#1 Climate
CO₂ risks in the portfolio are measurable

#2 Plastic waste
A problem for oceans and mankind

#3 Opioids
Addiction risk is an engagement issue

#4 Nuclear weapons
Exclusion is the best defence
The battle against climate change has helped to make the issue of sustainability more of a priority for investors. The European Union has now introduced legislation to create a low-emission, resource-efficient circular economy. Its action plan contains a number of recommendations aimed at directing more private capital into sustainability-oriented investments in order to achieve the climate-policy targets agreed in Paris and the United Nations sustainable development goals. Banks in particular will be forced to adapt to the action plan as it is expected that the action plan will result in a number of regulations, recommendations and certification requirements for banks from mid-2020.

It is hoped that regulatory pressure will trigger a change in the mindset, particularly among institutional investors who have so far been rather reluctant to engage with the issue. Consideration of sustainability and climate protection will become a mandatory element of investment decisions. As a mainstay of the economy, the financial system will be just as affected by this transformation as the manufacturing companies in the real economy. The opportunities, risks and challenges that this transformation process poses for investors will also be discussed at our sustainability conference on 25 June 2019.

For an active asset manager, climate change is of course just one of the many sustainability aspects to be addressed as part of risk management. We have clearly illustrated this with the various topics covered by this issue of engage! We have sought to draw your attention to risks that are still frequently underestimated by investors, such as the problem of plastic waste, of drug epidemics and of nuclear weapons. Our ESG experts have examined how these issues relate to our investments in depth over the past year and believe they are relevant. Where our investigations have revealed a need for dialogue and for action, the risks have been addressed in our engagement activities on behalf of our investors.

Yours sincerely,

Alexander Schindler
Member of the Board of Managing Directors of Union Investment

Climate transformation adds momentum

Cover picture: "Where the Tides Ebb and Flow", a work by Argentinean artist Pedro Marzorati. The blue busts projecting out of the water warn of the consequences of rising sea levels caused by global warming. The sculptures were installed in Montsouris Park as part of an art exhibition staged during the UN climate conference in Paris in December 2015.
Introduction

Building on strong foundations

The new ESG department has big plans for the coming months.

The reorganisation of portfolio management as part of the NLPM (Next Level Portfolio Management) initiative also involves expanding the company’s environmental, social and governance activities. Since October, the newly created department has been part of the Research & Investment Strategy (RIS) function. Dr. Heinrich Pontzen, previously head of the Institutional Client Group at HSBC in Düsseldorf, was appointed to run the ESG department at the start of the year.

The reorganisation is not so much a reboot as a logical extension of the existing approach, stresses Pontzen. “When I arrived here, I found a highly skilled team, combined with an openness to new ideas throughout the entire organisation.” The aim is to build on these foundations over the coming months and years in order to raise ESG at Union Investment to a new level. The necessary structure has been put in place over the coming months and years in order to raise ESG at Union Investment to a new level. The necessary structure has been put in place.

“ESG will become standard”

“Engagement is one of our strengths, and we want to develop it further,” explains Pontzen. Pontzen has identified two approaches to make this change both profitable and sustainable. Firstly, he sees huge potential in the integration of ESG analysis and big data. “Sustainability and digitalisation will be the defining themes in our sector and beyond for years to come.” The information we have gained from smart data analysis should be applied to a greater extent to research and to our investment decisions in the future. We have to find a way of making the immense volume of data manageable, and then available for the purposes of sustainability research. We already have a valuable and well-used tool in SIRIS. The task now, in the coming months and years, is to further develop it and integrate it more deeply into all day-to-day portfolio management activities.

Finding effective compromises

“ESG activities should be combined with greater integration of sustainability factors into the whole investment process at Union Investment. The aim is not to ‘make the niche bigger, but to take what we have learned from the niche and apply it to the whole portfolio management process and beyond. We are in the midst of a shift in values and we can be and want to be the driving force behind this change with our investment decisions.’

Pontzen has identified two approaches to make this change both profitable and sustainable. Firstly, he sees huge potential in the integration of ESG analysis and big data. “Sustainability and digitalisation will be the defining themes in our sector and beyond for years to come.” The information we have gained from smart data analysis should be applied to a greater extent to research and to our investment decisions in the future. We have to find a way of making the immense volume of data manageable, and then available for the purposes of sustainability research. We already have a valuable and well-used tool in SIRIS. The task now, in the coming months and years, is to further develop it and integrate it more deeply into all day-to-day portfolio management activities.

A second major project for the next few years will be extending ESG to all asset classes. In the past, ESG criteria were primarily applied to equities, and in the early days the team was in fact part of equity fund management. Things have changed in recent years, and fixed income is now also a focus of sustainability activities. It is important to continue in this direction. “I would like ESG to apply to every asset class,” emphasises Pontzen. Within each asset class, opportunities should be identified in future without ignoring the risks. He hopes the new research will enable him to focus attention on the opportunities. “Climate change is a fact we have to live with. However, it is also clear that not everyone in the corporate world is going to be a loser as a result of this change.”

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I would like ESG to be an issue that doesn’t exclude any asset class.”

Board decision provides tailwind

The Board of Managing Directors adopted a resolution in September 2017 and, through this expression of its will, gave the matter deeper relevance and added impetus, as Pontzen quickly realised. “I can feel that we are all pulling in the same direction.” The position of Union Investment as a sustainability-focused asset manager will be further strengthened. The company had already secured market leadership in Germany. Now the aim is to make its presence felt more strongly at European level. The foundations have already been laid. “We now want to build on them — and we will.”

Building on strong foundations

The new ESG department has big plans for the coming months.

