Environmental, Social and Governance Policy

Table of Contents

1. Background

Article 41a of the EU-Directive 2016/2341 from December 14, 2016 and the translation into Belgian law in the form of the adaptation of the the law of October 27, 2006, underlines the importance of environmental, social and governance (ESG) factors in the decision making and in the overall risk management of IORPs. It specifically requires a necessary disclosure of the stance of each IORP toward these factors.

A few years ago (2012), Nestlé European Pension Fund OFP (NEPF) recognized the need for tackling this issue and made a first step by integrating ESG considerations in its Statement of Investment Principles (SIP) and its asset allocation. The fund also recognized its own lack of resources and the need to gather forces to go one notch further on research. Implementation of principles was also a problem, due to the very limited sustainable investment offering.

The present document is the first formal ESG policy of NEPF. The purpose is to set the ESG principles that NEPF is considering when investing. These are beliefs of the fund, based on research available and discussions that have been held within NEPF.

2. Principles

Principle 1: considering ESG factors can create economic value in the best interest of the stakeholders of the fund

Pension funds and their members are by essence long term investors. Sustainability is expected to have a positive impact on the risk/return profile of the investments on the long run. Further, it is a move away short termism and the behavior of some potential investee companies.

Principle 2: pension funds are not solely investors but also have a social role to play. Investing in a sustainable manner can create long-term positive value for the society and contribute to securing a sustainable world.

Congruous with the terms of the EU directive 2016/2341 (Whereas 7), "IORPs should, where relevant, take into account the objective of ensuring the intergenerational balance of occupational pension schemes, by aiming to have an equitable spread of risks and benefits between generations in occupational retirement provision." This is the main social goal of pension fund.

This principle is also aligned with the commitments publicly expressed by the Nestlé Group.

Principle 3: local (asset owner) regulations might also be an incentive to consider ESG in a proactive way. This is especially the case for NEPF that is expected to operate in a cross-border environment and bring strong governance.

3. UN Principles for Responsible Investment

The EU Directive 2016/2341 (Whereas 58) explicitly makes reference to principles set by the United Nations. The later has indeed laid down 10 principles in its United Nations Global Compact. These are derived from the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

They can be grouped and presented as follows:

Human Rights

Principle 1: businesses should support and respect the protection of internationally proclaimed human rights;
Principle 2: make sure that they are not complicit in human rights abuses.

Labour

Principle 3: businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
Principle 4: the elimination of all forms of forced and compulsory labour;
Principle 5: the effective abolition of child labour;
Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment

Principle 7: businesses should support a precautionary approach to environmental challenges;
Principle 8: undertake initiatives to promote greater environmental responsibility;
Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

Principle 10: businesses should work against corruption in all its forms, including extortion and bribery.

These broad business conduct principles can be translated in Principle for Responsible Investment (PRI) that can be applied in defining an ESG-strategy

PRI 1: We will incorporate ESG issues into investment analysis and decision-making processes.
PRI 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
PRI 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
PRI 4: We will promote acceptance and implementation of the Principles within the investment industry.
PRI 5: We will work together to enhance our effectiveness in implementing the Principles.
PRI 6: We will each report on our activities and progress towards implementing the Principles.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. NEPF is not a signatory of UN PRI but certainly endorses and wishes to implement these principles.

4. Ways of implementing these principles

There are different ways of endorsing sustainability in investment matters, the main categories are:

- ESG Integration
- Positive / best-in-class, negative/exclusionary and norm based screening
- Active ownership
- Impact investing / Themed investments
- Climate change-related investments

The below go in the details of these approaches from a generic perspective.

