-conformities in cars as soon as possible once they are on the road can help prevent recall costs from ballooning. In our engagement, we have learned of the importance of having an organizational structure and clear allocation of responsibilities. In one example, a company suffered significant financial losses and reputational damage for not being prepared to adequately respond to customer complaints. At the company, only one person was authorized to initiate a recall, and this resulted in an extremely slow response. Moreover, the lack of communication among quality officers across markets meant that the defects reported were treated as minor, isolated issues, failing to recognize these defects as a larger trend that in turn brought safety concerns.

quality management and performance is scarce and spotty. Besides reporting on warranty and liability expenses, there are very few disclosures on product quality.



Source: Society of Automotive Analysts/NHTSA data

### Not all recalls are the same

One of the main surprises in our engagement and assessment of carmakers' performance was finding that those manufacturing the most reliable vehicles (i.e. with the lowest defect rate) do not necessarily have a lower incidence of recalls. Instead, these high-quality carmakers opt for a proactive approach and are more likely to voluntarily recall vehicles, even for minor defects that pose no safety-related concerns. We note that

premium carmakers are the ones predominantly taking this approach, as it helps ensure customer expectations are being met. Moreover, next to safety-related recalls, over the past three years we have observed the emergence of recalls due to non-compliance with air quality and carbon emissions regulations. Although only a couple of carmakers have been mandated by regulators to recall high-emitting vehicles, we again notice premium carmakers voluntarily offering customers to retrofit their cars.

### Emphasis on transparency

For investors it is very challenging to assess the level of carmakers' preparedness to respond to vehicle defects. Our engagement is allowing us to gain a better view of how product quality processes and controls work in practice. Nonetheless, more transparency on defect-rates of vehicles and recall campaigns initiated, both voluntarily and mandated by a transport safety agency, would be helpful in this assessment. Existing disclosures vary from one carmaker

to the other, making it hard to make comparisons and draw reliable conclusions. In our engagement we are encouraging companies to increase their disclosures on product quality and recalls data. We will continue our dialogue and communicating our progress in the coming two years of our engagement.

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## SPOTLIGHT ON

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Evert Giesen,  
Credits Analyst

### Product Quality

**The automotive sector is currently undergoing major change, driven by the megatrends of electrification of the powertrain, autonomous driving and shared mobility, topics which gain significant attention from investors.**

Yet whilst these trends are worthy of investor attention, it is important to not forget that product quality is key to the longer term success of any car manufacturer. If consumers lose faith in the quality of a brand its longer term prospects are poor. In the past, Japanese car manufacturers were able to enter the US car market as the US consumer had a positive view on the quality of their cars. US manufacturers went through difficult times in those years.

Product quality can also help to reduce the number of recalls. Although recalls are to some extent part of the business, manufactures should try to limit them as much as possible. As the recent example of airbag manufacturer Takata shows, recalls can drive companies into financial distress.

Product quality is key to the longer term success of car companies. In addition it can help to reduce the downside risks of high recall costs. As credit investors we are always looking at factors that can reduce the downside risk of our investment. Having a good view on the product quality of a car manufacturer can help us to make a better informed investment decision. The engagement process helps us to build this view.









# Reducing Global Waste

**Sylvia van Waveren**

Senior Engagement Specialist

**Peter van der Werf**

Senior Engagement Specialist



**The world's waste mountain is growing higher every day, with the focus today on not producing it rather than trying to recycle it. This is now the subject of our engagement efforts with companies to promote 'circular' resource recovery, and lower their environmental footprints.**

## Codes of conduct

- UN Global Compact
- SDG 12: Responsible Consumption and Production'

## Environmental Management : Emissions, Effluents and Waste

Emissions and effluent should be included in the primary process of a company's environmental management. The efficient use of resources results in immediate cost savings. Even the efficient processing of waste(water) requires energy and some of the waste(water) always ends up in the environment. Therefore, the prevention of emissions and effluent is vital. This is followed by stimuli to encourage companies to use efficient processing methods, such as recycling. Companies have to develop strategies for managing the financial and operational consequences of their contribution to the generation of emissions and effluent. This will mean setting targets for reducing emissions and effluent, including measuring performance and reporting progress. A company that makes use of the technological possibilities to reduce emissions and effluent and that contributes actively to technological innovations in this area, reduces reputational risk and assumes a leadership position.

Waste is a pressing problem that gets worse every day. At current rates of urbanization and population growth, global waste generation is estimated to rise to 2.2 billion tons per year by 2025, which translates into 1.42 kg of waste per person per day.

All businesses are legally obliged to safely manage and dispose of their waste, though the reality is of course different, depending on the locale. Many countries have been scrutinized for their failure to establish sound waste management systems, and are now starting to take action. We expect tightening environmental legislation to have direct implications for businesses.

## The best form of waste management: don't produce it

The most efficient way to manage waste is to not produce it in the first place, and while the majority of companies might not be there yet, the global trend is to move from 'waste management' to 'resource recovery' thinking.

Waste management is not only crucial to protect the environment; it is also in companies' own interest. Embedding 'circular principles' into operations will reduce resource consumption, improve resource efficiency and reduce the overall cost of waste management, which is good for the bottom line. Moreover, by tracking





## REDUCING GLOBAL WASTE

Out of the 17 SDGs, at least 12 are either explicitly or implicitly linked to waste. For example, sustainable waste and resource management has the potential to reduce greenhouse gas emissions by 15-20% across a number of sectors, which means it can contribute to SDG 13, 'Climate Action'.

The SDG most directly related to this area is No. 12, 'Responsible Consumption and Production'. This has high ambitions, calling on companies to: "By 2020, achieve the environmentally sound management of chemicals and all wastes throughout their life cycle, in accordance with agreed international frameworks, and significantly reduce their release to air, water and soil in order to minimize their adverse impacts on human health and the environment."

### The objectives of our engagement

Robeco wanted to play its part in reducing waste by engaging with selected investee companies. In the second quarter of 2018, we began our engagement dialogue with 12 predominantly small/mid-cap companies that operate in solar energy, industrial waste management, and technology. The engagement's core objective is to improve the companies' quantitative reporting on their contribution to SDGs, especially SDG 12. In addition, we will challenge each companies' strategic approach to managing performance on material ESG issues, and seek out opportunities for sustainable management of resources, such as the recovery of materials. We believe that companies that adequately address these issues and adopt long-term strategies can achieve greater success in the future.

The five engagement objectives are:

- 1. Environmental Impact Assessment**  
We want companies to conduct an Environmental Impact Assessment

based on analysis of a product's life cycle and production processes. We want them to disclose the cost and volumes of the resources used, and its environmental impact,, the use of the product and its 'end of life' impact, including the availability of recycling or takeback initiatives.

#### 2. Environmental Strategy

With the outcome of the Environmental Impact Assessment, companies should set targets to reduce their footprint, increasing efficiency of resource use and reducing their operating costs as a result. We want companies to use circular economy principles to reduce resource use rather than deal with the waste it generates afterwards.

#### 3. Sustainability Reporting

We expect companies to continually improve their sustainability reporting and provide disclosure on key ESG issues in addition to annual financial disclosure. We would like to see better disclosure of energy use and CO2 emissions, and encourage companies to quantify their SDG contribution.

#### 4. Corporate Governance

We will assess the effectiveness of individual companies' corporate governance practices, in particular, their management and supervision of ESG issues – through an assessment of board composition (skills, tenure, diversity etc.), and incentive structures, focusing on the use of non-financial metrics in long-term executive compensation schemes where applicable.

#### 5. Social Impact

We will encourage companies to increase their human capital management performance, and reduce labor risks in their supply chains. Where relevant, we will

and communicating efforts around waste minimization, companies build a database that can easily be shared with stakeholders, while being simultaneously able to improve their corporate image and attract more skilled workers in the long run.

### Waste management is linked to at least 12 UN SDGs

Another initiative to improve global waste management is linked to the United Nations Sustainable Development Goals (SDGs). Investors can play a role in promoting efficient and sustainable waste management methods by targeting those companies that are contributing towards achieving the SDGs.



address the use of resources extracted from war zones (conflict minerals) and other supply chain management issues.

### Baseline analysis

We have made a baseline analysis for each company, in which we assess it on a number of indicators that we have identified for the five engagement objectives. Examples of such indicators are the presence of a renewable energy program for objective 2 (Environmental Strategy) or board independence for objective 4 (Corporate Governance).

We make concrete recommendations to each company about how it can improve its performance on the indicators, such as 'Make a formal commitment towards circular economy principles or philosophy', 'Include environmental impact considerations in the design stage of new products', or 'Implement initiatives to reduce hazardous waste'. We will measure the companies' progress during the end phase of the engagement program in 2021.





# Data Privacy



Danielle Essink  
Senior Engagement Specialist

**Internet and telecommunications (ICT) companies are increasingly associated with the collection of customer data and the subsequent risk of data privacy breaches. ICT companies often have control over the information availability and communication accessibility in their countries of operations, which exposes them to freedom of expression related perils. As a result, ICT companies are exposed to reputational, legal and operational risks.**

## Codes of conduct

- UN Global Compact
- UN Guiding Principles on Business and Human Rights
- SDG 16: Peace, Justice and Strong Institutions

## Human Rights: Privacy and Freedom of Expression

The first and second principles of the UN Global Compact provide a framework for companies to operate responsibly to prevent breaches of human rights. Human rights are basic standards aimed at securing dignity and equality for all. Systematic breaches of such human rights could have a negative effect on a company, its immediate surroundings, and other stakeholders. Article 12 of the Universal Declaration on Human Rights specifically draws on the right to privacy as one of the human rights which is described as “the protection against arbitrary, unreasonable or unlawful interference with a person’s privacy, family, home or correspondence, as well as attacks on their honor or reputation”. Additionally, Article 19 defines freedom of expression as “the right... to hold opinions without interference and to seek, receive and impart information and ideas through any media and regardless of frontiers”.