Achim Philippus
Member of the Board of Managing Directors
at Union Investment Institutional

Source: Union Investment.
Summer 2018 was a powerful reminder that Germany is not immune to climate change. 2018 was the hottest year since meteorological records began in 1881 and the farming industry felt the economic impact directly, with crops failing in many parts of north-east Germany. Experts warn that this is a mere precursor of things to come. Eight of the nine hottest years since 1881 have been in the 21st century.

**Alarming data**

Global greenhouse gas emissions were higher in 2018 than ever before. The data is deeply concerning and shows how important it is to redouble our efforts to prevent climate change. This was underlined recently in the IPCC special report ‘Global Warming of 1.5°C’ presented at the UN Climate Conference in Katowice. The IPCC report stressed that every 0.1 of a degree on the temperature scale counts, particularly in respect of the so-called tipping elements in the Earth system. Tipping elements are supra-regional components of the Earth system that experience a qualitative change in function as soon as a certain temperature threshold is crossed. These include, for example, the Greenland ice sheet, the permafrost areas in Siberia, the tropical coral reefs, and the Amazon rain forest. Once such tipping elements are activated, self-reinforcing processes are set in motion that are difficult or impossible to halt. The rainforest, which locks in CO₂, could gradually turn into savannah, the coral reefs could die off and the ice sheet melt. The consequences would be catastrophic as both the speed and the consequences of the tipping process are unforeseeable.

The threshold for many tipping elements lies between two and four degrees of global warming. This partly explains why the Paris climate agreement set a target of keeping global warming to below two degrees Celsius compared with pre-industrial levels. We only have a few years left to achieve this target. By 2050 at the latest, net emissions of greenhouse gases must be brought down to zero.

**Failure to act may be costly**

But even the former self-proclaimed poster child of climate protection, Germany, risks missing its reduction targets by a wide margin. The underwhelming performance to date could have painful consequences for the economy. The costs could run into the billions because certificates will have to be purchased for all greenhouse gas emissions that exceed the targets. Unchecked climate change could have even more far-reaching effects, however, which is why the World Economic Forum in Davos believes climate change constitutes...
The melting of the polar ice caps as a result of the changing climate has also been witnessed in Alaska, as can be seen here at the Lamplugh Glacier.

The most important tipping elements in the Earth system

- **Ice bodies**
- **Ocean and atmospheric currents**
- **Ecosystems**

1. Arctic sea ice
2. Greenland Ice shield
3. Yedoma permafrost
4. 4/5 Boreal forests
5. Jet stream
6. Atlantic thermohaline circulation
7. Methane hydrate
8. South-west North America?
9. West African monsoon
10. Indian summer monsoon
11. Methane hydrate
12. El Niño – southern oscillation
13. Amazon rainforest
14. Tropical coral reefs
15. Marine biological carbon pump
16. West Antarctic ice sheet
17. East Antarctic ice sheet
18. Greening of the Sahara
19. Drought in the Sahel
20. Dwindling of dust sources

There are three groups of tipping elements: melting ice bodies, changing currents and circulations of the ocean and atmosphere, and threatened eco-systems. Question marks denote systems whose status as a tipping element is not yet scientifically proven.

Source: Potsdam Institute for Climate Impact Research.

one of the greatest risks to the functioning of global supply chains. Virtually all sectors would be affected, be it through supply shortages, crop failures, storm damage, increased investment risk or exchange rate losses.

Some business sectors have already recognised this risk. A growing number of companies are taking action to reduce their susceptibility to the effects of climate change and are pursuing ambitious targets to become carbon-neutral before 2050. "These pioneers are not being opportunistic, but proactive. That earns the companies respect and offers the prospect of better long-term upside potential for investors," says Jennifer Paffen, an ESG analyst at Union Investment.

Initiatives for transformation

The transformation of the global economic system into a carbon-neutral world demands immense investment. However, it also affords huge opportunities for companies and investors, such as through new patents and innovative business models. While fossil fuels are becoming less important, renewable energies are now a vital aspect of climate protection measures. This also has implications for the financing of the Paris climate targets, a matter that has been addressed by the action plan for funding sustainable growth put forward by the European Commission in March 2018. The plan is part of the EU’s efforts to create a low-emission, resource-efficient circular economy. Capital flows – which are increasingly shaped by investment decisions and explicitly take account of sustainability criteria – are one of the levers that will help achieve this.

"The EU action plan should now also bring additional pressure to bear on financial players who had been waiting to see what the EU would do," predicts Dr Henrik Pontzen, head of ESG in portfolio management at Union Investment. "So far, they have tended to regard global warming and the necessary switch to climate neutrality as more of an abstract risk." A lack of transparency and comparable standards means it has always been difficult to accurately quantify and assess these risks. It was difficult for the markets to put a precise figure on how great the climate risks and transformation opportunities really are, both with regard to individual companies and entire sectors. There are →
now new, clearly defined guidelines for investors and companies that should make it easier to drill down on whether the information being disclosed is complete and material. In May 2018, the Task Force on Climate-related Financial Disclosures (TCFD) developed a framework that provides a valuable tool for use in climate reporting. The TCFD recommendations are a lever that will help investors and companies to take a holistic view of the risks and opportunities of climate change and of a low-emission economy in the core areas of each company.