	Pros	Cons
ESG Integration This approach tackles sustainability by systematically taking into account ESG factors in the financial analysis and in the decision making process for active management. For passive management, ESG integration can be implemented by incorporating ESG factors in the index design	▪ High sustainability impact ▪ Good coverage of most asset classes ▪ Improved decision making process ▪ Benchmarks are readily available ▪ Can be combined with active ownership	▪ Reliance on third party providers and the related cost
Best-in-class Best-in-class screening allows selecting issuers for their superior ESG performance relative to their peers.	▪ High sustainability impact (selection of the best ESG performers) ▪ Aims to positively influence corporate behaviour and the economy as a whole (superior long term performance) ▪ Good coverage of most asset classes ▪ Benchmarks are readily available	▪ Reliance on third party providers and the related cost ▪ Discretionary decision to establish threshold for inclusion ▪ Concentration on smaller investment universes
Negative screening This approach excludes issuers based on business activities or location based on ESG criteria	▪ Simple and transparent way to express specific ESG views/beliefs ▪ Easy to implement and document ▪ Less resource-intensive ▪ Particularly relevant to companies or industries not open to behavioural change	▪ Low sustainability impact ▪ Static picture not factoring evolution ▪ Concentration on smaller investment universes ▪ Potential unintentional bias which may lead to a less good risk/return profile
Active ownership This approach implies voting or engaging with the issuers. This might be done directly or by delegating to investment managers or third party providers.	▪ High sustainability impact ▪ Long-term engagement with the issuers ▪ Participation in the economic benefits of ESG improvements ▪ Works for active & passive strategies	▪ Resource intensive ▪ Cost ▪ Limited to corporate issuers
Impact investing / Themed investments This approach not only focuses on financial return, but also on environmental and social benefits. Aim is to also contribute to a sustainable world.	▪ High sustainability impact ▪ Distinct share of portfolio allocation fully dedicated to responsible investing ▪ Potential to create a positive environmental and social impact ▪ Pure ESG strategy ▪ Diversification effect	▪ Higher due diligence resources ▪ Lower liquidity ▪ Higher fees

Another question that might be raised is whether all strategies can be rolled out across the asset classes used by NEPF. The below table summarizes which strategy could be applied.

	Government bonds	Corporate bonds	Public equities	Private equities	Real estate	Hedge funds
ESG integration	✓	✓	✓	✓	✓	✓
Best-in-class	✓	✓	✓	✓	✓	
Exclusions	✓	✓	✓	✓	✓	✓
Active ownership		✓	✓	✓	✓	
Impact investing		✓	✓	✓		

Finally, the discussion around active and passive asset management can also be discussed in an ESG context. Some of the strategies can indeed not be applied as easily as others in all cases.

	Active management	Passive management
ESG integration	Investment manager integrates ESG factors into investment decision-making	Investment manager selects and passively replicates benchmarks that integrates ESG factors into index design
Active ownership	Pension Fund may retain and implement their voting and engagement rights themselves or delegate their voting and engagement rights to their external managers or to third-party providers	
Best-in-class	Investment manager determines screening strategy	Investment manager selects and passively replicates benchmarks designed on specific screening
Exclusions	Investment manager determines screening strategy	Investment manager selects and passively replicates benchmarks designed on specific screening
Impact investing	Investment manager determines impact investing strategy and select securities	Investment manager selects and passively replicates benchmarks that consist of the respective impact investing strategy-eligible securities

5. NEPF's strategy regarding sustainability

Being a pension fund located in Belgium, the minimum requirements are set by European directives and Belgian laws and regulations.

Being a cross-border pension fund, NEPF also has to consider broader requirements that could apply locally.

Beyond minimal requirements, NEPF indeed sees long term economic benefits to take into account ESG factors in its investment process and recognizes that the fiduciary duty entrusted to the fund also encapsulates a commitment to social or environmental issue to contribute to a better world for its members.

However, NEPF has the conviction that broad principles are only worth if they can be implemented in an effective manner. The limited size of the fund and the fact that it is exclusively invested through off-the-shelves vehicles certainly limit the possible.

Based on that the medium to long term goal is to:

- Move away from broad benchmarks and invest specific ESG universe and use related benchmarks.
- This can be achieved through either active or passive vehicles
- NEPF will seek to ensure that its managers are taking into account ESG factors. For that purpose, the fund might leverage on the overall relationship of the Nestlé Group and Pension Funds with its managers.

6. Document control & history

DOCUMENT CONTROL				
Type	NEPF Policy			
Procedure	ESG Policy		Total number of pages	7
A version of procedure becomes effective when approved by the Board of NEPF. Approval of this page indicates approval of all pages in this procedure.				
Version	Reason for Change	Guideline Effective Date	Updated by	Document status
V181010	New document			

Signatures by ManCom & date	
By signing the ManCom is confirming that the above steps have been fulfilled and that validations have been granted, so that the procedure is "Approved" and thus current.	