How many online services do you use? And how many do not ask for a subscription fee? Ever thought about the business model of these companies? More and more companies use data as input for their business activities, and for some, data is even the main driver of revenue. But how do these companies ensure consumer trust in the long term? 2018 has been the year in which the use of data by companies and their related business models became much clearer to the public. This was a result of the EU General Data Protection Regulation (GDPR) that came into force in May 2018, but also because of the large data breaches at some ICT companies

that were reported in the news, with the subsequent societal debate about privacy.

## The impact of GDPR

Over the past three years, we have engaged with companies in the ICT sector on data privacy and freedom of expression. We have seen increasing interest in the topic, both from companies and from other investors. The GDPR has played a key role, as it aims to enable EU citizens to have better control over their personal data, including where it is stored, the purpose of it, and their ability to erase that data. While this is a European law, it applies to organizations anywhere in



the world that do business with anyone in the EU, and therefore has broad-reaching effects globally. It requires organizations to categorize, record and specify how long an individual's data has been held and when it will be erased, which is also known as 'the right to be forgotten'.

We have discussed the implementation of GDPR with the companies in our engagement peer group that are affected by it. Some of these companies already set up project groups to ensure compliance as early as 2016, and were very open about their approach. For other companies, transparency on their implementation only started at the end of 2017, or even as late as early 2018. Compliance with GDPR is key, as penalties can be as high as EUR 20 million, or 4% of the company's global annual revenues, whichever is greater. All companies part of our engagement peer group exposed to GDPR have updated their privacy policies and improved transparency towards users on the information they are sharing.

### Freedom of expression

While most attention in the media and public debate over the past years has been around privacy, our engagement theme also covered freedom of expression. ICT companies face an increasing number of orders from governments around the world that seek to restrict access to services and disrupt networks. The consequences of disruptions include restricting internationally recognized rights to free expression, preventing access to vital emergency, payment and health services, and disrupting contact with family members and friends. In some cases, these mandates pose an additional risk of human rights breaches when they restrict the free flow of information in the run-up to elections, or are used to target particular regions, districts or ethnic groups. Shutdowns can also

undermine economic growth and long-term development, affecting local businesses and tourism.

One of our key engagement expectations was focused on collaboration by companies with key players across the ICT sector, including peers, vendors, business partners, customers, NGOs and government organizations. We sought to work together to manage human rights risks relevant to data privacy and freedom of expression. We have seen the companies in our engagement peer group that collaborate in the Global Network Initiative actively engaging governments on the topic of freedom of expression and network shutdowns. We have also seen some of the companies increase their disclosures around government requests over the past three years.

### Ranking Digital Rights Index is a key resource

One of the key resources we used for our assessment of the performance of companies on data privacy is the Ranking Digital Rights Index (RDR). This is a non-profit research initiative working with an international network of partners to set global standards for how companies in the ICT sector should respect human rights. RDR produces a Corporate Accountability Index evaluating the world's most powerful internet, mobile, and telecommunications companies on their disclosed policies and practices regarding freedom of expression and privacy. Besides a ranking of companies, RDR also provides several investor guidance documents.

To get more investors involved in the topic of data privacy, Robeco took a leading role in setting up an ICT campaign within the Investor Alliance for Human Rights. Over the course of 2018, several webinars were organized in which NGOs presented their data

privacy work to the investor community. To emphasize the importance of the topic for investors, the Investor Alliance for Human Rights has put out an investor statement supported by 49 investors. This calls on companies to respect human rights, and refer to the Ranking Digital Rights (RDR) Corporate Accountability Index as a tool to help them improve their governance systems and performance on salient risks related to privacy and freedom of expression.

### The next steps around human rights and technology

The rapid development and the increased use of new technologies by companies across sectors poses many questions on how human rights might be impacted. We have discussed privacy and freedom of expression with companies in the ICT sector for the past three years. Earlier in 2018, we started an engagement theme focused on cyber security that includes an engagement objective around privacy. We will actively follow developments to ensure human rights are taken into account when companies adopt new technologies in their business.



# ESG Challenges in the Biopharmaceutical Industry



Peter van der Werf  
Senior Engagement Specialist

The pharmaceutical industry is one of the least trusted, while at the same time providing an essential service to society. Moreover, biopharmaceutical companies operate in an environment of increasing chronic diseases, aging populations and growing needs in emerging markets. This poses a challenges to a company's competitiveness and long-term financial performance, to which the ability to innovate, to attract and retain talent, and to anticipate regulatory developments, are important to factors. Peter van der Werf recently concluded a three-year engagement based on five financially material engagement objectives: Access to Healthcare, Clinical Trial Transparency, Innovation Management, Product Quality Management, and Business Ethics and Pricing.

## Codes of conduct

- UN Global Compact
- SDG 3: Good Health and Well-Being
- SDG 9: Industry, Innovation and Infrastructure

## Healthy Living: Access to Healthcare

Access to healthcare is very important for society. In addition to the state and insurers, the biopharmaceutical industry plays a major role in improving access to healthcare. The biopharmaceutical industry develops innovative medicines, provides access to medicines in developing countries or for socio-economically disadvantaged groups, and improves the quality of medicines. Various biopharmaceutical companies have been getting negative publicity of late owing to corruption scandals and the omission of key information from clinical studies. Improvements in these areas would lead to greater confidence in the healthcare system.

## Access to Healthcare

Over the past three years we have noted significant progress on our engagement objective Access to Healthcare. This progress is reflected in the 2016 Access to Medicine Index (ATMI) and is also visible through the various patient assistance programs.

Despite the improvement in the overall access to medicine made by the pharmaceutical industry, two billion people still lack access to the medicine that they need. Pharmaceutical

companies have a key role to play in tackling this issue, given their dominant position in the supply chain of medicine. Because of their pricing power, these companies can have an immense impact on the savings that can be made in national healthcare budgets, and in improving overall access to medicine.

We have observed only moderate progress in the development of specific products; in the waiver of patent rights in the poorest countries,



## ESG CHALLENGES IN THE BIOPHARMACEUTICAL INDUSTRY

increasing transparency and providing more meaningful reporting on the results of trials, a company can build trust with patients and relevant stakeholders. We noted broad progress in our engagement peer group. Most companies made strong improvements on the back of new regulation that came into force in 2014. Those who made little progress remained at the minimum transparency level to be compliant, but we have encouraged them to increase transparency, also for trials conducted before 2014. Moreover, we consider it best practice to provide short summaries, where trial results are explained in simple language for the layman, so that clinical study reports become understandable to a wider audience.

### Innovation Management

Through its commitment to research and development (R&D) to create new treatments and cures, the biopharmaceutical industry provides an essential service for patients, in particular for those with serious un-met medical needs. Innovative medicines and therapies have had a positive impact on societal well-being over the past decades, through increasing life expectancy and providing a better quality of care. These medicines, for example, help to increase childhood cancer survival and reduce death rates for patients battling serious conditions such as heart disease and HIV/AIDs. Furthermore, innovation is key to ensure the long-term sustainability of each company's business model.

We raised the topic of clinically relevant innovation versus commercial innovation with many of the companies. We encourage them to focus their R&D budgets on innovations that bring true progress for patients, for example by providing cures for diseases that were previously regarded as chronic diseases. Looking at the Internal Rate of Return of the

R&D activities of the companies in our peer group, we identified companies that had made good progress, and those that had stalled in their innovation output.

### Product Quality Management

Product quality management is another material factor that we identified in our research, as there have been many issues with the safety of products, or with the mislabeling of packaging that led to significant health risks for patients. We observed a stable trend in terms of product recalls, combined with the efforts of many of the companies to deliver a culture of operational excellence, supported by strong human capital management performance.

### Business Ethics and Pricing

For the topics Business Ethics and Pricing, most of the companies in our peer group still have significant challenges to tackle. We identified a few companies for whom we closed the Business Ethics objective after judging it to be non-effective, and transferred them to our Enhanced Engagement program due to allegations of bribery and corruption or illegal marketing. Not having ethical sales practices is often caused by incentive schemes that include unrealistic sales targets, or by a corporate culture that allows ethical oversight to slip.

We had many conversations with companies on allegations of predatory pricing, with the topic taking centre stage during the 2016 US presidential elections. We encourage companies to develop value-based pricing strategies, which means the price of the product is not determined on a per-drug basis, but is calculated based on the clinical outcome of the drug, and therefore the actual health benefit to the patient. Unfortunately, this pricing strategy is still in its infancy, and many companies are struggling to move beyond the pilot phase. Several barriers to adopting it

enabling manufacturers to make generic versions of their products; and in refining the way that access activities are organized. We regard access to medicine as an opportunity for biopharmaceutical companies to contribute to the United Nations' Sustainable Development Goals.

### Clinical Trial Transparency

Clinical Trial Transparency is an important means for biopharmaceutical companies to increase trust in their research. By



were mentioned in terms of different payors in the healthcare system not aligning with the pharma companies; hospitals not being able to deal with invoices at the moment of the evaluation of the treatment; or data collection not being significantly robust to deliver a value-based reimbursement model.

In addition to the value-based pricing strategy, we have encouraged companies to publish a pricing policy that would only allow single-digit annual price hikes. Several companies have made these commitments, but others remain cautious as they fear losing the room to manoeuvre in case they failed to set a proper price at the launch of the drug.

### Concluding three years of engagement

Robeco has successfully closed its dialogue with most of the companies in the engagement peer group. We will continue to monitor the progress of companies in this sector as they try to rebuild society's trust in them in the years to come. We closed our engagement program with the biopharmaceutical industry by concluding that getting pricing right and tackling business ethics is still a challenge for some, and that clinically relevant innovation is key for long-term success. During our engagement we obtained the commitment of companies to give better access to healthcare, better clinical trial transparency, and a more equitable pricing policy.







