

Engagement Report

Sustainable investments 2022



Engagement: In dialogue towards a more sustainable world

Taking responsibility also applies to investing money. Investor dialogue with companies on ESG issues has in recent years become a very effective lever for transforming business towards sustainability. Engagement stands for the active influence of investors on companies, borrowers or legislators to bring about certain changes, for example in the case of serious human rights abuses or an inadequate climate strategy. The possibilities for exerting influence include, in particular, direct dialogue with management or the board of directors.

We show which dialogue activities Luzerner Kantonalbank (LUKB) carried out on behalf of its investment solutions and LUKB Expert investment funds in 2022.

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Companies value exchange with investors

Dialogues were held on more than 400 ESG topics on behalf of the investment solutions at LUKB and the LUKB Expert investment funds. Roland Wöhr, Head of Sustainability in Asset Management, explains how LUKB operates.



“Making a difference as responsible investors: In dialogue towards a more sustainable world.”
Roland Wöhr, Head of Sustainability in Asset Management

Dialogue with companies - how does LUKB do it?

Roland Wöhr: If LUKB approached companies on its own, their willingness to engage in dialogue would not be very high. But when we approach companies together with other investors who pursue the same goals, the doors open. Companies increasingly appreciate this direct exchange with the capital market. And we are convinced that dialogue in association with other investors is more efficient and effective, also from the perspective of the companies with which we are in dialogue. That is why we rely on direct participation in collective investor initiatives and on engagement pools for corporate dialogue - otherwise we as LUKB would not be able to achieve much.

What is an engagement pool?

Many are familiar with Ethos, which carries out engagement activities for numerous Swiss pension funds. Our partner is ISS ESG, an international counterpart of Ethos. We are a partner there in three pools: on compliance with global standards, on climate change and on biodiversity. In the pool for compliance with global standards and norms, ISS ESG conducts dialogue with companies on behalf of around 70 major investors such as pension funds. These manage assets worth over USD 2,000 billion.

What happens if a company does not participate?

The willingness of companies to enter into dialogue with investors is great. This is also understandable, because this way companies hear the owners or potential investors much more directly and understand which risks they consider important or where they see potential for improvement. If companies do not offer satisfactory solutions, there are various options, such as shareholder resolutions at general meetings, as is regularly done in the Climate Action 100+ (CA100+) initiative, up to and including selling the company's shares.

The first experiences have been gained - what next?

We are consistently pursuing our engagement strategy with a focus on compliance, climate change and biodiversity. Credible active ownership includes not only dialogue but also the active exercise of voting rights. In 2023, for example, we extended the voting rights of Swiss shares in LUKB funds to companies in Europe and the United States. We rely on ISS ESG voting analyses with a strong weighting of sustainability factors and climate change.

Our goals for dialogue

LUKB focuses on three areas in its dialogue with companies: First, we hold companies with gross violations of international norms and standards accountable. Secondly, we are committed to ensuring that the largest contributors to climate change advance their climate strategies. And thirdly, we address companies from sectors with a high risk of biodiversity loss. Luzerner Kantonalbank relies on dialogue activities with other investors together, known as investor-led initiatives or engagement pools.



Compliance with global standards

Compliance with global standards is central to us. LUKB is involved in a standards-based pool and seeks dialogue with companies in cases of human rights abuses, labour rights abuses, environmental scandals or incidents of corruption.

LUKB activities in 2022:

- Dialogue on the ISS ESG standards-based engagement pool
- Support for initiatives of the FAIRR investor network



Climate-friendly alignment

The effects of climate change are one of the greatest challenges facing society. We are committed to making businesses more climate-friendly.

LUKB activities in 2022:

- Participation in the Climate Action 100+ (CA 100+) initiative
- Dialogue on the ISS ESG Net Zero engagement pool



Maintaining biodiversity

The loss of biodiversity has serious consequences for the well-being of our society. We call on companies to improve their transparency on biodiversity risks, their impact on nature and their strategy for managing nature-related risks.

