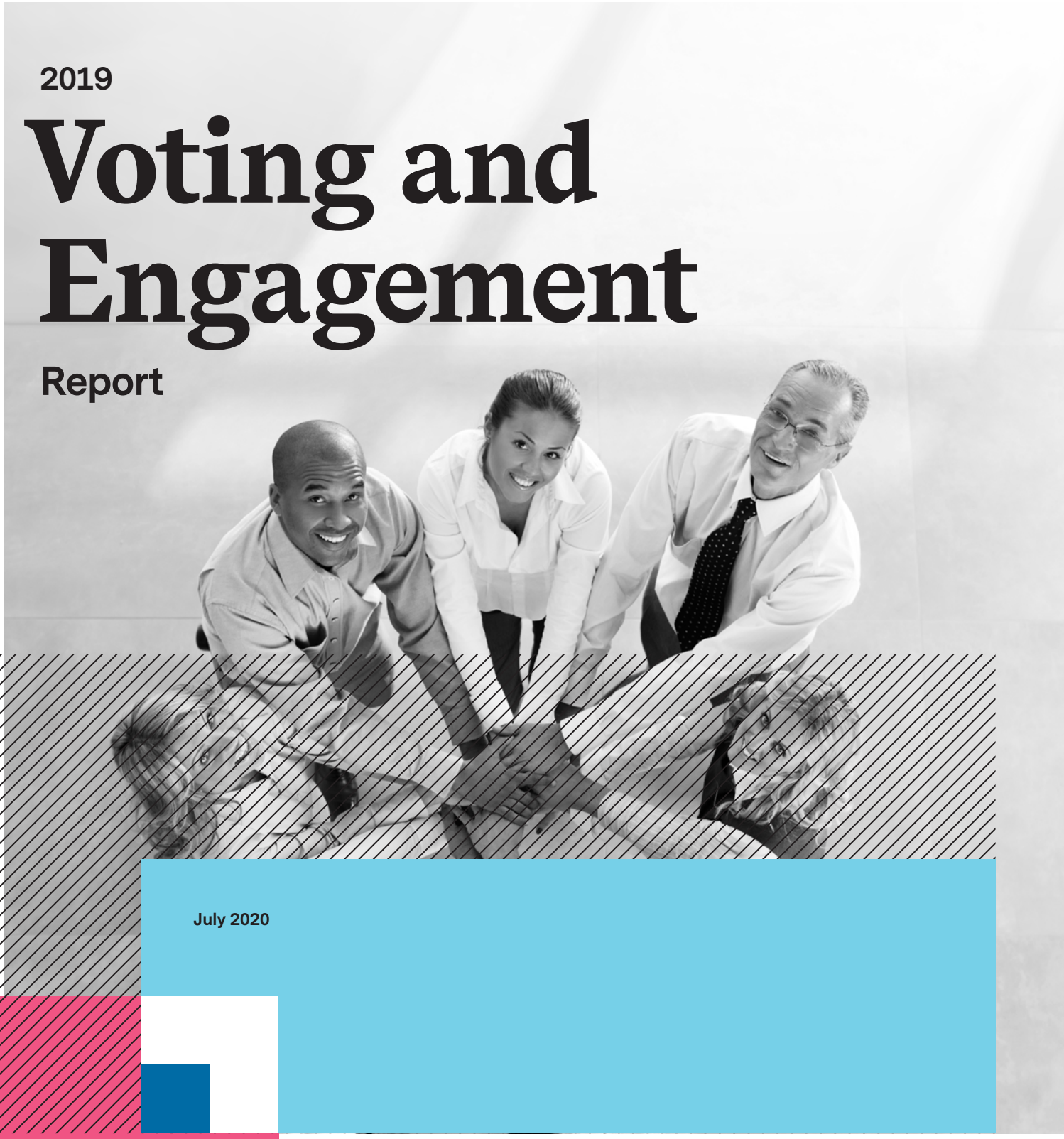
Vontobel

2019

Voting and Engagement

Report



July 2020

Asset Management

Voting and Engagement

Overview

As a signatory to the UN Principles for Responsible Investment, Vontobel Group commits to being an active owner and to incorporate environmental, social, and corporate governance (ESG) issues into its ownership policies and practices. We believe this is important for the development of sustainable economies, societies and the environment, and that material ESG issues can impact the future success of a company and, therefore, its investment potential.

Vontobel Asset Management (Vontobel) is an active asset manager and strongly believes in the fundamental analysis and monitoring of investee companies. Vontobel's portfolio managers invest in the bonds and equities (or similar instruments) of companies after seeking to gain a deep understanding of a company's business strategy, risks, capital structure, and corporate governance structure.

Vontobel is committed to integrating ESG factors into the investment processes where appropriate. We believe an effective identification of material ESG risks requires thorough analysis and continuous monitoring. See also our Vontobel Group Sustainable Investing Policy.

Vontobel considers engagement to be an important element of its investment activities. As an active manager, Vontobel generally prefers to engage with the managements of investee companies directly. Vontobeldoes not have a standalone engagement team. We believe in direct contact between investee company management teams and investment professionals such as portfolio managers and analysts who have the specific expert knowledge and understanding of the context in which the company has been selected as an investment.

In addition, our investment teams have access to proxy voting and engagement service providers to support them in their engagement activities and decision-making processes.

Use of proxy voting advisors

The Sustainable Equities boutique partnered with Hermes Equity Ownership Services (HEOS) in 2011 in order to improve the quality of our voting decisions and the breadth of our engagement. HEOS helps institutional shareowners around the world meet their fiduciary responsibilities and become active owners of the public companies in which they invest. The selection of HEOS followed a comprehensive internal research process evaluating the different proxy voting and engagement services available in the market to select the solution that fit closest with Vontobel's aims and methodology.

