Pareto
Asset Management

Responsible investments

Report 2-2020

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Showing our cards

We have written several times about our commitment to responsible and sustainable investments. This report, made to show how we handle this commitment, is the tenth of its kind. We like to think that we are constantly getting a little better, through experience and not least the opportunity to learn from our own mistakes. But showing our cards in this way, we are open to the fact that you may see it differently. In any case, we believe that openness has an intrinsic value – just as we are concerned with openness in the companies we are considering investing in. In the business jargon, we call it transparency.

Let's just admit it right away: this is not altruism. We think that it is right for Pareto Asset Management – that it benefits us in the long run. Inasmuch as our asset management has a distinctly long-term perspective, it is only natural that we take environmental, social and governance aspects into account. Such factors do influence long-term value creation and sustainability.

We also believe that our management philosophy is well suited to the purpose. Active investment choices, thorough analyses of a limited number of companies and a long-term perspective form a good starting point for sustainable management. If you are serious about achieving something by way of your investments, you just can't invest with your eyes closed in a broad-based index.

If this is to be done properly, it must be made committing. In 2014, we formalised our commitment by signing the UN PRI (United Nations Principles for Responsible Investment). In 2017, we became a member of Norsif, the Norwegian forum for responsible and sustainable investments, and of its Swedish sister organisation Swesif. In 2018, yours truly joined the board of Norsif, and later the same year Pareto Global Corporate Bond became the first fixed income fund in Norway and Sweden to receive the Nordic Swan Ecolabel.

The quality of our work with sustainable management is nevertheless something that we can only show in practice, whereupon it becomes evident that it is a demanding exercise. It raises many dilemmas with no clear answers, and it requires a lot of subjective judgment. It also implies that we make mistakes. Many mistakes. We learn from these mistakes and we realise that we still have a lot to learn – which will be apparent on the following pages, for better or worse.

The report includes our guidelines for responsible investments. We also provide some more detail on how we go about implementing these guidelines, and on some of the institutions and sources we utilise.

Last but not least, we provide an exposé of actual dilemmas: These companies have caused us a bit of a headache, and still do. That way you gain an impression of the trade-offs and assessments we have to make in practice. We can make mistakes, but we can not avoid making decisions. In this report you will catch a glimpse of how some of these decisions have come about.

And perhaps some we regret having made.

Kind regards

Finn Øystein Bergh
Chief Economist & Strategist

Guidelines for responsible investments

1. BACKGROUND AND PURPOSE

Pareto Asset Management AS ("Pareto Asset Management") aims at contributing to sustainable development of markets and long-term value creation by investing in a responsible and ethical manner. We believe that responsible investments are important for achieving the best possible risk-adjusted return for our unitholders and customers. Sustainability and sound corporate governance give companies competitive advantages and contribute to long-term value creation.

This document sets out guidelines for responsible investments undertaken by Pareto Asset Management on behalf of our unitholders and individual asset owners. The purpose of the policy is to prevent Pareto Asset Management from contributing to the violation of human rights, labor rights, corruption, environmental damage or other unethical actions. Furthermore, we consider it important to integrate sustainability assessments into our investment processes, as this can also affect the long-term value of our investment.

We expect the companies that we invest in to comply with the same principles.

As part of our efforts to promote responsible investments, Pareto Asset Management has signed the UN Principles for Responsible Investment ("UN PRI")[1]. These guidelines are based on UN PRI, the UN Global Compact[2], the guidelines for the Norwegian Government Pension Fund Global, the Principles for the exercise of ownership rights in investment companies from the Norwegian Fund and Asset Management Association, as well as internationally recognised principles and conventions.

2. RESPONSIBLE INVESTMENTS

2.1 Priorities

We seek to invest in companies that have good quality of operations and management. The companies should have a clear focus on ethical issues in their attitudes and actions, as well as having a value base for the business that complies with the guidelines. The companies must exert good corporate governance, comply with national legislation as well as international conventions, and show an open and complementary information policy. This means we emphasise social conditions, the environment, sustainability and good corporate governance when considering a company.

Ethical risk assessments must be conducted before an investment can be made.