# Food Security: How can investors contribute to SDG2: Zero hunger?



Peter van der Werf  
Senior Engagement Specialist

**Food insecurity stems from economic and social conditions that hinder the sufficient availability of, and access to, food. This differentiates food insecurity from the personal state of hunger and creates an important link to investors. Agricultural input providers and food companies play an important role in shaping the circumstances that could foster food security. Therefore, investors in these companies have the opportunity to contribute to SDG 2 (zero hunger), which strives to improve food security and nutrition, and promote sustainable agriculture.**

## Codes of conduct

- UN Global Compact
- OECD Guideline
- SDG 2: Zero Hunger

## Human Rights: Social Supply Chain Standard

Companies are increasingly being held accountable for poor labor conditions in their operations and that of their supply chains. This is the result of a number of different trends. The first of these is the transfer of production to low wage countries, resulting in companies being faced with non-Western labor standards and conditions in their supply chain. Then there is a trend towards the more rapid and wider dissemination of information on the external effects of corporate activities. Furthermore, non-governmental organizations (NGOs) are playing an increasingly important role as social watchdogs and, finally, consumers are becoming more aware and more demanding in terms of corporate social responsibility. It is very important for companies, especially those that operate internationally and have well-known brand names, that generally accepted labor standards are followed throughout the supply chain.

The persistent concern for food insecurity throughout civil society is reflected in an increased awareness of the issue among regulators. There is widespread recognition that this is a defining development challenge for the 21st century. With that in mind, agricultural policy is being stretched in unprecedented directions. New factors and challenges that need to be taken into account by policymakers are as diverse as poverty, food price volatility and climate change, to the role of gender in rural areas and developing agricultural technology.

## Farm productivity is key

One of the most important factors contributing to food insecurity is farm productivity. This depends in a large part on how farming inputs are utilized. Differences in input quality and availability across markets persist, as farmers in developing countries struggle to access farming machinery, crop protection products and seed varieties. Regional discrepancies contribute to enhance the imbalances in the global food system. One of the results of these imbalances is the greater rate of food loss in food-insecure regions. Whilst this is in part due to poor infrastructure and practices





## FOOD SECURITY: HOW CAN INVESTORS CONTRIBUTE TO SDG2: ZERO HUNGER?

when analyzing the contribution of companies operating in the agricultural industry to SDG 2. First, we looked at product portfolios and innovation management. Following waves of consolidation in the agricultural landscape, products such as fertilizers, pesticides and seeds are nowadays often sold by integrated agrochemical companies. These companies' products and services have the potential to be well aligned with SDG 2, as all three product groups can support farmers in food-insecure regions by closing the yield gaps that put them at a systemic disadvantage.

Second, we assessed pricing and intellectual property management. The food security challenge requires differentiated approaches with regard to intellectual property, depending on the market in question. For instance, agrochemical companies relying on direct revenue from the sale of seeds and waiving royalty fees could foster the development of small farming in food-insecure regions.

Third, we explored how inclusive business models should be developed using public-private-partnerships. The societal challenge of food insecurity is exacerbated by the lack of integration of smallholder farmers into global markets for both inputs and outputs. A large share of small farmers lack the know-how, technological inputs and financing to compete in markets with their produce. A potential solution is that agrochemical firms could engage with smallholder farmers, both as customers and by including them directly in the product development and breeding process of seeds. Mechanization and irrigation companies already provide technological services to farmers in advanced markets, allowing them to control their crops with greater precision, ultimately increasing yields. Beyond this kind of unilateral action,

a collaborative approach to problem solving is needed. The complexity of agricultural sectors, especially when they are as fragmented as in food insecure regions, calls for partnerships between companies, governments, NGOs, and public academic bodies.

### Companies need to develop strategies

Our food security engagement theme aims to encourage companies active in the agricultural sector to contribute to food security. Our dialogue will focus on sustainability reporting and transparency; product portfolios and the geographic distribution of operations; innovation management, and public-private partnerships.

### Addressing food security in sustainability reports

A company can only play a significant role in achieving sustainable development objectives if it is committed to the integration of ESG considerations to its business model. For this reason, we view an analysis of ESG disclosure as indispensable in judging how advanced their sustainable development considerations are. Strong sustainability reporting can also be an important reflection of the maturity of internal sustainability processes, a prerequisite for a meaningful contribution to development.

### Conducting a food security impact assessment

In our research, we identified sub-Saharan Africa, South and East Asia as the regions that are most vulnerable to food insecurity. The more active and targeted that a company's involvement in a food-insecure market becomes, the greater is its potential to exert a positive influence. When building on an emerging market presence, food security-oriented product stewardship is an important approach to enhance the product's impact. Tailoring its

following harvest, food loss during crop cultivation and harvest presents an urgent challenge. Pests, pathogens and weeds have consistently posed threats to crop output, and the problem has become exacerbated as food safety and harvest quality as well as quantity have become central concerns for food security. Companies operating along the value chain have the ability to improve farming practices and productivity in developing countries.

### Innovative solutions to help farmers in food-insecure regions

Our research identified four main engagement topics to consider

offerings to the needs and expectations of food insecure communities, and to smallholder farmers in particular, are other strategies that can achieve the same goal.

#### Developing an innovation strategy for smallholder farmers

Since the quest to improve farm yields lies at the very heart of improving food security, innovation becomes an overriding factor of importance in staying ahead of rapidly evolving forces, such as climate change and soil

degradation. The attainment of food security depends on the availability of advanced forms of crop protection, hybrid seed varieties and technological solutions. The allocation of company resources to innovation for food security can confirm whether a firm is truly committed to contributing to sustainable development. R&D efforts should be mindful of the four dimensions of food security, namely availability, access, utilization and stability in the food system.

#### Engaging in public-private partnerships when commercial business is not viable

Collaborating with other stakeholders elevates corporate impact from a one-dimensional and necessarily limited effort, to a comprehensive search for solutions on a larger scale, that leverages expertise from different areas of society. Whilst governance in food insecure regions does not always meet high standards, governments, regulators and public institutions offer one key piece of the puzzle for progress on the topic.

### SPOTLIGHT ON



**Holger Frey**  
Senior Portfolio Manager  
RobecoSAM Sustainable  
Food Equities

#### An investor perspective on food security

**People in developed countries take food security for granted. However, malnutrition remains a major challenge in many developing countries, and with the world's population moving towards 10 billion by 2050, food security remains a moving target for the decades to come. Fortunately, projections foresee a continuous increase in wealth creation for developing countries, which should turn the challenge into an opportunity, as rising consumer purchasing power supports farmers economically.**

At the core of food security is creating a stable and efficient food production system. Comparing productivity measures such as yield per acre on a global scale, it is obvious that the large differences in yield dispersion cannot be explained by climatic and soil conditions alone. Often, they are an indicator of entirely different farming practices. To be more precise, it does not come as a surprise that output without the deployment of modern farm equipment and inputs produces below optimal results.

Against this backdrop, a promising opportunity arises in precision farming. While a broad-based adoption of digital farm technology appears to be a given in developed countries in the years ahead, developing countries could become a compelling market as well. Whereas the conventional evolutionary pattern would suggest a repeat of the development in developed countries – the broad-based adoption of mechanical tools, followed by agricultural nutrients and chemicals and finally biotech seeds – precision farming could serve as an enabler for all of this. A similar

step-change has been observed for the rapid adoption of mobile communication technology in developing countries. As digitization facilitates a significantly more efficient use of farm inputs, costs and outputs become more manageable.

Besides the growth in production-related investments, more capital is also expected to be allocated to food-related infrastructure, contributing to the greater stability of, food supply. Opportunities include basic logistics such as rail links, or more specific issues such as supply-chain management and automation. Given the stable underlying demand pattern for food products, investors should prefer related investments to more cyclical end markets.









# Improving Sustainability in the Meat & Fish Supply Chain



Peter van der Werf  
Senior Engagement Specialist

Experts estimate that antibiotic-resistant infections will kill 10 million people per year worldwide by 2050. A key driver of this worrying trend is the overuse of antibiotics in livestock production, primarily by farmers to increase yields. To begin to address this issue, Robeco organized a Business Roundtable to bring together investors, companies and industry experts to share knowledge, with the ultimate goal of changing corporate conduct and improving risk management. Engagement specialist Peter van der Werf highlights the main takeaways of this event.

## Codes of conduct

- UN Global Compact
- SDG 12: Responsible Production and Consumption
- SDG 15: Life on Land

## Human Rights: Social Supply Chain Standard

Companies are increasingly being held accountable for poor labor conditions in their operations and that of their supply chains. This is the result of a number of different trends. The first of these is the transfer of production to low-wage countries, resulting in companies being faced with non-Western labor standards and conditions in their supply chain. Then there is a trend towards the more rapid and wider dissemination of information on the external effects of corporate activities. Furthermore, non-governmental organizations (NGOs) are playing an increasingly important role as social watchdogs and, finally, consumers are becoming more aware and more demanding in terms of corporate social responsibility. It is very important for companies, especially those that operate internationally and have well-known brand names, that generally accepted labor standards are followed throughout the supply chain.

In late 2017, Robeco held the roundtable together with the UK-based investor research group Farm Animal Investment Risk and Return (FAIRR) and the Business Benchmark for Farm Animal Welfare (BBFAW), along with the Dutch sustainability consultancy Finch & Beak. The roundtable highlighted the urgent need to engage in further discussion on animal welfare and phase out antibiotics, as both companies and investors remain inadequately informed not only about the risks, but also about the opportunities involved. This coincides with new regulation, shifting consumer

preferences and trade restrictions on antibiotic use in livestock that are changing the way the food industry operates.