Next to HEOS, Vontobel also has engaged with Institutional Shareholder Services, Inc. (ISS), and Ethos Services SA (ETHOS) for our Swiss domiciled funds, who are also specialized in the exercise of voting rights and also provide research services.

All equity positions held by Vontobel are executed in line with the Vontobel Voting Policy. This voting policy follows, among others, the recommendation for best practice on corporate governance published by the European Fund and Asset Management Association.

Further documentation on Vontobel's funds and sustainability practices, including our voting and engagement policy statements, are available at: https://am.vontobel.com/en/sustainable-investing.

Voting and engagement process

The proxy service providers provide Vontobel and its responsible portfolio managers with their recommendations on how they intend to vote. If the portfolio managers disagree, which may occasionally happen if the standard recommendation does not match the portfolio managers' in-depth knowledge of a company and its management, the portfolio manager can change the vote directly within the online proxy-voting platform.

The portfolio manager[1] will notify his final proposal to vote in writing and by providing justification for any choices that deviate from those recommended by the engaged proxy-voting service provider. The respective management company will validate the justification and coordinate with the depositary bank on all further steps. Each deviating advice on the exercise of voting rights must be documented by the portfolio manager and the documentation has to be provided to the management company in each particular case on a timely basis.

This process ensures that we execute all of our voting obligations while maximizing efficient use of Vontobel's resources by freeing the investment team of the administration effort and basic research required for dealing with the majority of proxy votes, but retaining the authority for portfolio managers to personally make a decision in the interests of our investors on the issues we think are most important.

Formal engagement programs are carried out by HEOS. The company seeks a balance between direct corporate engagement, ensuring its clients' major holdings are covered and focus on activities which add the most value to its clients' holdings from a risk management point of view, and public policy/best practice engagement, which if effective can positively benefit all companies in the affected region or sector. Such programs often take place over a number of years and on a variety of issues, particularly with companies in regions or sectors where transparency is poor.

By partnering with HEOS, we are able to participate in many more engagements than we could undertake internally, we benefit from the greater influence that the combined shareholding of all HEOS clients has compared with our individual holding, and support engagements with companies that do not currently meet the standards for our sustainable funds but may do so in future if they improve their performance on ESG factors.

In addition, Vontobel analysts and portfolio managers are encouraged to engage informally on relevant topics with the management of companies in the course of their fundamental research. Our analysts regularly contact companies in order to learn more about governance standards or environmental performance and receive relevant information that is not covered in company reports.

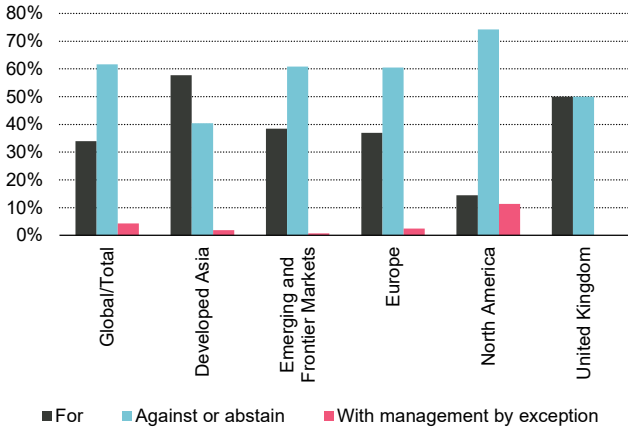
The next pages outline the voting records for ISS and HEOS, and engagement examples from our Sustainable Equities boutique as well as the Quality Growth boutique. The voting results for our Swiss domiciled funds are available on request.

Further documentation are available at:
https://am.vontobel.com/en/sustainable-investing

Voting record and engagement – Hermes

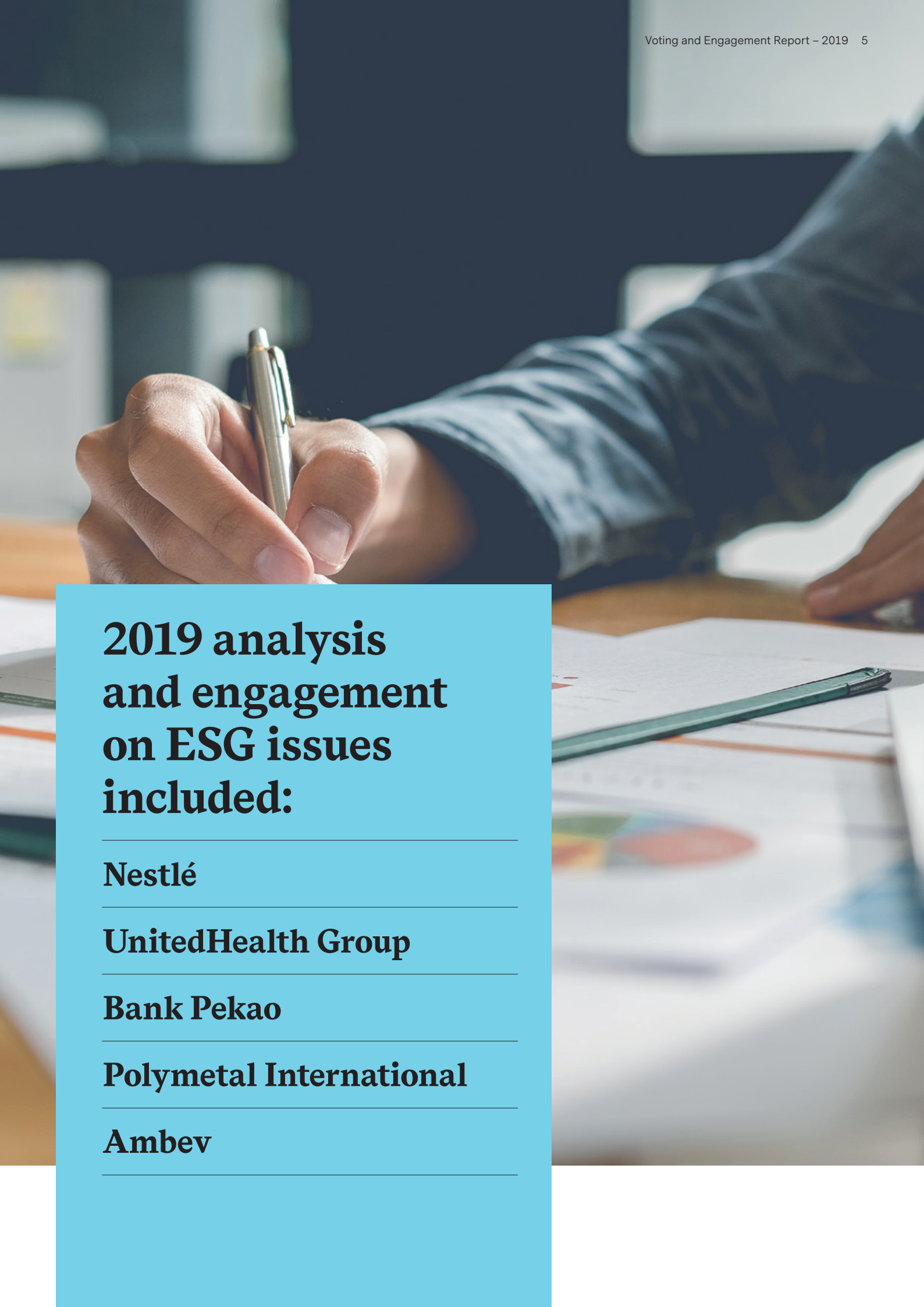
During 2019, we voted at 463 company meetings worldwide on 5,817 resolutions. At 279 of those meetings, we opposed one or more resolutions. We voted with management by exception at four meetings and supported management on all resolutions at 180 meetings.