2.2 Exclusion of companies

Pareto Asset Management shall not be invested, on behalf of our funds and customers, in companies which themselves or through entities they control:

- Produce weapons that, in normal use, violate basic humanitarian principles
- Produce tobacco
- Sell weapons or military equipment to states subject to sanctions from the UN Security Council or other international measures directed at a particular country that Norway has supported (mandate for the management of the SPU section 3-1 second paragraph letter c)
- Mining companies and power producers that themselves or consolidated with controlled entities receive 30 per cent or more of their revenues from thermal coal, or base 30 per cent or more of their operations on thermal coal activity
- Produce pornography

[1] The contents of UNPRI can be found here: www.unpri.org/pri/an-introduction-to-responsible-investment.

[2] The UN Global Compact contains ten general principles derived from the Universal Declaration of Human Rights, the ILO Declaration of Fundamental Principles and Rights in Work and the Rio Declaration on Environment and Development.

Pareto Asset Management may decide to exclude a company if there is an unacceptable risk that the company contributes or is responsible for:

- Human rights violations, such as killing, torture, deprivation of liberty, forced labour and exploitation of children, including child labour[3]
- Violations of individuals' rights in war or conflict situations
- Breach of basic employee rights
- Severe environmental damage
- Actions or omissions that lead to greenhouse gas emissions at an aggregated company level
- Corruption
- Other repeated or significant violations of basic ethical norms

Pareto Asset Management shall exercise a precautionary principle in connection with investments in biotechnology companies, gambling and alcohol.

2.3 Exclusion decision

Companies listed on the exclusion list of the Norwegian Government Pension Fund Global after the decision of Norges Bank's Executive Board shall be automatically excluded from the investment universe of Pareto Asset Management.

If legitimate doubt arises as to whether an investment is in line with the guidelines, a separate ethical risk assessment shall be conducted. This assessment can be based on input from our customers and other stakeholders, as well as various publicly available sources. Pareto Asset Management will nevertheless always draw its own conclusions based on a specific assessment of objective, verifiable facts.

3. CORPORATE GOVERNANCE

Pareto Asset Management shall exercise active ownership in the portfolio companies in order to promote responsible business operations. This means that we will use our ownership rights and influence in the companies to help move the companies in a positive direction in terms of social relations, environmental issues, sustainability and good corporate governance.

When there is a specific reason to believe that a company violates our policy of responsible investments, we will consider addressing the issue with the company's management and encouraging the company to correct the circumstances. If necessary change is not implemented, Pareto Asset Management will normally sell all positions in the company.

[3] This includes "the worst forms of child labour" as defined in the ILO Convention (No. 182) Article 3.

4. RESPONSIBILITY FOR MONITORING AND CHECKING THE GUIDELINES

Pareto Asset Management has established an ethics committee entrusted with the responsibility to ensure that the company's guidelines for responsible investments are up to date and appropriate, as well as assess and decide exclusion of companies in accordance with paragraph 2.3 of the guidelines. It will also assist portfolio managers with training, advice and sparring as needed. In particularly demanding cases, the Ethics Committee shall inform the CEO.

The Ethics Committee is headed by the company's Chief Economist & Strategist and consists, in addition, of representatives of different departments as required.

Twice a year, the Ethics Committee prepares a report on our guidelines for responsible investments and the practice of these. The report reviews specific topics we have worked with as well as relevant company assessments and dilemmas. It shall be available to our customers.

The chairman of the Ethics Committee shall annually provide the Board of Pareto Asset Management with an overview of the status of ongoing work for responsible investments in the company.

The Compliance Manager shall supervise compliance with our Guidelines for Responsible Investments, including the necessary exclusion of companies. In addition, the compliance officer will attend meetings of the Ethics Committee as an observer.

Background and facts

Behind the UNPRI principles is the UN Environment Program Finance Initiative (UNEP FI). UNEP FI is a global partnership between the United Nations Environment Program and the financial sector. Among the goals for the collaboration is to identify, promote and realize best environmental and sustainability practices in the financial industry. Central to this collaboration are ESG questions, derived from the English concepts **e**nvironmental issues, **s**ocial issues and corporate **g**overnance.

