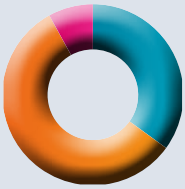
Active Ownership Report Q3-2018

BCPP | 01.07.2018 - 30.09.2018

BORDER TO COAST
PENSIONS PARTNERSHIP

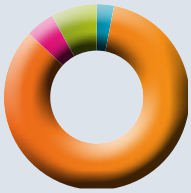
Engagement activities by region

North America	35%
Europe	57%
Pacific	8%
Emerging Markets	0%



Shareholder meetings voted by region

North America	3%
Europe	84%
Pacific	5%
Emerging Markets	8%



Voting overview

2018	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Total number of meetings voted	N/A	N/A	57	
Total number of agenda items voted	N/A	N/A	917	
% Meetings voted against management	N/A	N/A	72%	

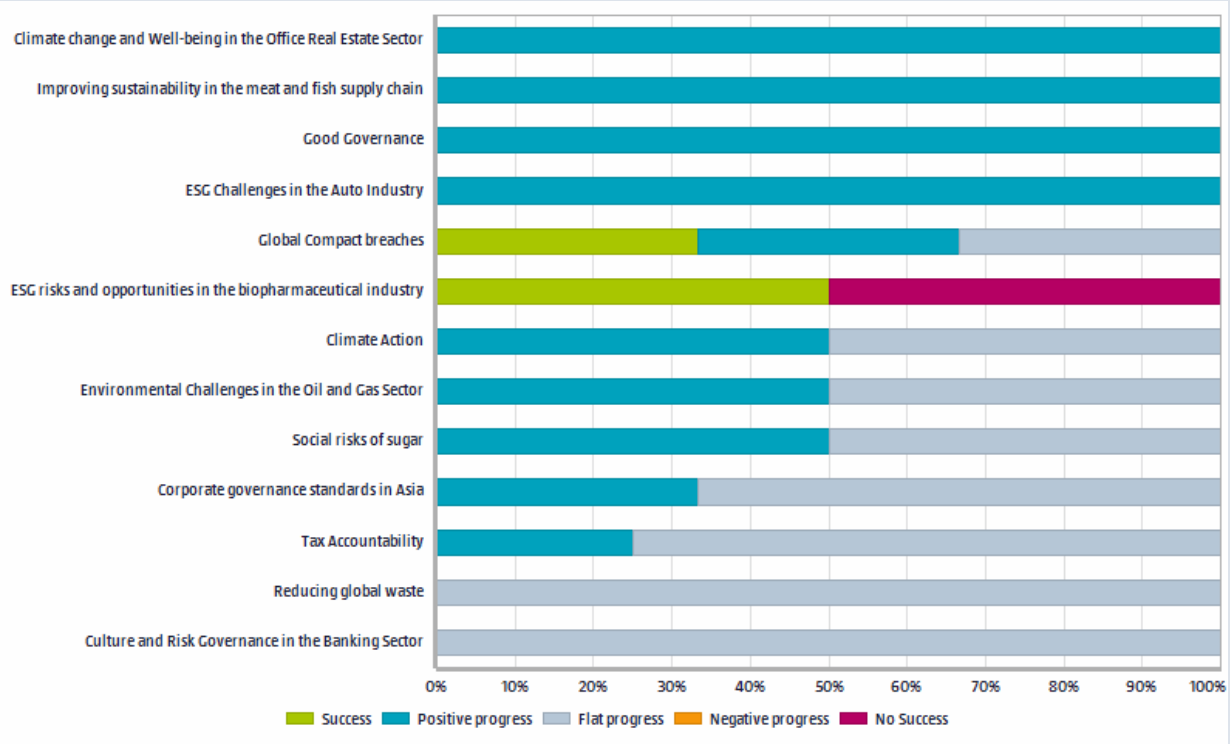
Engagement overview by topic

Environmental Management	9
Environmental Impact	1
Human Rights	
Healthy Living	3
Social Management	
Corporate Governance	8
UN Global Compact	2

Engagement by contact type

Analysis (no actual contact with company)	2
(Open) Letter	3
Meeting at company offices	3
E-mail	17
Active voting	2
Shareholder resolution	
Conference call	8
Speaking at a shareholder meeting	
Meeting at Robeco offices	4
Speaking at conferences	

Engagement results per theme



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Introduction

Robeco places great value on external verification of the quality of our active ownership approach. That's why, each year, we dedicate a significant amount of time to answering the annual United Nations Principles for Responsible Investment questionnaire. This year, we are delighted to report that the UN PRI granted Robeco the highest score for all aspects of its sustainability investing approach, including strategy and governance, ESG integration and active ownership.
We view Robeco's consistently outstanding scores as a credible recognition of Robeco's approach to active ownership and the services we offer our clients, and are delighted that for another consecutive year our approach to being active owners of the securities held in our clients' portfolios has been awarded the highest possible score by the PRI.

