ROBECO
The Investment Engineers

2017 Active Ownership Report

ROBECO | 01.01.2017 - 12.31.2017

EUR 240 Billion

Assets under engagement

EUR 63 Billion

Assets under voting

206

Number of engagement cases

4,733

Number of shareholder meetings voted

177

Number of companies engaged

73

Number of markets voted

45 (87%)

Number of cases closed successfully

60%

% Meetings with votes against management

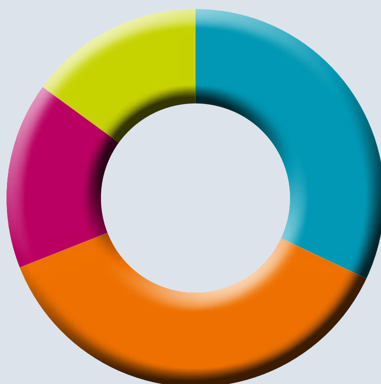
14

Number of engagement themes

52,242

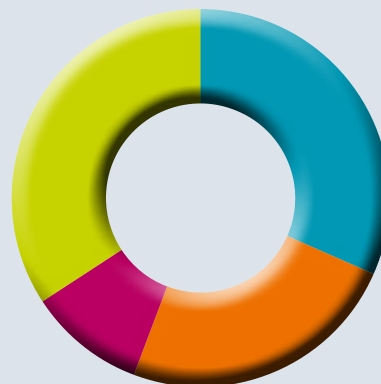
Number of proposals voted on

Engagement activities by region



Region	%
North America	32%
Europe	37%
Pacific	16%
Emerging Markets	15%

Shareholder meetings voted by region



Region	%
North America	32%
Europe	24%
Pacific	10%
Emerging Markets	34%

Contents

In our 2017 Active Ownership Report: Cristina Cedillo highlights the necessity of business model innovation in the auto sector, Ronnie Lim promotes the need for continued improvements in corporate governance in Japan, and Danielle Essink explores in the impact of the new European Union General Data Protection Regulation (GDPR), plus an update on all of our 14 engagement themes.

Voting highlights

Kenneth Robertson & Laura Bosch take a look back at some notable shareholder meetings from 2017

ESG challenges in the auto industry

The business models of global automotive industry players will significantly change in the coming years as car use is transformed. Cristina Cedillo examines the factors at play.

Environmental challenges in the oil and gas sector

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Data privacy

The European Union is to introduce new regulation on data security and consumer data privacy. Danielle Essink on the company level impact

ESG risks and opportunities in the biopharmaceutical industry

Peter van der Werf on the impact of ESG trends on the biopharmaceutical industry

Corporate governance in Japan

Ronnie Lim provides an update on the Japanese government's initiatives to encourage both investors and companies to improve their governance

Board quality: What constitutes a quality board?

Michiel van Esch spoke directly with the chairmen and lead independent directors of several companies for over three years to answer the question: What constitutes a quality board?

Engagement with policymakers in 2017

Carola van Lamoen and Guido Moret provide insight into our policy engagement work which took place in 2017

2017 was another successful year for Robeco's Active Ownership activities. During the year we saw growth in both the number of clients and the amount of assets under engagement and voting. Since Active Ownership forms a key component of our sustainability investing proposition, we are increasingly able to reap the benefits of integrating it into our investment processes. Our approach results in better informed investment decisions and benefits society.

Robeco's Active Ownership activities primarily consist of voting and engagement for the companies held in our client's portfolios. In our engagement program we focus on financially material sustainability themes and the elimination of severe breaches in the areas of human rights, labor relations, the environment, bribery and corruption. In this report, we provide an update on all engagement themes that were run during 2017, as well as a summary of our voting activities during the year.

During 2017, two engagement themes – board quality and social issues in the food and agri supply chain – came to an end. We also launched three new themes, including ESG challenges in the auto industry, the social risks of sugar, and corporate governance standards in Asia, all of which produced reports on their levels of success.

Finally, I would like to draw your attention to the contribution that our active ownership activities make to the Sustainable Development Goals (SDGs) of the United Nations. We have mapped the objectives of the engagement themes with the SDGs, and specifically target one or two SDGs within our engagement themes. This will become more important in future years as the SDGs are embraced.

Peter Ferket
Head of Investments and
Member of Robeco's Executive Committee

Voting Highlights

Proxy voting is an integral part of Robeco's Active Ownership approach. The aim of our voting activities is to encourage good governance and sustainable corporate practices, which contribute to long-term shareholder value creation. With this in mind, Corporate Governance Analysts Kenneth Robertson and Laura Bosch provide an update on our 2017 voting activities.

How Many is Too Many? Assessing Director Over Commitment

Board quality and corporate performance are inextricably linked and, as sustainable investors, we aim to ensure that the companies in which we invest take a proactive approach to building independent, knowledgeable and diverse boards. It is also important that once directors are elected, they have the time to fully dedicate themselves to the important work of the board. In turn, whether directors have enough time to sufficiently fulfil the duties entrusted to them by shareholders should be of key concern to all investors.

However this is not always the case, and in many instances it is clear, either by examining attendance rates or counting outside commitments, that directors may be overstretched. There are of course advantages to directors holding more than one board seat or executive position. Indeed sharing of best practices, networking and education gained by a director at one company can also be used at another company where he sits. However, balance is key, in that too many outside board seats can lead to negative effects.

One recent study conducted by the University of Michigan focused specifically on the US financial sector, arguing that directors of the country's largest financial institutions are too busy to execute their governance roles effectively. They found that outside board seats held by a director could limit the time that a director spends assessing the firm's strategy and risk or contribute to cognitive overload, using the examples of JP Morgan and Wells Fargo to strengthen their case. Overcommitted directors, they posit, may 'consciously or subconsciously shirk their advising and monitoring responsibilities' as a result of holding too many board seats.

A second study, conducted by Rotterdam School of Management, drew similar conclusions when

exploring the link between 'director attention' and firm value. They argue that when directors hold a greater number of board seats, the chance of an issue arising at one firm which will absorb all of their attention is greater, and example of which include mergers and acquisitions. When such events happen, it is possible that the director no longer has the ability to dedicate sufficient time to their other board roles. The study therefore concludes that "distracted directors spend less time and energy to monitor and advise managers and leave room for managers to shirk at the expense of shareholders, leading to significant declines in firm value."

These studies are particularly interesting in that they come at a time when companies in the S&P 500 are hiring fewer actively employed executives joining from outside boards than in the past. In fact, the 2016 Spencer Stuart Board Index shows that only 19% of new independent directors are active CEOs, chairs, presidents and chief operating officers, compared with 24% in 2011, 29% in 2006 and 49% in 1998. Furthermore, in 2016 nearly one-third (32%) of the new independent directors on S&P 500 boards are serving on their first outside corporate board.

Therefore, the potential over boarding of directors is something which must be considered by investors when casting their voting decisions. The expertise and other qualities brought to the board by a director must be balanced against their ability to dedicate a sufficient amount of time to the role. It is therefore our policy to assess if non-executive directors are holding an adequate number of board seats taking into account local market practices, as well as the overall duties and responsibilities held by the nominee in each board room. For this reason, we voted against the election or reelection of over 300 board members during the first half of 2017, due to concerns that they would not have sufficient time available to them to appropriately fulfil their duties.

Vote Confirmation Initiative

Most investors vote on resolutions at the shareholder meetings of their investee companies by proxy. In practice, this means that votes are delivered to shareholder meetings from a computer platform rather than by attending the shareholder meeting in person. This is positive, in that it allows investors to vote for all of their holdings, rather than just a small selection of companies who's shareholder meetings the investors are able to attend in person.

However, several agents are involved throughout the entire proxy voting chain, implying that when investors cast their votes, several parties must process these instructions before the vote reaches the company. To ensure a continually high quality and efficient voting process, Robeco carries out a vote confirmation audit on an annual basis to monitor the voting chain in a selection of markets where votes have been cast to identify potential issues. This involves tracing back votes starting at the issuer level moving all the way up to the proxy voting distributor.

Robeco is firmly committed to enhancing transparency and efficiency in the proxy voting chain. As a result, we contributed to a working group, together with the UN Principles for Responsible Investment (PRI), to assess the proxy voting chain in two developed markets, with the aim of confirming the voting instructions cast by the groups participants.

In 2017, we also joined a pilot project launched by Citibank, which aims to directly connect issuers with investors, with the aim of bringing greater efficiency, accuracy and transparency to the voting process. A platform named Proximity Voting was developed, the purpose of which was to ensure issuers received votes in real time, while investors received better confirmation that their votes were received and counted at the meeting. Several key European investors and issuers were involved in the successful pilot.

After the conclusion of the pilot phase, the product will be rolled out initially in the UK market for the 2018 proxy season, with plans for additional market expansion later in 2018. This represents a potentially disruptive innovation to the voting chain, since the platform would directly connect

investors to issuers, reducing the amount of intermediaries throughout the voting chain. This would in turn facilitate a better information flow amongst all parties involved. We believe that it is the responsibility of all investors to contribute to improvements in the voting chain, and will contribute to any such initiative where possible.

We believe that enhancing transparency and efficiency in the voting chain is of the upmost importance. Having the ability to easily verify the voting instructions cast by investors at shareholder meetings also further improves the overall quality of our activities, in that a more transparent voting chain can also enhance engagement between issuers and investors as both parties can exchange information at a faster pace.

We will therefore continue to proactively embrace initiatives such as Proximity Voting which we hope will in turn continue to create momentum for change at the industry level, which is in the best interest of both investors and issuers. We are aware that Citibank is only one player in a vast global industry, and that continual improvements will require the input and collaboration of all global custodians. We will therefore use the lessons and best practices learned in this project to encourage other custodians to continue to strive towards the creation of a more efficient and transparent voting chain.

Company Highlights

Hewlett Packard Enterprise Co

Proposal: advisory vote on executive compensation

Hewlett Packard Enterprise Company provides information technology solutions. The Company offers enterprise security, analytics and data management, applications development and testing, data center care, cloud consulting, and business process services. Hewlett Packard Enterprise serves customers worldwide.

Meeting Date: 22 March 2017

During the Annual General Meeting of Hewlett Packard, shareholders are asked for an advisory vote on the implementation of the executive compensation policy for the previous year. However, during the year in review, the company took a number of actions on executive pay which we deem far from best practices, leading us to vote against the implementation of the plan.

When assessing compensation plan structure, we believe it is essential that an appropriate balance is struck between fixed and variable compensation, and short and long term performance. Performance must be measured over a sufficiently long period to capture the degree of long term shareholder value creation. A portion of this compensation must also be truly 'at risk' to appropriately align pay with performance, including reduced pay-outs when the company underperforms its peers.

The company has established a clear long term incentive (LTI) plan for its executives, based upon multiple metrics including Total Shareholder Return (TSR), Return on Investor Capital (ROIC) and Share Price. However, it appears that in calculating the level of 2017 awards made under the LTI, the entirety of these awards will be tied to absolute share price, with performance measured over a period of less than 3 years. This is a clear departure from the plan approved by shareholders in the past, and we view this development as a regressive step for the company.

Furthermore, the company made a number of one off additional payments to executives totaling USD38 million, the most significant of which was made to the CEO of USD 15 million. If it is accepted that the compensation plan has failed to sufficiently incentivize executives, and align pay for performance, we believe companies should redesign their compensation programs going forward rather than make additional discretionary grants. These grants were tied to a rolling, absolute share price hurdle, the maximum target of which has already been met for the year, resulting in full pay out of these awards. The early accomplishment of all performance conditions for these grants therefor leads us to believe that the performance conditions attached to these awards were not sufficiently stretching for the executives in question. Targets used for variable compensation should be sufficiently challenging to incentivize added value and outperformance, and in this case we do not believe this to be the case.

For these reasons, we voted against the advisory vote on composition at the 2017 shareholder meetings. The advisory vote on executive compensation was approved by shareholders with 71% of the vote.

Exxon Mobil Corp.

Proposal: 20 C scenario planning
Exxon Mobil Corporation operates petroleum and petrochemicals businesses on a worldwide basis. The Company operations include exploration and production of oil and gas, electric power generation, and coal and minerals operations. Exxon Mobil also manufactures and markets fuels, lubricants, and chemicals.

Meeting Date: 31 May 2017

SDG 13: Take urgent action to combat climate change and its impacts
Over the course of the last two years, a number of the large oil majors, including BP, ConocoPhillips, Royal Dutch Shell and Total have endorsed 2 degree scenario analysis as a means to increase transparency on the effect which limiting climate change to below 2 degrees will have on the value of their portfolios, through reduced demand for oil and gas. Such proposals are in line with the Financial Stability Board's Task Force on Climate-Related Financial Disclosures which indicated that it favors two degree scenario analysis when formulating appropriate action on climate change.

At the 2017 annual general meeting of the company, a shareholder proposal was filed requesting that, 'beginning in 2018, ExxonMobil publish an annual assessment of the long-term portfolio impacts of technological advances and global climate change policies, at reasonable cost and omitting proprietary information. The assessment can be incorporated into existing reporting and should analyze the impacts on ExxonMobil's oil and gas reserves and resources under a scenario in which reduction in demand results from carbon restrictions and related rules or commitments adopted by governments consistent with the globally agreed upon 2 degree target. This reporting should assess the resilience of the company's full portfolio of reserves and resources through 2040 and beyond, and address the financial risks associated with such a scenario.'