LUKB activities in 2022:

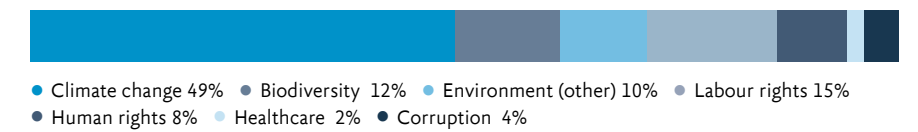
- Dialogue on the ISS ESG Biodiversity engagement pool
- Support for initiatives of the FAIRR investor network

Active around the globe

In 2022, LUKB was in dialogue with companies on 400 topics, whether through initiatives or in the pool. Dialogue on environmental issues accounted for the largest share (72%), with climate change and biodiversity issues making up the vast majority. Social issues were the subject of dialogue in about 100 cases and corruption in 15 cases.

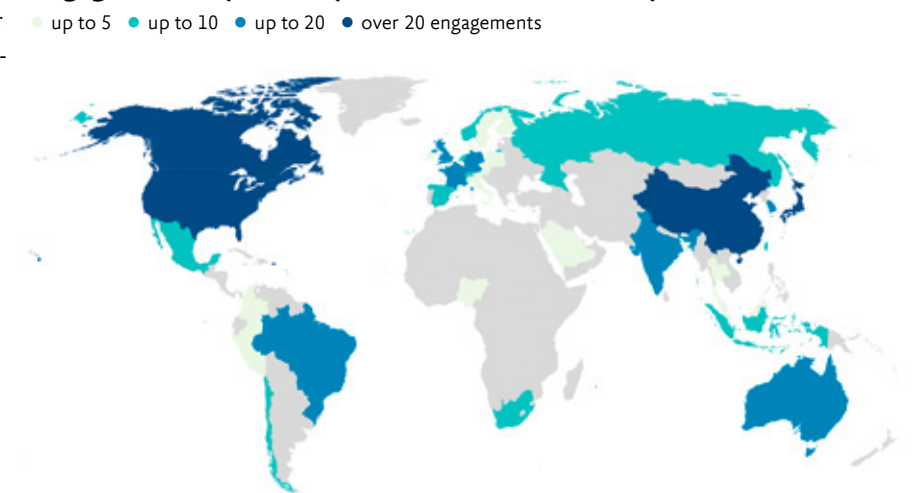
Violations of standards usually take place locally, often involving subsidiaries or partners in emerging countries, while the companies responsible are based in industrialised countries. In contrast, our dialogue on climate change, which has global implications, relates to the entire company. The dialogue was conducted with companies from over 40 countries. Around 70% of the companies were based in industrialised countries, around 30% in emerging markets. Most activity took place through our three engagement pools with ISS ESG (50%) and the Climate Action 100+ initiative (42%). The willingness to engage in constructive dialogue was very high, not only in the big global initiatives such as CA100+, but also, for example, in the standards-based pool, where it was over 70%.

Breakdown of the 400 dialogues by area



Source: Luzerner Kantonalbank, ISS ESG, Climate Action 100+, FAIRR

Engagements by country of domicile of the companies



Source: Luzerner Kantonalbank, Datawrapper

Exercising voting rights enhances credibility

By actively voting at AGMs, investors can promote responsible corporate governance. LUKB will actively exercise voting rights for most equity positions in the LUKB Expert funds from 2023. LUKB is supported in this by the specialised service provider ISS Governance, in particular with regard to voting recommendations and representation at AGMs. A voting guideline regulates how to vote, for example if the majority of the board of directors is not independent. In addition to good corporate governance, criteria on environmental and social aspects are explicitly included in the voting guidelines applied by LUKB. Special focus is placed on climate change. Details on voting behaviour are presented in the 2023 report.

