Bayerische Versorgungskammer: Fixed Income

FY 2019

The purpose of the ***reo®*** (responsible engagement overlay) * service is to engage with companies held in portfolios with a view to promoting the adoption of better environmental, social and governance (ESG) practices. The ***reo®*** approach focuses on enhancing long-term investment performance by making companies more commercially successful through safer, cleaner, and more accountable operations that are better positioned to deal with ESG risks and opportunities.

Engagement in review

In November, the U.S. Securities and Exchange Commission (SEC) proposed additional rules for regulation of the proxy voting process, including tighter rules for proxy advisory firms and higher thresholds for re-submission of shareholder resolutions. If finalised, the new rules would weaken shareholder access to independent proxy voting advice, potentially impede discussion of emerging ESG issues. The PRIsent a letter to the SEC opposing the proposed changes, which we signed.

On a more positive note, the UK's Financial Reporting Council (FRC) published in October an ambitious new UK Stewardship Code that seeks to set a higher standard for effective stewardship. We actively participated in the Code's consultation process and we aim to be early adopters and plan to integrate many of the requirements of the new Stewardship Code in our Responsible Investment reporting in early 2020, one year ahead of required reporting cycle.

As evidenced by the outcome of this year's annual UN climate conference, governments struggle to bridge the gap between what science demands and the world's current emissions. Despite the disappointment, actions by investors and companies signal important indicators of progress. Investors are mobilizing on climate action at a dizzying speed. A global investor statement to governments on climate change, drafted by IIGCC was endorsed by 631 investors. And Climate Action 100+ has played a key role driving many companies, including some of the world's largest, to publicly declare their support for the Paris Agreement and/or announce zero net emissions commitments. We continue to be active participants in both initiatives.

Environmental challenges of Indonesia's natural bounty

Engagement trip

We travelled to Indonesia to meet some of the country's largest companies, as well as other actors helping to advance ESG practices Most of our discussions touched on environmental challenges linked to the exploitation and use of natural resources.

We met with palm oil giant **Indofood** to discuss challenges resulting from its withdrawal from the Roundtable on Sustainable Palm Oil (RSPO) earlier in 2019, prompted by allegations of labour violations and meaning itspalm oil can no longer be RSPO-certified. We shared our concerns that this can lead to lower environmental and social practices across Indofood's planted area and supply chain. We also had a meeting with **Bank Mandiri**, during which we continued our discussion on the financing of palm oil and other agricultural commodities. Our meetings with **Adaro Energy** and **United Tractors (UT)**, both in the coal mining industry, focused on the long-term risks to their businesses. Both companies confirmed that conversations on business diversification feature heavily during board meetings. But ultimately, they remain bullish on coal as the preferred fuel to cover Asia's growing energy needs.

Finally, we met with the financial services regulator, OJK, and the Indonesian chapter of the World Wildlife Fund (WWF).

BASF SE – a look into the world's largest chemical plant

Engagement field trip

In November we organized a site visit for reo clients to BASF's plant in Ludwigshafen, Germany - the largest chemical complex in the world. We had a tour of the site, with in-depth explanations about energy production and consumption, internal transport infrastructure and workplace safety measures. We were particularly interested in discussing progress on safety practices after the 2016 explosion that killed five workers. The accident led to stronger safety oversight and more stringent performance goals.

We also spoke about efforts to address potential physical impacts from climate change,like the drought on the Rhine river in 2016, Mitigation measures include options for low-tide boats, enhanced forecasting, more storage on site, and alternative transport routes. Finally, we discussed initiatives around diversity, carbon management and litigation risks.

Navigating the social costs of sourcing cobalt for the green revolution

Engagement collaboration

We attended a roundtable on responsible cobalt sourcing hosted by the PRI as part of our involvement in their project on the theme. The event brought together companies, investors, intergovernmental bodies and NGOs to discuss the issues surrounding sourcing from the Democratic Republic of Congo (DRC).

Despite the boom in demand, the social issues around DRC-based large-scale mining (LSM) and artisanal or small-scale mining (ASM) remain, such as bribery and corruption, pollution, the use of child and slave labour, unsafe working conditions and funding local militia.

The political and operating environment in the DRC remains complex. Any solution must, therefore, involve multistakeholder co-operation. Although LSM is less exposed to many of the issues seen with ASM, in practice ASM cobalt continues to enter the mix that large miners distribute, and it contributes more economic benefits to local communities than LSM.