The proposal is similar to that filed by the Aiming for A coalition at Royal Dutch Shell in 2015, which passed with near unanimous support. However, unlike many of its peers, the company has not provided investors with any analysis of how its portfolio performs under a two degree scenario. This is despite the company themselves acknowledging in their 2015 10k filing that 'a number of countries have adopted, or are considering adoption of, regulatory frameworks to reduce greenhouse gas emissions,' and that such policies, regulations, and actions could make its "products more expensive, lengthen project implementation timelines, and reduce demand for hydrocarbons;"

Furthermore, in terms of wider performance the company received 'E' grades from the Carbon Disclosure Project on Climate governance and strategy and Emissions and resource management. ExxonMobil therefore performs below its peers in its emissions performance and wider climate governance and strategy considerations. In the wider context, the materiality of climate change, environmental management, and 2 degree scenario planning for the company has been highlighted with recent legal action in the United States. The company is currently under investigation by the US Securities and Exchange Commission over its reserve reporting and asset valuation, as well as wider climate governance at the company.

This is in addition to a legal class action filed by numerous investors relating to the booking of company proved reserves. Due to a persistent low oil price environment, the company further disclosed that approximately 4.6bn barrels of oil equivalent may be required to be de-booked as proved reserves. Arguably, the company is also likely to be amongst the most affected by regulatory frameworks aimed at limiting carbon emissions, in that the company has the has the highest absolute level of proved reserves of any of their peers.

We therefore believe that adoption of this proposal will help shareholders gain a better understanding as to the risks presented to the company's current business model by climate change. For these reasons, we strongly supported the shareholder proposal filed at the 2017 shareholder meeting. The proposal subsequently received the support of 62% of shareholders.

Facebook Inc.

Proposal: Gender Pay gap
Facebook, Inc. operates a social networking website. The Company website allows people to communicate with their family, friends, and coworkers. Facebook develops technologies that facilitate the sharing of information, photographs, website links, and videos. Facebook users have the ability to share and restrict information based on their own specific criteria.

Meeting Date: 01 June 2017

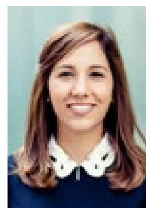
SDG5: Achieve gender equality and empower all women and girls
Robeco believes that a diverse workforce at all levels of the organization with equality of opportunity for all should support business performance, and therefore financial performance, over time. Therefore, we prefer boards and workforces which are not only diverse across a range of metrics, but also reflect the diversity of the business, the challenges and the economic context within which it operates. We also believe that companies with people from different backgrounds are more likely to approach issues from various perspectives, leading to more comprehensive decision-making and more effective supervision.

Gender diversity is therefore one area which we believe should be an important focus for investors. Robeco's own studies indicate that companies with more diverse boards being better positioned to outperform, whilst research by Morgan Stanley found that the stocks of those American companies with the highest scores on diversity beat those scored the lowest by 2.3 percent on a monthly annualized basis over the last 5 years. We therefore believe that when considering overall board and workforce composition, assessing gender diversity is important, and subsequently that any potential gender pay gap would represent a sizable barrier to achieving overall gender diversity at organizations. We therefore supported a shareholder proposal filed at Facebook, Inc. requesting that they prepare and publish a report demonstrating that no gender pay gap exists at the company.

Recent research by Morgan Stanley showed that the tech sector ranked below average in terms of the percentage of female employees, managers, executives and board members. In terms of representation of women, the Tech sector ranks 5th lowest on gender composition at the Board level, and lowest or second to lowest at all other levels. It should be stated that, in the sector as a whole, data suggests that virtually no pay gap between men and women exists in the tech sector. However, due to a lack of disclosure, data on a company level is harder to come by. Facebook themselves have claimed that no gender pay gap exists at the company, and that systems and procedures are in place to ensure no gap can occur. However, without the data behind it, it is hard to verify such a claim. We therefore support increased disclosure in this area, in the belief that eliminating any gender pay gap, if one does exist, will in turn help gender diversity at the company.

When making voting decisions, Robeco also considers the framework of the United Nations Sustainable Development Goals (SDG's), which we believe all companies, including ourselves and the companies in which we invest, have a role in implementing. In this case, the requests of the shareholder proposal are in line with the aims of SDG 5, Achieve gender equality and empower all women and girls. Therefore, for the reasons above, we supported the shareholder proposal at the 2017 annual general meeting. The proposal failed to gain the support of a majority of investors at the 2017 shareholder meeting.

ESG challenges in the auto industry



The business models of global automotive industry players will significantly change in the coming years as car use is transformed, says Robeco's Cristina Cedillo.

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.

Disruptive Trends and the Future of the Automotive Industry – A New Engagement Theme

The automotive industry is facing new pressures as well as huge opportunities. Operational challenges such as ever rising fuel efficiency requirements and costly recalls raise questions about the industry's efforts in ensuring the highest product quality. Regulations on emissions and fuel efficiency are set to increase in the coming years across all the main markets. Due to the emergence of defeat devices used to enhance the performance of cars when being tested on emissions, regulators' scrutiny has increased in the past couple of years. Failing to meet new standards can lead to hefty fines, and the recent controversies surrounding excessive emissions from diesel cars illustrate how stricter regulatory requirements can impact carmakers. In addition, the increasing technological complexity of auto components escalates the risk of malfunctions. Faulty products can lead to recalls, which can be costly and cause brand damage.

At the same time, the automotive industry has to answer fundamental questions related to its future product offering, and on the pace of the shift from the traditional internal combustion engine to plug-in hybrids and ultimately to electric vehicles. All this while the sector is becoming more

digitalized, attracting new entrants such as Google and Uber who propose their own solutions.

Finally, we believe that the business models of car makers will significantly change over the next decade due to mobility becoming a service, the rise of shared mobility solutions and the potentially wide-ranging use of batteries. These are all exciting and potentially disruptive developments that will bring fundamental changes to the auto industry. These changes will increase the industry' s cost base, since production costs of hybrid and electric cars are higher than the costs to produce a traditional car, and substantial R&D spending will be necessary to remain competitive. From the investor perspective, companies' ability to navigate through a challenging regulatory environment, while offering high quality and innovative products, will determine their competitive position and long-term financial performance.

Polluting cars are regulators' latest target

Climate change and pollution concerns are pushing the regulatory agenda towards increasingly challenging emission-reduction targets. As the transport sector is among the most heavy emitters, it is not a surprise that regulators are looking at carmakers to develop cleaner technologies. Diesel cars were once considered to be the most cost-effective technology to reduce carbon emissions. Now, regulators no longer believe that green diesel is the answer to a low-carbon future. In order to tackle both air pollution and climate change, governments are focusing increasingly on electric cars. As a result, several countries are banning sales of new diesel and petrol cars in the coming two decades, including the UK, France, Norway and potentially the world's biggest vehicle market, China. This trend is likely to continue.

Towards a low carbon future

We believe that the development of low-carbon technologies, such as hybrids, electric motors and alternative fuels, will become an important part of carmakers' strategy. Several carmakers are already betting on electric vehicles, and a few have committed to phasing out cars that are purely fueled with diesel and gasoline in the coming five years. As improvements in battery technology and pricing are being made, it is expected that electric vehicles will make up 14% of global car sales by 2025.

But electric vehicles are not the only alternative. There are other low-carbon technologies that the auto industry is also exploring. Cars powered with hydrogen are one example. These vehicles combine hydrogen and oxygen to produce electricity to run a motor. Their advantage over battery electric vehicles is that refueling is much less time consuming. Refueling hydrogen-powered cars is comparable to refueling a conventional cars, as hydrogen can be pumped in the same way as gasoline. As all of these technologies continue to develop over the coming years, we expect carmakers to draft a clear strategy to transitions their fleet to low-carbon technologies.

Engaging on five key objectives

With this in mind, Robeco started an engagement program in the auto industry. The Swiss research provider InRate prepared a baseline research to support this engagement. The research report analyzed 35 different indicators across the peer group, including governance of emissions reduction targets, recall costs and rates, strategy on electrification of the vehicles, and R&D spending.

This engagement aims to improve the policies and behavior with regard to product quality management and performance, environmental footprint in new products, and lobbying activities. We allow three years for the dialogue.

Effective Product Quality Management Systems

We expect automotive companies to continuously improve the management systems used to manage product quality. This includes having clear management systems for product quality that ensures, among others, compliance with emissions standards across main markets; appropriate R&D spending to ensure product quality; and careful supplier selection.

Impeccable Product Quality Performance
As a function of sound product quality management, we expect the track record of automotive companies to be spotless. Some relevant performance metrics include recall rates and costs, number of incidents in the past five years, and fleet emissions.

Forward Looking Product Development
We expect automotive companies to focus on innovation and to fine-tune product development to make sure their future products meet client demand and regulatory requirements. Likely, different approaches depending on brand history, national and regional circumstances, starting position and skill set might make sense. A key topic of discussion is the alignment of companies' strategies to a low-carbon future, including the reduction of the environmental footprint, during production as well as during the use of the product. This entails strategy for hybrids and electric vehicles, push for semi-autonomous and fully-autonomous vehicles, and high average fuel efficiency rates.

Innovative Business Model
We expect automotive companies to develop business models that takes into account the possibility of mobility becoming a service, the rise of shared mobility, digitalization (Smart Cars) and the potential non-automotive related use of EV batteries (e.g. as grid stabilizer).

Responsible Lobbying
We expect automotive companies to be responsible and transparent on their lobbying activities on the national and regional (e.g. EU) level and on their positions on relevant environmental legislation (e.g. CAFE standards, fleet emissions regulation, energy efficiency directive). This includes establishing a responsible lobbying policy, disclosing memberships in trade associations, and ensuring that the company's positions are aligned with those promoted by associated third parties, such as trade associations that companies are part of.

Start of a 3 year engagement theme

With these engagement objectives we will conduct our dialogue with carmakers. During the second quarter of 2017, we launched the engagement by contacting them with a request for initiating a dialogue. Our engagement allows us to make our voice heard, learn more about how car manufacturers will deal with these challenges and profit from arising opportunities, and pick the winners of this transformation.

SPOTLIGHT ON

Jurriaan Hofman
Global Equities analyst

Shifting Business Models

The business models of global automotive industry players will significantly change in the coming years as car use is transformed.

Hofman says the auto industry is facing four themes that will affect its future sustainability scores, and therefore its investibility by Robeco. First and foremost is the move towards greener cars, particularly New Energy Vehicles led by electric and hybrids. This is partly being led by regulations over emissions, with some governments planning to phase out combustion-engine powered vehicles in the coming decades.

Secondly, there is the move towards making cars safer, with more in-car features such as automatic braking and parking assistance, using new digital camera technology. Thirdly, we see growing consumer demand for self-driving vehicles, though this awaits government approvals for public use. Finally, new business models such as Uber are leading the growth in consumer services such as car sharing.

"We certainly see a long-term trend towards increasing 'electrification', and in particular, a shift in auto sales towards hybrid cars," Hofman says. "This trend is particularly favorable for the companies that provide the technology for electrification."

"However, we believe the electrification trend mostly provides challenges for the auto manufacturers. At the moment, the production costs of hybrid and electric cars are higher than the costs to produce a traditional car. Moreover, most consumer are not willing or able to pay for these extra costs. This situation makes it difficult for auto manufacturers to earn sufficient profits on the sale of hybrid and electric vehicles."

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σ=.5"
σ/√n
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σ=.6"
σ/√n

Environmental challenges in the oil and gas sector

The traditional business models of oil and gas companies are under threat, and new legislative frameworks such as the COP21 agreement reached in Paris in 2015 add additional pressure. So how to tackle this double-edged sword? Sylvia van Waveren outlines Robeco's engagement approach.

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; SDG9: Industry, innovation and Infrastructure

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.

Recent developments

The business models of oil and gas companies are being eroded by rising capital intensity and diminishing returns. This effect is amplified by technology dynamics such as the rise of renewable energy, the promise of energy storage and the potential of electrified transportation. At the same time, the threat of tighter environmental and climate change legislation on a global, regional, and national level is looming in the background, and pressure for more concerted climate-policy coordination has increased with the COP21 agreement reached in Paris in 2015. As a result, energy resources may become stranded, i.e. assets that at some time prior to the end of their economic life are no longer able to earn an economic return, as a result of changes in the market and regulatory environment associated with the transition to a low-carbon economy. Therefore, additional factors need to be integrated in the analysis of fossil fuel assets to ensure climate risk is priced properly, and that capital is allocated in alignment with the transition to a low carbon future.

Relevance for investors

Oil and gas companies must reconsider their business strategies either by increasing dividends, or by directing future capital investments towards renewable projects instead of high-cost high-emissions fossil fuels that could

become unburnable in the future. As investors, we need to know how these companies will deal with changes in the industry, how they will address these significant risks, and how they plan to profit from any opportunities that arise. This will allow us to pick the winners of this transformation.

Start of a 3 year engagement theme

In 2016, Robeco commissioned research by the Carbon Tracker Initiative (CTI). Based on our engagement objectives, the report analyzed a large number of key performance indicators which form the basis for our engagement dialogues. We subsequently began to engage with both international oil and gas companies (IOC's) and national oil and gas companies (NOC's); together these companies account for one-quarter of current global oil supply, over one-fifth of current global gas supply, and USD1.6 trillion in enterprise value.

Five engagement objectives

Our engagement objectives are based on the drivers which will shape the new energy world. Our engagement objectives focus on encouraging companies to implement a future-proof business strategy, strive for operational carbon-efficiency, assess asset portfolio resilience and work on product stewardship. We also added public policy as an objective, as we believe that companies should, at the very least, not lobby against stricter climate change regulation.