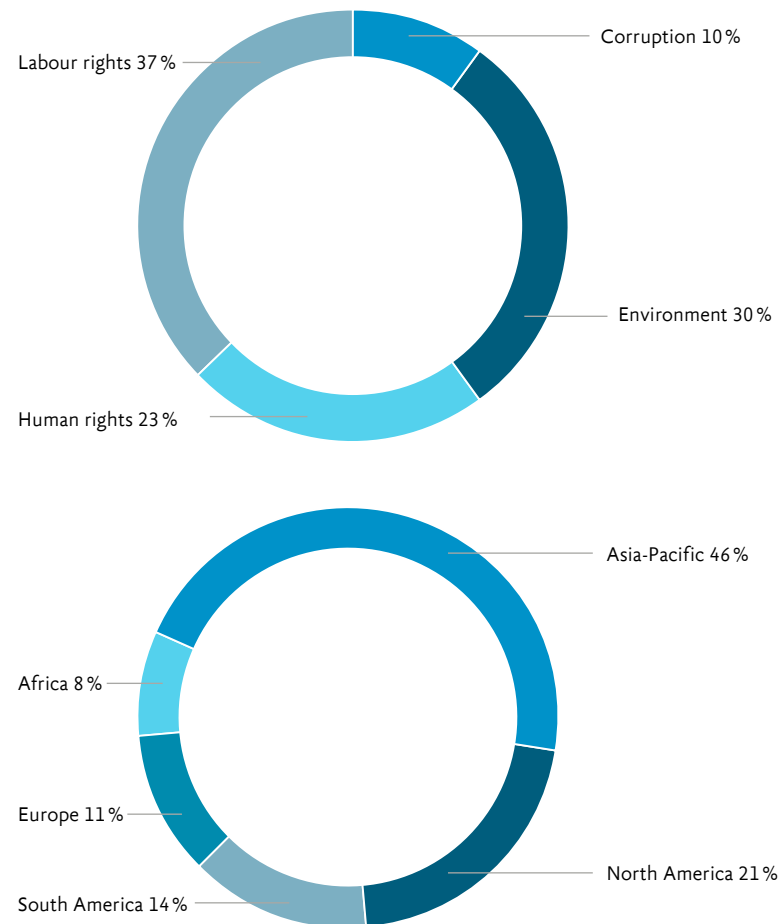
Focus: Compliance with global standards – what’s behind it?

Our partner ISS ESG identifies companies with serious social and environmental incidents. These are incidents that contradict responsible corporate governance and violate global standards and norms.

ISS ESG assesses such incidents and formulates requirements on how companies can remedy the negative impacts and prevent further incidents. In 2022, dialogue was sought with companies on more than 140 such incidents.

Most involved labour or human rights abuses and occurred in the Asia-Pacific region (about 46%), followed by North America, South America, Europe and Africa. The willingness of companies to engage in dialogue with investors is very high overall. Over 70% of the companies contacted responded. It should be borne in mind that for many companies that have not yet responded, the dialogue was not initiated until the last quarter of 2022. In most cases, a gradual improvement in disclosure and willingness to engage in dialogue could be achieved through continuous follow-up. In successful engagements, companies could be persuaded to increase transparency, stop a controversial practice or announce a specific and time-bound strategy to reduce risk.

Standards-based dialogue by topic and region



Source: Luzerner Kantonalbank, ISS ESG

Which standards are relevant?

Global norms and standards provide the framework for the standards-based dialogues. These include:

- UN Global Compact: A voluntary commitment by companies to seven principles to make globalisation more socially and environmentally responsible.
- OECD Guidelines for Multinational Enterprises: A corporate code for responsible business conduct.
- UN Guiding Principles on Business and Human Rights: These define the responsibility of companies with regard to the human rights impacts of their business activities.
- International Labour Organization (ILO): A specialised agency of the United Nations that sets international labour and social standards.

Example of Barrick Gold: Dialogue on human rights and water pollution



Barrick Gold is accused of complicity in human rights abuses by security forces at the North Mara Mine in Tanzania. The company is also accused of failing to prevent water pollution at the Porgera Mine in Papua New Guinea. ISS ESG formulated clear objectives for both incidents, which include transparent disclosure, the initiation of tangible measures and the adoption of appropriate guidelines. The company engaged in constructive dialogue on measures and has already implemented some of them. ISS ESG will continue to monitor implementation of the measures and keep the engagement dialogue open.

Example of Carrefour: Evidence of forced labour at suppliers



In mid-2022, Carrefour was contacted about failures to prevent forced labour in its supply chain in China. Carrefour subsequently submitted remedial measures, including external investigations to identify non-compliance at its suppliers, mapping of its suppliers and the intention to use only traceable materials by 2030. The company also works with the NGO International Federation for Human Rights to prevent human rights abuses in the supply chain. ISS ESG takes note of the disclosures made by Carrefour in the engagement dialogue, but will continue to monitor the effectiveness of the company’s commitments.



Find out more:

The [annual report on the standards-based engagement pool](#) provides in-depth insight.