The recommendations point the way forward. In its action plan, the European Commission announced that it would include the TCFD system in a revised version of the CSR Directive. Union Investment also supports the findings of the Task Force to date and uses them, for example, in its dialogue with companies to call for climate risk analyses to become a deeper and more established element of business and financial reporting. The benefits of greater transparency with regard to how individual issuers of securities deal with the challenges of climate change are very clear to the cooperative-sector asset management company: “We use the identified opportunities in our investment decisions, and we try to minimise identified risks or manage them as effectively as possible against the background of climate change,” explains Jennifer Paffen, an ESG analyst in portfolio management at Union Investment.

Professor Ottmar Edenhofer, Director and Chief Economist of the Potsdam Institute for Climate Impact Research

Professor Edenhofer, the EU action plan for funding sustainable growth will be a major step forward in the fight against climate change. What more do you think needs to be done? There is no doubt that the reform of the financial system and reorientation of capital flows towards a greener and more sustainable economy is an important supporting measure. But new regulations won’t have any effect if the oversupply of fossil fuels is allowed to continue holding sway over the market. The most effective means of controlling this is to have a minimum price for carbon emissions that rises over time.

Carbon trading has long been an effective tool for reducing greenhouse gas emissions. Will that continue to be the case in future or are there better alternatives? The trade in CO2 certificates should be a marketplace enabling the best and most efficient technologies for avoiding emissions to be identified. But it is not yet fulfilling this role. Policymakers must introduce a minimum price for the certificates, and sectors such as transport and building management, that have so far not been included in the emissions trading system, will have to sensibly price their carbon emissions. And of course global coordination is important, particularly with the Chinese who are also planning to introduce an emissions trading system.

What makes you optimistic about the fight against climate change? I am not optimistic, but I haven’t given up hope. It’s easy to become frightened and anxious. The extreme weather events associated with climate change will increase. But after a lost decade it is clear that politicians are now beginning to take action. The last global climate summit strengthened multilateralism, the German government is showing serious interest in carbon pricing, and lots of people are taking to the streets on Fridays.

#Potsdam Institute for Climate Impact Research (PIK)
PIK carries out research into global change, climate impacts and sustainable development. Established in 1992 as an interdisciplinary institution, PIK is considered one of the world’s leading authorities in the area of climate impact research.
Oceans full of plastic waste

Plastic waste has become a serious threat to the ecosystem of the oceans and to mankind. More than 5.25 trillion pieces of plastic are floating around in the oceans, killing animals, polluting beaches and, ultimately, endangering human health. The issue of plastic waste is also of concern to the ESG Capital Markets & Stewardship team at Union Investment.

Potential solutions

Thanks to their material properties, plastics actually offer many benefits. They are light, inexpensive, hygienic, and long-lasting. Their durability means they can be reused multiple times, but in practice this rarely happens. The recycling rates for plastic are still very low. In Europe, around 30 per cent of plastic waste is recycled, in China it is around 25 per cent and in the US just 9 per cent. However, experts reckon that around 95 per cent of plastic products are only used once and then thrown away.

There are several promising approaches for stemming the flood of plastic:

• Reduction of plastic waste. In the past, Europe has always exported the majority of its plastic waste to China but on 1 January 2018, China introduced tighter import restrictions for waste recycling and put an end to the trade in plastic waste. This step was instrumental in the decision of the European Parliament to vote in favour of the European Commission’s proposed ban on single-use plastic products. From 2021, certain products for which alternatives already exist will be banned. These include, for example, plastic cotton buds and disposable plates and cutlery. Notwithstanding this move by the EU, however, it is vital that companies and consumers reduce their reliance on plastics.

The ‘Great Pacific garbage patch’ between California and Hawaii is a collection of floating waste material. Primarily plastic. Around 80,000 tonnes of it swirls around in an area covering 1.6 million square metres, which is roughly four times the size of Germany. And that is only the tip of the trash-berg: every year, up to 13 million tonnes of plastic waste ends up in our oceans. “Unless there is a drastic change in our obviuous production and disposal of single-use plastic packaging, by 2050 there will be more plastic (by weight) than creatures living in the sea,” warns Duy Ton, a portfolio manager in the ESG Capital Markets & Stewardship team. Experts estimate that by 2050 there will be one tonne of plastic for every three tonnes of fish.

The World Bank is already warning of the risks in a report: if plastic waste is not properly collected and managed, our waters and ecosystems will be contaminated and harmed for centuries, if not millennia. From the perspective of a sustainable investor there is therefore an urgent need for action. Investments can be used to counteract the current trend in a variety of ways, including preventing the further accumulation of waste and reducing it through the use of alternative materials and better recycling systems.

It is high time we learned how to deal responsibly with plastic.

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Plastic waste

Research into alternative materials: In order to halt the pollution of the oceans and the environment, biodegradable alternatives must be developed and used. There are already a number of promising approaches here. Companies that are already researching and developing sustainable solutions are of particular interest to sustainability-oriented investors.

Improving the recycling system: Recycling is also an investment issue. Plastic can be recycled and reused more times than virtually any other material. Improved recycling systems offer opportunities for reducing the number of single-use products. It is particularly important to make sure that the plastics are properly sorted to ensure the purity of the recycled materials. Some companies, such as Tomra, are well on their way to meeting this challenge. With the necessary incentive systems from the regulators, significant progress is possible in this area. This issue was a key aspect of Union Investment’s engagement activities in 2018. Duy Ton discussed plastic waste with numerous companies in order to raise their awareness of the issue and press them to look for solutions. “We are seeing some companies looking into very promising alternatives, and some have even brought solutions to market already,” says Duy Ton. The Finnish company Stora Enso, one of the world’s largest forestry companies, specialises in the development and manufacture of packaging materials. The company is a major provider of solutions in the fight against plastic waste. Many of its products are biodegradable replacements for plastic packaging. One of its major challenges is to find alternatives for plastic bottles. The company is working on the development of a material made from wood fibre and starch that can match plastic in terms of weight, hygiene, looks and price.