Update and progress halfway

Our engagements started in the second quarter of 2016 and the engagement activities and contact points with the 12 companies have been solidly established since then. Our engagements with the International Oil companies are showing comparatively more progress than those with the National Oil Companies.

Methane becomes an important topic

During our engagement conversations focused on operational carbon efficiency, the topic of methane emissions became increasingly important. Natural gas is widely marketed as a low-carbon fuel because it burns roughly 50 percent cleaner than coal. However, this ignores a major problem: methane emissions. Methane – an invisible, odorless gas, and the main constituent in natural gas – is routinely emitted by the global oil and gas industry, posing a climate change risk and a reputational and economic threat to investment portfolios. Institutional investors worldwide are increasingly encouraging oil and gas companies to disclose and improve their management strategies to minimize methane emissions.
We joined a new initiative launched by The Principles for Responsible Investment (PRI), representing 36 global investors and USD 4.2 trillion in assets under management, that engages with 31 oil and gas and utilities companies across five different continents, to improve their methane management and disclosure practices. The PRI initiative complements existing methane engagement efforts focused on the U.S. led by the Interfaith Center on Corporate Responsibility (ICCR) and CERES. We are the lead investor on two companies in these collaborative engagements.
As part of our engagement, we seek to understand companies' risk management practices, including how they measure methane emissions, which reporting metrics and data points they use, what reduction techniques are applied, and what challenges these companies face.

Recent methane developments

In view of escalating investor pressure, oil and gas operators across the globe are now progressively recognizing the risks and opportunities associated with methane. We see companies making new, concrete commitments to reduce methane emissions and improve disclosure on their performance. For example, the CEOs of ten leading oil and gas companies announced a move toward 'near-zero' methane emissions at a recent OGCI (Oil & Gas Climate Initiative) event. The companies taking part in the OGCI, account for nearly 20% of global production, including Eni, BP, Total, Shell, and Statoil.

Last month ExxonMobil surprisingly raised the bar for methane emissions management with the announcement of its new methane reduction initiative for its national subsidiary, XTO. The program will cover all XTO upstream and midstream assets, and includes leak detection and repair, the phase out of high-bleed pneumatics and R&D to achieve technological innovation. This announcement comes on the back of increasing shareholder pressure on the company to improve reporting on climate, including methane. We sees this program as an innovative and sensible move by ExxonMobil that should alert policymakers, trade associations and industry peers to the business case for methane reduction.

SPOTLIGHT ON

Sylvia van Waveren
Engagement Specialist

The paradox of natural gas

Natural gas is giving investors a headache, due to a paradox in its effect on climate change.

What has happened?

Gas is often seen as a green fuel that is a much better for the environment than oil or coal. However, its main ingredient, methane, is also one of the biggest contributors to climate change when unburned gas escapes during its extraction, with fracking proving a particularly large problem.

Such is its potency that methane has 80 times the warming power of carbon dioxide over a 20-year timeframe, and is responsible for about 25% of global warming. Estimates suggest that energy companies are releasing at least 3.5 trillion cubic feet of methane into the atmosphere each year, equivalent to all the gas sold by Norway.

Yet the contribution to global energy needs made by cleaner-burning gas cannot be disputed, accounting for 22% of world electricity production in 2014, up from under 8% in 1988, meaning we now burn much less coal and oil.

So how to tackle this double-edged sword? Robeco's Active Ownership team is engaging closely with the oil& gas industry to try to solve the conundrum of how methane can be a boon and a curse at the same time.

Why is it important?

Robeco's engagement forms part of a wider campaign by institutional investors to encourage oil and gas companies to improve and disclose their management strategies to minimize methane risk to climate change.

The importance of the initiative is such that it is being led by United Nations Principles for Responsible Investment (PRI), of which Robeco is a signatory, representing 36 investors and USD 4.2 trillion in assets. The PRI published its Investor's Guide to Methane jointly with the US-based Environmental Defense Fund which has worked to combat methane release in the increasingly important American shale gas industry.

And it has not fallen on deaf ears – many of the oil majors participate in the Oil and Gas Methane Partnership, the industry's own initiative to improve emissions reporting and cut methane emissions. Members include BP, Eni, Repsol, Statoil and Total.

What does it mean for investors?

"We see the methane issue more as a business opportunity than a risk," says Sylvia van Waveren, who is leading Robeco's engagement with the oil & gas industry. "What we often say to companies is that methane is a potential revenue source; it would be a waste if companies do not use it because it escapes into the air."

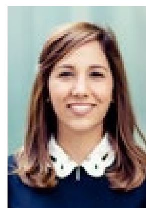
"When we talk about motivation at the company level, it's still early days: European companies are talking in general terms and just now are conceptualizing methane policies. If we're lucky, they have calculated how much methane is part of their greenhouse gas emissions. And if we're more fortunate, they are producing regional and segregated figures from carbon, but it's really very meager how motivated the companies are and what triggers them most."

"One issue that is particularly bothersome is that many companies do not know how to calculate, estimate and set targets to reduce methane. It is still a mystery to many of them. That's why we come in with engagements. We need to keep them sharp on this issue and ask them for their actions, calculations and plans."

"We rely very much on our knowledge that we get from within the sector when we are in dialog with them as institutional investors," she says. "We review data analyses and make intermediate reports of scoring. We find best practice solutions and we hold companies accountable. There are also times when we name names. So in that sense, that is how engagement works."

Researcher measuring methane and CO2 emissions from peatland to determine its contribution to climate change, Tolkansuo, Northern Ostrobothnia, Finland

Environmental challenges in the European electric utilities sector



Decarbonization is key to the long term future of the European Electric Utilities Sector. But what does this mean on an individual company level? Cristina Cedillo explores shifting business models within the sector.

Codes of conduct
- UN Global Compact Principles 7-9
- Rio Declaration on Environment and Development
- OECD Guidelines for Multinational Enterprises Chapter IV
- SDG 13: Climate Action; 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

Since 2015 Robeco has been in an ongoing dialogue with companies in the European utilities sector to discuss the challenges and opportunities that climate change poses to their business. As we are now half way through our three-year engagement, we have seen positive progress achieved by all the companies in the peer group. As momentum was reached with the adoption of the Paris Agreement on climate change, it has become apparent that all companies in the engagement peer group view climate change as a risk that could significantly impact their business. With a varying degrees of ambition, we see all companies making efforts to adapt their business models to place them in a better position to transition to a low carbon economy.

Move towards decarbonization

The utilities sector is one of the industries with the largest contribution to global greenhouse gas (GHG) emissions. As such, much emphasis is placed in reducing their emissions. In the EU, a significant level of decarbonization and near zero emissions are required by 2050 in order to meet the target of below 2°C warming.

All companies in the peer group have set emissions reduction targets. However, only a handful have had their

targets externally validated to be in line with the level of decarbonization required to limit global warming increase to below 2°C. Externally validated targets define a company's pathway that specifies how much and how quickly they need to reduce their greenhouse gas emissions by 2050. Enel is an example of best practice on this front. It has a proactive emissions reduction target that has been validated by the Science-Based Targets Initiative as being compatible with a 2°C transition. It aims to become carbon neutral by 2050.

Coal exposure

Another essential aspect in decarbonizing the utilities sector is reducing exposure to coal, and transitioning to less carbon-emitting natural gas or renewables. Regulation in the EU is certainly pushing the industry to exit coal. In April 2017, a coalition of national energy companies from every EU nation – except Poland and Greece – announced that there would be no new coal plants built in the EU after 2020. Euroelectric, Europe's electric industry association, also said that it would not invest in coal plants after 2020. This development is very encouraging, but much work still needs to be done to fully phase-out existing coal plants.

Unlike coal and gas plants, wind and solar farms do not provide a steady flow of electricity. As long as the storage technology for renewable energy is not fully developed and economically feasible, coal and gas plants will be needed to serve as backup. Exiting from coal entirely will require not only significant efforts from companies, but sufficient incentives from governments and an appropriate regulatory framework. For example, Energias de Portugal plans to exit from coal only when financially feasible. Iberdrola on the other hand has one of the most proactive climate strategies in our peer group, with a carbon neutral target by 2050, strong renewables targets and very low exposure to coal. However, they have been asked by the government to maintain operational their coal plants to serve as backup at least until 2020.

Nonetheless, some great achievements have also taken place in this area. In March 2017 Engie began the decommissioning process for the Australia-based Hazelwood coal plant, one of the most polluting coal plants in the world. The company has more plant closures planned in the next couple of years, which will help it reduce emissions significantly.

Deployment of renewable energy

The EU has set the target of generating at least 45% of electricity from renewables by 2030. The companies in the peer group are making progress with varying degrees of speed and ambition. Most of the companies in the peer group have targets on increasing renewable capacity. By 2020, the expected renewables capacity of companies in the peer group range from 23% to 76%, while the median target for European utilities is about 30%.

Energias de Portugal has the most ambitious renewables target in the peer group, at 76% of installed capacity by 2020. The company is already a global leader in wind power and has the highest share of generation from renewables in the group, at 34%. Engie has the least ambitious renewables target in the peer group, with an expected capacity of 23% by 2020.

Business model innovation

The utilities sector finds itself in dire straits. Increased efficiency in energy generation, and the proliferation of renewable energy have slowed growth in energy demand, affecting utilities companies' profitability. Stricter regulations and aging transmission and distribution systems requiring expensive upgrades further exacerbate this situation. The industry is thus pushed to look beyond its traditional business model and search for innovative solutions that diversify income streams while securing a transition to a low carbon economy.

We already see the first positive developments: All companies in the peer group have a dedicated team or department to invest in low-carbon technologies and customer-oriented solutions, such as smart meters. Storage is one of the technologies that almost all companies are investing in. This is because those who are

successful in developing a storage solution, and are able to scale it throughout their business, will gain a significant competitive advantage.

Fortum is now developing the largest lithium-ion cell battery ever made within Nordic countries. This is a promising development that allows regulating inflows of renewable energy into the grid. We hope to see similar developments among peers in the coming years.

Status of our engagements

In April 2017, the Carbon Disclosure Project (CDP) produced a research piece ranking the largest European electric utilities companies on their readiness for a low carbon transition. Since our engagement objectives have a broad overlap with the performance indicators used by this research, we compared the CDP's findings with our own and updated the corresponding companies' profiles. Overall, we found that CDP's research confirmed our views on the status of progress made by companies. With this in mind, we will continue our engagement with the electric utilities companies in the coming years.

SPOTLIGHT ON

Chris Berkouwer
Global Equities analyst

Behold the wind turbine as big as the Shard

Wind turbines have come a long way since the first windmills centuries ago – with the next generation among Europe's tallest structures.

What has happened?

The need to extract increasingly more power from turbines to make them commercially viable without subsidies means the core structures will stand over 200 meters tall. To the tip of the blades, they'll reach over 300 meters, making them taller than the London skyscraper, the Shard, the tallest building in western Europe.

Power yields from turbines have needed to rise to make them competitive with traditional energy sources and avoid taxpayer-funded subsidies that have raised domestic energy bills. The first generation of commercial wind turbines in the 1990s (standing about 50 meters tall) had a total generation capacity of about 0.5 megawatts of electricity.

The megawatt figure represents the total capacity; depending on the number of hours per year that the blades rotate, the total electricity generation is measured in kilowatts per hour. So if a 10 megawatt capacity turbine operates for 24 hours a day and 365 days a year, the amount of electricity it would generate 87.6 million kilowatts per hour.

Typically, wind turbines operate for only half that time. Since wind power entirely depends on wind availability and speed, both of which are inherently unreliable, the solution has been to make the turbines bigger, more efficient and more productive. The largest turbines have not been able to produce electricity as competitively as fossil fuel burners – until now.

What does it mean for investors?

"Wind has finally become a competitive alternative to conventional energy," says Chris Berkouwer, an analyst with Robeco's Global Equities team. "Over the lifecycle of a wind turbine, it will return 35 times more energy back to society than it consumes, compared to a negative return for coal power plants."

"The era of subsidies for wind energy is also coming to an end. After the first hype, most turbine companies massively restructured, resulting in much better business models. Now that balance sheets are restored and profitability has improved, 'wind' is a very interesting financial investment too."

Climate change and well-being in the office real estate sector

After 3 years of successful engagement with Retail Real Estate Investment Trusts (REIT's) on carbon management, Sylvia van Waveren shifts her focus to Office REITs.

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.

Recent developments

Climate change, and its associated risks and opportunities, may lead to significant investment challenges. CO2 management at companies is therefore a recurring theme in our engagement program. The real estate sector represents a large share of the annual global emissions of CO2 and other greenhouse gases, making it a key focus of our carbon related engagements. The sector as a whole accounts for nearly 40% of the world's energy consumption and 33% of global greenhouse gas (GHG) emissions. In addition, it accounts for 30% of raw material use, 25% of solid waste, 25% of water use and 12% of land use. Over the last three years, we have successfully engaged on carbon management with Retail Real Estate Investment Trusts (REITS).

In Q4 2017, we therefore expanded our engagements in the real estate sector to include office spaces. In addition to engaging on carbon management, we will also address 'Health & Well-being' (H&WB) in our dialogue with these companies.

Relevance for investors

Various economic benefits can be achieved by real estate companies through having a portfolio of environmentally friendly and healthy office buildings. First, the proactive management of a buildings'

environmental performance and carbon emissions can lead to lower energy costs through energy efficiency measures. Second, they 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 proactive climate change strategy reduces the risks related to the potential implementation of stricter environmental legislation by governments.