Through our signature, we committed ourselves to respond to ESG questions that may follow, to the best of both our customers in the long run and for society as a whole:

1. We will implement ESG issues in our investment analysis and decision-making processes
2. We will practice active ownership and implement ESG in our ownership policy and its exercise
3. We will work for satisfactory reporting on ESG topics from our portfolio companies
4. We will promote acceptance and implementation of the principles in the financial industry
5. We will work with other signatories to strengthen the effect of the principles and their implementation
6. We will report on our activities and our progress in implementing the principles

Our signature also includes a more general, implicit obligation to follow principles and standards anchored in the UN. These are voluntary, non-judicial recommendations that express expectations of good corporate governance, and which provide expectations for good corporate practices in dealing with environmental and social issues. In assessing our investments, these principles and standards will act as a reference framework and guide.

The UN Global Compact contains ten general principles derived from the Universal Declaration of Human Rights, the ILO Declaration of Fundamental Principles and Rights in Work and the Rio Declaration on Environment and Dvelopment. The principles are general and state, among other things, that companies must respect human rights and not be involved in violations of them, maintain freedom of association and collective bargaining rights, and eliminate all forms of forced labor, child labor and discrimination in working life.

Product based exclusion criteria

Weapons and ammunition

A variety of types of weapons, ammunition and warfare methods are prohibited under international law, such as the Geneva Convention.

Both Saab and Kongsberg Gruppen are currently excluded from the company's investment universe as a precautionary principle. In this report's section on company assessments, we also show how we have worked to clarify whether the American company Heico is involved in weapons production.

Tobacco

Tobacco is a legal stimulant, which according to WHO is causing several million deaths in the world each year.

Coal

Pareto Asset Management follows the Norwegian Government Pension Fund in its assessment of coal producing companies.

Pornography

Pareto Asset Management does not invest in companies producing pornography.

Product based precautionary principles

Biotechnology

Modern biotechnology touches life's big questions and has an impact on what we think about human worth. It is therefore relevant to the whole global population, and not just doctors and researchers who carry out in vitro fertilisation, map genes and research stem cells. Investments in biotechnology may involve a risk of violation of fundamental ethical norms.

Alcohol

We have considered whether there should also be an absolute ban on investments in alcohol but has concluded that it is neither desirable nor manageable in an ethically consistent and sound manner.

Alcohol as a food additive is generally considered to have many positive aspects. Furthermore, alcoholic beverages are embedded in most societies, with many businesses indirectly profiting from alcohol consumption. Breweries, wineries and distilleries stand out as obvious examples, but also wholesalers, hotels, restaurants, airlines, shipping companies, railways and especially grocery chains may have a significant portion of their profits from the sale or delivery of alcohol. The same applies, of course, to real estate companies with revenue-based rent, such as the listed company Olav Thon Eiendomsselskap (OSE).

An absolute ban on investments in companies with interests in alcohol will therefore likely be perceived as a case of double standards, and insurmountably complicated. In consideration of the significant social and health problems relating to alcohol abuse, the company will nevertheless apply a precautionary principle with investments in alcohol.

Gambling

We have considered whether there should be a ban on investments in gambling. At this point, our assessment is that a general ban is problematic for several reasons.

Gambling has a relatively wide definition, covering everything from games that primarily fills an entertainment function, to more economically active activities where the outcome is largely due to chance and luck.

For the purpose of these guidelines, it's the possible harmful effects that are of importance. The consequences of gambling can be summarised in two words: gambling addiction.

Pareto Asset Management does not want to act in a way that contributes to increasing and more harmful gambling addiction. As part of the investment process we must therefore always raise the question of whether the company in question has a way of business that it is likely to create gambling addiction.

In our opinion, a general ban will not contribute to better achievement. An important element is that a significant part of the gambling business largely, or wholly, fills an entertainment function. Although the gains are in the form of money, unlike the teddy bear in the amusement park, the stakes are normally such that participation is for fun, excitement and surprise, not because it nourishes some presumption of getting rich.