Voting decisions by region (in %)



Source: Hermes EOS for Vontobel AG, 2019.

[1]The Portfolio Manager is responsible for investment management of the sub-fund. Portfolio managers are usually employed within the Vontobel Group.

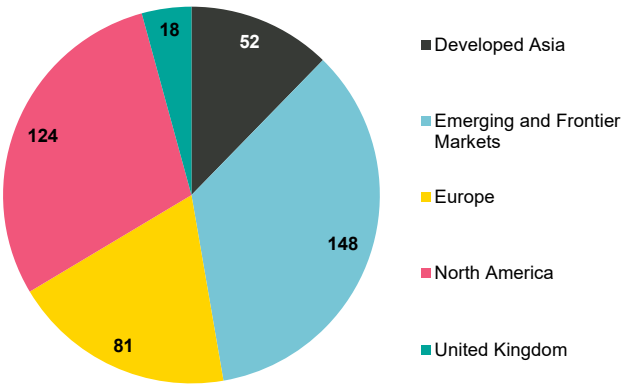


2019 analysis and engagement on ESG issues included:

- Nestlé
- UnitedHealth Group
- Bank Pekao
- Polymetal International
- Ambev

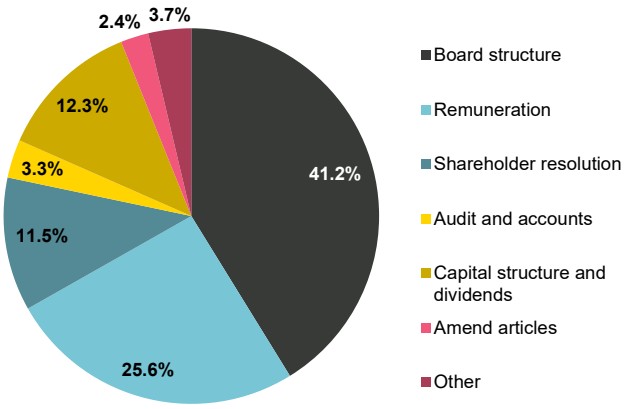
Voting activities

Company meetings voted worldwide



Source: Hermes EOS for Vontobel AG, 2019.

Voted against or abstained by issue



Source: Hermes EOS for Vontobel AG, 2019.

Engagement activity in 2019

In 2019, HEOS engaged on our behalf with 38 companies in Vontobel Sustainable and Thematic Investing portfolios, on a range of 134 environmental, social, governance, strategy, risk, and communication issues. Engagements with companies typically involve more than one issue simultaneously and are in addition to any discussions surrounding voting matters. Governance issues were the biggest concern; these represented 35.8% of all engagement issues. Remuneration continued to be a key issue in many markets, particularly in the UK. Executive pay plans are complex and difficult to understand and they are often misaligned with the interests of long-term shareholders and the performance of companies. HEOS published remuneration principles for clarifying expectations to overhaul executive remuneration structures so that they better align management with the interests of their long-term shareholders and factor in issues of fairness.

Social and ethical issues were the next largest group, covering issues such as human rights, labor rights, and supply chain management issues such as child labor.

Given the introduction of legislation on modern slavery in the US and the UK in 2015, engagements on human rights made up a large part of social engagements in 2018. HEOS engaged with the communities living in proximity to their operations and built good relationships with them.

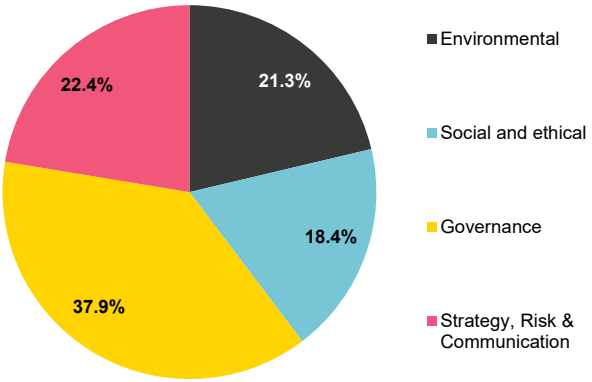
On strategy, risk, and communication, HEOS continued to encourage companies to produce integrated reports to take into account equally their financial and material environmental, social, and governance risks. HEOS also requested companies to set and report on sustainability targets and urged for more disclosure on audits, including reporting on the non-audit fees paid to auditors.