The World Health Organization has warned that as a result of overuse of antibiotics, we are approaching a 'post-antibiotic era' where bacterial resistance to their effects mean that routine operations will no longer be possible, and many diseases and infections will no longer be treatable. With over 80% of antibiotics in the US being used in animal factory farms, many solely for illness prevention or





## IMPROVING SUSTAINABILITY IN THE MEAT & FISH SUPPLY CHAIN

### A strong business case

The case for ensuring adequate animal welfare standards in factory farming practices is also strong. Intensive farming practices with a dense concentration of animals have already raised serious concerns over animal welfare, health, and hygiene, and they come with both a human and financial cost. Structured around these core issues, the roundtable addressed both the company and investor perspectives by building the corporate case for prioritizing animal welfare and phasing out antibiotics, as well as the case for engaging on these topics, and considering them as part of ESG integration.

### Tools for investors already available

The BBFAW is the leading global benchmark of company performance on farm animal welfare, providing a tool that investors can use to integrate farm animal welfare into their investment processes. A large number of companies are making significant commitments to reduce or avoid antibiotics in their supply chains, as is also reflected in the recent publication of the BBFAW 2018 benchmark.

However, the reduction or avoidance of antibiotics can only be achieved responsibly when companies also address the conditions in which animals are reared, meaning that they must look at issues such as stocking densities, adequate lighting, feed or access to pasture. Companies should clearly distinguish between therapeutic and non-therapeutic use of antibiotics, and refrain from claiming that their meat is 'antibiotic free', because antibiotics should still have a place in food systems when animals get sick and require treatment. FAIRR contributed to the roundtable by presenting its research showing the ESG risks of livestock production, and specifically over-use of antibiotics.

growth-promotion purposes (so-called non-therapeutic uses), a global public health crisis is approaching.

The financial risks that these developments pose to investors include legislative, operational, and reputational risks as a result of new regulation, combined with shifting consumer preferences and trade restrictions on antibiotic use in livestock. Regional changes in legislation can also disrupt market access, as certain imports would be prohibited.

### Industry characteristics remain challenging

As industry experts, Nutrivice Consultancy also provided its perspective on the challenges of phasing out antibiotics in the supply chain. The consultancy said the perception that applying antibiotics to the daily production of meat is a simple and cost-effective management tool remains among the main difficulties in reducing antibiotic use. The 'pressure' on raising production and yields per square meter of farmland also remains a critical issue.

This issue in particular deserves attention, as the yield derived in kilograms of produce per square meter of land is the main economic driver at the farm level. Nutrivice told the roundtable that there is a need to educate people involved in the food industry about biological matters related to the farming of livestock, and the dangers connected with the irresponsible use of antibiotics. However, the use of antibiotics as a prevention mechanism and a growth-inducer is in fact not always correlated with the economic gains that emanate from them.

In order to gain a viable economic model, some changes need to be implemented. For example, if consumers are willing to pay five cents more per kilogram for meat in the store, the animal industry can phase out the use of antibiotics. Among other necessary changes that were mentioned include improved vaccination schemes; improved care for animals in the early stages of their life; and adequate water management to ensure that water is clean from specific minerals.

Importantly, Nutrivice stressed that an antibiotic-free system is not the end goal: antibiotics are needed to treat specific diseases, so becoming

antibiotic-free should not be the goal per se. What is necessary is to develop adequate regulation that would specify strict circumstances under which antibiotics can be used. In the end, experience in The Netherlands shows that it is possible to significantly reduce the quantity of antibiotics used in animal farming.

### Broad engagement theme

Robeco launched an engagement theme on 'Improving sustainability in the meat and fish supply chain' in 2016. Our research showed that the growing demand for meat will place significant pressure on natural resources in the coming decade. Within that context, animal welfare was identified as a financially material issue for investors.

Eleven companies in the food retail, restaurant, and food-producing sectors were selected for engagement. Several indicators were designed to gauge if a company has an animal welfare policy. These include focusing on issues such as routine mutilation, high stocking densities, pre-slaughter stunning, long-distance live transportation and the use of antibiotics during the growth phase.

The engagement has also explored the coverage of companies' policies in terms of geographic areas, supplier relations and subcontractors. The companies have been evaluated on three broad parameters: governance and management; leadership and innovation, and performance reporting and impact. Under governance and management, Robeco looks at the extent to which animal welfare is taken into consideration at board level. Under the leadership and innovation criteria, we have been evaluating whether companies devote sufficient resources to research and development. Finally, under performance reporting and impact, the engagement team analyzes the level and quality of a company's disclosure on its performance related to

farm animal welfare, and consequently the impact it creates. Robeco expects companies to adopt policies, standards and proper operational systems to ensure respect for animal welfare in the business processes of the companies' suppliers.

### Effective means of engagement

The roundtable proved to be an excellent way to share knowledge among all the relevant stakeholders. We were able to convey the message that at Robeco, we expect more companies in the engagement peer group to develop targets to phase out use of antibiotics that are important for medical use in humans across all markets and product portfolios. When we measure the progress between the start of our engagement in 2016 and the state of the industry today, we note significant progress in terms of commitments, though we will continue to monitor implementation of these targets closely.







# Social Risks of Sugar



**Peter van der Werf**  
Senior Engagement Specialist

**In July 2017 we began our engagement program aimed at encouraging companies to speed up product reformulation and innovation to ensure a successful business model in the long run. We also discussed how companies can provide more transparency around their lobbying activities, and ensure that their marketing is responsible. In this article, Engagement Specialist Peter van der Werf shares our mid-term findings.**

## Codes of conduct

- UN Global Compact
- SDG 2: End hunger, achieve good security and improved nutrition and promote sustainable agriculture
- SDG 3: Ensure healthy lives and promote well-being for all at all ages

## Healthy Living: Healthy Nutrition

UN Global principles 1 and 2 are designed for companies to respect and support the protection of internationally proclaimed human rights and to make sure that they are not complicit in human rights abuses. Human rights issues arise because companies do not consider the potential implications of their activities within their operating context. We link the way people are able to live a healthy life to basic human rights.

## Legislating sugar consumption

Sugar is added to almost all packaged food and beverages, making it hard to avoid. Our growing consumption of sugar is partly to blame for the current obesity epidemic, which in turn is the main cause of rising levels of diabetes, heart attacks and choked arteries. At the same time, consumers are becoming better educated about following a healthy diet.

Companies producing packaged foods operate in an environment where they face growing pressure to reformulate their products. The World Health Organization (WHO) has included safe levels of sugar intake in its dietary guidelines, and is contemplating a

further tightening of its standards. We have also seen an increase in sugar taxes around the world, most notably the one introduced in April 2018 in the UK.

## Product reformulation

Many companies have reported good progress on their efforts around product reformulation. Yet, the continuous growth of the global obesity pandemic raises the question if this current push to reformulate products is sufficient. All the companies in our engagement program recognize the need to reduce 'nutrients-of-concern' such as sugar, salt and fat. However, they quote resistance among consumers as the main reasons for





their focus on stealth reformulations, where the product has sugar or other ingredients removed without drawing attention to it on the packaging or marketing messaging.

In addition to hiding the reformulation, these companies have also cut sugar levels in very small steps so as not to alienate consumers from the taste they appreciate and value. This often results in products such as breakfast cereals that still contain high levels of sugar, thereby providing a majority of the maximum recommended daily intake of sugar in the first meal of the day, particularly for children.

### Impact of UK sugar tax

One of the instruments that governments can apply to disincentivize consumers from consuming high sugar products is by levying a sugar tax. One example came in 2016, when the UK government announced one such measure. All ready-to-drink beverages that contain at least 5g of added sugars per 100ml are subject to the tax. The levy amounts to EUR 0.20 per litre for drinks with 5g of sugar or more per 100ml, rising to EUR 0.27 for drinks with more than 8g.

Since the tax was introduced on 6 April 2018, consumers have been shifting their soft drinks purchases to low-sugar alternatives and water, according to IRI, a market data company. An additional 7% of lower-sugar soft drinks were consumed in the UK every week, with total sales of soft drinks in the country rising in value by EUR 5.5 million to EUR 185 million per week, partly due to higher prices.

The effect on sales for many companies has been immediate and clear. Brands producing predominantly high sugar content beverages saw their volumes decline by up to 2%, while all other major brands saw a positive impact on volume sales. This leads to a first conclusion that the introduction of the levy has had a clear impact on the soft drinks category, based on data up to the end of Q2 2018.

Impact of sugar tax in other countries Yet this trend is not solely limited to the UK. In Mexico and Chile, two countries facing rapidly rising obesity rates, the government introduced sugar taxes in 2014 and 2015 respectively. For Mexico, the 1 peso per litre soda tax resulted in a 5.5% drop in sales the first year and a 9.7% sales decline in the second year. Chile levied a tax on sugary drinks while reducing the tax on non-sugary beverages. The impact on total sales volumes has not yet been reported for

Chile.

While the effect has been notable in Mexico, many proponents of sugar taxes advocate for more significant price increases, the intended effect of which would be to reduce sales volumes. In the United Arab Emirates, a tax on carbonated soft drinks and energy drinks was brought in on 1 October 2017. Energy drinks are taxed at 100% and soft drinks at 50%. Companies reported a much more significant impact on their sales figures.

It is important to note, however, that the application of sugar taxes has not been uniform across markets, and in some instance, due to flaws in implementation, the results have been less clear. Belgium, for example, introduced a tax where all sugar containing drinks, even in very small amounts, are taxed at the same rate. The resulting lack of price differentiation therefore does not incentivize consumers into making healthier choices, therefore limiting the positive health impacts of the levying of such a tax. This is often also cited as the main drawback for most sugar taxes globally.

### Staying in line with consumer preferences

Robeco regards effective sugar taxes as one of the main instruments that governments can use to alter consumer preferences. Nutritional education has only reached a small amount of consumers, while voluntary pledges have not as yet instilled sufficient urgency in the product reformulation efforts of companies. In most cases, it is still more profitable in the short term to continue selling legacy high-sugar content products, instead of reformulating or innovating into new product lines.