Ten years since the financial crisis began, the importance of Active Ownership, I would argue, is greater than ever. Investors need to understand and address not only good corporate governance and risk management, but also take into account a broader set of material sustainability criteria, and ensure that the biggest such risks are mitigated within their portfolios. Active ownership is one key way in which this can be achieved.

We therefore continue to look forward, not back, to continually improve the quality of our voting and engagement approach. As with every quarter, in our active ownership report, we update you on the most recent status of a selection of the engagement themes that we run on our clients' behalf. From sugar taxes to managing one of the world's most pressing concerns, global waste, we always aim to ensure that the most material ESG issues in our clients' portfolios are addressed in our engagement program.

Carola van Lamoen
Head of Active Ownership

Voting Highlights

Proxy voting is an integral part of Active Ownership. The aim of our voting activities is to encourage good governance and sustainable corporate practices, which contribute to long-term shareholder value creation. During the quarter, we voted at 57 shareholder meetings, voting against at least one agenda item in 72% of cases. Below we provide some highlights from the quarter.

Codes of conduct
- ICGN Global Governance Principles

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

A decade after the collapse of Lehman Brothers, Masja Zandbergen and Kenneth Robertson explain why governance is so crucial for the banking sector.

How time flies – last weekend the 10th anniversary of the start of the global financial crisis took place, when global markets plummeted after Lehman Brothers filed for Chapter 11 bankruptcy protection on 15 September 2008. Having gone through the Asian crisis and the dot.com bubble, this was not the first market crash I had experienced. However, the implications of this crash, which was the onset of one of the largest financial crises in living memory, were much wider-reaching. I would expect and hope that the financial community has learned from this experience... it has certainly affected the way we analyze the financial industry from an investment perspective. In this article, we discuss our view on corporate governance in the financial sector, and why we engage with banks on ESG issues.

Far-reaching governance impacts

Aside from its immediate and far-reaching consequences, the crisis provoked serious discussion as to the role that poor corporate governance practices played in the crash. Ten years on from Lehman, board composition and the appropriateness of incentive

structures remain a key focus of our voting approach.

The failure of boards to sufficiently understand and mitigate risks was seen as one contributing factor to the financial crisis, highlighting the strong financial materiality of poor corporate board oversight. Since then, the financial industry has undergone significant change. The assessment by policy makers across the globe that banks had been allowed the opportunity to take excessive risk led to significant changes in regulation, which have in turn affected corporate governance regimes at many major global financial institutions.

Having the right skills in place

Understanding the quality of a company's corporate governance, and therefore its ability to understand and mitigate the key risks facing their organization, forms a critical part of our voting approach. In one way or another, many of the failures of the global financial crisis of 2008 could be in some way related to the nomination process of the companies concerned. For example, prior to filing for bankruptcy, the board of Lehman consisted of ten people, of whom nine were retired, four were over 75 years of age, and only two had experience in the financial industry. The audit committee included a theater impresario with no background in the fields of banking, risk management or audit. Clearly, this was not to be considered a case of best practice. So what, when reviewing the boards of today's banks, is?

We believe the role of the nomination policy is crucial to ensuring that risks are reduced by having the right skills mix, competencies and independence at both the supervisory and executive board level. Specifically, the transparent and considered approach of recommending directors to specific roles needs to be in place to manage these very issues. Using an appropriate and well-structured nomination process is therefore key in ensuring effective long-term risk management in the sector.

In our voting approach, we pay particular attention to the skills of nominees to the board's audit, risk and credit committees, to ensure that the composition of the board includes those with a deep understanding of risks, and how to mitigate them. In particular, we look for nominees with strong backgrounds within the sector and geography within which the companies operate, as well as outside experts with the knowledge to challenge prevailing assumptions about a company's risk appetite.

Independence is key

While the right skills are important, board members must also be able to raise their concerns as and when they see them. Board independence is therefore another aspect of corporate governance that is of particular importance in mitigating risk. Yet, many financial institutions, particularly in the US, continue to grant a dual mandate to their CEOs, allowing them also to sit as chairman of the board. To achieve effective management supervision, it is very important that the board can exercise independent judgment, and is free of conflicts of interest. It is of the upmost importance that the board is in a position to act as sparring partners for the management team, and that the CEO is accountable to a board composed of members who have an in-depth understanding of the business and the topics at hand, whilst also possessing sufficient independence to oppose senior management when things go wrong.