Environmental engagements in this area typically seek the disclosure of relevant environmental indicators and encourage companies to develop plans for managing their environmental footprint, set appropriate targets, monitor and disclose progress. In addition, HEOS encourages companies to disclose explicit and practical examples of how they manage environmental risks and press for board involvement in overseeing progress. In 2018, HEOS pushed for enhanced disclosure of climate-related risks and sought greater transparency on stress-testing and portfolio resilience in a range of carbon-constrained scenarios at companies where the issue is particularly material. HEOS engaged with automotive companies globally on their adherence to emissions standards and their commitment to sustainable drivetrain technologies.

Progress on engagements is measured by a series of milestones, marking events such as companies acknowledging the issue, committing to making improvements, and actually implementing the improvements.

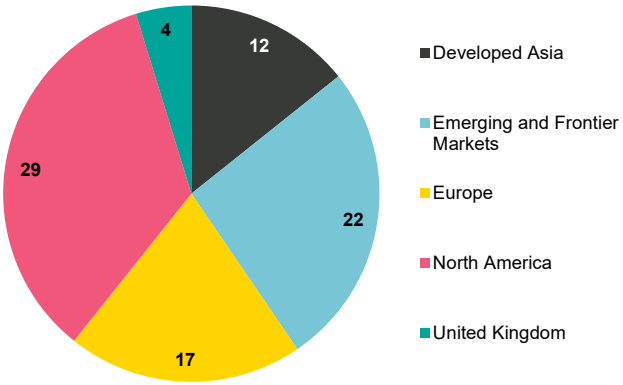
In 2018, HEOS made progress on 49% of its ongoing engagements.

Engagement themes worldwide



Source: Hermes EOS Report for Vontobel AG, 2019.

Engaged companies by region

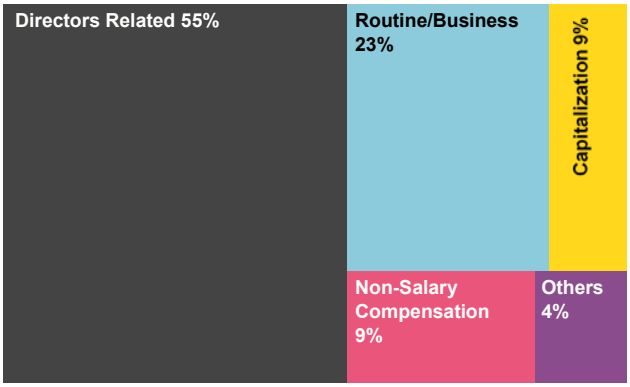


Source: Hermes EOS Report for Vontobel AG, 2019.

Voting record – ISS

As investors, we express our views through votes. Over 2019, we voted on 2,322 proposals across our Quality Growth strategies in aggregate. While we use the research and services of proxy advisory firms, we have full independence to vote in the way we see fit to represent the best interests of our investors. We use the services of ISS for the placement of our proxy votes and storage of our voting records. In 2019, as outlined in the following table, more than half of the votes we placed related to directors, including elections and remuneration.

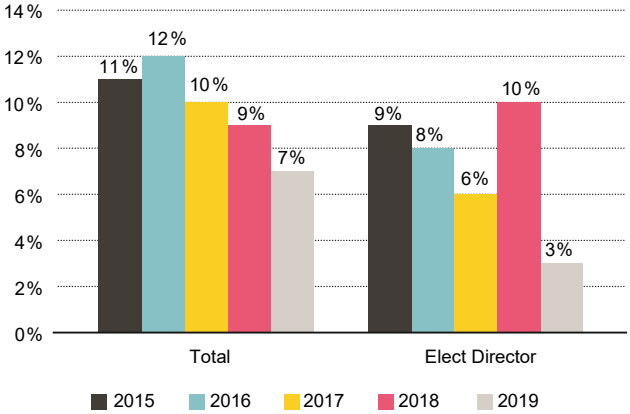
Proportion of vote proposals by subject



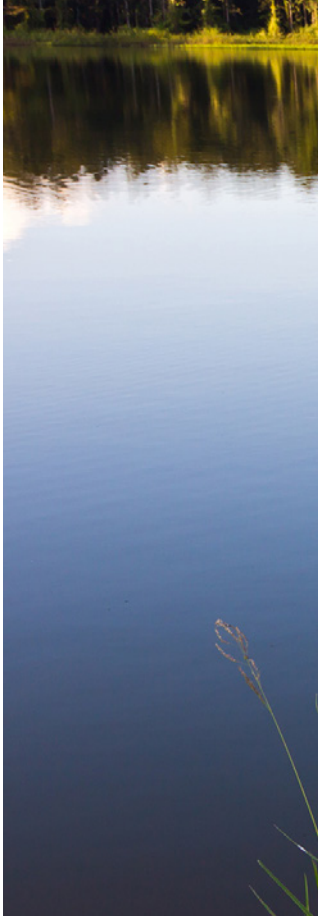
Source: ISS.

In 2019, some 7% of the votes made were "against" proposals. The against proportion of votes came down in 2019 to the lowest level in the past five years. The fall in against votes has been primarily due to a lower proportion of votes against the election of directors. The against votes for director election was 3% in 2019 (33 votes against – ISS code M0201 Elect Director), well below the 9% (75 against votes) in 2015. While we see this direction as positive because boards are paying attention to suitability, it is still too short a time period to classify this trend as a structural shift. But, in our view, it is a move in a positive direction. There was also a fall in the number of votes related to anti-takeover proposals. We believe this resulted from reduced M&A activity around portfolio holdings, but this was a smaller category by the number of votes compared to that for director elections.