### Next phase in our engagement

In the coming 18 months, we will continue to engage with the companies

in our peer group to reduce the total volume of added sugar in their product portfolios. We believe that if they adopt a product portfolio that is well placed to thrive in a low-sugar economy, these companies will develop a superior business model compared to those that remain solely focused on their legacy products. This can in turn enable investors to reduce the risk in their investment portfolios that these companies will be held liable for health impacts on consumers based on (over) consumption of their products.

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### SPOTLIGHT ON

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**Amir Maani Shirazi**  
Analyst, Global Credits

**Stephen Verheul**  
Analyst, Global Credits

#### Investor perspectives on product reformulations

**We believe that growing awareness by the consumer about nutritional content of food and beverages will lead to them choosing differently. Such awareness results in a lower demand for high-sugar content food and beverages, and ultimately the market for these food and beverage products will contract in the longer run.**

Large food and beverage companies have so far only made small changes in terms of portion size reduction and improved product labelling. And the industry falls short in delivering tangible innovation to an improved nutrition profile overall for the product offering. Healthy snacking offers a great opportunity to innovate in this space, with most of it to date coming from smaller companies that have responded to this trend.

In the medium term, regulation and taxation will negatively impact demand, and food producers face the choice of either changing their product portfolio to offer healthier choices to consumers, or becoming less relevant. As a result, we expect bond spreads to reflect the higher risk profile of companies with unhealthy foods in the future, though we do not see this materializing yet today.

Next to the food and beverage companies using sugar in

their products, the sugar producers themselves will also see an impact. The European Commission estimates sugar consumption to decline by 5% per year until 2030. However, sugar production within the EU area is actually showing an increase, due to the abolishment of production quotas. This means European sugar producers will have to rely more on the export market. Nevertheless, the financial impact for now is expected to be limited, as population growth in emerging market countries, combined with growth in their disposable income, is expected to make up for the declining demand in the EU and other developed markets.









# Corporate Governance in Japan

Ronnie Lim

Senior Engagement Specialist



For many years, Robeco has been actively engaging with Asian companies to improve board composition, shareholder rights, and long term shareholder value creation. The most recent iteration of this comes in the form of our 'Corporate governance in Asia' engagement theme, launched in 2017, where our key areas of focus are increasing the quality of reporting on corporate strategy and improving capital management. Following on from our first year of company dialogues, our concerns remain about many companies' low priority to create shareholder value, says Robeco's Hong Kong based engagement specialist Ronnie Lim.

## Codes of conduct

- The ICGN Global Governance Principles (ICGN, revised 2014)
- Local corporate governance codes
- SDG 16: Peace, Justice and Strong Institutions

## Corporate Governance: Accountability & Transparency

A company's corporate governance structure specifies the rights and responsibilities of the various stakeholders such as the management, supervisory directors, shareholders and other stakeholders. An effective corporate governance system focuses on a company's long term business continuity and protects shareholders' interests. A well-functioning corporate governance system can contribute to long term shareholder value. International and national principles and codes provide guidelines for good corporate governance. Corporate governance covers a number of important issues. Relevant subjects are: remuneration policy, shareholder rights, transparency, effective supervision of management, independent audit and risk management.

Several changes to corporate governance codes around the world are putting in place a broader definition of value creation. This includes the current debate in the UK (for example s.172 of the Companies Act) about the role of the board in considering stakeholder interests, and the revisions in the Dutch Corporate Governance Code giving a central role to long-term value creation. However, for sheer news impact, it would be hard to beat this year's annual open "Letter to CEOs" from Larry Fink, head of Blackrock, the world's largest asset manager, where he called on companies to incorporate

a social purpose and pursue a strategy for long-term growth. Mr. Fink's two key expectations were (i) that every company must not only deliver financial performance, but also show how it makes a positive contribution to society, and (ii) to make shareholder engagement productive, companies must be able to describe their strategy for long-term growth.

## The prevalence of integrated reporting

Many Japanese companies already have a global leadership position in sustainability. For example, over 300





Japanese companies already produce reports that integrate financial and sustainability information. By the end of 2018, it is expected that this number will increase to 500 companies, thereby catapulting Japan to first position globally in integrated reporting. The widespread adoption of integrated reporting in Japan contrasts to U.S. companies, which have generally been laggards. The tendency to report on intangibles (or non-financial capital) could be due to traditional Japanese model of collectivist/stakeholder capitalism, compared to the primacy of shareholder value in the U.S.

### Assessing the corporate governance discount

Yet despite a significant recovery since the financial crisis, Japanese companies' market value added ("MVA") or market capitalization minus book value has been stagnant around 1.0, while the MVA of companies in the U.S. and UK remain much higher. If we assume that financial capital is related

to the net assets side of the Price-Book-Value Ratio (PBR), while nonfinancial capital is related to the MVA side of the equation, then Japanese companies' emphasis on nonfinancial capital (or "social purpose") has not created shareholder value. There could be several possible explanations of this dichotomy, one of which is the persistent and significant "corporate governance" valuation discount caused by (a) pervasive cross-holdings, (b) a deep aversion to risk (proxied by low leverage ratios), (c) investing in or retaining low-return businesses (evidenced by low return on equity, and negative returns on capital), and (d) poor payouts to shareholders (low dividends and/or buybacks).

### Putting forward a coherent financial strategy

The foregoing analysis is also supported by anecdotal evidence. We observe in many of our engagement meetings that Japanese managers are often keener to showcase their companies' intangibles (in the form of social or environmental contributions), rather than discuss a coherent financial strategy that adequately addresses their poor capital management. In our introductory meetings, we often use a presentation to explain Robeco's fundamental process and how we integrate ESG analysis.

### Struggling with corporate governance fatigue

In June 2018, the Japan's Financial Services Agency and the Tokyo Stock Exchange respectively published revisions to (a) the Guidelines for Investor and Company Engagement, and (b) the Corporate Governance Codes. In response to feedback from many companies that they were suffering from "corporate governance fatigue" attributed to formulaic, "box-ticking" engagement, the new codes provide very specific guidelines to direct investors' dialogue with companies to

address awareness of a company's cost of capital, profitability targets, capital efficiency, etc. with a view to value creation for the Japanese economy and people.

### An integrated approach to engagement

As our active ownership programme increases in intensity with underperforming companies on topics relating to financial management, our portfolio managers are also becoming more involved in the dialogue. The responses (enthusiastic or otherwise) from companies can provide insights into our investment cases. This forms an iterative, positive feedback loop whereby ESG/financial analysis together with engagement also informs our fundamental equity investment process.

Japan's companies are now leading the world in demonstrating the value of intangible assets, and how having a social purpose ensures continued license to operate. While increased reporting on the social and environmental risks and opportunities is laudable for a corporation, it is also our thesis that for that corporation to thrive, it must also create value for its shareholders.

Our ongoing analysis shows that while many Japanese companies may appear to demonstrate more awareness of their contribution to society, a significant number have been destroying shareholder value. Addressing this under-performance is fundamental for the proper performance of our stewardship role. Therefore, our active ownership programme in Asia is broadly focused on improving corporate governance with two specific objectives of increasing the quality of reporting on corporate strategy and improving capital management.



# Corporate Governance in Asia



Ronnie Lim  
Senior Engagement Specialist

**Political change in South Korea is increasing support for the reform of key corporate governance principles, namely transparency and accountability. Yet, while public support for reform of the chaebol structure does exist, it is more nuanced than meets the eye. So, what does this mean for investors? Hong Kong-based engagement specialist Ronnie Lim explores the impact of change for investors.**

## Codes of conduct

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## Corporate Governance: Accountability & Transparency

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South Korea has been in the international headlines during an eventful year. Last year's dramatic elections in the country led to the impeachment and dismissal of the former president, and the subsequent election of President Moon Jae-in. This was then followed by this year's summit in Panmunjom, where the leaders of both North and South Korea committed to lasting peace on the Korean peninsula, with the North starting a process of denuclearization that is supported by US President Donald Trump.

South Korea's new President Moon is a liberal committed to openness,

and there have been widespread public and investor expectations of significant reforms of the 'chaebol' – large industrial conglomerates that are controlled by a family. Almost all equity investors in Asia are shareholders in several South Korean companies which are either chaebol holding companies or subsidiaries of them. Although investors are happy to own these companies because they produce globally competitive technologies and products, they also suffer from several issues including weak governance, poor shareholder communication and poor capital management.





The South Korean market – dominated by the chaebol – is often ranked close to bottom on corporate governance scores. These issues have been widely attributed as the main causes of the ‘Korea discount’, where otherwise excellent companies are penalized by investors.

Many chaebols have been criticized for low dividend payouts and other governance practices that favor controlling shareholders at the expense of minority investors. Prior to the 2017 elections, other issues included investor fury over chaebol-related party transactions, the reluctance by regulators to adopt an investor stewardship code, and acquiescent minority investors.

While there was significant hope from South Korean voters and investors ahead and after the elections for significant reform of the dominance of the chaebol (see Chart 1 below), the subsequent reality has been much more nuanced, as the euphoria has quickly waned.

The reality is that Koreans themselves have conflicted attitudes towards the chaebol, and this is reflected in policy making and enforcement. For decades, Koreans have witnessed a parade of chaebol chairmen go in and out of courthouses facing charges on a myriad of economic crimes, but a serious judicial outcome is still considered unusual. While there is widespread resentment of the chaebols’ monopolistic behavior, many Koreans still aspire to work for them, and critical press coverage is often also inconsistent.

Robeco’s recent active ownership activity in South Korea has two primary objectives: ) the disclosure of corporate strategy and ) improving capital management. While we also

engage with both policymakers and our portfolio companies in South Korea to improve board independence and quality, we do not underestimate the cultural/structural barriers and lack of incentives for meaningful reform. We are mindful that chaebol reforms could have limited impact, even after the ‘transformation’ of holding companies and apparently ‘straightforward’ objectives like increasing dividend payouts. This is due to the varying incentives for the founding/controlling families, and how management control is exercised.

