J. SAFRA SARASIN

Sustainable Swiss Private Banking since 1841

Sustainable Investment Spotlight

Sustainable Investment Research, Bank J. Safra Sarasin

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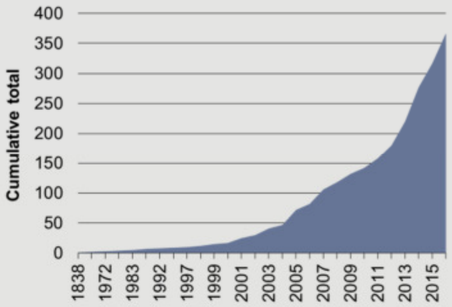
Stricter European regulations favour sustainable investments

- **A torrent of regulations is tightening the transparency requirements for companies and investors with a view to improving the analysis and management of risks.**
- **Two milestones have already been set in the European Union: the revision of the Pension Fund Directive and of the Shareholder Rights Directive promotes greater transparency and requires institutional investors to disclose relevant risks that have not been recorded in a standard way.**
- **Compared with Europe, the Swiss regulator is less prescriptive.**
- **Thanks to its market leadership in sustainable investments, Bank J. Safra Sarasin is well positioned to benefit from the rapid growth of this market segment.**

Figure 1: Number of legal requirements for sustainable investments worldwide



Source: Bank J. Safra Sarasin, based on UN PRI, 2016

Figure 2: Map of all European countries with regulatory measures in the area of sustainable investments

Source: SSF, Neher, 2015

Regulatory measures on the rise

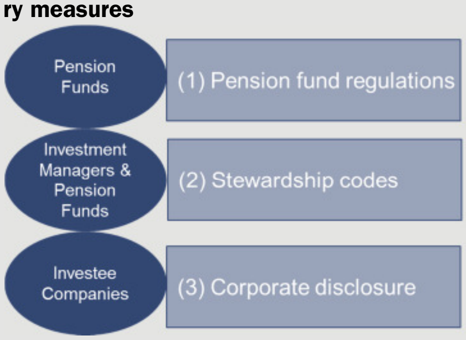
There is currently a marked shift towards tougher regulatory measures in the area of sustainable investments, as illustrated in Figure 1. There are actually more than 350 legal requirements worldwide, half of which were introduced during the period 2013 to 2016 (UN PRI, 2016). Most of this regulation focuses on long-term value drivers, including environmental, social and governance (ESG) factors.

Enormous diversity

The regulatory measures come in many different shapes and sizes: on the one hand, there are "hard" regulations governing sustainable investments which set out legally binding and precise duties and obligations. On the other hand, there are "soft" or voluntary guidelines which reference a broad field of quasi-legal instruments that are loosely defined and whose direct consequences are unclear. These types of regulation can be divided into three categories:

1) Pension fund regulations
2) Stewardship codes for asset managers and pension funds
3) Transparency rules for corporations

Figure 3: Typology of the different regulatory measures



Source: Bank J. Safra Sarasin, based on UN PRI, 2017

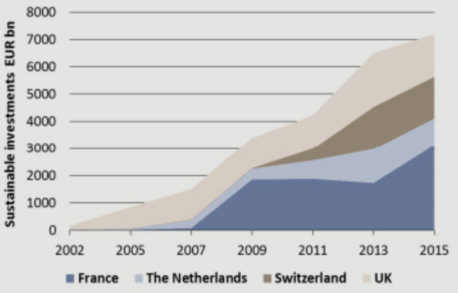
Europe still leads the way

When it comes to "hard" regulation in the area of sustainable investments, European markets have developed very differently. Although 13 European countries have certain regulatory requirements in place (see Figure 2), their scope varies enormously. While some countries, including Austria

Germany and Spain, focus on compulsory disclosure by pension funds, others such as Sweden and France and the Netherlands even go one step further. These countries have additional regulations governing the financing of weapons or require ESG criteria to always be considered in the investment process for public pension schemes.

One point worth noting is that countries with a more advanced regulatory environment in the area of sustainable investments, such as France, the Netherlands and the UK, also lead the way when it comes to the volume of sustainable assets under management. Figure 4 shows the dynamic growth of sustainable investments and suggests that regulations in the area of sustainable investments are closely correlated with the maturity of the market in question.

Figure 4: Absolute development of sustainable investments in European countries



Source: Bank J. Safra Sarasin, based on Eurosif, 2017

Overview of regulatory measures in leading EU countries

Several countries have fixed rules in the area of sustainable investments which vary in terms of scope and format. The situation in the three leading European countries is briefly summarised in what follows.