Five engagement objectives

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

1. Climate Change Management: This objective evaluates the companies' initiatives and policies surrounding climate change management. This includes their response to the various risks and opportunities presented by climate change, the 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. License to operate: We believe that transparency is a good indication of the legitimacy of a company's business operations. As such, companies should be sufficiently transparent about their sustainability activities, thereby earning and strengthening their license to operate. This encompasses aspects like proactive communication, the level and depth of sustainability reporting, and their participation in relevant initiatives (like GRESB and CDP), and certifications such as BREEAM and LEED.

3. Environmental Management System: 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 like ISO 14001.

4. Reducing Energy Consumption and Carbon Emissions: Under this objective, we review and look for reductions in energy consumption and carbon emissions 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. Health & Well-being: It is increasingly recognized that office spaces can influence the health and well-being of employees. These issues are progressively viewed as important areas of opportunity for the real estate industry because they are a driver for workers' productivity. Furthermore, tenants increasingly expect these considerations to be adequately covered in the design process of offices, and are often willing to pay a premium for healthy offices. Companies will be reviewed in their efforts and initiatives aimed at addressing these changing demands, as well as their ability to promote health and well-being for both employees and tenants.

Health & Well-being becomes an important topic

We believe that the objective "Health & Well-being" is financially material to our investments, in that a company's employees are one of its most valuable resources. Critically, employee costs typically account for 90% of a business' operating costs. Companies that therefore improve their productivity gains can have significant financial and competitive advantages. In fact, according to a recent study, businesses with elaborate employee H&WB programs outperform the S&P 500 significantly. 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, 46% reported that they were easier to lease out, and 28% said that these buildings commanded

higher rents.

There are several ways to manage the H&WB factor in office buildings. For instance, companies can invest in the construction of a healthy office. According to the World Green Building Council, there are nine different elements of a healthy office that can lead to happier, healthier and more productive employees: indoor air quality and ventilation, thermal comfort, daylighting, noise, interior layout and design, look and feel, location, and access to 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 United States routinely offer wellness programs, which can consist of a range of activities like fitness programs, weight-loss interventions and smoking cessation programs. In general, an amalgamation of strategies are employed to improve employees' and tenants' H&WB.

Global Real Estate Sustainability Benchmark (GRESB)

The research underpinning this engagement program comes from the Global Real Estate Sustainability Benchmark (GRESB) Real Estate Assessment, and the Health & Well-being Module supplement. GRESB is an industry-driven organization committed to assessing the sustainability performance of real estate assets globally. In 2017, 850 property companies and real estate funds completed the GRESB Real Estate Assessment, representing 77,000 assets and over USD 3.7 trillion in value.

We selected companies from the United Kingdom and the United States for this new engagement theme, after an evaluation based on their performance in the GRESB assessments. The companies are all holdings in the Robeco Property Equities Fund. We will engage with these companies for three years.

Social issues in the food and agri supply chain

Living wage is the largest opportunity to contribute to the Sustainable Development Goals in the agricultural supply chain, says Peter van der Werf.

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

Human Rights: Social Supply Chain Standards
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.

Sustainability in the agricultural supply chain: Paying a living wage

According to Oxfam, cocoa farmers receive just 3% of the retail price of a chocolate bar, with many farmers earning less than US $1.25 a day – significantly below the World Bank's threshold of US $ 1.90 a day for extreme poverty. Palm oil workers are also systematically paid below minimum wage levels, despite local regulations.

In the face of growing social inequality, paying workers a living wage provides a key opportunity to reduce inequality . This discussion is especially relevant for companies operating in the agricultural supply chain, with the prevalence of smallholder farmers, and the use of the piece-rate system where wage is paid per harvested piece of product. As such, for 2017, Robeco has chosen to focus on the issue of living wage when engaging with companies in the 'Social Issues in the Food and Agri Supply Chain' theme.

A living wage is a minimum income necessary for a worker to meet basic needs of their families for products and services such as food, clothing, housing, health care, and education. Without a living wage, workers may be forced to work excessive hours or multiple jobs, become bonded laborers or put their children to work instead of school. They might also suffer social

deprivations, and be denied their basic human rights to food, shelter, nutrition, health, housing and education.

Consumers are becoming more aware regarding human rights, and companies need to meet the expectations of stakeholders regarding a sustainable supply chain.

Living wages are especially crucial for workers in the Agricultural supply chain

The prevalence of smallholder farmers in supply chains like palm oil and cocoa, highlights the importance of paying a fair wage. In commodity production, a smallholder often does not receive a wage, but earns his income through the sale of his products. For a smallholder to earn a living wage, he has to receive a fair price for his products, that covers operating expenses and allows for a decent living standard. The production of cocoa in particular, is characterized by smallholder farmers who together produce around 90% of global supply. Ensuring a living wage for cocoa workers will contribute to supply base stability.

The agricultural supply chain is also characterized by the use of quotas, and a piece-rate system where wage is paid per piece. On palm oil plantations, workers often have to work long hours to meet high quotas, potentially facing a range of penalties for things like not picking up palm fruits on the ground and picking unripe fruit. It is known that palm oil workers often ask the help of family members or children in harvesting the loose fruit on the ground during harvest to meet such daily quotas. Children as young as eight are exposed to hazardous, hard physical work – sometimes dropping out of school to help their parents on the plantations. Paying palm oil workers a sustainable living wage can mitigate the risks that large palm oil traders and refineries are exposed to accusations of child labor or exploitative practices in their supply chain.

Paying a living wage makes business sense

Workers receiving a living wage are more likely to be better motivated, and therefore more productive and less likely to leave their jobs. This results in reduced recruitment and training costs. Workers are also likely to be healthier, thereby reducing the loss of man hours due to sickness. Furthermore, paying out a living wage is also beneficial for companies' brand reputation and risk mitigation.

There are several approaches companies can take – they can directly influence the level of wages they pay to their workers, or for what price they buy products directly from farmers. Indirectly, they can influence the level of wages in the supply chain and world market.

As a sustainable investor, we believe that engaging with companies on such material issues not only enhances their competitiveness and profitability, but also generates measurable benefits for investors and society at large. The payment of minimum wage is regarded as a baseline requirement, and we encourage companies under engagement to develop a policy to provide a living wage beyond this legal requirement, and to discuss how to address living wage with their suppliers.

In 2017, we entered concrete discussions with companies regarding the calculation of a living wage, and development of fair remuneration policies for workers. We found several best practices within the industry that signal towards a fair treatment for workers in the supply chain.

Tesco using its clout to set living wages

We consider Tesco to be a best practice example for its sector – the company is currently working on a tea sourcing project in Malawi where 50.000 workers are now benefitting from wage improvements. Since Tesco sources between 60 to 70% of its total volume of tea in this relatively small country, it has the necessary leverage to influence living wage and minimum wage discussions with government officials and other stakeholders.

In a similar fashion, Tesco has changed its supply base for its bananas to a small number of suppliers, from which it purchases the total volume of

production. This enables Tesco to set the standard for living wage at their suppliers.

Mondelēz's additional methods to combat low cocoa prices and fair wages

The topic of fair wages for farmers during a period of historically-low cocoa prices featured prominently in Robeco's engagement with Mondelēz. This low price undermines the investments that Mondelēz and other companies make towards a resilient supply chain, and causes small cocoa farmers to fall below the poverty line.

Although Mondelēz does not want to work with a guaranteed minimum price for cocoa due to the distortionary effects, it provides additional resources to farmers in these hard times. This allows the farmers to achieve a total income that qualifies as living wage. Mondelēz employs capacity building programs to train farmers on multiple cropping and farming practices to increase crop yield. To enable greater oversight of the production process, Mondelēz also organizes farmers in cooperatives, and utilizes other mechanisms like an alternative contract farming model.

We appreciate such additional methods employed by companies to tackle living wage issues, demonstrating the many ways a company can contribute towards a more sustainable supply chain.

Nestlé commits to pay a living wage in its factories

In a show of industry leadership, Nestlé compensated all production facility employees who received a salary lower than the living wage between 2013 and 2015. In addition, as of 1 April 2016, Nestlé pays all its factory employees a living wage. This is definitely a step in the right direction for Nestlé, and we welcome more collaboration towards multi party solutions as Nestlé alone would not be able to provide a living wage to all workers and employees of suppliers.

Rethinking supplier relationships is key moving forward

Through our engagement with the companies, we realize that although supplier engagement on living wage is progressing well, no food producer or retailer we engaged with was able to commit to a comprehensive living wage policy for the supply chain. In addition, we found that for a company to influence a supplier to make a significant contribution to a living wage, at least a 70% purchase guarantee for a longer time period is needed with that supplier. Without, the supplier cannot commit to raising wages in the factory or at the farm based on the commitment of the contract.

This highlights several key opportunities for companies to differentiate themselves in the agricultural supply chain. For large food producers and retailers, the use of an ecolabel that indicates a guaranteed living wage for agricultural products like bananas can be a feasible way to ensure a living wage in the supply chain.

Companies should also rethink their current supplier relationships, and look for strategic opportunities where long-term relationships can be formed. This would allow companies to have significant leverage, and create long-term impacts like living wages for workers throughout its supply chain.

Moving forward, we believe that early adopters stand to benefit as consumers, investors and governments alike become more determined to work towards a sustainable agricultural supply chain with measurable impact on the Sustainable Development Goals.

Social risks of sugar

Increasing sugar consumption is a major contributing factor to the current obesity epidemic, and the subsequent rise in the prevalence of diabetes, heart attacks and choked arteries. Peter van der Werf outlines the relevance for investors.

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
Healthy nutrition is an important theme for companies in the consumer staples, health care and specialty chemicals sectors to consider. Ingredients such as sugar and salt, as well as the fat content of products, can have a significant impact on consumers' health if consumed in large quantities over a long period of time. At the same time companies can provide education on healthy nutrition education or food supplements as an opportunity to contribute to healthy living.

Why is sugar a problem?

Sugar is one important contributor to the current global obesity epidemic, given its presence in almost all packaged food or drinks. At the same time, advances in technology and transport mean that many people lead increasingly sedentary lifestyles and expend fewer calories, a trend which is particularly evident in urban environments.

As of 2014, more than 1.9 billion adults were overweight, and of these over 600 million were considered obese. The economic costs of this epidemic are also clear, representing USD 2 trillion annually, or nearly 3% of global GDP. It is estimated that obesity, along with smoking and armed violence, is one of the top three social burdens generated by humans. This is likely to continue to grow, with obesity estimated to affect almost half of the world's adult population by 2030. Besides obesity, the growing consumption of added sugar is linked to diabetes and other health risks.

What are the risks and opportunities for investors?

The correlation between obesity risk and negative impact on company performance can also be significant. Companies with product portfolios containing a high percentage of high-sugar content products face regulatory risks, as governments

continue to introduced a range of policies, regulations, taxes and other measures aimed at reducing consumer exposure to, and consumption of, less healthy foods and beverages. Examples include the banning of certain foods or restricting advertising of less healthy products to children, regulation of the use of health and nutrition claims, and strengthening food labelling requirements. A further indirect regulatory risk comes from regulations or campaigns that make it clearer to consumers that certain products have higher amounts of unhealthy ingredients. Therefore, if companies fail to adjust to changing dietary preferences, they may lose market share, revenues and profits.

Companies are also increasingly faced with reputational risks related to increasing awareness of health risks resulting from high sugar consumption. Food and beverage manufacturers are the primary target of scrutiny by consumer advocacy groups and consumers themselves. A number of companies have already been subject to lawsuits, for instance for making inappropriate claims on nutritional quality and labelling. This is expected to increase, posing legal risks to companies within our portfolios. A number of financially material risks therefore exist to the long term sustainability of companies' current business model. For this reason, we began a new engagement theme on the 'Social Risks of Sugar'. Strong alignment also exists between this engagement theme and UN Sustainable Development Goals (SDG) 2: End hunger, achieve good security and improved nutrition and promote sustainable agriculture and SDG 3: Ensure healthy lives and promote well-being for all at all ages, presenting specific impact investing opportunities to select those companies under engagement which make a strong contribution to the achievement of these goals.

Engagement objectives

Our research identified five main engagement topics for consideration by investors: innovation management, labelling, product reformulation, responsible marketing, and responsible lobbying activities. The objectives provide an overall view of the direction in which we wish to see companies move, however it is not a one-size-fits-all approach. For instance, sweet beverage companies such as PepsiCo will have different goals when considering innovation management than a company such as Danone. However, we expect that all companies will publicly commit to the WHO guidelines that a maximum of 10% of daily calorie-intake should come from added sugars.

Under innovation management, we expect companies to diversify their total product portfolio to include a range of healthier products. As consumer preferences move towards healthier options or options with reduced amounts of sugar, this will become increasingly important to the long term sustainability of each company's business model. Similarly, for product reformulation, companies should set clear reformulation targets which include sugar reduction, and keep track of their progress on an annual basis. In addition, we expect more of the Research and Development (R&D) budget to be used for improving the nutritional quality of these products.

With respect to product labelling, we believe that companies should devote adequate efforts to clear and comprehensive labelling, which includes both back-of-pack and front-of-pack labelling. Nutritional information should be easily accessible and understandable in order to inform consumers what kind of product they purchase. Some companies have taken steps to add a nutritional daily intake guideline for sugar to product labels, which is considered to be best practice. Overall, product labelling should be organized, consistent, easily accessible, and should include multiple indicators.

We also expect companies to adopt responsible marketing policies, both toward children and adults, which should be applied on a global scale. Many companies do not apply policies consistently across all markets and operations, which is a cause for concern. In addition, we expect companies to make significant shifts in their marketing spending toward promoting the healthier products in their product portfolios.