Robeco’s Active Ownership team also often works collaboratively with other investors to magnify the influence of our agenda. Our activities include becoming a signatory to the Korean Stewardship Code, contributing to the Korea Working Group of the ACGA, supporting the policy agenda of the Fair Trade and Financial Services Commissions in South Korea, and leading key engagement meetings with the management of major chaebols.

A recent case involved a proposed related-party transaction at a large auto parts and logistics company. Despite our persistent questions and objections to the lack of strategic rationale and valuation, the companies were unable to adequately explain or justify their merger terms, and we were prepared to vote against management on the proposed merger spin-off. Prior to the voting deadline, they cancelled the shareholder meeting where this proposal was being sought.

**CG Watch market scores: 2010 to 2016 (%)**

	2010	2012	2014	2016	Change 2014 vs 2016
Singapore	67	69	64	67	(+3)
Hong Kong	65	66	65	65	
Japan	57	55	60	63	(+3)
Taiwan	55	53	56	60	(+4)
Thailand	55	58	58	58	
Malaysia	52	55	58	56	(-2)
India	49	51	54	55	(+1)
Korea	45	49	49	52	(+3)
China	49	45	45	43	(-2)
Philippines	37	41	40	38	(-2)
Indonesia	40	37	39	36	(-3)

Source: Asian Corporate Governance Association (ACGA), 2016

# Risks and Opportunities in the Global Cybersecurity Landscape

Kenny Robertson  
Active Ownership Specialist

Danielle Essink  
Senior Engagement Specialist



In 2015, The World Economic Forum identified a large-scale cyberattack “as one of the high-impact risks most likely to crystallize over the next 10 years”. Only two years later, the WannaCry ransomware attack paralyzed the IT infrastructure of companies and government departments worldwide, affecting everything from car production to hospital admissions. Whilst the sheer size and impact of the attack was new, the underlying trend was not. As technological advances have permeated every business and sector, the risks associated with such advances have risen concurrently. Companies are facing an ever-greater number of cyber-attacks, with the number of data breaches increasing by nearly 70% from 2015 to 2017 in the US alone, according to the US-based think tank, the Identity Theft Resource Centre. Cybersecurity has therefore never been as important a topic as it is today.

## Codes of conduct

- SDG 16: Peace, Justice and Strong Institutions

### Risk & Crisis Management: Cyber Security

The number of cyberattacks faced by companies continues to rise. As the pace of digitalization also increases, this trend is likely to continue. Yet many companies are still underprepared for the increasing number of cyber threats that they face. To ensure that companies have the right culture and policies in place, investors have to be vigilant in making sure that companies are following procedures, training their workforces, and keeping up with the latest developments. Companies must ensure that their IT systems are secure, and that appropriate policies, governance and risk structures are in place to mitigate and minimize the effects which a cyberattack could have on their day to day operations.

### Failing to prepare is preparing to fail

Yet, many companies are still underprepared for the increasing number of cyber threats that they face. One recent survey by the insurer Hiscox found that whilst two-thirds of respondents ranked cyber threats alongside fraud as the top risks to their business, nearly three-quarters of organisations were ranked as novices on cybersecurity, demonstrating a clear gap between size of the threat

perceived by companies and their ability to mitigate any such risks that arise. Furthermore, a 2018 survey by consultants PwC found that 48% of respondents did not have an employee security awareness training program on cybersecurity, whilst 54% did not have an incident-response process.

### Cybercrime: the new piracy?

As the number of successful cybersecurity breaches rise, so too do the associated costs, thereby



has reached approximately USD 500 billion, extracting roughly 15-20% of the internet's annual economic value. In terms of impact, this places cybercrime on a similar level to narcotics and piracy. On a micro level, other studies have also sought to quantify the cost of individual data breaches. One such study by the Ponemon Institute which analysed breaches ranging from 2,600 to 100,000 records found the average cost to be USD 3.6 million globally in 2017, or USD 141 per compromised data record. Interestingly, the average cost varies significantly by country, with the highest average per capita (defined as the total cost of data breach divided by the size of the data breach) cost experienced in the United States, Canada and Germany.

### The rise of the mega-breach

In most of these cases, the costs at a corporate level are relatively small, due to the size of the breach, and therefore tend not to have a material effect on a company's share price. For so called 'mega-breaches' however, the impact is much larger, as was seen over the course of 2017. One notable example is that of a large US data analytics and technology company which experienced a large-scale cyber-attack between May and July that year. During this time, the information of 143 million people held by the company was compromised, leading to an immediate and large-scale impact on the company's share price following the announcement of the breach. In the following months, three key company executives, including the CEO, stood down in response to the incident.

necessitating urgent action from companies across sectors and markets. One of the most notable examples was the WannaCry ransomware attack which affected 300,000 computers across 150 countries, the cost of which is estimated to be as high as USD 4 billion. Whilst this attack was remarkable in both the number of affected parties and the associated economic cost, it also represents a larger underlying trend. As the number of cyberattacks increase, their associated economic cost is also increasing, with research by consultants Accenture showing a 27.4% increase in the average cost in 2017 alone.

A recent study by Credit Suisse shows that the annual cost of cybercrime

greater levels. Recent analysis by insurance broker Lloyds suggests that a major global cyberattack has the potential to trigger USD 53 billion of economic losses, roughly equivalent to the cost of a major natural disaster such as 2012's Superstorm Sandy. The materiality of cybersecurity to companies, and in turn investors, is therefore clear to see. Yet, given the rising number of recorded attacks, and the fact that in many cases, companies are lagging in their cyber preparedness, significant downside risks are present for companies operating in today's digital world.

### At the forefront of data privacy: the EU General Data Protection Regulation (GDPR)

Strongly related to issues of cyber security is the ever-greater demand from consumers for data privacy. All companies must balance the utilization of consumer data with the need to maintain consumer trust in the long term. GDPR enables European citizens to have better control over their personal data, including where their personal data is being stored, the purpose of it, and the ability to erase that data. The challenge for companies therefore is to ensure that consumer data is stored safely, to avoid the associated economic and reputational costs of any breach occurring.

### Engaging on cyber risk

Early in 2018, Robeco's Active Ownership team commissioned research from a leading cybersecurity firm, focused on companies in the Telecoms, Consumer and Payments sectors, with the aim of better understanding the risks and opportunities present for each of the 10 selected companies to be engaged with. Beginning in Q3, we will begin our dialogs with these companies, the aim of which will be to encourage risk mitigation around the potential cyber risks we have identified at each company.

The economic impact of a global cyberattack could reach even

## SPOTLIGHT ON



Vera Kruckel  
Trends Investing Researcher

### Cybersecurity in the investment process

Cybersecurity is an increasingly important topic for investors – both from a risk and an opportunity perspective. Taking a look at the risk side first, cyber security is a potential deterrent to many of the digitalization themes that Robeco invests in in its trends portfolios. Simply put, there will be no self-driving cars if there is no absolute certainty that brakes cannot be hacked. Nor can payments or our health care go digital if we don't have complete trust that our data is well protected. In addition, stock price impacts following reports of a breach are getting more severe; the best example clearly being Equifax. Clearly, it is beneficial for investors to engage with companies to ensure that their products, policies and procedures are up to the highest standards. Cybersecurity is rapidly becoming an important part of an organization's governance profile – and therefore is now an integral part of investor's ESG analysis.

In fact, no matter how much companies spend on technical cybersecurity solutions, in the end, success hinges on the judicious and disciplined implementation of cybersecurity policies. In most cases, negligent or risky behaviour, disregard for or ignorance of procedures, and sloppy implementation of security policies by company employees lie at the root of the problem. A lot therefore depends on an organization's culture, its explicit policies, and its agility in developing resilience to cyberthreats. To ensure that companies have the right culture and policies in place, investors have to be vigilant in making sure that companies are following procedures, training their workforces, and keeping up with the latest developments. Active engagement by investors can play a vital part in fostering the right culture to keep cybersecurity risks to a minimum. Next to starting up an engagement trajectory, Robeco will increasingly include its assessment of cyberattack resilience in its sustainability analysis of investment candidates and portfolio holdings.

Where there are risks, there are opportunities as well, and in the case of cybersecurity, investment opportunities are plentiful. The Robeco trends team uses cybersecurity as one of the underlying trends in a number of its investment portfolios. Next to being a nice diversifier in the portfolio due to its low correlation with other trends, cybersecurity is an attractive growth sector that is growing in line with an ever-increasing threat landscape. As more critical and sensitive data moves online, the amount and value of what is to be protected increases – and so does the incentive to

attack. The Internet of Things will add another 50 billion unprotected devices to the network, and will become the gift that keeps on giving to the attackers. Together with increased regulatory requirements – specifically GDPR – this will drive significant demand for cybersecurity products for many years to come.

However, as an investor, it does pay to be selective, as the cybersecurity industry is very diverse, and the dynamics of one segment are in no way comparable to those of others. As new threats emerge, so does the demand for different cybersecurity products, and so will new winners supersede those who were yesterday's front-runners. In this ever-changing environment, competitive advantages do not last long, competition is cut-throat, and economic profit generation is sparse. Just a handful of long-standing market participants have thus far managed to build long-lasting competitive advantages. Those form the base of the Robeco investment portfolios, together with some smaller, more agile and innovative players, who bring solutions the industry needs to keep up with in its constant arms race with attackers.