Furthermore, gambling, like alcohol, has such an extent that it can be difficult to draw sharp limits. One might imagine a kiosk chain with deployed slot machines of a type approved by the relevant authority, where the kiosks get a lease while the profits are due to a third party. The chain then has no benefit of increased gaming on the vending machines, and their own activity can be claimed to be limited to the letting of floor space.

Similarly, gambling is offered on most cruise ships and passenger ferries, as well as at some hotels. In addition, there are companies producing the game machines used without this being considered gambling. For these reasons, we have concluded that there should be no general ban on gambling. On the other hand, it seems obvious that it should apply a precautionary principle when investing in companies that offer gambling.

Conduct etc.

Human rights violations
Gross or systematic violations of human rights such as killing, torture, deprivation of liberty, forced labour, the worst forms of child labour. In our reviews, we have not found any circumstances that indicate that any of our portfolio companies contribute to such human rights violations.

Serious environmental damage
Serious environmental damages can be said to include severe climate impact in the form of relatively high greenhouse gas emissions, which is also in line with Norway's international commitments and the government's climate report.

Based on this review, we are not aware of circumstances that indicate that any of our portfolio companies contribute to serious environmental damage. However, we have found reason to assess the situation for Norsk Hydro's operations in Brazil (page 14).

Greenhouse gas emissions
Actions or omissions that unacceptably lead to greenhouse gas emissions at an aggregated company level. Many will argue that the oil industry contributes to unacceptable emissions of greenhouse gases. Therefore, we have looked into our investments in this sector.

In November 2016, the Carbon Disclosure Project (CDP) analysed the climate strategy of the world's largest oil and gas companies entitled "Which oil and gas companies are preparing for the future?"

Statoil (now Equinor) was top rated, followed by Eni and Total, while Exxon was in tenth place.

"Statoil performs strongly across most key areas. It has the highest percentage of gas in its proved reserve base and has increased the proportion of gas in its production the most in recent years. With a low reserve life (and high percentage of developed proved reserves) it potentially has more flexibility than others to adapt its capital expenditure strategy. The company has the lowest upstream emissions intensity and manages its methane and flaring emissions better than its peers. Statoil has also made recent commitments on low-carbon energy, focusing on offshore wind projects and has assessed the economic impact of the IEA450 scenario on its portfolio."

In November 2018, the report "Beyond the cycle" was issued, where the CDP analyses how oil companies are positioned towards the transition to a low carbon economy. Equinor is ranked on top of a total of 24 major oil companies. ExxonMobil, which is now out of our portfolios, was ranked as number 17.

See also the section on climate risk.

Gross corruption
In August 2017, Samsung heir and Group Vice Chairman Lee Jae-yong (50) was sentenced to five years in prison for corruption.

Jae-yong was found guilty of enabling bribes to organisations where he expected reciprocal support from former President Park.

We assume that this case will contribute to a changed pattern of action, both in the company and among shareholders. South Korea has a special business structure that from time to time has led to challenging corporate governance issues. The local markets are adapting to such global regulatory demands, and we look at the disclosures and verdict in this case as a step in the right direction.

Pareto Total holds shares in Samsung.

Other particularly gross violations of basic norms
We have not identified other gross violations of basic norms.

Corporate governance

Engagement policy

Pareto Asset Management conducts meetings with the management and board members in many of the portfolio companies, as well as shareholders, on a regular basis. This dialogue is the most important instrument we use in our work as an active owner.

Grounds for initiating engagement activities may be breach of ESG criteria, substantial investment in the company or a need for more information on critical ESG damage that has already occurred.

Requests from clients can also be grounds for engagement.

Proxy voting

Pareto Asset Management has established its own voting guidelines. These are based on the Norwegian Code of Practice for Corporate Governance.

Active ownership

Obviously, our portfolio companies are not perfect. If we decide to invest in a company, there is most often a lot we wouldn't mind being able to change. That leaves us two options.

There is a phrase called "voting with your feet", which means leaving something or someone you disagree with, rather than trying to change them. In our industry, we might also say that we vote with our wallets. We do this when we sell something we do not want to own – or, conversely, seek particularly promising investments.

But we do more than that. We also try to influence the companies we own. We vote at annual general assemblies, we have direct dialogue with management or try to work with other committed shareholders. And we do believe that, sometimes, we can push the development in the desired direction.