The issue was also addressed at several AGMs, where Union Investment made use of its voting right to support promising initiatives. “At the McDonald’s AGM, we used our vote to call for greater transparency in the battle against plastic waste,” says Duy Ton. The fast-food giant signalled that it takes the issue of plastic waste seriously and promised that by 2025, plastic waste will be eliminated from its packaging.

A volunteer helping to clear plastic waste from Manila Bay in the Philippines. Researchers are frantically working on new methods to rid the oceans of the immense quantities of plastic waste.
In conversation with Vera Bürgi, Managing Director of OceanCare

To what extent is the pollution of the oceans with plastic waste also a risk to people?

Every year, around nine million tonnes of plastic waste ends up in our oceans. Countless marine creatures starve to death with bellies full of plastic, accumulate toxins in their bodies or become tangled up in plastic and drown. Plastic waste is a massive threat to the marine ecosystem. All life on Earth depends on the health of the oceans. And that includes human life.

What should investors do to help prevent the oceans from becoming choked with plastic?

Investors can get involved philanthropically and support organisations such as OceanCare. Our organisation sits on international committees and works to ensure that binding regulations for the production, disposal and classification of plastics are formulated and implemented. OceanCare also seeks to reduce individual plastic use by changing attitudes and raising awareness around the world about more responsible use of plastics. The United Nations’ sustainable development goals (SDG) offer companies an opportunity to make a commitment to the UN concerning their own individual contribution to reducing plastic. Plastic is a problem that affects us all. The only hope for improvement is if every part of society works to contain the ever-growing mountains of waste.

How are investors responding? Do you see any grounds for optimism?

According to scientific calculations, the global peak in plastic production has not yet been reached, which means that marine pollution will continue to increase. On the positive side, the problem has become the focus of public attention in recent years and people are genuinely concerned. The growing realisation of companies and investors that they have to live up to their corporate responsibility makes us optimistic. However, the extent of the plastic problem means that a lot more engagement is needed in this area. In any event, rapid and fundamental realignment to create a genuine circular economy is required.
Drugged nation
The battle against painkiller abuse is an engagement issue

More than two million US citizens are already affected and are classed as opioid-dependent. The impact is reflected in the reduction in average life expectancy in the US.

Drug abuse is now the leading cause of death among the under 50s— Ahead of traffic accidents, gun violence or AIDS. Cautious estimates from the US Center for Disease Control and Prevention (CDC) suggest that around 100 Americans die of an opioid overdose every day.

But the huge increase in overdose deaths is not the only problem facing the US. The opioid crisis is also causing immense damage to the US economy. The costs of working days lost, the loss to the labour force of well-trained middle-aged professionals, the treatment of withdrawal symptoms, and re-integration into society run into several billion dollars.

Trump declares a national emergency
In 2017, US President Donald Trump declared the opioid crisis a public health emergency, calling opioid addiction the worst drugs crisis in the history of the US. The crisis is also interesting from a sociological perspective. Those most affected are white, middle-class Americans. Economically deprived federal states such as Alabama, Arkansas, West Virginia and Kentucky, were the first to see opioid abuse reaching high levels.

The unstoppable advance of opioids
But how did it come to this, and what has happened since the public health emergency was declared? Dijana Biogradanovic, an ESG analyst in the Sustainability and Engagement team within Portfolio Management at Union Investment, has been investigating.

“Until the early eighties, doctors had serious concerns about prescribing opioids for pain relief.” A relatively short letter in the readers’ section of the January issue of the New England Journal of Medicine (1980) triggered a change in prescribing practice. The letter was something of a door opener in terms of downplaying the risks of opioids. In just five sentences, medical researchers Professor Hershel Jick and Jane Porter claimed that of 12,000 hospital patients whose pain was managed with narcotic drugs, only four had gone on to develop an addiction.

Although the proposition was not based on any peer-reviewed study and the statement referred only to patients treated in hospital, the letter had an enormous impact. In the years that followed, it was cited in around 600 scholarly articles on opioids. Jick’s conclusions were used time and time again as proof that the painkillers were harmless. Other studies with similarly limited information value followed.

The consequences were fatal. In 1995, the unlisted pharmaceutical company Purdue Pharma LP was granted a licence by the US Food and Drug Administration (FDA) for the opioid OxyContin. The drug »

Opioids is a collective term used to describe a chemical group of natural, synthetic and semisynthetic substances used to alleviate pain, which have morphine-like (or, as the name suggests, ‘opium-like’) properties. Regular consumption of opioids can lead to physical and psychological dependency.
Opioids

Right to be pain-free

At the same time, several lobby groups in the US were demanding that patients’ pain be taken more seriously. “Pain was elevated to a sort of ‘fifth vital sign,’” says Bogdanovic. “Doctors faced calls to assess pain with the same urgency as heart rate, respiratory rate, blood pressure and body temperature.” Pain management thus became a key criterion in patient questionnaires for rating hospitals. As a result, hospitals were concerned to keep patients as pain-free as possible, which increased the incentive to prescribe pain medication. “Little by little, the culture of prescribing in the US changed,” explains Djana Bogdanovic. “Opioids were increasingly prescribed for chronic back pain or knee problems – sometimes for weeks at a time.”

“The pharmaceutical industry profited hugely from the use of opioids to treat chronic pain,” says Bogdanovic. “A new, secure long-term revenue stream was created.” In the period from 1999 to 2014 alone, revenue from prescription opioids had quadrupled. However, the frequency of pain reported by patients remained unchanged.