You get what you pay for

Still, managing risk involves more than simply taking a best practice approach to board composition. A plethora of examples exist where excessive risk-taking that is encouraged and incentivized by poorly constructed compensation plans has led to negative impacts on a company's (and particularly a bank's) bottom line. If companies over-incentivize excessive risk taking in the way they pay their senior management, excessive risk taking will in all likelihood take place. Many have argued that corporate remuneration structures have incentivized CEOs and top executives to take excessive risks, and played an important role in the significant losses incurred in 2008.

It is therefore a critical component of our voting approach to heavily

scrutinize the executive pay plans of the companies in which we and our clients are invested. We focus our analysis on symmetrical alignment with investor interests, and on comprehensive disclosures by the remuneration committee about executive performance evaluation. Risk-adjusted metrics also play an important role.

Lessons learned?

Overall, we see that, on the whole, board composition practices have improved in the 10 years following the 2008 crisis. In particular, regulation has led to boards nominating more members with financial expertise than in previous years. Yet, it is still difficult to understand what goes on behind closed doors, and therefore to assess the quality of the board. In this regard, disclosure of board self-assessment results represents the next step forward for investors in understanding how risk is mitigated at board level.

Executive compensation also remains a key concern, in both our voting and engagement approach. The topic therefore plays a key role in our engagement theme: Risk Governance and Culture in the Banking Sector. This program aims to grasp how banks are setting their risk tolerances, implementing compliance and risk management systems, and managing their culture. Engagement on this topic is necessary because the quality of a company's risk management framework and the nature of its culture cannot be captured by only studying annual reports, risk statements and other company documents.

A tick-box approach to corporate governance is one thing, and while conflict-free boards and having the right KPIs in remuneration policies are important, the real issue of course lies in the culture. That's why, in our engagement approach, we look at a wider range of factors, including culture, how people are incentivized via non-financial criteria, and the tone from the top. People in the financial industry should realize that finance is not a goal in itself, but merely a tool to create socio-economic prosperity for all stakeholders.

ESG Challenges in the Auto Sector

2016 was a record year for recalls in the US, both by the number of recall campaigns and the number of vehicles affected. As much as 20% of all cars in service in the US were subject to recalls, costing carmakers and suppliers USD 22.1 billion – a 26% increase over the previous year. These recalls can be very costly, affecting an automaker's bottom line, the company's stock price, or both. This is perhaps best illustrated by Toyota's recall crisis of 2009-2013, where vehicles affected with unintended acceleration (a fault that resulted in casualties and injuries), led the company to recall 9 million cars globally and suspend production of some of its most popular models in some markets. Toyota's shares dropped 20% in a month and worldwide sales declined by almost 20%.

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

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

Experts suggest that the high volume of recalls is likely to continue. Firstly, a key driver behind this trend is the growing level of complexity of vehicles and the increasing number of electronic components supplied by multiple parties in the supply chain. Secondly, cost-cutting by car manufacturers can also be said to play a role in the increase of recalls. AlixPartners estimates that global carmakers have cut between a third and a half of their employees in their quality management divisions following the financial crisis. Furthermore, staff numbers have not reached pre-crisis levels despite observing growth in the sector, primariliy because of the industry's need to invest in new technologies, like electric vehicles and self-driving capabilities.

Opening up the black-box

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

on warranty and liability expenses, there are very few disclosures on product quality.

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

Getting it right the first time

Minor defects and malfunctions are impossible to fully prevent. But a carmaker can become exposed to significant financial risk when a defect is known to endanger many people, is expensive to repair, or when the company has been aware of the defect for a long time before it was disclosed or otherwise discovered. Yet, some carmakers have product quality management based on a zero-defect ambition. Although their zero-defect ambition is not achieved in practice, these carmakers actually have an above-average performance relative to peers in terms of lower number of 'things gone wrong' during the first 200,000 kilometers driven. In our engagement, we learned that this zero-defect ambition in practice means integrating quality targets at each stage of vehicle development, from the design phase and assembly, to delivery and use by customers. While setting a zero-defect target does not translate into better performance, it may say something about the attention paid to product quality and being more successful in translating this high-level ambition into effective internal controls and processes.