A technological solution currently being explored is blockchain, although there were mixed messages on how well this could work in practice, particularly with ASM. Our expectation is to continue exploring the issue alongside other investors in the collaborative engagement project.

Targeting the opioid epidemic

Engagement collaboration

We decided to joined IOPA (Investors for Opioid Accountability), which was established in response to the opioid crisis. The U.S. Centers for Disease Control and Prevention reported that in 2017, opioid overdoses caused 47,600 deaths in the U.S. Companies in the opioid supply chain have come under intense legislative and regulatory scrutiny for their role in contributing to the crisis.

The IOPA has focused on manufacturers, distributors, and retail pharmacies, asking them to employ governance tools to improve corporate practices, culture, board accountability, compensation incentives, and risk mitigation.

In 2020 we are committed to engaging other key companies in the opioid supply chain and will use the platform provided by the IOPA to encourage the implementation of practices to strengthen governance through Board oversight.

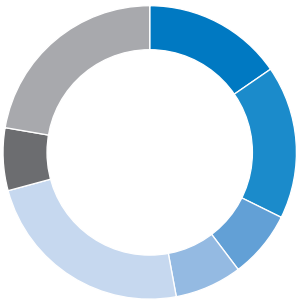
Companies engaged this quarter

Companies Engaged	Milestones achieved	Countries covered
157	102	21

Companies engaged by region

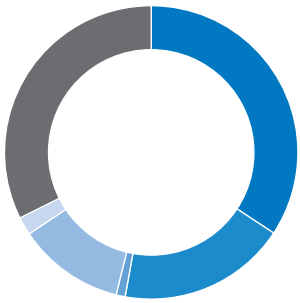


Companies engaged by issue ***



Climate Change	92
Environmental Standards	101
Business Conduct	44
Human Rights	44
Labour Standards	141
Public Health	41
Corporate Governance	133

Milestones achieved by issue



Climate Change	35
Environmental Standards	19
Business Conduct	1
Labour Standards	12
Public Health	2
Corporate Governance	33

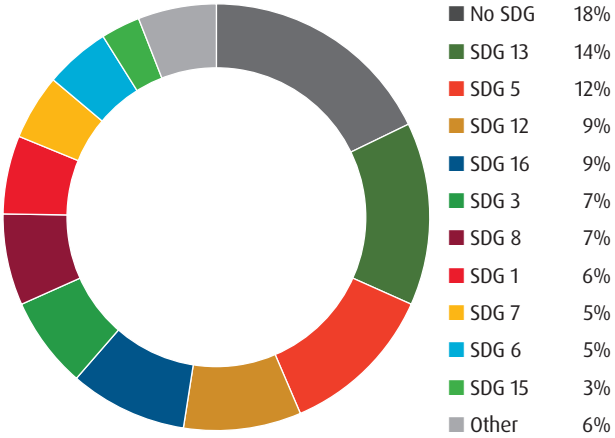
* ***reo***® is currently applied to £131bn ($161billion / €147billion) of assets as at 30th September 2019.
** Companies may have been engaged on more than one issue.
*** This report has been compiled using data supplied by a third-party electronic voting platform provider. The statistics exclude ballots with zero shares and re-registration meetings. Meetings/ballots/proposals are not considered voted if: ballots have been rejected by voting intermediaries (e.g. where necessary documentation (such as Powers of Attorney, beneficial owner confirmation, etc.) was not in place); instructed as "Do not vote" (e.g. in share-blocking markets); or left uninstructed. This document is for professional advisors only and should not be circulated to other investors. Past performance should not be seen as an indication of future performance. Stock market and currency movements mean the value of, and income from, investments in the Fund are not guaranteed. They can go down as well as up and you may not get back the amount you invest.

Engagements and Sustainable Development Goals (SDGs)

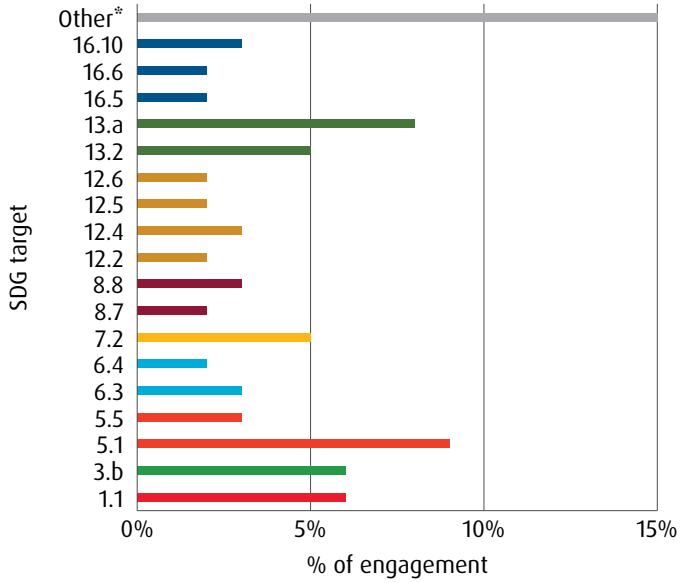
The 17 Sustainable Development Goals (SDGs) were developed by the UN and cross-industry stakeholders with a view to providing a roadmap towards a more sustainable world.

