



WHEB

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Responsible Investing: Engagement Report Q3 2015

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Introduction

Sustainability issues have enjoyed great prominence in the pages of the financial press over the past quarter. This has been most notable in September due to the scandal involving Volkswagen and their use of so-called 'defeat devices' to achieve US emission standards. The story raises a number of very important issues for both the automotive and the investment industry. Many investors were caught short by environmental, social and governance (ESG) analysis that rated Volkswagen very highly. We comment on this as well as our engagement with companies that have been affected in the report below.

We've also enjoyed a number of engagement successes in encouraging companies to issue sustainability reports. We comment below on whether we have achieved a tipping point in sustainability reporting as well as on the efforts that we are putting into public policy activity in advance of the international negotiations on climate change at the end of the year. One area of particular focus has been on lobbying – and how to encourage companies to adopt positive approaches to strong and effective regulation of carbon emissions.

Volkswagen and the fall-out for the automotive sector

At the end of September, Volkswagen admitted that several of their car models had been using software to achieve tail-pipe emission standards in tests that were not replicated in real world conditions. In some cases this meant nitrous oxide emissions exceeded regulatory limits by more than 40%.

The fall-out from the scandal is still being assessed, but is expected to impact the use of diesel in the sector as well as investment analysis and thinking. We've discussed these broader impacts in a separate blog,¹ but have also engaged companies in the fund that are affected by the scandal.



The FP WHEB Sustainability Fund has no direct exposure to Volkswagen. We never considered the company to be investable because it does not, in our view, 'provide a solution to a sustainability challenge'. In fact, as has become abundantly clear, VW products are actively creating sustainability challenges. However, we do invest in two companies, Johnson Matthey (JM) and Umicore, that sell emission control systems to Volkswagen and the rest of the car industry. We have spoken to both companies in order to understand their exposure to the fall-out and what might happen next.

The first point to emphasise is that the 'defeat devices' are part of the engine management system developed by Volkswagen. Both JM and Umicore are involved in supplying catalytic converter and emission control systems but are not responsible for the software systems. However, while these companies are not involved in VW's deliberate deception, the scandal is threatening to undermine the use of diesel as a fuel. We continue to monitor this situation closely but, on balance, believe that diesel will play an important role in the sector not least because diesel helps the car companies to achieve carbon dioxide emission targets. In addition, when correctly applied, the latest European standard for diesel engines is very similar to the emission standards for petrol engines. We anticipate that this standard will be rolled out worldwide, and means that diesel will play an important part in achieving air quality and climate change targets in Europe.

We believe that the scandal will lead to a tightening of emission testing protocols and standards. This will be positive for testing companies including Horiba which is in the portfolio and made the testing system that led to the discovery of the defeat devices in the first place. We believe that tightening standards will in turn drive demand for more emission treatment technologies and a shift to hybrid and electric vehicles, something that we have been anticipating and are actively positioning the fund for.

¹ <http://www.whebgroupp.com/has-volkswagen-caused-a-pile-up-in-the-auto-industry/>

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Has sustainability reporting reached a tipping point?

Over the past few quarters we have been delighted to have achieved a number of successful engagements with portfolio companies that have published their first sustainability reports. While relatively common among European businesses, sustainability reporting has been much less common in the US where a significant proportion of the fund is invested. Kansas City Southern, Stericycle and now IPG Photonics and Canadian Solar are all investee companies that we have encouraged to issue these reports and which now publish reports of reasonable quality in this area.

Canadian Solar is the most recent name that we have been able to add to this list. The company had produced a Chinese version, but under pressure from investors and other stakeholders has finally produced a report in English. We strongly believe that producing sustainability reports is a positive stimulus that requires companies to put in place effective management and performance reporting systems that in turn lead to higher quality and more effective businesses.



While we are not clear that this success is necessarily reflective of a wider shift in the US, it is notable that in contrast to previous years, companies indicate that we are not the only investor asking for this kind of reporting. Our ultimate objective is to encourage companies to adopt fully integrated types of reporting that position sustainability issues as core to business strategy². These first sustainability reports are not yet in this style, but represent a very positive first step in this direction.

Accelerating carbon reduction initiatives: Suez (Water Management)

We are pleased to report that Suez, a major water and waste management business held in the fund, has published an updated set of carbon reduction initiatives. Suez was one of two companies³ that performed poorly relative to industry peers in the carbon audit of the FP WHEB Sustainability Fund. We have pushed the company to increase the level of ambition in their carbon strategy and their new commitments clearly do this. Notable among the 12 new targets is a commitment to reduce greenhouse gas (GHG) emissions by 30% by 2030 and to help clients avoid 60 million tonnes of GHG emission by 2020. In 2014 the company produced 7.8 million tonnes of GHG emissions while reducing clients' emissions by 8.9 million tonnes. The company has also committed to advocating for a carbon price through its lobbying activities in national and supranational jurisdictions.

Public policy activities

Low carbon policy in the UK

Along with other UK-based investors, we have been surprised and disappointed by the extent and degree of government cuts in support for the low carbon economy in the UK. This has included cuts to support mechanisms for low carbon power, building energy efficiency, low carbon vehicles and carbon reporting and disclosure.

The UK represents a small portion of our portfolio and so are not overly exposed to these changes. Nonetheless, we have been active in engaging with the government to encourage a more predictable and reliable approach to policy in this area.