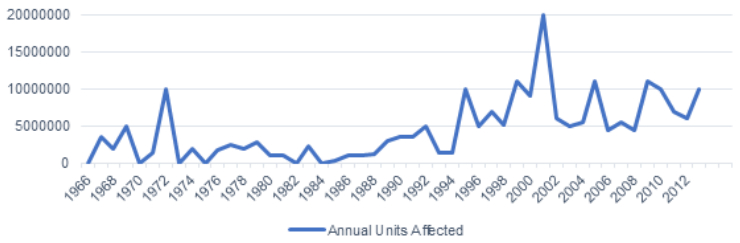
Knowing when to act

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

Not all recalls are the same

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

Time Series Summary of Recall Trends in the US 1966 - 2012



Source: Society of Automotive Analysts/NHTSA data

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

Emphasis on transparency

For investors it is very challenging to assess the level of carmakers' preparedness to respond to vehicle defects. Our engagement is allowing us to gain a better view of how product quality processes and controls work in practice. Nonetheless, more transparency on defect-rates of vehicles and recall campaigns initiated, both voluntarily and mandated by a transport safety agency, would be helpful in this assessment. Existing disclosures vary from one carmaker to the other, making it hard to make comparisons and draw reliable conclusions. In our engagement we are encouraging companies to increase their disclosures on product quality and recalls data. We will continue our dialogue and communicating our progress in the coming two years of our engagement.

SPOTLIGHT ON

Product Quality in the Automotive Sector

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

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

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

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

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

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

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

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

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

The best form of wage management: don't produce it

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

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

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

Waste management is linked to at least 12 UN SDGs

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

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

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

The objectives of our engagement

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

The five engagement objectives are:

1. **Environmental Impact Assessment**
   We want companies to conduct an Environmental Impact Assessment based on analysis of a product's life cycle and production processes. We want them to disclose the cost and volumes of the resources used, and its environmental impact,, the use of the product and its 'end of life' impact, including the availability of recycling or takeback initiatives.
2. **Environmental Strategy**
   With the outcome of the Environmental Impact Assessment, companies should set targets to reduce their footprint, increasing efficiency of resource use and reducing their operating costs as a result. We want companies to use circular economy principles to reduce resource use rather than deal with the waste it generates afterwards.
3. **Sustainability Reporting**
   We expect companies to continually improve their sustainability reporting and provide disclosure on key ESG issues in addition to annual financial disclosure. We would like to see better disclosure of energy use and CO2 emissions, and encourage companies to quantify their SDG contribution.
4. **Corporate Governance**
   We will assess the effectiveness of individual companies' corporate governance practices, in particular, their management and supervision of ESG issues – through an assessment of board composition (skills, tenure, diversity etc.), and incentive structures, focusing on the use of non-financial metrics in long-term executive compensation schemes where applicable.
5. **Social Impact**
   We will encourage companies to increase their human capital management performance, and reduce labor risks in their supply

chains. Where relevant, we will address the use of resources extracted from war zones (conflict minerals) and other supply chain management issues.

Baseline analysis

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

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

Social Risks of Sugar

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

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

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

Legislating sugar consumption

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

Companies producing packaged foods operate in an environment where they face growing pressure to reformulate their products. The World Health Organization (WHO) has included safe levels of sugar intake in its dietary guidelines, and is contemplating a further tightening of its standards. We have also seen an increase in sugar taxes around the world, most notably the one introduced in April 2018 in the UK.

Product reformulation

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

where the product has sugar or other ingredients removed without drawing attention to it on the packaging or marketing messaging.

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

Impact of UK sugar tax

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

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

The effect on sales for many companies has been immediate and clear. Pepsi and Coca-Cola saw their volumes decline by 2% and 1% respectively, while all other major brands saw a positive impact on volume sales. This leads to a first conclusion that the introduction of the levy has had a clear impact on the soft drinks category, based on data up to the end of Q2 2018.

Impact of sugar tax in other countries

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

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

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

Staying in line with consumer preferences

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

Next phase in our engagement

In the coming 18 months, we will continue to engage with the companies in our peer group to reduce the

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

INVESTOR SPOTLIGHT

Amir Maani Shirazi, Analyst, Global Credits, and
Stephen Verheul, Analyst, Global Credits

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

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

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

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

Corporate Governance in Asia

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

Codes of conduct
- 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.

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

South Korea's new President Moon is a liberal committed to openness, and there have been widespread public and investor expectations of significant reforms of the 'chaebol' – large industrial conglomerates that are controlled by a family. Almost all equity investors in Asia are shareholders in several South Korean companies which are either chaebol holding companies or subsidiaries of them. These include large, household names such as Samsung Electronics, LG and Hyundai Motor. Although investors are happy to own these companies because they produce globally competitive technologies and products, they also suffer from several issues including weak governance, poor shareholder communication and poor capital management.