Many opioid addicts move on to cheaper drugs such as heroin. The people of New York are putting up signs to try to stop drugs being sold in their neighborhoods.
America in the grip of an opioid crisis

The problem grew to the point where it could no longer be ignored by politicians. But it was hard to turn back the tide. According to Dijana Bogdanovic, despite the stricter controls that have now been introduced for the prescription of opioids, there is no immediate solution to the problem in sight. “Users have moved on to the black market, or switched to other opioids, including heroin and Fentanyl.” An estimated one million Americans now take heroin. For many of them, the ending of painkillers paved the way for the descent into the swamp of drug addiction.

The opioid crisis will in all likelihood continue to occupy the US for a considerable time to come. The effects are still not fully clear. There are many different factors that led to the opioid epidemic. Regulatory control, aggressive marketing practices, greater flexibility in the pricing of drugs in the US and financial support for training programmes for doctors and patient groups all had a role to play in the emergence of the opioid crisis. Besides distributors, retailers and doctors, it is the pharmaceutical industry that bears the greatest responsibility. Purdue Pharma had been given a $600 million fine as long ago as 2007. In the grounds for its judgment, the court cited deliberate withholding of information about side effects and deception of the public. Other companies entangled in the opioid crisis are still at high risk of being sued. Multidistrict lawsuits mean they could face horrendous fines. And of course this means a greater risk for investors and for companies in a market that is characterised by takeovers.

Opioids are an engagement issue

Someone will have to be held responsible and made to pay for the economic and socio-economic costs. This is bound to have an impact on the record profit margins of many pharma companies that we have seen in recent years in the US.

That is why the subject of opioids and painkiller abuse is part of Union Investment’s engagement activities with pharma companies. We have already had some positive results. Our first discussions with Teva Pharmaceuticals, Johnson & Johnson and Novartis, among others, resulted in these companies explicitly distancing themselves from opioids. Some firms have stopped making opioids altogether. For some pharma companies, new business opportunities have opened up. Pfizer and Biogen have initiated clinical trials to investigate non-opioid painkillers that could help to reduce the potential for addiction.

Could this kind of opioid/painkiller addiction epidemic ever happen in Germany?

There are clear differences between the situation in Germany and that in the US. The prescription rate for opioids here is far below the excessively high rates seen in the United States. Our health system is accessible and well organised in all sectors and consequently there is a lesser risk of individuals self-medicating with prescription drugs obtained illegally due to lack of proper medical care. But that doesn’t mean there are no problems in Germany. Medical training often neglects aspects such as pain therapy and addiction medicine. A holistic, interdisciplinary approach to pain and addiction medicine during training is therefore very important.

The pharma industry has a legitimate interest in marketing its products and making profits. At the same time, patients have a right to receive evidence-based medical treatment. A problematic grey area may emerge between these two areas, for example through inappropriate promotion that is not based on scientific evidence. Lobbying activities can thus be extremely problematic. On the other hand, it is important to ensure that regulatory regimes do not choke innovation. In the field of psychopharmacotherapy, in particular, there have been recent examples where a genuine additional therapeutic benefit was not recognised, meaning that patients could not claim back the costs of such treatment from their health insurer.

How would you assess the lobbying activities of the pharma industry in Germany? Do they cause harm to patients?

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#3

Opioids

In conversation with Professor Oliver Pogarell, researcher in addiction medicine and senior physician at the Department of Psychiatry and Psychotherapy, Ludwig-Maximilians-University of Munich

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The opioid crisis remains an engagement issue for us. One example is participation in shareholders’ resolutions demanding investigations into the financial risks and the reputational risks of the opioid crisis. In 2018, for example, we pushed for such a shareholders’ resolution for the pharmaceutical distribution company AmerisourceBergen.

Are there prescribing practices in other areas of pharmacology in Germany that give you cause for concern?

Dependency on prescribed and legal drugs attracts relatively little attention in Germany. It is often referred to as ‘silent addiction’ because of its low visibility. It mainly involves sedatives, i.e. sleeping tablets and tranquilisers that are often used unquestioningly for long periods of time. Estimates suggest that up to two million people may be affected, with women being twice as likely to be affected as men, and prevalence increasing considerably among older age groups.

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#BAS

Professor Oliver Pogarell is first chairman of the Bavarian Academy for Addiction and Health Issues (BAS), an institute that links research with practice on relevant questions regarding the prevention and treatment of addiction.

Dijana Bogdanovic

ESG Analyst in the Sustainability and Engagement team in Portfolio Management at Union Investment
Excluded for good reason

Union Investment mutual funds are becoming nuclear weapon free

Weapons of war and nuclear energy are classic exclusion criteria for many sustainability-focused investors. These investors are particularly keen to exclude nuclear weapons, but this requires close examination of the production processes.

On 6 August 1945, the US dropped an atomic bomb over the Japanese city of Hiroshima. Three days later it detonated a second bomb over Nagasaki – both with devastating consequences. Hundreds of thousands of people were killed on the spot or died later from the effects of the explosions. Both cities were completely destroyed. More than 70 years on, the horrors of the bombing are still very present there.

Nuclear warfare is a major ethical problem. This applies both to the extent of the immediate damage and to the insalubrious risks for the post-war world. As with a nuclear accident (Chernobyl or Fukushima), the use of nuclear weapons contaminates huge swathes of land, rendering it uninhabitable for decades to come. Although nuclear weapons are among the worst weapons of mass destruction, they are tolerated at political level by many states as a form of deterrent. The proliferation of nuclear weapons was supposed to have been halted by the 1970 Nuclear Non-Proliferation Treaty, although the nuclear powers retained the right to keep their own nuclear weapons. This is an anomaly which means that nuclear weapons, unlike landmines, cluster bombs and chemical or biological weapons, do not count as outlawed weapons under international conventions.