# Good Governance



**Michiel van Esch**  
Senior Engagement Specialist

**Robeco has actively engaged with companies on corporate governance issues for over a decade. Whilst the debate around corporate governance has changed, our work on governance is still based on the same principles.**

## Codes of conduct

- The ICGN Global Governance Principles (ICGN, revised 2014)
- Local corporate governance codes
- ICGN Corporate Risk Oversight Guidelines
- SDG 16: Peace, Justice and Strong Institutions; SDG 5: Gender Equality

## Corporate Governance: Accountability & Transparency

A company's corporate governance structure specifies the rights and responsibilities of the various stakeholders such as the management, supervisory directors, shareholders and other stakeholders. An effective corporate governance system focuses on a company's long term business continuity and protects shareholders' interests. A well-functioning corporate governance system can contribute to long term shareholder value. International and national principles and codes provide guidelines for good corporate governance. Corporate governance covers a number of important issues. Relevant subjects are: remuneration policy, shareholder rights, transparency, effective supervision of management, independent audit and risk management.

A clear set of governance principles should create clarity on the responsibilities and rights of the various stakeholders in a company. Checks and balances should be of sufficient quality to avoid any misuse of power by management (or another stakeholder) to the detriment of other stakeholders. Furthermore, a quality corporate governance system cannot exist without a high degree of transparency and accountability.

Many academic studies have pointed to a relationship between corporate governance and stock performance. The difficulties in these studies are often that there are many different interpretations on what defines good

corporate governance, and that often it is difficult to appropriately quantify it. Still, when companies run into a crisis, as we have seen in previous years, with 'dieselgate' at Volkswagen, the accounting scandal at Toshiba and the Lava Jato corruption issue at Petrobras, everyone seems to agree that a lack of quality governance can be devastating to a company. Increasingly, we are therefore asked to engage with companies that are effectively controlled by one entity, such as a state or family.

In such cases, we often engage to press for more qualified, independent people on the board; an independent chairman or a lead



to arguments for better governance.

### Changes in codes or listing requirements create momentum

Often, a company's governance is largely determined by local guidelines, regulations and a common understanding of best practices. When local codes or guidelines change, this can create some momentum, and investors can provide feedback on the implementation of new codes. One example is the change in listing requirements for the Novo Mercado, the top-level listing on the Brazilian exchange. Many Brazilian companies historically have a dual share class structure and an agreement with the largest shareholders. Effectively, this often puts the company under the control of a single entity, even if the company is not majority owned. Recently, the exchange proposed several governance improvements for the top-level listing, including strict requirements for the share structure, disclosures around remuneration and nomination policy, and minimum standards for independence at board level. If these new requirements are implemented well, they can be very beneficial for the position of all investments. Therefore, we have started engagements with several of our Brazilian investee companies.

It would be misleading to think that the majority of governance changes are happening in emerging markets. In the US and Europe, institutional shareholders also have plenty to argue about when it comes to basics of corporate governance. US tech companies often use dual share classes to make sure that the founders of the company retain control, even when they need to attract external capital. The debate on differential voting rights was fully unleashed when a US technology company issued new stock in 2017 with no voting rights. Since then, the MSCI has started a

consultation on adjusting market weights for companies that do not provide full voting rights for all of its shareholders. Such an adjustment might incentivize companies to provide fair voting rights, but at the same time such changes only address one governance flaw, and will bias indices towards constituents in certain markets and sectors.

### AGM season puts corporate governance in the spotlight

In the Netherlands, there is also plenty to discuss on corporate governance, and the 2018 Dutch AGM season got a lot of press coverage. Despite the fact that governance engagement is an all-year activity, the annual AGM season places it into the spotlight, putting a lot of attention on the second quarter of the year. At the AGM, new board members are elected, potentially new remuneration policies are introduced, and shareholders have the opportunity to file resolutions as part of their engagement with a company.

In 2018, we attended several AGMs to voice our opinion on several engagement topics with Dutch listed companies in our portfolios. During one AGM, Robeco spoke out against the discharge of the supervisory board for the lack of accountability towards its stakeholders during a takeover offer, and a lack of diligence in assessing a nomination to the board by an institutional investor. Voting against the discharge of the board sends a strong signal from a shareholder, and is only done when investors believe that the board has not carried out its fiduciary duty appropriately.

Our participation in the AGM of Shell was preceded by an extensive engagement process. The AGM was one of the most widely debated shareholder meetings of 2018. For the third year in a row, an organization called 'Follow This' filed a shareholder

independent director; strict and transparent procedures for related party transactions; strong accounting committees, and restrictions on management authority in cases of conflicts of interests. Engaging with companies on their governance can safeguard portfolio value, but this is not an overnight activity, and requires persistent and frequent interaction. The first step of such engagements is to convince management that implementing quality governance structures is not just in the interest of minority shareholders, but will also have a positive effect for the controlling stakeholder. This is often a difficult exercise, and generally it takes a long time before a company starts warming

resolution requiring Shell to set targets related to climate change and the Paris Agreement. As Shell had already set its own 'Climate Ambition' policy, the debate quickly became quite technical on the differences between the resolution and Shell's own plans. At the AGM, we encouraged Shell to continue its leadership and implement its own 'Climate Ambition'. But we stressed the need for more urgency, more accountability in the short run, and a need to formalize Shell's plan in the performance metrics of its long-term incentive structure. Later in the year, Shell took action on this by setting short-term targets for cutting carbon emissions, and subsequently linking these targets to executive pay for the first time.

### A peek into the engagement process

The AGM is an opportunity for outsiders to get a peek into to the engagement process, but most of the time the AGMs cover only a fraction of our dialogue. One example is Unilever, where judging from attention around the AGM, the most important topic might seem to have been the pay level of the CEO. Yet, this was only a fraction of our dialogue with the company. In 2018, Unilever simplified its share structure by buying back preferred shares, and is reviewing its corporate structure in the light of Brexit.









# Tax Accountability: Filtering out the noise



**Michiel van Esch**  
Senior Engagement Specialist

**Corporate taxation has been in the focus of considerable public debate over recent decades. Much of the recent attention has focused on the long debated US tax reform of late 2017, which altered tax rates and triggered significant repatriations for several US multinationals. However, corporate taxation was the subject of discussion long before this point, with the OECD introducing stricter guidelines for baseline erosion and profit shifting (known as BEPS) long before the US tax reform was announced.**

## Codes of conduct

- OECD/ G20 Base Erosion and Profit Shifting (BEPS) Package
- The European Commission, Anti-Tax Avoidance Package (ATAP)
- SDG 16: Peace, Justice and Strong Institutions; SDG10: Reduce Inequality

## Corporate Governance: Accountability & Transparency

A company's corporate governance structure specifies the rights and responsibilities of the various stakeholders such as the management, supervisory directors, shareholders and other stakeholders. An effective corporate governance system focuses on a company's long term business continuity and protects shareholders' interests. A well-functioning corporate governance system can contribute to long term shareholder value. International and national principles and codes provide guidelines for good corporate governance. Corporate governance covers a number of important issues. Relevant subjects are: remuneration policy, shareholder rights, transparency, effective supervision of management, independent audit and risk management.

## What constitutes a quality board?

Numerous recent cases of tax avoidance and potential state aid concerns have led to increased demand for corporate tax practices to become more accountable. Investors should be aware that governments worldwide need to increase tax revenue, and are becoming stricter in the enforcement of fiscal policies. For investors therefore, better transparency and accountability in terms of corporate taxation can allow better judgements to be made as to whether an effective tax rate is sustainable over the longer run.

In 2016, Robeco started an engagement project on corporate tax practices, focused on pharmaceutical, media and tech companies. Our goal is to enhance the accountability and transparency of tax practices and rests on four sub-objectives: 1) Tax reporting and disclosures, 2) Policy and principles, 3) Regulatory impact assessments and 4) Tax governance and systems.

## Tax policies: high, higher and highest level disclosures

The UK was the first country to require listed companies to publish a document that explains by which principles their tax is calculated.





without paying unnecessary or double taxes”

- “Maintaining a healthy and constructive relationship with tax authorities”, and
- “The arm’s length principle applies for transfer pricing”.

Helpful, but a comprehensive overview it is not.

Often, tax governance is also covered in the documents, but this too remains extremely high level.

- “Ultimately, the supervisory board has a supervisory role over the company’s tax practices, with a specific role for the audit committee....”.

Again, a high level statement which says very little about the actual governance of tax practices at a company.

Increasingly, tax policies also provide information on the objective of tax departments. The statements that are usually included are:

- “The tax department is a support function to the business”
- “The integrity of tax reporting is of utmost importance”, and
- “The department is not necessarily incentivized to unduly or artificially lower the company’s effective tax rate.”

Once more, not much to go on here. So how can investors gain further insight into the underlying sustainability and appropriateness of a company’s tax position?

### Country by country reporting: the Holy Grail

Having had conversations with approximately 10 different pharma, tech and media companies, we noticed that talking directly with tax specialists gave us a much better understanding of the a company’s stance towards

certain fiscal codes, how they deal with conflicting approaches between tax authorities, and the quality of tax assurance.

Still, what we ultimately are trying to assess is the degree to which the OECD guidelines on baseline erosion and profit shifting are followed. In order to truly do this, information needs to be made available on profits, margins, taxes paid, allocation of intellectual property and the nature of economic activity in the company’s markets. This type of reporting is better known as Country by Country Reporting (CbCR).

The OECD requires these documents to be shared with tax authorities. Unfortunately for the investing public, these are not publicly available. US companies are required to file a tax reconciliation in their 10K reports, which allow investors get a sense about the effects of taxes paid in foreign countries, but they do not usually provide any of the above-mentioned data points per market. So far, companies have been very reluctant to provide country by country reporting.

The main argument often is the complexity of the report, and the confusion and misunderstanding it would create. The format in which the CbCR would be presented to the various tax authorities is often said to be not useful to investors. Another common argument is that the information is commercially sensitive, as it would disclose pricing practices and investments in specific products or markets. Yet, several companies have started publishing tax reports with CbCR for the top 10 or 15 markets in which they operate, and provide more narrative on examples of tax risks and challenges. We are encouraged by these examples, even though we haven’t seen much of these disclosures by pharma or tech companies.