We use the detailed underlying SDG targets to frame company engagement objectives, where relevant, as well as to articulate the positive societal and environmental impacts of engagement. Engagements are systematically captured at a target level, to enable greater accuracy and achieve higher impact.

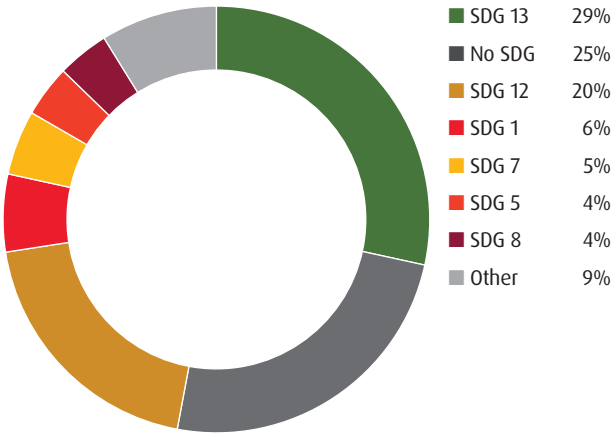
Engagement: SDG level



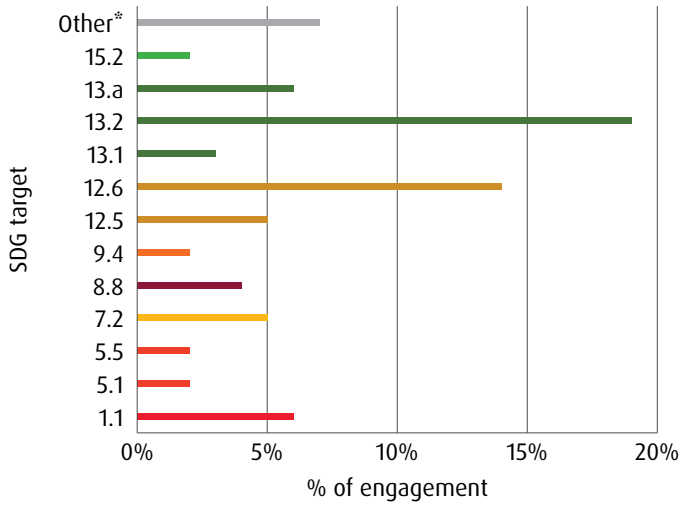
Engagement: SDG target level



Milestone: SDG level



Milestone: SDG target level



*Other represents SDG targets less than 2% of the relevant SDG Goal.

Engagement case studies

Company: McDonald's Corp	Country: United States	Sector: Consumer Discretionary
Priority Company: -	ESG Risk Rating:	Response to engagement: Adequate
Theme: Corporate Governance	Issue: Antimicrobial resistance (AMR)	

SDG:  3.b

Background

McDonald's is the largest fast-food restaurant chain in the world, and therefore exerts significant influence over its suppliers. We believe that the company can play an important role in addressing AMR by upholding responsible sourcing practices and adopting strong stewardship practices. As such, we support the implementation of an antibiotic policy that includes clear timelines for phasing out the routine, non-therapeutic use of antibiotics across all species. If the spread of AMR – fuelled by misuse and overuse – continues, livestock production may decline, a scenario which would have a materially negative impact on McDonald's business model.