This has included speaking on conference platforms, publishing letters in the media and writing directly to government as part of investor coalitions. So far we have not heard any positive news from the government on how they plan to replace the policies that they are cutting or phasing out.

Low carbon policy in Canada

The province of Alberta, and Canada more generally, has become a laggard on efforts to address climate change. A new administration in Alberta has sought to develop a more progressive position which we, along with other institutional investors, have wanted to support. In August we wrote a joint letter with over 50 other investors supporting the new policy and encouraging other Canadian provinces to follow suit.

² WHEB is an expert investor member of the Integrated Reporting Framework (<http://integratedreporting.org/>)

³ Smurfit-Kappa was the second company that we engaged and on which we reported in our Q2 2015 report.



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■ Corporate lobbying and climate change

A particular challenge to the agreement of an effective international framework on climate change is the intensive lobbying that many affected industry groups undertake. To address this issue a broad group of institutional investors has written to companies in Europe, the US and Australia encouraging them to develop robust climate change policies and position statements and to play a constructive role in policy discussions. The letter sets out specific actions that the companies should take including reporting publicly on the company's public policy positions that relate to climate change.

Because of our thematic approach to investing, we are not typically invested in companies that are most active in lobbying against effective public policy on climate change. On the contrary, most of the companies that we invest in lobby in support of strong policies that are likely to support their business activity. Nonetheless, we are keen to lend our voice to this initiative which we think can help to shift corporate policy activity in the build up to the negotiations in Paris and beyond.

Voting record: Q3 2015

The table below summarises the voting record for the FP WHEB Sustainability Fund from 1 July – 30 September 2015. Full details of how we voted on each of the individual votes are detailed in Appendix 1 (<http://www.whebgroupp.com/investment-strategies/listed-equity/fund-governance/engagement-and-voting-records/>) including with rationales for votes against management and abstentions and where we supported shareholder resolutions.

Meetings	# of meetings	%
# votable meetings	10	100%
# meetings at which votes were cast	10	100%
# meetings at which we voted against mgmt. or abstained	4	40%

Resolutions	# of resolutions	%
# votes cast with management	98	96%
# resolutions where votes cast were against mgmt. or abstained (see list in appendix ³)	4	4%
# resolutions where votes were withheld	0	0%

³ A complete list of resolutions and how we voted is available at <http://www.whebgroupp.com/investment-strategies/listed-equity/fund-governance/engagement-and-voting-records/>

Summary of other areas of work

The following section details the range of engagement work that we have done bilaterally with individual companies in our portfolio and in the wider investment themes as well as the voting that we have done at annual general meetings that were held during the quarter.

Company	Topic	Comment	Outcome	Date
Xylem	Auditor independence / Delaware reincorporation	Auditor tenure of 14yrs. Reincorporate in Delaware where law is more shareholder friendly	Responded saying audit rotation is sufficient and that company is already responsive to shareholders	15 July
Newalta	Auditor tenure	Auditor tenure is at least 16 years	Thoughtful response providing evidence of need for minimum audit terms	15 July
Smurfitt Kappa	Carbon strategy	Company scored poorly in our fund carbon audit	Responded clarifying that the peer group used for comparison is not correct	19 August
IPG Photonics	Sustainability reporting	Publication of first sustainability report	Conference call to provide feed-back on reporting	21 August
Orpea	Related-party transactions/ Remuneration / Board independence	Board director also provides tax services / Lack of long-term incentives / Insufficient independent Directors	Responded recognising potential to use longer-term incentives and justifying the Directors as representing key shareholders	1 Sept
Canadian Solar	Sustainability report	Company has only produced a Chinese language CSR report	Company published its first sustainability report in English at the start of Sept.	23 Sept
Umicore	Automotive emissions control	How VW emission scandal affects emission control	Company responded to say that their technology was not implicated in scandal (see above)	29 Sept
Suez	Carbon strategy	Company scored poorly in our fund carbon audit	Company has published updated carbon strategy (see above)	30 Sept
Johnson Matthey	Automotive emissions control	How VW emission scandal affects emission control	Company responded to say that their technology was not implicated in scandal (see above)	30 Sept
Novo Nordisk	Clinical Trials	Company does not publish all clinical trial data	Call organised for Q4 2015	13 July
Henry Schein	Mercury in dental amalgam	Mercury is used in dental amalgam and contributes to toxic waste	Company has agreed to a conference call to discuss the issue	30 Sept
Fresenius SE	Dividend pay-out Manufacturing safety	Allocation of dividends was too low & concern that approach to manufacturing safety is inadequate	No response as of 02/10	15 July

Company	Topic	Comment	Outcome	Date
DaVita Healthcare	Director attendance / Auditor tenure	One director attended less than 75% of board meetings and auditor tenure is now 15 yrs.	No response as of 02/10	15 July
Constellium	Director independence	Voted against Board member because of lack of independence	No response as of 02/10	15 July
CT Environmental	Corporate governance	Poor Director attendance / Auditor independence / excessive issuance of equity	No response as of 02/10	15 July
Cerner	Auditor tenure	Auditor tenure 32 yrs.	No response as of 02/10	18 August
HMS	Auditor tenure	Auditor tenure 34 yrs.	No response as of 02/10	24 August
Dassault Systemes	Restricted share plans	Inadequate criteria on performance and time horizon	No response as of 02/10	3 Sept.

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