Focus: Climate Action 100+



Climate Action 100+ - this is not a group of climate activists. This is the largest investor initiative in the climate change sector. Launched in 2017, this initiative has prompted numerous companies to adopt a more climate-friendly approach and deal more conscientiously with climate risks. LUKB has been involved in this influential initiative since 2021.

The Climate Action 100+ (CA100+) initiative focuses on the 170 or so largest emitters of greenhouse gases, accounting for around 80% of industrial emissions. The aim of the initiative is for companies to commit to the Paris climate goals and take appropriate action. CA100+ is the leading investor initiative in the climate sector and has been signed by over 700 institutional investors with USD 68,000 billion in assets under management.

The dialogue with the individual companies is conducted by small groups of investors from the initiative on behalf of all participants. The results of the dialogues are made available to all. Luzerner Kantonbank has been part of this investor initiative since 2021 and participates in a supporting capacity in the two corporate engagements Danone and Southern Corp.

The successes of the initiative launched in 2017 are considerable



75%

of companies have adopted a net zero target (50% in March 2021)



92%

of companies have climate change expertise on their boards (87% in March 2021)



91%

of companies report their climate risks according to the TCFD (72% in 2021)

Source: CA100+, Progress Update 2022

Management expertise and net zero strategies

Climate-related disclosure has improved significantly. 91% of focus companies have now signed up to the TCFD (Climate Risk Reporting) recommendations. For example, the Italian utility ENEL disclosed all relevant indicators for the first time in 2022. Greater transparency about climate-related risks and opportunities helps investors make more informed decisions. Another important goal of CA100+ is to improve board-level oversight of key climate-related issues. 92% of focus companies now have some level of board oversight.

And around 75% of companies have now committed to achieving net zero by 2050. When Climate Action 100+ was launched at the end of 2017, only five of the focus companies had committed to net zero. For example, Sasol, the largest integrated chemical and energy company in South Africa, developed a decarbonisation strategy in 2022 and presented it to its shareholders for a vote at the AGM. Even as the issues of decarbonisation and net zero have become increasingly important to the general public, investor engagement has played an important role in communicating the legitimacy, urgency and feasibility of these commitments.

High targets, but significant emission reductions are missing

In the real economy, rapid progress must be made to reduce emissions. Announcements and commitments without action are not enough. To halve emissions by 2030 and keep 1.5°C within reach, companies must now develop and implement credible transition plans in line with the Paris Agreement.

If dialogue with the company does not lead to the desired success, it is possible to put an issue on the agenda of the AGM. In 2022, there were a total of 37 AGM resolutions and agenda items initiated under CA 100+, of which 11 were shareholder resolutions and 26 were management resolutions. Four of the shareholder proposals received a majority of the votes cast. In addition, 22 shareholder proposals at North American target companies were settled early, i.e. the company took over the proposals and they were not put to the vote.



Find out more: The [annual report of Climate Action 100+](#) provides an in-depth insight.

States must act too

We have also made representations to states with regard to investor statements: With the Investor Statement on Biodiversity (initiators: UNEP FI, UN PRI and Finance for Biodiversity Foundation), we called on states and the financial markets at the Conference of the Parties to the Convention on Biological Diversity (COP15) to implement measures to stop and reverse the loss of nature. With the Investor Statement on Climate Change (initiator: the investor agenda), we called on countries at the 27th Climate Conference to take measures to limit global warming in accordance with the Paris Agreement.

For improvements in the food and agriculture sectors, we support various dialogue initiatives. This includes FAIRR's commitment to the judicious use of antibiotics in animal husbandry to curb antimicrobial resistance. Antimicrobial resistance has been identified by the World Health Organization (WHO) as one of the 10 greatest global health threats to humanity. The dialogue is aimed at seven globally active veterinary medicinal product manufacturers. Another example is the support of FAIRR's engagement on biodiversity risks in agriculture (especially in the handling of manure and fertiliser). This dialogue is aimed at 10 of the world's largest pig and poultry producers. We also support the dialogues on biodiversity risks in fish farming companies and on poor working conditions in meat processing.