Action

We arranged a call with operational specialists at McDonald's about AMR. We began by discussing the company's progressive stance on responsible antibiotic use. In 2015, the company announced its Vision for Antimicrobial Stewardship targeting producers and suppliers, and has since introduced species-specific policies for chicken (2017) and beef (2018). We were very encouraged to learn that McDonald's is partnering with its beef producers to measure and understand their use of antibiotics, and we commented positively on plans to establish reduction targets. We then asked about the company's recent efforts to reduce antibiotic use in poultry farms. The company representatives highlighted that the use of essential oils and enhanced biosecurity practices have resulted in a 70% reduction in use in some markets. We concluded that it is possible for the company to markedly improve antibiotic stewardship in chicken and beef production, but there are significant barriers to overcome in the development of an antibiotic policy for pork, due to fragmentation in the pork industry and a lack of regulatory oversight. We commended McDonald's for its commitment to responsible antibiotic use, based on the recognition that AMR is a critical public health issue, and strongly encouraged the company to continue to be as transparent as possible on issues related to antimicrobial stewardship.

Verdict

Our call with McDonald's was positive and informative, and confirmed our view that the company is a leader among peers on antimicrobial stewardship. The company representatives provided us with useful insights into all aspects of McDonald's approach to promoting responsible antibiotic use, and – given its high profile and global influence – we will closely monitor its progress in 2020. Important next steps will be the publication of an antibiotic policy for pork, and reduction targets for medically important antibiotics in the company's key beef sourcing markets.

ESG Risk Rating: Rating of a company's ESG risk exposure and risk management compared to industry peers. Source: MSCI ESG Research Inc.

Top quartile: GREEN Second quartile: YELLOW Third quartile: ORANGE Bottom quartile: RED

Appendix



SDG	Target	Target Summary
SDG1	1.1	Eradicate poverty and ensure a living wage for all
SDG1	1.4	Ensure equal rights to resources and basic services
SDG2	2.1	End hunger and ensure access to safe and nutritious food
SDG2	2.2	End all forms of malnutrition, particularly for children and women
SDG3	3.3	End AIDS, TB, malaria and other water-borne and communicable diseases
SDG3	3.5	Increase the prevention and treatment of substance abuse
SDG3	3.8	Access to medicines and health-care
SDG3	3.9	Reduce deaths and illnesses from pollution and contamination
SDG3	3.b	Support research into vaccines and medicines for diseases primarily in developing countries
SDG5	5.1	End all forms of discrimination against women and girls
SDG5	5.5	Ensure full equality of opportunity for women, including at leadership levels
SDG6	6.3	Improve water quality by reducing pollution
SDG6	6.4	Increase water-use efficiency to address water scarcity
SDG7	7.2	Substantially increase the global share of renewable energy
SDG7	7.3	Double the global rate of improvement in energy efficiency
SDG8	8.2	Achieve greater productivity through innovation.
SDG8	8.3	Promote development-oriented policies
SDG8	8.5	Achieve full and productive employment for all
SDG8	8.6	Reduce the proportion of youth not in employment or education
SDG8	8.7	Eradicate forced labour, modern slavery & human trafficking
SDG8	8.8	Protect and promote safe working environments for all workers
SDG9	9.1	Develop resilient and sustainable infrastructure
SDG9	9.4	Upgrade and retrofit industries to increase sustainability
SDG10	10.2	Empower and promote inclusivity for all
SDG10	10.4	Adopt policies to progressively achieve greater equality
SDG10	10.5	Improve the regulation and monitoring of financial markets
SDG11	11.5	Reduce social and economic losses caused by disasters
SDG11	11.6	Reduce the negative environmental externalities of cities
SDG12	12.2	Sustainably manage and make efficient use of natural resources
SDG12	12.4	Manage chemical usage and waste throughout their life cycle
SDG12	12.5	Reduce waste through prevention, reduction, recycling and reuse
SDG12	12.6	Encourage companies to adopt sustainable practices and enhance ESG reporting
SDG13	13.1	Strengthen adaptive capacity to climate-related events
SDG13	13.2	Integrate climate change plans into policies and strategies

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Appendix (continued)



SDG	Target	Target Summary
SDG13	13.a	Address climate change mitigation for developing countries
SDG14	14.1	Prevent and reduce marine pollution of all kinds
SDG15	15.1	Ensure sustainable usage of terrestrial freshwater ecosystems
SDG15	15.2	Promote the implementation of sustainable management of forests
SDG15	15.5	Take urgent action to reduce degradation of natural habitats
SDG15	15.a	Increase financial resources to conserve ecosystems
SDG15	15.b	Mobilise resources to finance sustainable forest management
SDG16	16.1	Reduce all forms of violent-related death rates
SDG16	16.5	Reduce corruption and bribery in all their forms
SDG16	16.6	Develop effective, accountable and transparent institutions
SDG16	16.7	Ensure responsive and inclusive decision-making at all levels
SDG16	16.10	Ensure public access to information and protect fundamental freedoms

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