Voted against proposals 2015–2019



Source: ISS, Vontobel Asset Management.



Nestlé – pressure on water sources in the US

Swiss-based Nestlé is the world's largest food and beverage company with sales across 190 countries and revenues of 93 billion US dollars in 2019. It produces a wide range of food products including beverages, milk products, pet care, prepared dishes, confectionery, and water.

The company has a strong philosophy of sustainability, reflected through its mission statement "Good Food, Good Life". In general, Nestlé has a strong ESG profile, which can be challenging for a company with significant scale built on products, such as food, where commodities are an important input. Nestlé uses a substantial quantity of water for ingredients, cleaning, and it is a product in its waters division. The company reported that it reduced its water consumption per ton of food by 30% between 2010 and 2018. However, its draw of spring/groundwater for use as a product (bottled water) has led to a number of issues in North America.

Nestlé Waters

Although it is the smallest of the company's divisions, Nestlé Waters is the largest bottled water company in the world. It has 52 brands with its product portfolio split between premium brands such as Vittel, Perrier and S. Pellegrino, as well as a range of regional spring/groundwater brands, including Poland Spring and Arrowhead in the US. The water segment was the slowest growth division for the year to September 2019, accounting for roughly 8% of Nestlé's total revenue for the year. Growth from premium brands was offset by falling sales from its more affordable brands. Geographically, 55% of Nestlé Waters' revenue came from North America in 2018.

Controversies surrounding water extraction in the U.S.

The bottled water industry has come under pressure in recent years as it faced scrutiny over plastic usage and water sustainability. Water scarcity is a sensitive issue as its impact can be felt throughout local communities, especially during periods of drought. In the U.S., water permits are issued at the municipality level, so Nestlé has faced challenges from different jurisdictions each with its own circumstance.

In 2015, the Nestlé Waters bottling operation in southern California faced intense scrutiny from conservation groups when it was revealed that its water permits had long expired while it continued pumping. This led to a multi-year process of negotiations on permit rights between the company, local and federal authorities, and conservation groups. The authorities eventually issued a new permit for Nestlé in 2018, although for a short three-year period and with conditions that would be imposed during droughts. The clash over Nestlé's water bottling operation is one of a number across the US with other issues reported in Michigan, Arizona, and Florida.

Another water-related issue centers around how municipalities are pricing the permits to extract ground or spring water. Water permits in the US are often issued for long periods and historically the rates charged by local authorities have tended to be low. At the same time, many municipalities are facing the need to reinvest in aging water infrastructure for necessary maintenance. This has the potential to create an awkward situation where municipalities will sell high-cost water to residents while selling low-priced water to private bottling companies.

Deep-dive research into the issues

To understand the underlying drivers of water risks and the potential pressure points that can affect Nestlé Waters' business, we spoke on this subject to industry veterans, water rights attorneys, lobbying groups, investigators, and scientists across different municipalities.

We see the risks associated with bottled water in the US as slow moving in most cases. There are challenges coming from anti-water groups that could raise costs for the company and risk damaging the brand – but we see this as a separate issue. In some cases, there is evidence of a fall in water supply, backed by a scientific approach, which raises real concerns. This tends to impact regions with less rainfall, such as Arizona and California, or poor infrastructure, such as Michigan.

The potential impacts for Nestlé include: higher prices paid for water supply from either higher prices through taxes or having to ship water from further afield, falling demand for bottled water, and potential for reputational damage. As a result, we believe the potential for operational damage is not significant. However, reputational damage could be a serious issue for the company's brand.

Engagement with Paul Bulcke, Chairman

In December 2019, we had the opportunity to speak with Mr. Bulcke, Chairman and former CEO, on the subject of water. Mr. Bulcke was well aware of the problems and is not happy with them. He mentioned that management does not see Nestlé as focused on a commodity business and that they are not that comfortable with how the ground/spring water part of the business has become commodity like. This is not the traditional core approach that Nestlé is known for. He mentioned that Nestlé is known for a high-quality and innovative collection of products.

As the chairman of a listed company, Mr. Bulcke could not say much beyond this regarding Nestlé's strategic plans for the water division without making a public announcement.

In our view, we can see management shifting its focus towards premium water brands where there is higher margin and away from the lower value-add products, such as the spring/ground water brands in the US. We would not be surprised if Nestlé decided to scale back on the lower-end water business or exit it altogether in the future. We believe management is taking the issues around water seriously, which can be seen by the fall in Nestlé's water intensity across its business. We will continue to monitor the company's progress in water sourcing.

UnitedHealth Group – political risk to the US healthcare system

The US is the only developed market without universal healthcare coverage, although the federal government covers about half of all medical spending. The issue has sparked division and heated debate among 2020 presidential contenders. With a US election in 2020 and the possibility of a change to the structure of the healthcare industry, we wanted to understand the potential risks the US healthcare market faces and how it might impact insurance giant UnitedHealth Group, which we hold in certain portfolios.

We spoke with a variety of hospital administrators, government employees, healthcare economists, doctors, insurance specialists, and others in Canada, Germany, Austria, Australia, New Zealand, Korea, and the United Kingdom. As a result, we discovered many are looking toward the US and the structure of the Affordable Care Act (ACA) as a new blueprint for managing costs and delivering care. The ACA moved payments toward value-based care (all-in costs for a given outcome) and away from fee-for-service with the aim of reducing the overuse of drugs, hospital beds, services, etc.