Finally, we will be working with companies to ensure that they are transparent about their relationships with policy makers and the scientific community. This currently represents somewhat of a black box, making it challenging to assess if companies are consistent between their company strategy and their lobbying efforts. We expect companies to adopt minimum disclosure standards and have clear and publicly available lobbying policies (including adequate oversight policies) in place.

The engagement peer group consists of Danone, General Mills, Kellogg's, Nestlé, PepsiCo, the Coca-Cola Company, Unilever, and the Kraft-Heinz company. We allow 3 years for the dialogue, with the dialogue deemed to be successful if a company achieves the success threshold based on its product portfolio improvements and sugar reduction activities.

SPOTLIGHT ON

Henk Grootveld
Head of Trends Investing

Coca-Cola cuts 3.75 billion in calories from drinks

We all like to count the calories - so how about removing 3.75 billion of them from a drinks portfolio? It's a welcome part of a wider trend, say Robeco's trends investing and engagement heads.

What has happened?

Coca-Cola in March 2017 decided to stop selling the fully sugared Sprite brand in the Netherlands amid the campaign to reduce sugar content of soft drinks. Low and no-sugar Sprite will remain on sale.

And it has produced numbers as large as the waistlines that excessive sugar consumption can cause. Removing the full sugar Sprite from Coca-Cola's Dutch portfolio of brands removes 3.75 billion calories from the shelves at a stroke – equivalent to more than 4,000 years' worth of the normal daily calorie intake of the average person.

How will it work?

If the withdrawal of traditional Sprite is seen as a success in the Netherlands, it could also be dropped in 100 other countries, Coca-Cola's country manager Richard Schlasberg told the Financieele Dagblad newspaper.

Coca-Cola markets 18 brands of its soft drinks in the Netherlands, and one-third of the income at its bottling plant at Dongen in the south of the country is now derived from zero or low calorie drinks.

The wider trend is that consumption of soft drinks by the average Dutch person fell to 91.5 liters per head in 2015 from 102.6 liters each in 2011 – still an average of a quarter-of-a-liter per day. Coca-Cola's latest move is part of a plan to cut the overall calorific content by 15% across the range.

What does it mean for investors?

"Our increased sugar consumption has led to an obesity epidemic, which is increasing the prevalence of diabetes, heart attacks and choked arteries," says Henk Grootveld, Head of Trends Investing at Robeco.

"We expect the food and beverages industry to be faced with declines in the volume of demand for their sugary products as consumers start looking for healthier alternatives."

Data privacy

The European Union is to introduce new regulation on data security and consumer data privacy. Danielle Essink on the company level impact.

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".

New European regulation on Consumer Data

The European Union is to introduce new regulation on data security and consumer data privacy. This General Data Protection Regulation (GDPR) is to replace the outdated Data Protection Directive, and will go into effect in May 2018.

As technology progresses, enterprises and consumers use and provide more digital services. In an on-premise world, this was not such an issue, because data that was in the hands of one provider was typically stored in a database in one location. As we continue to move to the Mobile Internet and increasingly use Cloud services, it becomes harder for consumers to control where their data is stored, and who can access and control that data.

Due to new technologies, such as cloud computing, social media, Big Data (i.e. advanced data analytics), more consumer data is stored in systems all around the world, in order to be processed and analyzed. As these systems are typically available online, we also see more attempts to steal that data, through hacking attacks and security breaches. There are several examples of cases where large amounts of consumer data have been stolen. recent examples include breaches at large consumer companies,

such as eBay, Yahoo and Target, or at data collection services such as Equifax, where large amounts of consumer data were compromised.

What is General Data Protection Regulation (GDPR)?

The General Data Protection Regulation is new EU legislation that seeks to enhance current data protection laws in Europe. The main objective is to enable EU citizens to have better control over their personal data, including where their personal data is being stored, the purpose for storing that data, and the ability to erase that data when it is no longer required. This legislation comes on the back of recent impactful technological changes, i.e. big data and the cloud, and will replace the outdated, existing legislation known as the EU Data Protection Directive, which is nearly two decades old. While in principle GDPR is a European law, this new legislation will apply to organizations anywhere in the world that do business with anyone in the EU, and will therefore have broad-reaching impacts globally.

Increased consumer data privacy protection

As we continue to consume, collect, and process data, the concept of who controls what data and where it is stored will become increasingly important. Through the passing of one of the most historic pieces of data protection regulation in European history, the European Union's General Data Protection Regulation looks to transfer control back into the hands of its citizens. This is done by requiring organizations to categorize, record and specify how long an individual's data has been held and when it will be erased ('the right to be forgotten'). As we have seen from examples at Google and Facebook, when severe intrusions happen, there is a larger number of individuals that want to have their data erased.

Consumer trust is therefore key. Companies need to find a balance between utilizing data whilst maintaining consumer trust in the longer term. However, the attitudes towards sharing data and trust in a company differs per age group. For example, millennials appear to be more accepting of the idea that they 'pay' for the free services that are provided by the large internet platforms with their data, and that a lack of privacy on the Internet is a part of modern life. Millennials in general seem much less likely to oppose providing personal data in exchange for free online services.

Strengthening data security

While GDPR speaks security language, it does not give a specific formula or checklist of technical capabilities required to be in compliance . Below are what we view as the most pertinent security guidelines:

1. 'Personal data shall be processed in a manner that ensures appropriate security, including protection against unauthorized or unlawful processing and against accidental loss'
2. 'Organizations must implement appropriate technical and organizational measures to ensure a level of security appropriate for the risk. Those measures must account for state of the art data security infrastructure'
3. 'Supervisory authorities must be notified if personal data is lost, stolen, or otherwise compromised, no later than 72 hours after the company has been breached'

Low knowledge and compliance by companies

A Veritas study published in early 2017 showed that while 31% of companies thought they were already GDPR compliant, once pressed further, only roughly 2% were actually prepared. This is concerning given the severe penalties for non-compliance (up to EUR 20 million or 4% of the company's global annual revenues, whichever is greater). Even more alarming is that technology research firm Gartner predicts that by the time the legislation comes into effect, only 50% of organizations will truly be compliant. We think this presents an interesting opportunity for security software companies, as many organizations will likely need to modernize their existing infrastructure, or consider a cloud-based alternative.

Engaging on GDPR compliance with companies in portfolio

For companies collecting consumer data, data security and consumer privacy are already important topics to consider. The reputational risk and potential loss of customers or users in case of a data breach have had a material impact on companies in the past. Consumer or user trust is key in many sectors, especially for companies that derive most of their income from the use of consumer data. GDPR adds the risk of severe financial penalties to the existing reputational concerns.

So far, we have focused our engagement efforts in the data privacy theme on a peer group of 12 Information technology companies. We will add the topic of GDPR to our engagement agenda in an effort to understand how these companies are preparing for the new regulation. Key topics in the discussion will include the type of information companies collect, how this information is used and stored and how the company mitigates the risk and severity of data breaches. Given the widespread relevance of GDPR and the growing importance of understanding company specific cybersecurity risk, we recently joined a new investor working group on cybersecurity. Through this investor working group we have the opportunity to broaden the scope of our engagement program to the financial, consumer and healthcare sectors.

ESG risks and opportunities in the biopharmaceutical industry

Despite progress on access strategies, pharma companies remain unable to fully align their R&D with public health threats explains Peter van der Werf.

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.

Recent developments

Biopharmaceutical companies operate in an environment of rising chronic disease, aging populations, and increasing demand from emerging markets. From an investor's point of view, a company's capacity to focus on long-term value creation through investing in improving the access to medicine in low- and middle-income countries is a key factor for positively contributing to the development of emerging markets.

Although companies have been increasingly embracing their role as access to medicine providers and have made significant progress in their access strategies related to drug pricing and access to vaccines, misaligned incentives prevent them from aligning their R&D strategies with societal public health threats.

Pharma companies are increasingly embracing their role as access to medicine providers

Providing access to high quality medicines can be considered one of the biopharmaceutical industry's key functions. Pharma companies have the capability to bring modern medicine to everyone, playing a major role in providing life-saving products for the two billion people that still lack access to them. We have seen good progress in our engagement peer group and the companies appear to be increasingly

embracing their role as access to medicine providers. They aim to increase their reach in terms of number of patients treated by supporting the biotech ecosystem, participating in clinical trials for therapies under development, or working to secure payer reimbursements to ensure patient coverage for their therapies through public and private health insurance programs.

One of the core issues in providing access to medicine remains inadequate access to good quality data, which is necessary to determine the number of patients with no or limited access to treatments in developing countries. Often, in addition to their own surveys, companies are dependent on patient population data from the World Health Organization (WHO) or governments in developing countries. Due to a lack of good quality data, it is complicated to calculate the companies' effect on reducing the burden of disease. However, leading companies such as GSK collaborate with NGOs and governments to find ways to break down these barriers and reduce the burden of disease more effectively.

More progress expected on setting minimum price increases per annum and making the drug pricing system more predictable

The affordability of high quality drugs is another crucial element of the pharma companies' access strategies and as such it is one of the industry's main priorities. We have inquired into the companies' disclosure regarding the assessment of the value of their new drugs and how such assessment translates into drug pricing. Novo-Nordisk is a best practice example for other companies to follow as the company has pledged to limit any potential future list price increases to no more than single digit percentages per annum and it commits to pricing based on the added value of treatments. Novo-Nordisk's new growth strategy involves growing by volume uptake, launching newer drugs at lower prices, and getting more patients to choose their drugs. Other companies are expected to follow in the growing movement to transform the complex drug pricing system, make pricing more predictable, and ultimately improving access to high quality medicine worldwide.

GSK remains the leader on overcoming barriers to the accessibility of vaccines in a low-resource setting, closely followed by Sanofi

Next to affordable drugs, vaccines occupy an important place in the pharma companies' access strategies. Vaccinations have had a significant impact in reducing diseases, disability, death and inequity globally, with up to 3 million children being saved each year, representing one of the most successful and cost effective ways to protect against disease. Going beyond drug pricing and registration, we have also focused on how the companies align their R&D, manufacturing and supply processes with vaccination needs, for example, by striving to make vaccine production equivalent to demand.

All companies have been taking steps regarding the alignment of supply and demand at a global level to mitigate or prevent potential shortages. They have also taken steps to ensure that the packaging, presentation, or features of the vaccines are designed so as to overcome barriers to access on the ground. GSK is the leader in this area with the largest vaccine pipeline (25 projects) along with ongoing researches regarding overcoming barriers to access in a low-resource setting. GSK also leads in the area of pricing and registration, and it is the first company to make vaccine price commitments for humanitarian situations. However, Sanofi remains the leader in filing registrations for vaccines and it also receives, alongside GSK, the highest score in the area of manufacturing and supply, with strong processes and commitments to ensure that vaccine production is equivalent to demand. Overall, we see significant progress from all the pharma companies in their commitment to assure access to vaccines.

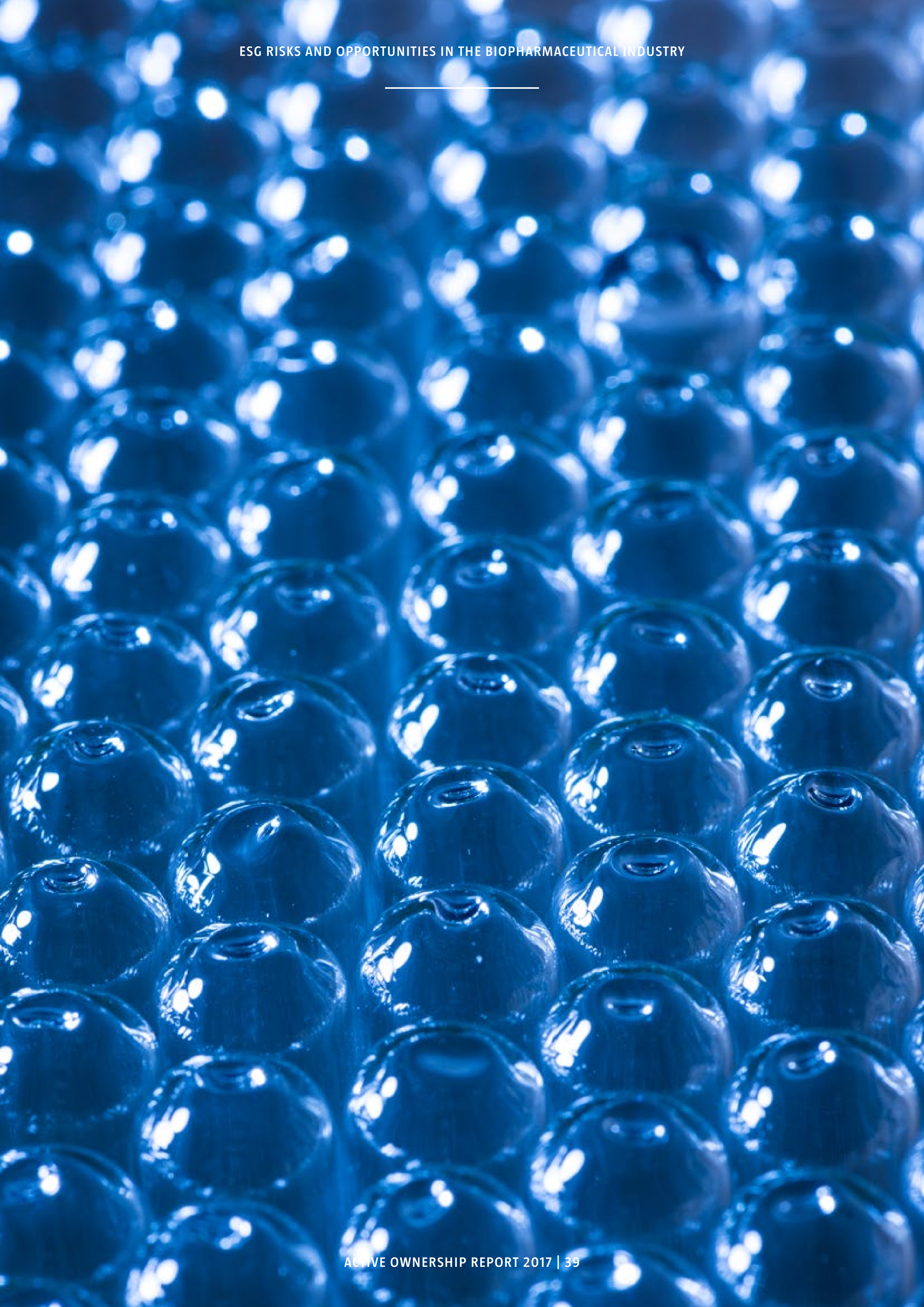
Companies are forced to focus on commercial viability ahead of large societal public health threats

Innovation management ties in with our other engagement objectives as it is through innovation and new treatments that unmet medical needs

are tackled and a better quality of care is provided, hence improving access to medicine for those in need. Despite significant advances in drug pricing and the accessibility of vaccines, the pharma companies do not align their R&D and innovation management with large societal public health threats since doing so is currently not commercial viable.