Increasingly, companies in other nations also publish their tax policies, or are converting their UK tax principles into global principles. At face value, one might think that these documents allow investors and the public to get a better understanding over whether companies are relatively aggressive or conservative around tax matters. However, these documents usually cover a very similar set of statements. The following principles are usually included:

- “Compliance with all applicable tax laws”
- “Tax payments should follow economic substance”
- “Paying taxes where taxes are due

### The tax debate is here to stay

Late in 2017, the US passed tax reform into law. Several of the US pharmaceutical companies in our program had pointed out that the US tax system was uncompetitive compared to other markets. Soon after the reform, US companies announced cash repatriations to the US, as a result of the lower tax rate. It was often argued that US companies had pursued active tax strategies as a result of the relatively high US tax rate. You might think that the US tax reform puts that discussion to bed, but you would be wrong.

Most companies in our engagement theme report the increase in tax audits and conflicts between jurisdictions as a continuing trend. Several jurisdictions are under pressure to increase their tax base whilst maintaining a competitive business environment for international institutions. The number of listed companies under public scrutiny for their tax contributions have not yet decreased. Our engagement with these companies will continue for another two years.









# Engagement with Policymakers in 2018

**Carola van Lamoen**  
Head of Active Ownership

**Robert Dykstra**  
Active Ownership Analyst



**Sustainable finance and climate change dominated Robeco's engagement with public bodies in 2018.**

## [Robeco participated in joint investor call towards G7 nations to increase climate efforts](#)

Climate change remains an important topic for Robeco, particularly following the launch of our own climate change policy in 2017. Robeco supports the targets for cutting harmful greenhouse gas emissions globally as set out in the 2015 Paris Climate Agreement. In May, Robeco was a signatory to the 2018 Global Investor Statement, signed by 288 investors from around the world, "calling on the governments of the G7 nations to increase efforts to achieve the goals of the Paris Agreement, accelerate private sector investment in the low carbon transition and commit themselves to improving climate-

related financial reporting." The statement was delivered in advance of the G7 Summit on 8-9 June 2018. Similar statements were issued in 2016 and 2017 and provided a strong signal of the investor community to the G7 nations.

## [Our efforts related to the EU Action Plan for Sustainable Finance](#)

Next to our policy efforts on climate change, we have given our opinion on the EU Action Plan for Sustainable Finance via the European Fund and Asset Management Association (EFAMA). In July 2018, Robeco supplied feedback to EFAMA regarding the letter it was sending to the European

Commission about disclosures relating to sustainable investments and sustainability risks. This included amending Directive 2016/2341. While this may seem rather technical, the final plan has the potential to introduce sustainable finance on a level playing field across the EU, and is a major debating point for sustainable investors.

Robeco's comments focused on the need to be positive, clear and not too conservative about promoting sustainable finance. Whilst we agree that ESG investment should not become a tick-the-box exercise, we also believe that the implementation of sustainable finance is unlikely to





be a 'one-size-fits-all' approach. We furthermore encouraged EFAMA to be ambitious in their recommendations. For example, the letter recommends that the asset management industry can contribute to a more sustainable economy by "engaging with companies in their portfolios to better understand the management of their ESG risks and opportunities." Robeco is convinced that engagement should also aim to improve overall ESG-conduct.

### Backing a Carbon Disclosure Project Statement

Also other investor initiatives prepared statements related to the EU Action Plan on Sustainable Finance. Robeco backed a statement in November by the Carbon Disclosure Project (CDP) which supported the EU Action Plan on Sustainable Finance and its aim to create a level playing field for carbon disclosure across the EU by standardizing sector-specific metrics. It also called for policy coherence

between investor duties and corporate reporting, so that companies actually disclose the information that investors require.

The CDP is a UK organization which encourages countries and cities to disclose the environmental impact of major corporations within their jurisdiction. It aims to make environmental reporting and risk management a business norm, and drive disclosure, insight and action towards a sustainable economy. Since 2002 over 6,000 companies have publicly disclosed environmental information through the CDP. Robeco is an active member of CDP for many years.

### Roundtable on Sustainable Palm Oil

Support for making palm oil production more sustainable led to Robeco participating in the Roundtable of Sustainable Palm Oil (RSPO) annual event in August. The industry faces issues related to deforestation, labor rights and has a substantial carbon footprint. We have engaged for many years with palm oil companies and we will step up our efforts in 2019. Robeco wrote to the RSPO backing its moves to strengthen its standards for certifying the sustainable production of palm oil, a certification process that undergoes public review every five years. The final letter was sent to members of the RSPO's Principles and Criteria Task Force, workshop consultation leads, and Secretariat.

Although a handful of firms are already engaging directly with the RSPO via calls and meetings, major letter updates will be shared with signatories as they occur, in addition to a high-level press release that was sent in August. On 15 November, the RSPO ratified and adopted a certification standard aimed at universally strengthening social development, environmental

protection, and economic prosperity across the sustainable palm oil value chain. The RSPO has also developed an additional and separate standard specifically geared toward independent smallholders which is due for ratification in November 2019.

### Exchange of Ideas

Finally, regulation has an important role to play in promoting sustainability, and therefore Robeco follows initiatives from the International Organization of Securities Commissions (IOSCO), an association of bodies that regulate the world's securities and futures markets. Members are typically primary securities and/or futures regulators in a national jurisdiction or the main financial regulator from each country. Collaboratively with many other investors, we wrote to IOSCO in April to express our support for its review of ESG issues in two of its committees. We called on IOSCO to endorse the Sustainable Stock Exchanges' Model Guidance on Reporting ESG Information to Investors as a consistent principles-based approach to disclosing sustainability issues.

We also asked IOSCO to engage with the World Federation of Exchanges (WFE) in their ongoing sustainability work, including examining metrics as a starting point towards developing a minimum, baseline level of disclosure. We also sought IOSCO's endorsement of the Financial Stability Board (FSB) Taskforce on Climate-related Financial Disclosures (TCFD) recommendations as a means for a deeper examination of climate-related disclosures

### Robeco's Engagement Policy

Sustainability investing is integral to Robeco's overall strategy. We are convinced that integrating environmental, social and governance (ESG) factors results in better-informed investment decisions. Further we believe that our engagement with investee companies on financially material sustainability issues will have a positive impact on our investment results and on society.

Robeco actively uses its ownership rights to engage with companies on behalf of our clients in a constructive manner. We believe improvements in sustainable corporate behavior can result in an improved risk return profile of our investments. Robeco engages with companies worldwide, in both our equity and credit portfolios. Robeco carries out two different types of corporate engagement with the companies in which we invest; value engagement and enhanced engagement. In both types of engagement, Robeco aims to improve a company's behavior on environmental, social and/or corporate governance (ESG) related issues with the aim of improving the long-term performance of the company and ultimately the quality of investments for our clients.

Robeco adopts a holistic approach to integrating sustainability. We view sustainability as a long-term driver of change in markets, countries and companies which impacts future performance. Based on this belief, sustainability is considered as one of the value drivers in our investment process, similar to the way we look at other drivers such as company financials or market momentum.

### The UN Global Compact

The principal code of conduct in Robeco's engagement process is the United Nations Global Compact.

The UN Global Compact supports companies and other social players worldwide in stimulating corporate social responsibility. The Global Compact became effective in 2000 and there are now approximately 9,000 participating companies. It is the most endorsed code of conduct in this field. The Global Compact requires companies to embrace, support and adopt a number of core values within their own sphere of influence in the field of human rights, labor standards, the environment and anti-corruption measures. Ten universal principles have been identified to deal with the challenges of globalization.

#### Human rights

1. Companies should support and respect the protection of human rights as established at an international level
2. They should ensure that they are not complicit in human-rights abuses.

#### Labor standards

3. Companies should uphold the freedom of association and recognize the right to collective bargaining
4. Companies should abolish all forms of compulsory labor
5. Companies should abolish child labor
6. Companies should eliminate discrimination in employment.

#### Environment

7. Companies should adopt a prudent approach to environmental challenges
8. Companies should undertake initiatives to promote greater environmental responsibility
9. Companies should encourage the development and diffusion of environmentally friendly technologies.

#### Anti-corruption

10. Companies should work against all forms of corruption, including extortion and bribery.

### Other relevant codes of conduct

- Robeco's engagement process is also based on the following internationally accepted codes of conduct:
- The Universal Declaration of Human Rights
- The Declaration on Fundamental Principles and Rights at Work of the International Labor Organization (ILO)
- The Rio Declaration on Environment and Development
- The UN Convention against Corruption
- The Global Reporting Initiative (GRI)

### About Robeco

Robeco Institutional Asset Management B.V. (Robeco) is a global asset manager, headquartered in Rotterdam, the Netherlands. Robeco offers a mix of investment solutions within a broad range of strategies to institutional and private investors worldwide. As at 31 December 2018, Robeco had EUR 162 billion in assets under management. Founded in the Netherlands in 1929 as 'Rotterdamsch Beleggings Consortium', Robeco is a subsidiary of ORIX Corporation Europe N.V. (ORIX Europe), a holding company which also comprises the following subsidiaries and joint ventures: Boston Partners, Harbor Capital Advisors, Transtrend, RobecoSAM and Canara Robeco. ORIX Europe is the center of asset management expertise for ORIX Corporation, based in Tokyo, Japan.

Robeco employs about 890 people in 15 countries (December 2018). The company has a strong European and US client base and a developing presence in key emerging markets, including Asia, India and Latin America.

Robeco strongly advocates responsible investing. Environmental, social and governance factors are integrated into the investment processes, and there is an exclusion policy in place. Robeco also makes active use of its voting right and enters into dialogue with the companies in which it invests. To service institutional and business clients, Robeco has offices in Bahrain, Greater China (Mainland, Hong Kong, Taiwan), France, Germany, Japan, Luxembourg, Singapore, Spain, Switzerland, Sydney and the United States.



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