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

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

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

The reality is that Koreans themselves have conflicted attitudes towards the chaebol, and this is reflected in policy making and enforcement. For decades, Koreans have witnessed a parade of chaebol chairmen go in and out of courthouses facing charges on a myriad of economic crimes, but a serious judicial outcome is still considered unusual. The imprisonment of the CEOs of the SK Group and CJ Group in 2013 and 2014 respectively for white-collar crimes, came as something of a shock because they marked a shift from this convention. Similar responses were observed more recently by the conviction and subsequent pardon of Samsung Electronics' Vice-Chair. While there is widespread resentment of the chaebols' monopolistic behavior, many Koreans still aspire to work for them, and critical press coverage is often also inconsistent.

Robeco's recent active ownership activity in South Korea has two primary objectives:) the disclosure of corporate strategy and) improving capital management. While we also engage with both policymakers and our portfolio companies in South Korea to improve board independence and quality, we do not underestimate the cultural/structural barriers and lack of incentives for meaningful reform. We are mindful that chaebol reforms could have limited impact, even after the 'transformation' of holding companies and apparently 'straightforward' objectives like increasing dividend payouts. This is due to the varying incentives for the founding/controlling families, and how management control is exercised.

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

CG Watch market scores: 2010 to 2016 (%)

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

Source: Asian Corporate Governance Association (ACGA), 2016

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

Reducing global waste
SunPower Corporation

Climate Action
Chevron
Royal Dutch Shell

Environmental Challenges in the Oil and Gas Sector
ConocoPhillips
ExxonMobil
Royal Dutch Shell
Total

ESG Challenges in the Auto Industry
Bayerische Motoren Werke

Climate change and Well-being in the Office Real Estate Sector
Great Portland Estates Plc

Improving sustainability in the meat and fish supply chain
DSM

ESG risks and opportunities in the biopharmaceutical industry
Biogen IDEC, Inc.
Johnson & Johnson

Social risks of sugar
Nestlé
Unilever

Corporate governance standards in Asia
Hyundai Motor
Samsung Electronics
SK Holdings Co. Ltd.

Good Governance
DSM
Royal Dutch Shell
Samsung Electronics
Unilever

Tax Accountability
Biogen IDEC, Inc.
Johnson & Johnson
Nestlé
Pfizer

Culture and Risk Governance in the Banking Sector
Barclays Plc
JPMorgan Chase & Co., Inc.
Wells Fargo & Co.

Global Compact breaches
During the quarter, six companies were engaged on behalf of Border to Coast Pension Partnership for potential breaches of the UN Global Compact.

Robeco's Engagement Policy

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

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

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

The UN Global Compact

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

Human rights

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

Labor standards

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

Environment

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

Anti-corruption

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

Other relevant codes of conduct

International codes of conduct

Robeco has chosen to use broadly accepted external codes of conduct in order to assess the ESG responsibilities of the entities in which we invest. Robeco adheres to several independent and broadly accepted codes of conduct, statements and best practices and is a signatory to several of these codes. The most important codes, principles, and best practices for engagement followed by Robeco are:

- International Corporate Governance Network (ICGN) statement on Global Governance Principles
- United Nations Global Compact
- United Nations Sustainable Development Goals
- United Nations Guiding Principles on Business and Human Rights
- OECD Guidelines for Multinational Enterprises

In addition to our own adherence to these codes, we also expect companies to follow these codes, principles, and best practices.

Robeco's Voting Policy

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 exercise of voting rights is limited to those companies held in our portfolios. This concerns shares held in the mandates of our clients, where Robeco has been requested to vote on the client's behalf. By making active use of our voting rights, Robeco can, on behalf of our clients, encourage the companies concerned to increase the quality of the management of these companies and to improve their sustainability profile. We expect this to be beneficial in the long term for the development of shareholder value.

Collaboration

Where necessary, Robeco coordinates its engagement activities with other investors. Examples of this includes Eumedion; a platform for institutional investors in the field of corporate governance and the Carbon Disclosure Project, a partnership in the field of transparency on CO2 emissions from companies. Another important initiative to which Robeco is a signatory is the United Nations Principles for Responsible Investment. Within this context, institutional investors commit themselves to promoting responsible investment, both internally and externally.

Robeco's Active Ownership Team

Robeco's voting and engagement activities are carried out by a dedicated Active Ownership Team, working in close collaboration with Robeco's Investment Teams, and RobecoSAM's Sustainability Investing Research team. This team was established as a centralized competence center in 2005. The team consists of 12 qualified active ownership professionals based in Rotterdam, the Netherlands, and Hong Kong. As Robeco operates across markets on a global basis, the team is multi-national and multi-lingual. The team is headed by Carola van Lamoen.

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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