One of the specific issues we have discussed is the growing threat of antibiotic resistance. We see this as an important area of research given that threat of the post-antibiotic era is looming as deaths from bacterial infections after routine surgeries are predicted to become the number one mortality factor surpassing cancer by 2050. However, most of the pharma companies do not consider conducting research on new antibiotics a priority area for R&D allocation due to the fact that any new antibiotics developed will be used by hospitals as last-in-line drugs. In the absence of a government incentivized funding, the companies are reluctant to venture into this area as it does not constitute a viable business model. Similarly, neither considerations related to other large societal public health threats nor the UN Sustainable Development Goals plan a significant role in most of the pharma companies' decision-making processes when selecting R&D projects.

However, as seen from our past engagements and projected sales for orphan disease drugs like Biogen's Spinraza, there is a strong business case to invest in innovative drugs that address unmet needs. As investors, we are not only looking for companies that seek to invest in R&D indiscriminately, but those that ensure efficient and effective allocation of such resources to ensure long-term value creation. We see this as an area that requires further incentivizing and where investors can significantly contribute with their stewardship activities



Improving sustainability in the meat and fish supply chain

Shareholder proposals are increasingly used by investors to encourage companies to act on financial material ESG issues. Peter van der Werf and Kenny Robertson explain why we filed our own proposal at the 2017 AGM of McDonalds.

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.

Co-filing a shareholder resolution at McDonalds on antibiotics

To satisfy a growing global demand for meat, farming methods are becoming increasingly more industrialized, a process often referred to as 'factory farming'. Along with this business model comes a host of Environmental, Social and Governance (ESG) risks, including concerns around animal welfare, labor standards, and product quality & safety management. Of particular concern is the growing reliance on antibiotics to keep animals healthy and to promote increased growth.

Antibiotics resistance

Whilst increasing the intensity of farming practices helps to maximize efficiency and returns, it can also expose animals to high levels of toxins from decomposing manure, in turn creating ideal conditions for diseases to spread. To counteract these unhealthy conditions, factory farmed animals are given recurring low doses of antibiotics. Many studies now suggest that this is a contributing factor to the development of antibiotic-resistant bacteria in humans through the consumption of meat containing these antibiotics.

The significance of this problem is clear with over 70% of medically important antibiotics in the US sold for livestock

use. Recent studies by The World Health Organization and the US Centers for Disease Control and Prevention claim that many of the medical advances made over the last century could be overturned due to antibiotic resistance, in part caused by the use of antibiotic use in food production. And, while it is still difficult to measure the exact impact, experts estimate antibiotic-resistant infections will kill 10 million people per year worldwide by 2050, with one of the major contributing factors being the overuse of antibiotics in food-producing animals.

From an investment perspective, the financial materiality of the issue is also clear. In addition to the clear societal impact, changing consumer preferences towards sustainably reared food products has the potential to negatively impact sales at fast food restaurants in the coming years, including those under McDonald's control. Numerous recent surveys and studies outline such a trend, with one example finding that at least 34 percent of respondents would be more likely to eat at McDonald's if they served meat raised without antibiotics and hormones.

McDonald's policy of phasing out antibiotics in its global supply chain
As a major player in the global restaurant and fast food industry, McDonald's purchasing power can be of huge importance in addressing this issue. Indeed, the company phased out the use of medically important antibiotics in its poultry supply chains in the U.S. in 2015. However, McDonald's has not committed to a similar sourcing policy for poultry outside the US, for beef or for pork. For this reason, in April 2016 investors holding over $1 trillion in assets called on McDonald's to set timelines to prohibit the use of medically important antibiotics in its global meat and poultry supply chains as they view its use as a risk to public health as well as to the brand. Robeco, together with 26% of all shareholders, also voted in favor of this resolution.

Robeco's perspective

In 2016, Robeco conducted a research project on 'Improving sustainability in the meat and fish supply chain'. As part of our research, we identified the impact of overuse of antibiotics on antimicrobial resistance as a major risk for the coming decade. McDonald's was one of the 11 companies we analyzed, and following our research, we began a dialogue with company representatives to share our findings. One topic which we consistently raised, were our concerns about the risks created by the use of medically important antibiotics in livestock production.

2017 Shareholder proposal

Following our dialogue with the company, we co-filed a shareholders resolution at the 2017 Annual General Meeting (AGM) of McDonald's, asking the Board to update the 2015 McDonald's Global Vision for Antimicrobial Stewardship in Food Animals, by adopting a policy regarding use of antibiotics by its meat suppliers. We requested that the company sets global sourcing targets with timelines for pork and beef raised without the non-therapeutic use of medically-important antibiotics. We emphasized the investor perspective, whereby given growing health concerns, changing consumer preferences, and industry trends, shareholders would benefit from more detailed plans that would set McDonald's on a course to phase-out the non-therapeutic use of medically important antibiotics in meat production. During preceding discussions with McDonald's, we commended the company for its openness to dialogue with its investors and appreciated the rapid progress that McDonald's had made in the US, with phasing out antibiotics important for human use from the US supply chain. This is precisely why we decided to co-file the shareholder resolution, as we believed that encouraging further progress in McDonald's global supply chain through constructive dialogue was essential.

McDonald's Board statement in opposition to the shareholder proposal

Prior to the vote, the McDonald's Board issued a statement opposing the shareholder proposal. According to the Board, the Company's vision has been – and continues to be – the preservation of antimicrobial effectiveness in the future through ethical and evolving practices. The 2015 Global Vision for Antibiotics builds on

these efforts and applies to all food animals (poultry, beef, pork, dairy, and eggs) served in McDonald's restaurants throughout the world.

The Board also stated that it believed the request was premature and it had the potential to divert resources, with no corresponding benefit to the company, customers, and shareholders. In concrete terms, the company stated that it was premature to set timelines for pork and beef because of the unique challenges present in the beef and pork supply chains, such as limited purchases of pork and beef cuts by McDonald's, sourcing complexity, and the need to ensure continuous supply of products for McDonald's restaurants. This is despite the fact that McDonald's is the largest beef buyer in the US, as well as a major pork purchaser. The Board also stated that it believes it has a strong track record of progress in implementing its Global Vision for Antibiotics in poultry.

Significant minority votes for the resolution

In May, when the shareholder meeting took place, 29,7% of McDonald's shareholders supported our shareholder resolution, marking a 3,7% increase from 2016 and representing a significant minority of the company's shareholder base. Although the resolution did not pass, the strong vote suggested that investors wish to extent current poultry policies to beef and pork, and to do so not only in the US, but also across McDonald's global supply chains.

Whilst the proposal itself did not pass, it appears the relatively high level of support it did receive encouraged the company to take action. In August 2017, only a few months after the proposal was voted upon at the AGM, McDonald's committed to begin curbing the use of high value human antibiotics in its global chicken supply by 2018 and expressed that it is working on antibiotic plans for other meats, dairy cows and laying hens.

McDonald's has put in place the following timeline for the implementation of the policy

In 2016, the company announced their commitment to serve broiler chicken not treated with antibiotics important to human medicine as defined by the World Health Organization ('WHO'), in all US McDonald's restaurants nearly a year ahead of schedule.

Furthermore, the company has recently announced that, starting in 2018, it will begin implementing a new broiler chicken antibiotics policy in markets around the world, requiring the elimination of antibiotics defined by the WHO as Highest Priority Critically Important ('HPCIA') to human medicine. To make sure this policy can be effectively implemented, the company will proceed with a three tiered approach.

1. January 2018 – HPCIAs will be eliminated in broiler chicken for Brazil, Canada, Japan, South Korea, the U.S., and Europe, with an exception for Colistin for Europe only.

2. End of 2019 – HPCIAs will be eliminated in broiler chicken for Australia and Russia, and Europe plans to have removed Colistin.

3. January 2027 – HPCIAs will be eliminated in all other designated markets around the world. McDonald's goal is to have this policy implemented before this date.

After the publication of the updated Global Vision for Antimicrobial Stewardship in Food Animals, we have requested a conference call with McDonald's. The company responded that their Sustainability team is currently devoting its resources to refining their public ESG disclosures, in an effort to reach the broadest number of stakeholders. They expect these disclosures to be public by the end of the year and offered to schedule a call at that time to continue our dialogue on the implementation of the new commitments to phase out routine use of medically important antibiotics.

Corporate Governance in Japan

Whilst corporate governance standards in Japan continue to improve, Ronnie Lim explores what further needs to be done to improve shareholder value creation in the land of the rising sun.

Codes of conduct
- Japanese Stewardship Code
- ICGN Global Governance Principles
- SDG 16: Peace, Justice and Strong Institutions; SDG4: 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.

Corporate governance in Japan – an update

The recent snap elections in Japan produced a landslide victory for the incumbent Prime Minister Shinzo Abe, resulting in strong performance for Japanese equites. One of the aims of this government has been to enhance the stock market by making Japanese equities more appealing to international institutional investors, who have been net sellers of Japanese equities in the last three years. A key part of fulfilling this objective was to galvanize local and foreign investors to become more engaged with corporate managers to improve corporate governance and manage capital more effectively. The return on capital for Japanese equities has been low compared to their developed market counterparts, and that has been a key reason for their valuation discount.

However, there has been mixed progress in corporate governance reform in Japan. Some of the evidence is anecdotal, but such progress includes the increase in outside directors, and modest growth in shareholder returns. Investors – both foreign and domestic – are now far more actively engaged with companies in Japan. Shareholders are also voting more against management, which is a new, positive development in a consensus-driven culture.

The response from investors

The launch of Japan's Stewardship Code in 2014 and the Corporate Governance Code a year later are critical tools in the government's push to improve corporate governance. These tools aim to change behavior by both investors and companies.

The decision by Japan to follow a principles, rather than a rules-based, approach has allowed for innovation by some signatories. Japan's Government Pension Investment Fund ('GPIF') announced a five-point action plan in February, which included their shift from merely monitoring their external managers to constructive communication by exchanging views on stewardship activities. It also announced a decision to allocate 10% of investments in its Japanese equities to be linked to a number of ESG indices. As the world's largest pension fund, the GPIF's actions are influential, and are likely to be closely followed by other asset owners in Japan and the rest of Asia.

According to Bloomberg, for 58 Japanese domestic asset managers that disclose data, they voted against directors at a median of 20% of holdings in the year to June 2016 (compared to 15.5% in 2015, and 12% in 2014). This shows an 30% year on year increase in asset managers voting against the (re)election of directions since 2014.

As one of the asset managers supporting the code, we responded to a number of very detailed requests recently from some Japanese institutions about how we are fulfilling our role as signatories. This shows that although such codes are merely voluntary, when consensus builds in Japan for adoption, this can lead to substantive action being taken.

The role of collective engagement
From our engagement work, we do however still observe a lack of progress in other areas. One notable deficiency in the current Code is that there is no explicit approval for collective engagement by investors. Several investors have been pushing for the regulators to issue more clarification that collective engagement is not a breach of concert party rules, including notably, Japan's Pension Fund Association. We have therefore conducted most of our engagement by ourselves as there is uncertainly between investors as to what collective action is permissible.

The response from corporates

The Financial Services Agency and the Tokyo Stock Exchange hosted a meeting of the Council of Experts concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code in October. Observations included the following:
(1) Smaller companies had relatively large cash holdings;
(2) On the subject of cross-shareholdings, one member called for the disclosure of individual voting records, while another identified issues with those responsible for instigating the crossholding of shares.

A significant cultural feature in Japan has been that companies are run for the benefits of many stakeholders, with employees and customers often having priority over investors. The two codes have increased corporates' focus on making adequate returns on capital and their receptiveness to increase corporate value. Although it remains very difficult to measure the change in companies' corporate governance, a number of studies have shown some improvements.

Board independence is increasing, but problems remain

For example, the number of independent or outside directors have grown substantially, with around 80% of companies having at least two people that satisfy the Tokyo Stock Exchange's definition of an independent outside director. Our finding is that most Japanese corporate are willing to implement the corporate governance code and we have experienced an increase in appetite for Japanese corporates to discuss with us corporate governance, as well as the usual operational issues.