To start with, it is important to note some basic differences between the US health insurance market compared to insurance products in other developed markets dominated by government-run health schemes (also referred to as Single Payer). These markets do not generally have mass-market insurance products. They are typically aimed primarily at wealthier customers for elective or specialist surgery.

We engaged with UnitedHealth's management to get a read on the US political landscape from their vantage point. We covered how the company engages with Washington policymakers and makes its case for a public/private solution. Some takeaways from that discussion are:

1. United Healthcare argued that the private insurance sector is better equipped with manpower and wherewithal to administer payments and manage costs than the government. For example, United Healthcare has 300,000 employees including 85,000 medical staff and a "vast infrastructure" while the federal Centers for Medicare[1] (coverage for the elderly) and Medicaid[2] (coverage for the poor) have 5,000 employees. They believe they can drive better health outcomes and higher patient satisfaction for a lower cost.
2. Cultural differences matter. The company said they are working to drive better health outcomes, alongside better patient satisfaction and affordability. Difficult choices have to be made but if these can be done in a way that adds value to customers who can be healthier and stay in their homes for care then they feel this would be well received. This compares to some markets where waiting times for certain procedures can take more than a year.
3. The company conceded that Medicare and Medicaid are underfunded, which explains why states are moving toward managed care (i.e. Medicare Advantage). Due to its scale, particularly with huge databases of ailments, treatments, and outcomes, the company is able to provide cost-effective treatments that are guided by experience. They pointed out that the states are not equipped with A.I. or the volume of Big Data that the company has, which can establish the best care options.
4. The company is fully engaged with Washington, but is circumspect about radical change: "All the people here are involved [but] the reality is that in DC there is a very, very, very small chance that this will move forward."

This engagement helped deepen our confidence that the company would be well placed over the foreseeable future, despite an upcoming election where the structure of the healthcare market is a major headline issue. Regarding a structural change, we concluded that the financial markets were more nervous than was justified.

There are also important cultural differences. Government-run health care programs, many of which were launched decades ago, tend not to be stigmatized or polarized by politics the way they are in the US Many outside the US seem to accept that they pay for health care through taxes and that medical services will be rationed.

Even so, we found a broad belief from our sources that government-run systems are often plagued by fraud such as over-billing, inefficiency, and runaway costs. Benefit cuts, staffing shortages, and hospital bankruptcies also appear to be a problem. As the costs of health care rise, so do the taxes that pay for the programs. But, even as the funding has risen, there appear to be many examples of hospital failures in countries such as the UK and Germany. This has led to a lack of access to affordable health care and poor outcomes for certain communities.

Those in government and industry expressed concern that tax hikes will be needed to keep up with the rising costs of treating chronic diseases and aging populations. Some worried that those tax hikes will produce a backlash and test the patience of constituents who are paying for these systems, yet increasingly receiving less.

[1]Medicare: primarily health coverage for people over 65 years old.
[2]Medicaid: federal program of health coverage for lower income people.

Bank Pekao – second unexpected CEO change

Bank Pekao is the second-largest retail bank in Poland. The company was publicly listed in 1998, which was followed by UniCredit, an Italian bank, buying a strategic stake in the company in 1999. Bank Pekao developed a reputation as a conservative lender under the control of UniCredit. This was illustrated during the fast growth in Poland of home mortgages in Swiss francs. Homeowners benefited from low-interest rates but were exposed to exchange rate risk. This became a problem for Polish borrowers when the Polish Zloty devalued against the Swiss franc and the government required banks to compensate borrowers. Bank Pekao, as a conservative lender, had very little exposure to these mortgages. The company is also running a dividend payout ratio just below 100%.

In June 2017, UniCredit sold its 32.8% stake in Pekao to two Polish government-controlled investors: PZU (state-run insurance company) and PFR (a state development fund). This sale provided UniCredit with 55 bps of Common Equity Tier 1 (CET1) capital and transferred control of the country's second-largest lender to the Polish government.

At this point, we viewed the company as having become a State Owned Enterprise (SOE). There were concerns in the market, which we shared, that as an SOE Pekao may become a tool of government policy and be used to consolidate the banking market in Poland. We do not look at investing into SOEs as a problem as long as the interests of the controlling shareholders are predictable. However, within governments, decision-makers and priorities can change with little notice. So while we may invest in SOE banks, we need to remain vigilant.

In the same month the sale closed, a new Supervisory Board for the bank was voted in with four of its nine members coming from PZU and PFR. This was almost immediately followed by the replacement of the long-serving CEO, Luigi Lovaglio with a new CEO, Michal Krupinski. Mr. Krupinski was the previous CEO of the state insurance company PZU.

We met Mr. Krupinski both in his previous role at PZU and as CEO of Pekao. We recognized that while relatively young, his banking experience was decent, having worked with Merrill Lynch in Poland before becoming head of the Supervisory Board at Alior, another listed Polish bank of which PZU had purchased an important stake in 2015. Following conversations with senior management at both Pekao and PZU, we felt that the government was well aware of the value associated with well-run healthy banks. Mr. Krupinski mentioned that the conservative lending culture at Pekao is deeply entrenched and that he did not want this to change with the change in leadership.

The other question that has been concerning the market relates to the chance that Pekao could be merged with Alior. However, our concerns were calmed when the head of PZU made a statement that they intend to keep Pekao and Alior as separate entities. We had engaged with senior management at both Bank Pekao and PZU in 2017 and from the conversations, we felt the bank was well-run and that the fears of government conflicts of interest were not warranted for minority shareholders at that time.