Although the number of nuclear warheads has fallen in the 30 or so years since the end of the Cold War, there is increasing investment in the modernisation of nuclear weapons. This is the conclusion of the Stockholm International Peace Research Institute (SIPRI), which has reported in detail on investment in the modernisation of nuclear arsenals. The risk of nuclear conflict has risen again.

On 6 August 1945, the US troops inspect the devastating impact of the atomic bomb dropped on Hiroshima in 1945.
New nuclear powers are arming themselves, and old nuclear powers such as the US are taking a critical look at existing arms control agreements. On 1 February 2019, the US terminated the INF treaty signed in 1987 with what was then the Soviet Union, which sought to reduce the number of intermediate range nuclear missile systems in Europe.

Growing risk: more and more states now own nuclear weapons

As a responsible investor, Union Investment has taken a clear position against nuclear weapons. “At the recommendation of the ESG committee and as part of a regular process in which we discuss sustainability issues and ethical questions, we decided in April 2018 to exclude manufacturers of nuclear weapons and companies that are involved in the maintenance of such systems from all mutual funds,” explains Janne Werning, coordinator of the ESG committee and an ESG analyst at Union Investment.

This decision set in train the process of gradually eliminating nuclear weapons from all of Union Investment’s mutual funds. The policy excludes, in particular, companies that are involved in the manufacture of carrier rockets, nuclear warheads and specific components. A ban on buying shares in such companies came into force immediately. “Any existing positions held in the funds are gradually being reduced with the aim of complete elimination by the end of 2019,” explains Janne Werning.

As part of its policy to exclude nuclear weapons, the Union Investment sustainability team has started a discussion with the companies concerned. The aim of this engagement activity is to encourage companies to cease their involvement in the production of nuclear weapons or at least to spin off the business units concerned.

Companies include private firms that work for the nuclear arms programs of the US, the UK and France, including Airbus, Northrop Grumman and Safran. “We think it is unlikely that the large corporations will make significant changes. The financial dependence of these companies on government orders for weapons systems is simply too great,” explains Janne Werning. “But...”

Fewer, but no less dangerous

The nuclear powers are modernising their arsenals

The ESG committee

The ESG committee was set up by Union Investment in 2016. It has seven permanent members from the areas of equities, bonds, research & investment strategy (ESG department) and portfolio solutions. The aim of the committee is to bring together portfolio management expertise and sustainability expertise in a formalised structure. It holds central responsibility for specifying a sustainable investment strategy – one that systematically addresses ESG aspects. The committee meets every two months, but ad-hoc meetings can also be called if more immediate action is required as a result of unexpected events.

**Nuclear weapons**

in the longer term, there is a chance of them spinning off the military business from the civilian.” In addition to reducing its shareholdings, Union Investment’s aim now from a sustainability perspective is to remain in contact with the companies and to send a clear message against weapons of mass destruction.

“But in the longer term there is the chance of them spinning off the military business from the civilian.”

Janne Werning, ESG Analyst at Union Investment

**Union Investment wants to know more**

**A challenging process**

Union Investment categorically does not invest in companies that make weapons which are banned under international law, such as cluster bombs, landmines, and biological or chemical weapons. Serious ethical questions are also asked about investments in companies that play a key role in the production of nuclear weapons. Like weapons banned under international law, the production of nuclear weapons carries a high reputational risk.

The challenge in excluding nuclear weapons, however, lies in understanding the precise production and value-creation chains for this complex technology. Nuclear weapons are not just the atomic warheads, but also comprise a number of individual components such as carrier systems, electronics, and sensors. It is difficult to identify the specific companies concerned. Often, civilian companies involved in aerospace and the tech sector supply parts that have non-military uses but can also be used in the production of nuclear weapons. There are also many companies that are involved indirectly, or to a lesser degree, such as through production of small parts for the assembly or maintenance of nuclear weapons systems. While the civilian sector does not present any concerns from an ESG perspective, as a socially responsible asset management company we want to exercise some influence on the military activities of the companies involved, on behalf of our investors.
The Brazilian mining corporation Vale has been the focus of public attention since the collapse of a dam at one of its mines. Vale had already been excluded from Union Investment’s sustainability-oriented funds due to similar incidents in the past.

Vale had been put on the Union Investment-wide exclusion list after it failed to signal any willingness to improve following engagement dialogues. This means that it is excluded from all products actively managed by Union Investment. The disaster occurred on 25 January 2019, not far from the small Brazilian town of Brumadinho. The dam in front of a holding basin at the Corrego do Feijão iron ore mine collapsed, sending twelve million cubic metres of toxic sludge cascading down the valley. The mud buried everything in its path, including – tragically – the mining company’s canteen. The number of fatalities steadily rose in the days that followed. At the latest count, at least 200 people had lost their lives and around 100 were still missing. It is uncertain whether they will ever be found beneath the mud.

In addition to the human cost, the capital markets also reacted strongly. Vale’s shares fell by around a fifth on the next trading day, wiping €13 billion off the company’s value. The government froze the company’s accounts to secure funds for possible compensation claims. Questions of guilt remain unanswered. One thing we do know is that the dam had been checked by the German inspection company TÜV SÜD just a few months earlier; and the company’s own internal procedures had apparently not revealed any major problems. We will have to wait for the final results of the ongoing investigations to find out whether Vale acted negligently or there was mounting evidence that, despite initial denials, Vale may have been informed about possible defects in the dam before the accident.