Our partners



ISS ESG is an international service provider for responsible investment solutions with many years of experience. In the area of engagement, it leads the standards-based pool for international investors and represents assets of over USD 2,000 billion. Thematic engagement pools on specific topics have also been offered for some years. ISS also supports us in recommending and exercising voting rights. More information on its website: www.issgovernance.com/esg/

A proud participant of:



The Climate Action 100+ initiative, which LUKB joined in 2021, focuses on dialogue with around 170 companies that are responsible for 80% of global industrial greenhouse gas emissions. The goals of the dialogue are, for example, transparent climate risk reporting or a credible commitment to reducing greenhouse gas emissions. More information on its website: www.climateaction100.org/



Founded in 2016, this organisation aims to drive improvements in nutrition and agriculture. The members, who together represent assets of over USD 70,000 billion, have access to various reports and databases. FAIRR, together with investors, leads multiple engagements with companies in the agriculture and food sectors. More information on its website: www.fairr.org/

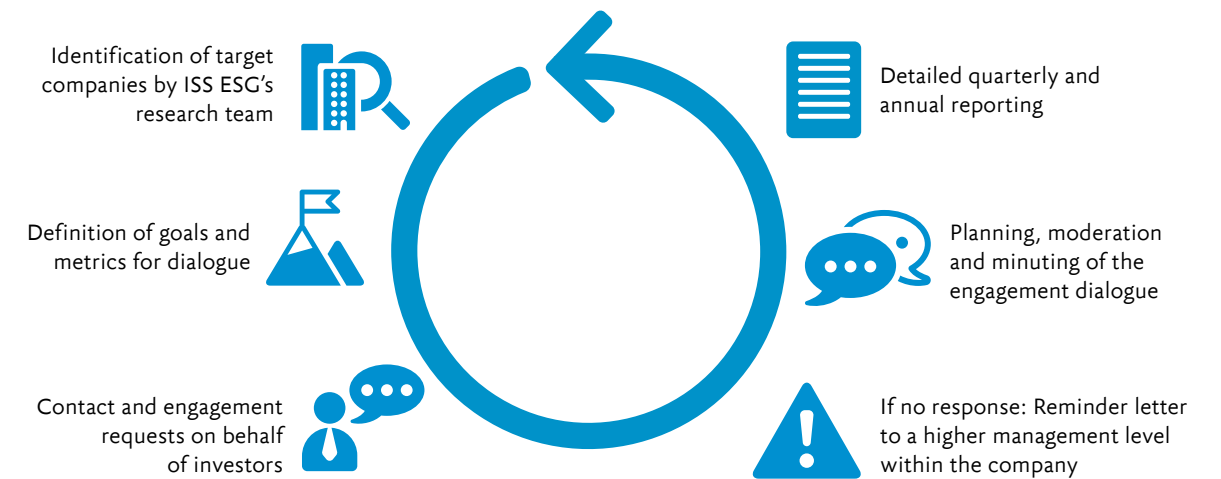
Setting clear goals and sticking to them

We illustrate how an engagement process works with the example of the standards-based process: As a first step, ISS ESG's large team of analysts identifies companies worldwide that are involved in controversial incidents and develops demands for dialogue. At the beginning of each engagement, clear and achievable objectives are defined in four main categories: disclosure, implementation, correction and termination. These must then be tackled together with the company.

The dialogue with the companies usually starts with a written contact, followed by meetings and further correspondence. These interactions and the results achieved are recorded and evaluated transparently. ISS ESG assesses the quality of corporate dialogue: Once the goals have been achieved and the controversy resolved, the engagement is closed. Most companies participate adequately in the dialogues. The process can be discontinued

if there is little prospect of achieving the goals of the engagement. If dialogue with the company does not lead to the desired success, there are various options to choose from, ranging from putting an issue on the agenda at the AGM to divestment. Detailed information on each engagement is available to LUKB on a platform and there is the opportunity to attend meetings.

Engagement process for ISS ESG engagement pools



LUKB's escalation strategy

Most of the dialogue on behalf of Luzerner Kantonalbank is conducted via service providers. Escalation therefore occurs primarily as part of these engagement activities, i.e. through repeated contact via different hierarchy levels. If, despite extensive attempts at dialogue, no goal-oriented exchange is achieved and expectations are only inadequately met within the framework of the engagement, various escalation levels are possible depending on the severity of the engagement trigger. The assessment is qualitative case by case. Possible escalation steps include, for example, LUKB contacting the company directly to encourage dialogue, downgrading the company's LUKB sustainability rating, adjusting our voting behaviour at the company's next AGM, or even selling the position.



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