Fast forward two years and in November 2019, CEO Michal Krupinski resigned abruptly along with two senior officers: the deputy chief and a management board member. The reason given for the departure was that Mr. Krupinski wanted to pursue a career outside of Poland. The bank's supervisory board appointed Marek Lusztyn, head of risk management, as the next CEO (acting CEO pending regulatory approval). The press* noted that the Ministry of State Assets had recently been reestablished under the leadership of Jacek Sasin, deputy Prime Minister. This ministry has stewardship of state entities. Any abrupt changes in the CEO role should raise red flags for investors. Bank Pekao has seen its leadership change twice in three years of government control. Given the potential interconnectedness between SOEs and political goals, it is important to establish (as best we can) the goals of the current responsible parties within the controlling shareholder. Under Mr. Krupinski's tenure, Pekao had not veered from its path as a conservative lender and earnings growth remained steady.

* www.bloomberg.com/news/articles/2019-12-01/pekao-s-new-ceo-to-keep-current-strategy-analyze-mbank-purchase

We held a call with CFO Tomasz Kubiak after the announcement of Krupinski's resignation. Mr. Kubiak said he does not believe Mr. Krupinski's resignation was politically motivated. While he was not able to explain why two additional senior executives had also left at the same time, he did point to the fact that acting CEO Lusztyn was a 20-year veteran of the group and had been running the risk department and that he did not appear as a risky political appointment.

We tend to agree, although the visibility of the government's motivations is not particularly clear. However, we see the government benefiting from a steady stream of dividends. A secondary benefit stems from Polish ownership over foreign ownership of a major banking institution. Foreign banks may become capital constrained through a banking crisis – as was the case for many country subsidiaries of European banks during the banking crisis. Although this should not really be enough on its own as Poland has its own Central Bank (Narodowy Bank Polski), it imposes required reserve levels as set by the Monetary Policy Council – but it's an important consideration for a government if the capital buffers had been too low.

Soon after taking the CEO role, Mr. Lusztyn confirmed the bank's financial targets remain unchanged. The bank is performing well with its selective growth strategy and has managed its costs effectively. We took this as a sign that the supervisory board was comfortable with the risk/return profile of the bank and the overall management team. With this view of the continuity of purpose, we believe the bank has a strong franchise.

Polymetal International – safety concerns on tailing dams

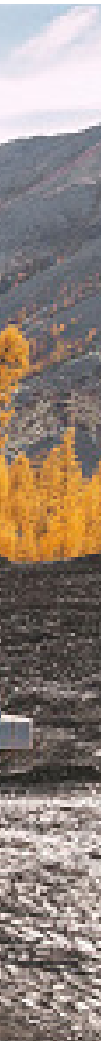
Polymetal International plc is a leading precious metals mining group operating in Russia and Kazakhstan. The company has a portfolio of nine producing gold and silver mines and a large pipeline of future growth projects. The company first appeared on the financial screens of mtx in 2018.

An initial ESG screening resulted in a positive opinion on how the company manages ESG issues and it passed our ESG MSF threshold. However, the concern about **Tailings Storage Facilities** (**TSF**) was growing after the collapse of the Brumadinho mining waste dam in Brazil, owned by Vale, on January 25, 2019. The dam released a mudflow that advanced through the mine's offices, along with houses and roads downstream. As a result of the collapse, 270 people died, making it one of the deadliest mining disasters in modern history. Soon after, a group of institutional investors wrote to 726 extractive companies seeking greater disclosure on the management of their TSF. The so-called "Investor Mining & Tailings Safety Initiative" represents more than 13 trillion US dollars in assets under management.

These activities underlined the importance to extend our due diligence efforts on Polymetal with specific fact-findings regarding the operation of tailings dams. This came in addition to our standard ESG investigations such as the usage of cyanide in the gold purification process, effective health and safety measures, carbon footprint reduction targets, and their community engagement programs. According to our own ESG assessment framework, these are key ESG risks.

In June 2019, our Energy and Materials Analyst spent one week in Russia and Kazakhstan on a field trip and company visits to several materials and mining companies. During this occasion, Polymetal presented a report on the management of their TSF. This report and the additional explanations of the CFO and the ESG Manager gave an extensive and convincing description of their TSF management. Polymetal operates nine TSFs, and historically there have been no environmental accidents involving tailings facilities. In 2018, they enhanced their corporate TSF management system to improve executive oversight, including emergency response plans. The clear goal was to eliminate the causes of dam failure. At all of Polymetal's TSFs, the management clarified, emergency failure would have no impact on settlements, buildings, or facilities where people live or work. Thus, the risk of loss of human life is minimal.

After the Brumadinho disaster, Polymetal thoroughly reviewed all of its upstream TSFs and conducted visual, geological, engineering, and hydrological surveys. To conclude, the company disclosed all requested information to the tailing safety initiative. In addition, they explained that they are shifting towards safer methods of waste storage, such as the dry stack (filtered cake) tailings. Dry tailing storage significantly reduces the possibility of dam failure, drastically lowers the potential damage from such accident, and eliminates tailings run-off. Their target is to deploy this technology at all new sites and dispose of 15% of all tailings as dry stacks by 2024. These improvements will definitely put them in a leading position among mining companies.



Other ESG issues that were discussed during the meeting include the following topics:

- **Cyanide usage:** Polymetal is a signatory of the "International Cyanide Management Code for the Manufacture, Transport, and use of Cyanide in the Production of Gold" (Cyanide Code). This Code is a voluntary industry program for gold and silver mining companies. It focuses on the safe management of cyanide during the gold extraction process. Companies that adopt the Cyanide Code must have their mining operations that use cyanide audited by an independent third party. Only those operations that meet the requirements of the Cyanide Code can be certified. Polymetal published an extensive third party audit report in 2019, which confirmed the full certification of all mines that use cyanide.
- **Health and safety measures:** The representatives of the company described some details of their H&S management system. It is annually audited according to the ISO 45001 requirements. Interestingly, the group CEO and operational executive team formally committed to personal accountability, with health and safety indicators added to their remuneration-linked key performance indicators (KPIs). They can forfeit up to 50% of their annual bonus earned for non-safety-related KPIs if long-term disabilities or fatalities occur among employees and from 2020, this will also extend to include contractors. This is clearly above average sector measures.
- **Carbon footprint reduction targets:** The company explained that they operate an integrated climate and energy management system. This includes a financial assessment of climate-related risks. Their energy efficiency program is in line with ISO 50001 (Energy Management), but it is not certified yet. Polymetal is in the process of reducing its reliance on diesel power through some sizeable renewable energy projects at remote sites (wind and solar). Already now Polymetal is among the Top Ten precious metal mining companies with regard to carbon intensity.
- **Community engagement programs:** They mentioned several examples of a constructive relationship with local government and communities and underlined their transparent and productive dialogue with stakeholders. Polymetal works directly with communities and with relevant NGOs for mutual benefit. A particular focus lies in protecting the rights of indigenous communities and supporting them to prosper.