Ad-hoc meeting of the ESG committee

As soon as news of the dam collapse in Brumadinho reached Union Investment, the ESG committee convened for an ad-hoc meeting to review the case. It quickly established that none of the sustainability funds contained any Vale securities, because the company had been excluded from this portfolio for several years. The conventional funds contained only very small holdings of the company’s shares, partly because its low ESG score acted as a warning signal for the teams focused on corporate fundamentals. The question of possible negligence still has not been definitively answered. Nonetheless, Union Investment sought contact with the company to establish how such mistakes can be avoided in future and how Vale can regain investors’ trust.

The issuer’s exclusion from the sustainability-oriented funds is due to its discreditable track record. In November 2015, a dam burst at the Mariana mine operated by Vale, resulting in 19 deaths. The share price plummeted and the mine still remains closed today. The accident caused immense environmental damage and an entire village had to be relocated.

Problems not taken seriously

Contacts with the company after that incident failed to persuade the fund managers that there would be no similar accidents in the future – and their judgement was proven correct by the tragic and immensely damaging events of January. Vale had always emphasised that the 2015 dam burst occurred at a mine that was operated as a joint venture with another company, BHP Billiton, and that the Brazilians did not have sole control of the complex. Jennifer Paffen, an ESG analyst at Union Investment, had talks with the Vale management in 2018: “In our discussions, the company’s representatives were unable to cite any specific measures that would help to prevent such an incident from happening again in future.” There were no credible descriptions of systemic changes to the risk management procedures. The company managers seemed far more concerned with shifting the responsibility for the dam breach to its joint venture partner. Further complicating factors included other environmental offences and inadequate communication and cooperation with the local population, who had not been involved in the company’s various projects. The company seemed to take Union Investment’s concerns lightly: “Vale communicated in a way that did not match the severity of the problems being addressed. There were no signs of any in-depth analysis of existing areas of concern. Fattally, as we now know.” The catastrophe that occurred in January proves that the ESG team made the right decision. The subsequent fall in share price did not have any impact on the sustainability portfolios.

Maintaining dialogue

But the story does not end there. Union Investment believes in dialogue with companies, regardless of whether its funds are actively invested in them or not. So in February – in accordance with the decision of the ESG committee – a letter was sent to the Vale management team, who responded with an offer of talks. However, the success of the engagement has been limited: so far there has apparently been no significant improvement in the risk management of the dams, nor has there been any productive cooperation on prevention, either within the company itself or in relevant industry associations. There is also growing evidence to suggest that Vale suspected there were possible defects in the dam even before the breach, and that it was therefore negligent in failing to prevent a possible accident.

The dialogue and the resulting analyses show that structural inadequacies were among the causes of the dam burst and that no adequate measures have since been put in place to prevent, so far as is possible, a future occurrence. The risks far outweigh any potential upside; there can be no question of exposure to this paper, both from a sustainability perspective and for reputational reasons. The collapse of the dam is a serious breach of the principles of the UN Global Compact, to which Union Investment is a signatory. As a result of this assessment, the issuer has been placed on the Union Investment-wide exclusion list. This means that Vale is excluded from all products actively managed by Union Investment.

“An accident waiting to happen”

The mining giant Vale: a textbook example of non-sustainable mismanagement

Martin Hampel Financial communication specialist at Union Investment
2018 was a challenging year for sustainability-oriented investors. Union Investment represented their interests in several areas.

The exceptionally long and dry summer that Germany experienced last year was yet another reminder of the changes associated with climate change. 2018 was also one of the four worst years in the past two decades for storms. According to the German Insurance Association (GDV), damage caused by acts of nature in Germany alone amounted to €2.6 billion. Alongside extreme weather events, other aspects that were worrying from a sustainability perspective also made headlines. These included Facebook and its handling of personal user data, and the multi-billion dollar takeover of Monsanto by Bayer, the cost of which is still rising due to a wave of lawsuits.

Once again, using its full range of engagement tools, Union Investment brought its weight to bear as a major German asset manager to influence companies to adopt more sustainable business policies. Representatives from Portfolio Management spoke at 15 AGMs. That is a new record. The most votes (580) were in the US. Given the looming threat of Brexit, it is interesting that the number of AGMs attended in the UK was not lower than in the previous year, but in fact rose by around 28 per cent. Union Investment was also active outside the AGMs, conducting around 525 straight-talking engagement dialogues with major companies.

Numerous ESG issues were discussed in constructive talks with hundreds of companies. The majority of...
ESG engagements (42 per cent) last year focused on social issues. For example, investee companies were urged to improve transparency in their labour standards. The issue of cybersecurity was also relatively high on the agenda. This primarily concerns people’s rights, particularly in terms of data protection and privacy. Other social issues discussed included controversial weapons and aggressive marketing of drugs.

In comparison with the previous year, governance issues increased in intensity and accounted for a total of 30 per cent of all engagements. Discussions concerning the composition of supervisory boards dominated in this area, along with executive board pay (primarily in view of key ESG performance indicators). Anti-corruption, the implementation of appropriate general sustainability strategies and CSR reporting were important topics of dialogue in the area of governance. Union Investment’s engagement in this area included contributing to the update of the German Corporate Governance Code. It worked on various task forces including the Schmalenbach Corporate Governance Reporting Group and the DVFA Corporate Governance Committee.

Corporate governance issues increased in intensity and accounted for a total of 30 per cent of all engagements.