France

France has a vast number of laws governing sustainable investments that are targeted at pension funds, state pension schemes and investment companies. In December 2015, Article 48 of the French Energy Transition Act was amended. This is the first of its type worldwide. It requires French pension funds, asset managers and insurance companies to fully disclose their investment guidelines, the carbon footprint of their portfolios and their orientation to climate targets, as well as reporting their climate risks.

The Netherlands

The Netherlands was one of the first countries to pass legislation on sustainable investments. The most recent law, passed in 2013, prohibits the financing of landmines and cluster bombs. It also bans financial institutions from investing in companies that produce such weapons.

United Kingdom

As in the USA, common law applies in the UK. Its market in sustainable investments has developed in similar ways to those countries where investor campaigns started at an early stage, such as the protests against the Vietnam War in the USA. One particular feature of the UK market is the series of laws encouraging disclosure by pension funds, strategies for charitable investments and tax relief for investments for the common good. Just recently the new "Code of practice for defined-contribution schemes" was passed in 2016, which requires pension funds to take into consideration all financially relevant factors, including ESG criteria, in their investments.

Two milestones set: the revision of the EU Pension Fund Directive and of the EU Shareholder Rights Directive

In December 2016, the revised "Guideline on the activities and the supervision of occupational pension schemes" was passed in Brussels. This directive is seen as a milestone for sustainable investments, as it requires (among other things) pension funds in the individual member states to disclose the extent to which ESG factors based on the principles for responsible investments supported by the United Nations are taken into consideration not only in their investment decisions, but also in their risk management systems. The member states now have up to 2019 to incorporate this guideline into national "hard" law. This comprehensive pension fund regulation will inevitably have an effect on the reporting practices of multinational companies.

In March 2017, another important milestone was reached in championing the long-term rights of shareholders: the revised "EU Shareholder Rights Directive". Amongst other things, the new regulation makes it easier for shareholders to exercise their voting rights across national borders and requires data transparency on the part of companies, investors and proxy advisors.

RI Reporting Awards: Best in class

Bank J. Safra Sarasin is the main sponsor of the RI Reporting Awards for asset owners. Every year Responsible Investor (RI) gives awards for the best examples of reporting by the world's biggest asset owners. In 2016 the Dutch pension fund Pensioenfonds Zorg en Welzijn (PFZW) won the award for large pension funds, while the French company ERAFP won the category "Small to mid-sized pension funds". As in previous years, the European winners come from the countries with the more mature sustainable investment markets. This is further confirmation that obligatory reporting and disclosure requirements lead to more and better information for the insured, investors and other stakeholders.

One point worth noting is that the reporting by PFZW, the winning pension fund in 2016, takes into consideration not only climate change but also the recently launched Sustainable Development Goals (SGD) in its investment strategy. Its reporting is well structured, intelligible and relevant. For example: the pension fund discloses its sustainable investment instruments according to its own classification, whereby it excludes certain sectors, integrates ESG factors and seeks direct dialogue with companies.

Uncluttered regulatory environment in Switzerland

In 2002 legislation was amended requiring investment funds to formalise arrangements for their shareholder rights. Investment funds are not legally obliged to exercise their voting rights. Even so, the new legislation can be seen as providing the legal basis for shareholder engagement. In 2014 the Ordinance against excessive compensation in Swiss listed companies (VegüV) – commonly referred to as the Minder Initiative – came into force. Under this new legislation, shareholders are given a greater say in executive remuneration. For example, companies now need to have the amount of compensation paid to members of the Board of Directors approved by an AGM vote. Employee benefit schemes are in turn obliged to exercise their voting rights at companies' AGMs.

VegüV – status two years on

Since 2015, VegüV requires specific agenda items to be voted on at annual general meetings. It is interesting to note that although far more agenda items are now being put to the vote, the average approval quota for compensation paid to both board and management members is still relatively high. This suggests that the initial intention of the initiative – restricting excessive compensation – has not been realised so far. Even so, the few proposals that attracted the most votes against in 2016 were those relating to compensation (Ethos 2016).

In 2013 Switzerland revised its Federal Act on War Material. The new version of the law prohibits the manufacture, trading and stockpiling of controversial weapons as well as any investment in such companies, which can be seen as a substitute for direct financing. These controversial weapons not only include cluster bombs but also atomic, biological and chemical (ABC) weapons and antipersonnel mines.