Although some investors and proxy voting firms have questioned the appropriate number of directors, as well as the disclosure of their relevant skills etc., we remain concerned that this could be form over substance.

We have previously reported that as outsiders, minority investors often have no real grasp of the actual dynamics of a how boards operate, who holds real power and if enough quality debate exists on corporate strategy and significant decisions.

The chairs of company boards remain dominated by company chairmen or presidents, with few outside directors fulfilling this role. There still appears to be little separation between the supervision and the execution of corporate strategy by company executives.

While there remains a widespread belief among Japanese corporates that corporate governance is a compliance issue, both companies and investors are not incentivized to invest more than the minimum resources to achieve relatively low hurdles. Therefore, we believe it is hugely important to steer the dialogue towards the creation of value, where we often have to educate our investee companies on how we evaluate their companies as financial investments. These engagements may also add insights to our investment process, as they may impact our investment scenarios.

The problem of cross-shareholdings persists

The greater structural issue are the pervasive cross-shareholdings (or allegiant shareholders & suppliers) where Japanese companies rely on long-established relationships to protect each other from hostile takeovers, and can be a real barrier for investors to pressure companies to change. In spite of the government and investors engaging companies, cross-holdings held by non-financial firms at the end of 2016 were 5.7% of the market's value, compared with 6.2% in 2002, according to Nomura research.

What we expect from companies – sustainable value creation

There are two main ways a company can use its free cash flow:
(i) reinvest to grow capital (via its existing businesses or by appropriate acquisitions), and/or
(ii) by returning capital to investors (via debt reduction, dividends and/or share buybacks.

However, for sustainable value creation, a companies' return on its capital needs to also exceed its cost of capital. When we used a company's Return on Investment Capital and subtracted its Cost of Capital ('ROIC-WACC'), our analysis indicated that only 31% of the 2031 companies in the TOPIX Index had an ROIC greater than their WACC. In other words, less than one-third of Japanese listed companies actually created value for shareholders over a five-year period.

Our meetings with companies this year revealed that although several companies could explain their business strategy reasonably convincingly, a number failed to appreciate the value of generating free cash flow, and continued making new investments with little regard as to whether the returns were adequate. We also find that corporate managers do not recognize this issue and consider low-yielding cross-holdings as a business necessity and high cash holdings with prudence.

We had a revealing meeting with ASICS, a company with a leading brand in athletic footwear. Although the company had amended their 'poison pill' strategy to prevent takeovers, the management did not seem to understand even the basics of investment hurdle rates. This is a significant issue of concern for us as the company is embarking on a risky change in its business model.

Another example is Mitsui Fudosan, a real estate company where our meetings focused on value creation. We challenged the company to not only increase their dividend payout, but also to justify making new investments that were unlikely to deliver an adequate return. Although there is yet no evidence that the company will adopt a more disciplined use of its capital, we are encouraged by our improved communication with the company, and expect to escalate our engagement to senior management soon.

Corporate governance standards in Asia

Effective corporate governance focuses on a company's long term business continuity and protects shareholders' interests. Ronnie Lim promotes the need for corporate governance improvements in Asia.

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.

Disclosure of Corporate Strategy in Hong Kong/China

Recent years have brought many developments in the corporate governance landscape in Hong Kong, with changes such as amendments to the corporate governance code, and the introduction of the Hong Kong Principles of Responsible Ownership. These changes have created some momentum for the improvement of corporate governance for Hong Kong listed companies (which included China-domiciled entities). Such changes can have strong relevance to investors, in that improving disclosure and corporate governance could enhance communication between investors and companies, and align shareholder interests with those of corporate managers.

In 2017, Robeco's Active Ownership team conducted extensive research to gain a better understanding of the existing state of affairs in corporate governance in Asia. The objectives were (a) to improve ESG integration in the investment process, (b) to document a 'baseline' of transparency & corporate governance issues, and (c) to refine our list of possible companies for engagement in Asia. When conducting our research, we focused on a peer group of 200 companies, selected in collaboration with Robeco's Asia Pacific (APAC) fundamental investment teams. Whilst limited in scope, we believe

that this research can contribute to gaining a better understanding of corporate governance developments in these markets, informing both our investment decisions and engagement process alike.

The key factors analyzed included the disclosure of corporate strategy, the disclosure of unexplained material costs, and other significant governance issues. The data and tools we used included an ESG Model (developed by RobecoSAM in conjunction with Robeco's Emerging Markets team), RobecoSAM's Corporate Sustainability Assessment Scoresheets, company Annual Reports, and research provided by external providers, including Bloomberg ESG scores and proxy voting analysis. We also wish to acknowledge the help received from the Asian Corporate Governance Association (of which Robeco is a member) for this project including their "CG Watch" research and for their counsel.

Below, the findings of our research related to the disclosure of corporate strategy are outlined. A clear disclosure of business strategy for a firm is essential for investors to assess how strategic management aims to foster a firm's competitive advantage, which could impact its future performance and value. Therefore, it is meaningful to disclose high-quality strategic information, which helps investors recognize and understand the goals and direction of the company. There are number of studies which support the importance of the transparent disclosure of the business strategy of an enterprise. For example, higher levels of strategy disclosure are associated with a lower cost of equity capital, lower bid-ask spreads and higher trading volumes. Furthermore, greater disclosure of strategy promises to reduce the information asymmetry between investors and corporations, increasing both stock returns and the willingness of markets to fund long term and innovative strategies.

In order to improve the rigor for an essentially subjective exercise, seven criteria (listed below) were used to measure the transparency level of business strategy which we adapted from the Institute of Chartered Secretaries and Administrators and some benchmark annual reports (e.g. Unilever and CLP).

External Drivers/Market analysis

1. Future market conditions and risks
2. Overview of market drivers and trends (Current)

Clear Outlining of Strategic Priorities

3. Describe strategy from both financial and non-financial perspective
4. Link each strategy to corporate responsibility or principal risks
5. Discussion of KPIs/Targets along with the company strategy

Business Model

6. Clear overview of what the Group does and its Divisional Breakdown/ Business Unit
7. Delivering value for stakeholders through Business (Importance/ Engagement)

Our study concluded that the Chinese firms listed in Hong Kong experienced issues around disclosure of corporate strategy, whilst the Hong Kong firms all had a clear disclosure of their strategies. Only 55% of the firms among 55 H-shares in Hong Kong included in the study had a section for disclosing their business strategy. In contrast, Hong Kong companies scored strongly in their disclosure of strategy, scoring 6 out of 7 for companies in the peer group. We applied a threshold score of 5, that is companies that scored 5 or higher were classified as having made a meaningful disclosure on their strategy.

Most firms tended to disclose the external drivers of their business and the future market conditions. Although, we scored this as having disclosure, many companies do not provide an in-depth insight into those future drivers and market. The criteria where the companies most lacked disclosure in were:

1. How the business model delivers value to their stakeholders
2. Targets or KPIs to be achieved in align with their business strategy
3. Linkage of their strategy to risks and corporate responsibility

Company management should adopt better disclosure of their corporate

strategy with the integration of risk management. The 2014 amendment on the Corporate Governance Code to upgrade the provisions of the Code relating to risk management and internal control should push the companies to integrate their strategy with the underlying risks that the company faces. It provides reassurance to the shareholders and helps them make rational investment decisions.

One example of best practice in Hong Kong is the electric utility CLP Holdings. It has adopted its own corporate governance code, which exceeds many of the requirements of the Exchange's Corporate Governance Code. CLP has consistently disclosed its strategic plan in relation to future economy, market trend, risks, shareholder value since 2007.

The disclosure on strategy and risk management is based on a 'comply or explain' approach in Hong Kong. In contrast, the NYSE Corporate Governance Standards require all companies to disclose their strategy as well as a clear risk management report for shareholders. To better enhance transparency and accountability, we recommend that the Hong Kong Stock Exchange voluntary provision for disclosure on non-financials should be upgraded to a listing rule, thereby making it mandatory for all companies to disclose relevant policies and performance in their annual report.

Based on our research Robeco will start an engagement project in 2017 with the aim to enhance disclosures in a selection of Asian markets. The next step in our project is to select the most relevant investee companies and define SMART objectives for engagement. Over the next three years we will report on the progress of our engagement

SPOTLIGHT ON

Michiel van Esch
Engagement specialist

Stewardship Codes

The most recent figures of the Global Sustainable Investment Alliance, which date from 2014, still indicate that the part of investments managed sustainably in Asia amount to just under 1% (compared with almost 59% for sustainability leader Europe).

Michiel van Esch, engagement specialist at Robeco, expects this figure to increase dramatically. "A growing number of companies in Asia realize they need to consider the sustainability of their business in order to attract investor capital and secure long-term growth," he says. "Corporate governance is an important factor in Asia," says Ronnie Lim, engagement specialist in Asia. "It is becoming increasingly important as international investors and local regulators are imposing global governance standards on the companies that they invest in. Good corporate governance requires several factors, including an effective board of directors, shareholders which are long-term oriented and engaged with company management, and good levels of transparency and communication with a company's stakeholders." "There is an increasing recognition that although there are many high quality companies operating in Asia, they could be better managed," Lim continues. "Companies could be more innovative, or have better financial reporting, or tighter capital discipline, and ultimately be rewarded with higher valuations by the capital markets. Therefore investors are expected to also contribute to creating corporate value for the benefit of pension funds and broader society."

What's a stewardship code?

Stewardship means that an institutional investor takes responsibility and assumes an active stance towards the companies in which it invests, on behalf of its beneficial owners. "Robeco embraces this concept," Van Esch states, "with a stewardship policy, active voting and engagement and an exclusion policy. This means that when a new stewardship code is introduced, we typically comply with its principles. Robeco complies with various stewardship codes, including the UK Stewardship code, the Dutch Eumedion Best Practice for Engaged Share-Ownership, the Hong Kong Principles for Responsible Ownership, the Japanese Stewardship Codes and the Taiwan Stewardship Principles for institutional investors." The stewardship concept is gaining momentum across the world. The first Stewardship Code was published in 2010 by the UK's Financial Reporting Council (FRC) in response to criticism about the role of institutional investors in the financial crisis. More than 300 signatories have signed it to date, including Robeco. "In a quality assessment of its signatories, the Financial Reporting Council awarded us the highest tier 1 rating for our stewardship policy. This means that we provide a good quality and transparent description of our approach to stewardship and explanations of an alternative approach where necessary," Van Esch says.

Tax accountability

As investors, tax represents perhaps the least understood line on a company's income statement. Michiel van Esch on breaking open the black box.

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.

Tax – Breaking open the black box

Traditionally, tax has been considered somewhat of a black box for investors, representing the least understood line on a company's income statement, due to a combination of weak disclosure, numerous tax codes and rules, multiple tax jurisdictions and complex tax planning by many multinational enterprises. However, a plethora of new legislation, combined with increased scrutiny from policy makers, tax authorities and society as a whole, has led to increased focus from investors on the transparency and accountability of a company's tax strategy.

Tax strategy can have a hugely material effect on company valuation, for example through its effect on free cash flow (calculated on an after tax basis), as well as potential risks from new legislation, reputational damage and litigation resulting from overly aggressive tax strategies. Indeed, if a substantial disconnect exists between where profits are booked and where the actual economic activity takes place, then a low effective tax rate may not be sustainable. On the other hand, a sustainable tax rate is one which is primarily driven by the underlying business, and reflects the location of the economic activities performed by the company. It becomes imperative that companies aim to improve their tax accountability and transparency

in order to minimize the long-term implications of tax-related risks.

Legislative pressure

In recent decades many company's operations have become more geographically diverse, and therefore exposed to a more diverse set of international and national tax regimes. There has also been greater focus placed on corporate taxation levels as governments face significant budgetary pressures post 2008. Key amongst these developments is the impending implementation of the OECD program on Base Erosion and Profit Shifting (better known as BEPS). The project deliverables are being finalized by the OECD and many countries are already transposing some of the action points in their domestic legislations.

BEPS refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations, where there is little or no economic activity. The BEPS package provides 15 Actions that equip governments with the domestic and international instruments needed to address tax avoidance and ensure that profits are taxed where economic activities generating the profits are performed and where value is created.

Beginning our engagement

With this in mind, Robeco started an extensive project on Tax Transparency and Accountability. The baseline research was conducted by PricewaterhouseCoopers. Out of this research, a framework was developed to help us better understand the quality of a company's tax disclosures and policies This allows investors to make an accurate prediction of the company's current and long term sustainable effective tax rate One key risk we identified during our research is around the transfer pricing arrangements and issues around intellectual property (IP). Other issues that will face further scrutiny are the limitations of interest deductibility, state aid and tax treaty benefits.

Various countries have included preferential regimes in their domestic tax laws, for example in relation to intellectual property. There is a risk that taxpayers reduce their effective tax rate by artificially allocating IP profits to these regimes. For this reason we have focused our engagements on high IP sectors, including Media, Information Technology and Pharmaceutical. Based on the results of our analysis, we formulated four engagement objectives to guide our discussions with companies.

Tax transparency

Due in many cases to a lack of disclosure, it is often hard to estimate a company's likely effective tax rate over the coming years. Concurrently, a company's tax position, the likeliness of regulatory fines, and the potential impact of regulatory reform can only be judged with appropriate disclosures. We therefore will encourage companies to provide investors with the types of disclosures: 1) A detailed tax reconciliation between an effective tax rate and an weighted estimated tax rate, 2) Country by country reporting on the company's revenues, net income and taxes paid, and 3) A predefined set of disclosures that allow investors to make an accurate prediction of the company's current and long term effective tax rate.