There were fewer engagements in the area of the environment than in previous years, with this aspect accounting for just 29 per cent of the total. The subjects of CO₂ transparency, decarbonisation, electrification and alternative energies remained important. Green bonds, the funding of environmental projects and the fight against plastic waste were relevant topics in the environmental sector.

Sustainable development goals

The United Nations’ sustainable development goals (SDG) are playing an increasingly important role in many engagement topics, and Union Investment addresses them in its engagement activities. The importance of the sustainable development goals was underlined by the fact that they topped the agenda at the Union Investment Sustainability Conference in June 2018.
As an internationally active shareholder, Union Investment attended and voted at a total of 2,288 annual general meetings in 28 countries last year. This equates to a year-on-year increase of 20.4 per cent.

Union Investment also had 536 company contacts in more than 32 countries in connection with UnionVoice activities. Many of them centred on environmental, social and governance (ESG) criteria.

**Voting activities by issue**

There are many facets to sustainability at UnionVote, ranging from a ban on drinking straws and disclosure of donations to climate change.

Once again, the nomination and formal approval of the management board was the dominant voting issue. The second-largest topic area was investor motions such as the ban on drinking straws, the disclosure of donations and motions concerning climate-related issues. These account for 16.7 per cent and are grouped together under ‘Other’.

Source: Union Investment.

**UnionVoice 2018**

The ten countries with the most engagement activities (%)

<table>
<thead>
<tr>
<th>Country</th>
<th>Engagement Activities</th>
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<tbody>
<tr>
<td>Canada</td>
<td>4.7</td>
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<tr>
<td>UK</td>
<td>9.9</td>
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<tr>
<td>Denmark</td>
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<tr>
<td>Germany</td>
<td>21.1</td>
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<td>France</td>
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<tr>
<td>Spain</td>
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<td>Switzerland</td>
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<td>US</td>
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<td>Australia</td>
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<td>Netherlands</td>
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<td>Denmark</td>
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The future starts here. Investors sense that they are at a crossroads. The investment decisions they make today will set the course for the coming decades. This was the thinking behind the new Union Investment campaign #beyondtomorrow. With a forward-looking slogan and inclusion of the hashtag symbol used in social media, the asset manager for the cooperative financial network is drawing attention to its sustainability activities and giving them an emotional dimension.

The new campaign focuses on the development of sustainability from an organisational perspective within portfolio management and the realignment of Union Investment’s ESG team (see Introduction on page 4). Climate change and its impact on the investment strategies of institutional investors are a key theme of #beyondtomorrow. Advertisements and banners feature individual Union Investment employees presenting images of icebergs, solar farms and fields of wheat, together with large numbers which highlight the relevance to investment decisions. “We don’t want to show catastrophes. We want to show what we need to protect,” says Stephanie Serff-Gerstein, Senior Marketing Manager at Union Investment.

In 2019, Union Investment picked up its fifth Scope Award in a row at a ceremony in Berlin. The asset manager for the cooperative financial network received the award in the ‘Sociably Responsible Investing’ category for the German-speaking countries. The verdict delivered by the panel of judges emphasised how Union Investment’s ESG research covers the MSCI All Country World Index in full. According to Scope, this makes Union Investment the best asset manager in the field of sustainable investments in Germany, Austria and Switzerland. “We are delighted to have received this award. It shows that sustainability criteria have been consistently and successfully addressed in both our corporate strategy and our investment process,” says Alexander Schmidt, Member of the Board of Managing Directors at Union Investment.

Key topics for investors in 2019

Regulation, corporate governance and the fight against climate change are giving additional impetus to the issue of sustainability. Union Investment is integrating these issues more deeply into its investment process for the benefit of its investors.

We will be dealing with many ESG topics in 2019, with regulations such as the EU action plan for funding sustainable growth being a particular focus. In June, the EU Shareholder Rights’ Directive comes into force. It will require institutional investors to engage more closely with corporate governance matters and looks set to provide further impetus to this whole area. The same applies to the amendment to the German Corporate Governance Code and the associated requirements placed on investors.

The continuing issue of climate change

Climate change is an ongoing issue. Union Investment is increasing its engagement in the transport sector, which is the second-biggest cause of carbon emissions after utilities. The fight against climate change and the resulting opportunities, risks and challenges will be among the topics discussed at the Union Investment Sustainability Conference on 25 June. Guest speakers include Lord Nicholas Stern, former chief economist at the World Bank and the European Bank for Reconstruction and Development, Professor Ottmar Edenhofer, director of the Potsdam Institute for Climate Impact Research, Christian Lindner, leader of the FDP; and former German president Joachim Gauck.

Closer integration

More extensive and deeper integration of sustainability into the investment process is a top priority for Union Investment. Portfolio management has been driving this issue forward for a number of years, with the result that ESG analysis is no longer restricted to the sustainability-oriented funds, but is now applied for all clients. The new ESG department will further intensify our activities in this area and make the topic an even higher priority.

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Five-times winner of sustainability award

Union Investment receives Scope Award for socially responsible investing

In 2019, Union Investment picked up its fifth Scope Award in a row at a ceremony in Berlin. The asset manager for the cooperative financial network received the award in the ‘Sociably Responsible Investing’ category for the German-speaking countries. The verdict delivered by the panel of judges emphasised how Union Investment’s ESG research covers the MSCI All Country World Index in full. According to Scope, this makes Union Investment the best asset manager in the field of sustainable investments in Germany, Austria and Switzerland. “We are delighted to have received this award. It shows that sustainability criteria have been consistently and successfully addressed in both our corporate strategy and our investment process,” says Alexander Schmidt, Member of the Board of Managing Directors at Union Investment.
We work for your investment