Swiss Code of Best Practice for Corporate Governance

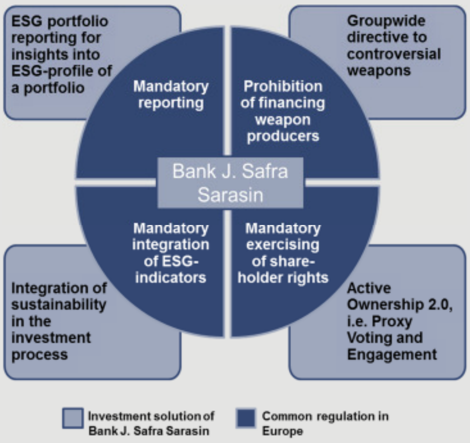
When it comes to voluntary guidelines in the area of sustainable investments, the "Swiss Code of Best Practice for Corporate Governance", including the "Guidelines for Institutional Investors to practice voting rights" published by the Swiss industry federation economiesuisse are worth special mention. Since being revised in 2014, the code – which mainly affects listed Swiss companies – is designed to make sure that sustainability has a positive impact on a company's long-term performance. The additional guidelines contain five principles for institutional investors to ensure they exercise their voting rights responsibly.

Bank J. Safra Sarasin is well positioned in the current regulatory environment

Bank J. Safra Sarasin is fully prepared to deal with the regulatory changes in Switzerland and the Eurozone. Its flagship role in the area of sustainable investments is reflected in its leadership of the Swiss market, with a 21.1% share in 2016. As Figure 5 shows, the Bank has developed a broad range of sustainable investment services, some of which already comply with regulatory requirements. Back in 2011 the Bank introduced a groupwide directive prohibiting the financing of companies producing war material. Controversial weapons include, for example, the producers of cluster bombs and antipersonnel mines in line with existing legislation in Switzerland and the Netherlands. This guideline applies to the entire J. Safra Sarasin Group.

For some years now, the Bank has also been exercising its voting rights for sustainability funds. Since the development of the Active Ownership 2.0 approach last September, the Bank always votes in accordance with its sustainable investment philosophy. On the one hand, Bank J. Safra Sarasin offers its clients customised voting recommendations. On the other hand, it can ar-arrange for the votes to be cast and offer customer-specific reporting that is based on VegüV criteria.

Figure 5: How Bank J. Safra Sarasin caters for regulatory trends



Source: Bank J. Safra Sarasin, 2017

At the core of Bank J. Safra Sarasin's investment philosophy lies the implementation of relevant environmental, social and governance factors in the investment process. This requirement is already covered by regulation in a number of EU member states. In the UK, this requires a new code, while France has introduced a law governing sustainable investment strategies for statutory reserve funds. The Pension Fund Directive recently put forward in the EU also requires ESG factors to be considered in the investment decision. If this does not happen, a report must be made.

Finally, the Bank produces customised ESG portfolio reporting for its clients which provide concrete insights into the ESG profile of their investment portfolios and individual securities. For example, the carbon footprint of a portfolio can be compared with the benchmark index, as required by Article 48 of the French Energy Transition Act.

Bank J. Safra Sarasin offers clients with a commitment to sustainability bespoke solutions and responses to new regulatory trends in the Swiss and European market.

Sustainability Rating Methodology

The environmental, social and governance (ESG) analysis of companies is based on a proprietary assessment methodology developed by the Sustainable Investment Research Department of BJSS. All ratings are conducted by in-house sustainability analysts. The sustainability rating incorporates two dimensions which are combined in the Sarasin Sustainability-Matrix® :

- Sector Rating: Comparative assessment of industries based upon their impacts on environment and society.
- Company Rating: Comparative assessment of companies within their industry based upon their performance to manage their environmental, social and governance risks and opportunities.

Investment Universe: Only companies with a sufficiently high Company Rating (shaded area) qualify for Bank J. Safra Sarasin sustainability funds.

Key issues

When doing a sustainability rating, the analysts in the Sustainable Investment Research Department assess how well companies manage their main stakeholders’ expectations (e.g. employees, suppliers, customers) and how well they manage related general and industry-specific environmental, social and governance risks and opportunities. The company’s management quality with respect to ESG risks and opportunities is compared with its industry peers.

Controversial activities (exclusions)

Certain business activities which are not deemed to be compatible with sustainable development (e.g. armaments, nuclear power, tobacco, pornography) can lead to the exclusion of companies from the Bank J. Safra Sarasin sustainable investment universe.

Data sources

The Sustainable Investment Research Department uses a variety of data sources which are publicly available (e.g. company reports, press, internet search) and data/information provided by service providers which are collecting financial, environmental, social, governance and reputational risk data on behalf of the Sustainable Investment Research Department.

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