Policy and principles

It is of key importance that companies have can show a consistent policy on how they deal with their tax responsibilities. This should include accurate and coherent disclosure on how the company decides in which jurisdiction it pays taxes, as wells as information on the use of tax treaty benefits, transfer pricing, intellectual property regimes, interest deductibility and state aid. Companies should explain in which of these areas they have discretion in making decisions and which guidelines they use to assess these matters.

Regulatory impact assessment

As more move towards implementing concrete measures to protect or enhance their tax revenues, various international initiatives and regulatory changes are taking place. One example is the OECD program on Base Erosion and Profit Shifting (better known as BEPS), but this is just one of numerous such regulatory initiative taking place across the globe. Another examples include probable tax reform in both the United Kingdom and the United States

after recent changes in government. Due to the highly material changes which these initiatives could have on how companies are allocating their profits, revenues and taxes and other business operations, we expect companies to conduct impact assessments outlining the effect of changing regulation on their operations.

Tax governance and systems

Tax reporting becomes of even greater importance in the new regulatory environment, and to ensure that all applicable regulations and the company's tax principles are followed, we expect companies to have a set of agreements and systems in place to ensure proper tax governance. This includes external verification, the use of appropriate IT infrastructure and a conflict free reporting structure. As we expect tax reporting to centralized and that it monitored closely throughout the organization, and clear supervisory role for the board.

Beginning of a 3 year dialogue

With these engagement objectives, we will guide our dialogue with the peer group. We have selected 10 companies for engagement, predominately focused on sectors with high use of intellectual property and transfer pricing (IP), such as the media, technology and pharmaceutical sectors. We focus here due to the high level of transfer pricing possible where the use of IP is high. Those companies are Amgen, AstraZeneca, Biogen, Johnson & Johnson, Nestle, PayPal, Pearson, Pfizer, RELX, and SAP SE. During Q1 2017, we have contacted all of the companies within the peer group to set up conference calls, and are encouraged by the level of response so far.

Board quality

The quality of a company's governance is important in an investor's analysis. But board performance is difficult to assess as much happens behind closed doors. Michiel van Esch on how engagement with various board members can provide good insights.

Codes of conduct

- The ICGN Global Governance Principles (ICGN, revised 2014)
- Local corporate governance codes
- ICGN Statement and Guidance on Gender Diversity on Boards
- SDG 16: Peace, Justice and Strong Institutions; SDG 5: Gender Equality

Corporate Governance: Board Practices

The Supervisory Board has the task to monitor and the guide the management of the company. In order to carry out this task properly, the majority of the board should be sufficiently independent and should have relevant industry knowledge and supervisory skills. The boards' supervisory tasks cover various aspects of the company's policies. Board members should make sure that such policies are implemented correctly and work effectively. A company's strategy, the audit process, control framework, risk management, but also mergers and acquisitions should be reviewed by the board.

What constitutes a quality board?

How to assess what's happening behind closed doors? One of the key topics for any investor is a company's governance. The board plays an important role in this respect. As shareholders often only have very basic information about the performance of supervisory boards, we spoke directly with the chairmen and lead independent directors of several companies for over three years. We found that transparency has improved, providing investors with some more insight into the quality of boards. The publicly listed company, in which ownership and management are separate, is inherently faced with an agency problem. This means that management's actions and interests might not always be aligned with the interests of shareholders or other stakeholders. In most markets, the board has a role in countering this problem. It supervises management in the best interest of shareholders and other stakeholders.

From many board members, we hear that responsibilities have increased. The time when people could easily sit on a double digit amount of boards is over. Depending on the market, they are also expected to assess company risk management and compliance systems, set appropriate remuneration and oversee accounting practices.

To meet all of these expectations, people with a variety of qualities are needed Nomination committees therefore need to allocate sufficient time and resources to find appropriate board members.

The role of the board in supervising financial companies

Many critics have attributed at least part of the financial crisis to poor governance practices. Perverse incentives for top management, a lack of risk oversight and poor checks and balances are often cited as causes of irresponsible corporate behavior in the banking industry. Nevertheless, financial companies often score well on many corporate governance practices such as independence criteria for board members, pay-for-performance structures and transparency via all sorts of reporting. Yet box ticking will not help investors to gain good insight into the quality of corporate governance. A different approach is needed.
We started an engagement project with insurance companies and banks in 2014, with the aim to understand and improve 1) the quality of public disclosures and biographies, 2) board nomination processes, 3) independence and objectivity in corporate boards, 4) diversity (in a broad sense) and 5) self-evaluations of board performance.

A tick box approach won't have the desired effect

A proper analysis of a board takes a lot of time, but much insight can already be gathered from public information. How many of the independent board members have credible experience in the industry? Does the board appear entrenched, judging by average tenures? Do the backgrounds of board members credibly reflect a company's market? Sometimes companies provide useful disclosures that help investors. Often however, these disclosures are formalistic, which makes this analysis hard to carry out.
Much of our work has focused on making sure companies have good nomination policies. We have found that companies do not need prescriptive rules for nomination, but require guidelines, planning and sufficient time to start a search process. It requires constant attention from the nominations committee and frequent reviews of board composition in terms of skills, gender, experience, etc.

The supervisory board mainly operates behind closed doors

Having a strong composition doesn't necessarily guarantee the board is going to work well. It simply means that on paper it has the right capacities to do so. In practice, shareholders have very little information about the performance of supervisory boards. Whereas executive management can often be judged on several KPIs and have substantial exposure in the media, supervisory board members mainly operate behind closed doors.

Supervisory boards are increasingly reporting on their activities and the evaluation of their performance. A trained eye can read between the lines and assess whether boards are doing more than rubber stamping. Still, the best way to gain real insight is to speak to board members themselves. During our engagement project, we managed to speak with the chairmen and lead independent directors of several boards. These meetings allowed us a peek into the boardrooms of our investee companies and rendered the most fruitful conversations.
All companies met local standards for the required number of independent directors. We had concerns, however, about companies that traditionally held on to dual mandates (CEOs who are also the Chairman of the board) and the level of industry experience of the independent board members. Solvency II helped our cause to a certain extent, by requiring splitting key responsibilities for top management which had led to dualism in several cases.

Three years on

We have seen positive developments in the insurance sector. Transparency and disclosure have improved markedly, making it easier for investors to gain a picture of board composition. Disclosure of board self-assessments has also become more prevalent, giving investors a look behind the scenes. And as for those candidates who gain a seat on the board, whilst more pressure is placed on their time, they also tend to have more relevant skills.

SPOTLIGHT ON

Kenneth Robertson
Active Ownership Analyst

Cyber Security

As technological advances have permeated every business and sector, the risks associated with such advances have risen concurrently.

The 2016 Gemalto Breach Level Index estimated that approximately 1.4bn data records were compromised in 1,792 data breaches in 2016, an 86% jump since 2015.

On a sector basis, financial institutions now face 300% more cyber-attacks than other industries, largely due to the value and extensiveness of the data which they hold. Much of this data is increasingly held in cloud based infrastructure, with the sector spending 69% percent more on cloud-based cyber security than in previous years. In total, financial institutions spent USD70bn on risk IT systems and services in 2016, with European institutions the biggest single group of investors in new cyber risk infrastructure. Cyber security, and the oversight of associated risks, has therefore formed one component of our engagement with European financials over the last three years.

One of the key focus points of our engagements has therefore been to encourage companies to implement a proactive nomination policy which ensures that the board continually reviews the skills required to effectively oversee the underlying business, and make new nominations should any skills gap be identified. An understanding of cyber security, and how to mitigate the potential risks of digitalization, is one such gap that many boards nomination committees have actively been attempting to fill. A recent Bank of England survey highlighted cyber risks as a key concern for companies, even to the extent that is overtook other forms of operational risk. Financial institutions, including those in our engagement peer group, are therefore increasingly looking to expand the breadth and depth of cyber literacy on their boards.

Engagement with policymakers in 2017

Robeco engages collectively on matters of public policy related to the promotion of ESG. This is in alignment with Principle 5 of the Principles of Responsible Investment. In 2017, Robeco participated in several policy initiatives on ESG topics. Here is a summary of the work we have done, and the outcomes achieved so far.

Robeco recognizes that the regulatory environment and policy setting of the countries in which we invest are a crucial factor for companies to be able to support their sustainability commitments. To develop a supportive environment, there are cases where it is worth engaging with the relevant policy-making institutions. This is usually done collectively through the investor associations of which Robeco is a member. In the past year, Robeco has engaged in a number of such initiatives. Some examples are outlined below.

Sound environmental regulation is key

Prior to the G7 and G20 Summits (in May and July respectively), Robeco joined global investors in calling on the G7 and G20 nations to implement the Paris Agreement on Climate Change. The investors publicly endorsed the deal since, prior to the summits, it was not clear whether the Agreement would be discussed. The letter stated that a failure to implement the Agreement would not only harm the climate, but also jeopardize trillions of dollars of investment needed to change business models to reduce CO2 emissions. In line with the request in the letter, the Agreement featured on the agenda of both summits, with all nations except the United States lending their support to the Agreement.

In August 2017, Robeco and other Investors within the ICCR and INCR (Ceres) investor networks published a letter of support for strong methane regulation in the US. This letter, sent to the US Environmental Protection Agency (EPA), was a reaction to the proposed two-year delay in the implementation of the Emission Standards in the Oil and Gas Sector. These performance standards had been in effect since June 2016 and were scheduled to require compliance by 3 June 2017, but were delayed by an internal decision within the EPA. The letter called for immediate implementation of the standards. It argued that the proposed stay of compliance deadlines and the expected

increase in methane emissions would not only harm the climate, but also investors who have positioned their portfolios with these regulations in mind. Upending the level playing field created by a set of uniform national standards would lead to unnecessary uncertainty for investors.

In September 2017, Robeco also signed a Statement of Support for the Task Force on Climate-related Financial Disclosures (TCFD) Recommendations. The statement affirms Robeco's commitment to support the voluntary recommendations of the industry-led Financial Stability Board TCFD on better disclosures of climate-related risks and opportunities. The disclosures constitute an important step forward in enabling market forces to drive efficient allocation of capital and support a smooth transition to a low-carbon economy by facilitating better-informed business and investment decision-making.

Modern-day slavery threat to supply chain management

In March 2017, Robeco collaborated with other investor-members of the PRI via a letter commenting on an informal proposal to establish a Modern Slavery Act in Australia. In the letter, we expressed our concern about the use of forced labor in the agricultural, construction and hospitality sectors in Australia. Apart from the obvious impact on workers' rights, the implication of Australian companies in using forced labor in their supply chains could lead to brand damage and the disruption of supply chains, harming the companies' license to operate as a consequence. This is neither in the interest of companies nor investors.

Robeco has also been stepping up its support for corporate reporting initiatives in the human rights area. In February 2017, we expressed our support for the UN Guiding Principles Reporting Framework via a joint letter. The Framework supports improved disclosure and enables investors to review companies' understanding and management of human rights risks. The Framework is an important external anchor for Robeco's engagement with companies on the assessment and management of human rights risks.

Better governance by raising Asian stock exchange standards

In April 2017, we sent a letter to the Singapore Exchange outlining Robeco's position on dual-class shares. The letter was a response to the Singapore Exchange's Consultation Paper on 'Possible Listing Framework for Dual Class Share Structures'. The paper proposed the introduction of a Dual Class Share Framework that would allow dual-class share listings in Singapore. In our response, we argued that no more than one temporary protective structure should be permitted, and that anti-takeover preference shares are preferred. Permanent forms of protection, such as granting extra voting rights and/or shares to founders/major shareholders or introducing shares with high and low voting rights (dual-class shares), are not appropriate. Opposition to the proposal has been also voiced by other investors and investor associations.

In August 2017, we sent a letter to the Hong Kong Exchange commenting on its proposed New Board. In the letter, Robeco expressed its lack of support for the proposed listing system as we believe it would increase the risks of further market fragmentation. We also discouraged the introduction of dual-class shares.

Also in August, we affirmed our support for the Singapore Stewardship Principles. These principles for responsible investors are intended to encourage companies to pursue the spirit of good governance and stewardship, and to be focused on the long term.

Creating a level playing field

Robeco's relationship with policy players is naturally different from our relationship with the companies with whom we engage. The core focus of our active ownership activities is to engage with the companies in which Robeco invests with the aim of improving their ESG scores. However, there are also links, although less direct, between our commitment to sustainability and institutions creating legal and regulatory frameworks. Policymakers play a crucial role in creating a level playing field for companies operating in different geographic markets and they have the power to both re-balance and upset this playing field. Some policies may damage shareholder protection, while the introduction of other policies could be beneficial from an ESG perspective. Policy engagement therefore is an important instrument in sustainability investing.

International Corporate Governance Network

Robeco encourages good governance and sustainable corporate practices, which contribute to long-term shareholder value creation. Proxy voting is part of Robeco's Active Ownership approach. Robeco has adopted written procedures reasonably designed to ensure that we vote proxies in the best interest of our clients. The Robeco policy on corporate governance relies on the internationally accepted set of principles of the International Corporate Governance Network (ICGN).

The ICGN principles have been revised in June 2014. The proxy voting policy is the standard policy for Robeco. For discretionary mandates Robeco can implement any proxy voting policy a client prefers.

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 2017, Robeco had EUR 161 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 877 people in 15 countries (December 2017). 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 is 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.

More information is available at www.robeco.com

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