In summary, the additional information of the management on key ESG issues was convincing. They gave us a transparent picture of Polymetal's substantial ESG efforts and resulted in a top position in our own ESG assessment framework among companies in the materials and mining sector. This view is supported by the excellent ESG ratings that Polymetal achieved by ESG raters (No. 1 among 47 peers by one and top quintile by another).

Furthermore, in a ranking among Russian metal & mining companies carried out by WWF and UNDP, Polymetal was ranked first place. Since 2018, the company has been included in the Dow Jones Sustainability Emerging Markets Index.

Ambev – drilling into corruption probe accusations

Ambev SA is the largest brewer in Latin America and the fourth-largest beer producer globally. It produces, distributes, and sells beer and non-alcoholic beverages in Brazil, other Latin American countries, and Canada. Its controlling shareholder (62%) is Anheuser-Busch InBev N.V., the largest brewer in the world. We started to invest in Ambev in June 2019.

In early August 2019, it was widely reported in the media that the company had been accused of "inappropriate payments" to two former Brazilian presidents aiming at preventing an increase in beverage taxes. The accusation made in a plea bargain testimony by jailed former finance minister Antonio Palocci implicated a number of Brazilian companies. Ambev immediately denied the accusations saying they were, "False because we never made any inappropriate payments of any nature to receive undue benefits. And incoherent because, since 2015, the beverage sector has suffered through a major increase in (federal corporate) taxes, by around 60%, contradicting everything that was alleged."

We investigated news reports on the allegations (benefiting from our native Brazilian Portuguese speaker in our team) and learned that prosecutors involved in the "car-wash" anti-graft operation were disparaging of Palocci's testimony. Further, we found that, indeed, since 2015 taxes on the Brazilian beverages industry had increased significantly. On the other hand, we found that Ambev spent heavily on political lobbying and was No. 9 in a list of Brazilian corporate political donors – however, this practice is not uncommon globally (e.g. in 2014, 70% of Brazil's campaign finance came from corporates). Under the company's code of business conduct, such spending must be approved at the committee level. No allegations were found suggesting illegal campaign finance.

We wrote to the investor relations team at Ambev to ask them to clarify the processes in place to prevent bribery and corruption within the company and the connection with the group parent's (ABI) own mechanisms. We received a prompt reply from Ambev's IR, articulating the company's approach of zero tolerance towards bribery and corruption, including various codes of conduct, relevant policies (updated in 2017), a dedicated legal and compliance team, board oversight, an executive ethics committee, application of rules to suppliers, a whistleblower helpline, and close co-ordination with ABI's compliance team.

We continued to monitor the Palocci story, while his deposition was accepted, there appears to be no further investigation into his allegation of bribery by Ambev officials. We judged that the company had good policies and risk management practices in place regarding bribery and corruption, and risk exposure on the issue was limited.

On wider ESG matters, Ambev shows mixed performance.

On environment, Ambev performs well on the key issues of water scarcity, plastics, and carbon. Having implemented a comprehensive water management strategy that includes suppliers, a 46% reduction in water use, and below-average freshwater intensity, Ambev is regarded as a peer leader on this issue. Likewise, it is a leader on recycled packaging, working with circular packaging cooperatives it has 33% recycled content per bottle in 2018 and a goal of 100% for all products by 2025. It has strong carbon/energy reduction programs as well as a program to stimulate more sustainable agricultural practices (including tilling to prevent soil erosion, water quality monitoring to avoid pesticide contamination, and a water basin management model).

Under the social pillar, our concerns focus on its health & safety record with an above-average number of fatalities, particularly in the distribution chain. Its measures to address this risk are weak. It has also faced penalties over labor violations, particularly excess overtime. On responsible drinking, it has strong programs (more advanced in Brazil than elsewhere) and targets 20% of its beers to be no or low alcohol by the end of 2025.

Ambev is weak on Governance matters. Only 18% of the board can be considered fully independent and no independent chair. It has issues of over boarding, under-attendance, entrenchment, and lack of diversity. Pay practices overall are below the global average. There are various restrictions on the rights of minority shareholders but from 2020 they will have a dedicated board representative.

Anheuser-Busch InBev (ABI): we met with representatives from Ambev's parent and controlling shareholder on a number of occasions in 2018 and 2019. In February 2019, our financial analyst and our ESG specialist both for Consumer Staples met with ABI's Global VP of Sustainability and discussed various ESG matters.

Overall, we formed the impression that ABI appears to understand the competitive advantages of committing to sustainable goals and understands its potential as an industry leader to drive change by collaborating with peers, local authorities, and experts. Both, in this meeting and another in 2018, we discussed the issue of business conduct/corruption, given its importance for business operations on emerging markets. We felt the company's commitments were adequately supported by strong policies and procedures. From our discussions with ABI's investor relations, we concluded that ABI had strict rules in place when it comes to Bribery & Corruption and it had started to enforce these higher standards in the wider regions under its influence through its subsidiaries.

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