Our Norwegian equity portfolios consist of companies we know well, in many cases after years of ownership and a number of opportunities for dialogue with management. In the fund Pareto Aksje Norge, which has a relatively low turnover rate, we have engaged in dialogue with practically all the companies in the portfolio on corporate governance, environment and (to a lesser extent) social conditions over the past few years. These are companies we know well, with direct lines to top management. Last year we discussed e.g. management succession with a number of banks, as well as the impact of ESG quality on business loans and green housing loans. We also continued a previous governance dialogue with Bonheur and discussed sustainable consumer products with Orkla.

This is not altruism. We do it to understand and control the risks in the companies we own. Thus, we have a good commercial justification for integrating ESG themes into our investment management.

This is how we are affected by e.g. the situation in Belarus, where protests broke out after what was apparently election fraud – few believe that incumbent President Alexander Lukashenko received over 80 per cent of the vote in the election in August. After the election, there was also a strike at the industrial giant Belaruskali, which produces over 15 per cent of all potash (potassium carbonate) in the world. The company is consequently an important part of the value chain of the Norwegian fertiliser producer Yara.

At least one of the strike leaders was arrested, and the media reported both pressure and serious threats in a situation where several protesters in Belarus were said to have been beaten. We therefore contacted Yara and raised a number of issues. Among other things, we pointed out that Yara's suppliers must comply with their own code of conduct, and that they must take action if they receive information that confirms breaches.

Yara then communicated to us that they had daily contact with the management, that they sought information from several sources (including the trade union), and that they used Norwegian authorities as advisers. In addition, the company would send its own personnel to Belarus.

And so, we get confirmation that large companies today have a completely different attention to ESG-related issues.

We do it to understand and control the risks in the companies we own. Thus, we have a good commercial justification for integrating ESG themes into our investment management.

In Pareto Global as well we engaged with several companies on such topics. With Ralph Lauren we continued our discussion on various ESG related issues; we kept confronting Ryanair with labour relations and greenhouse gas emissions; and In our dialogue with Attendo, staffing at nursing homes and possibly "ghost staffing" in hourly lists remained on the agenda (we feel compelled to add that we have found no reason to distrust the company).. With Michelin we raised questions about both the environment and corporate governance, the latter to better understand internal controls and measures implemented after the company was subjected to fraud in Thailand. Similarly, we discussed ESG issues with the American homebuilding company Lennar, which, like Ryanair, is no longer in the portfolio.

Our primary compass when voting at annual general assemblies is that our actions should be in the best interest of our unitholders. This normally coincides with the interests of most of the shareholders in the company. We assess the proposals put forward and feel a particular responsibility to vote if there are proposals that in our opinion do not benefit our unitholders and other shareholders. But we can also vote just to express our support for the proposals put forward, which we are increasingly willing to do. At the time of writing, we are considering how this work can be most effectively systematised for our Norwegian portfolio companies.

Abroad we have voted or sent notification of a planned vote for all proposals in Attendo, against proposals on incentives and compensation schemes in Polaris and CVS Health, and against board proposals and compensation schemes in LabCorp. In foreign companies, we do not receive automatic notification from the custodian, so we must follow ordinary and extraordinary general meetings ourselves. We also have to go through a slightly more complicated digital maze with registration and codes. This means that the additional time spent on voting abroad is not always in the best interests of unitholders.

The last year our chief investment officer has been a member of the Norwegian Air Shuttle nomination committee. This has represented a small extension of our work for good corporate governance in the companies we are invested in. He resigned from the nomination committee on June 30 this year, as none of our funds any longer have shares in the airline.

Climate risk in our portfolios

In our analysis, we strive to find companies with a favourable relationship between potential upside and downside. Finding companies with a good margin of safety is an important part of risk management. For an active manager, therefore, climate risk is included as a natural part of our company analyses.

Climate risk can be categorised as follows:

- Physical risk: Physical damage caused by climate change
- Transition risk: Financial risk from regulations, technology, consumer behaviour and political actions when transitioning to a sustainable society
- Liability risk: Claims for damages due to actions that can be linked to climate policy and climate change

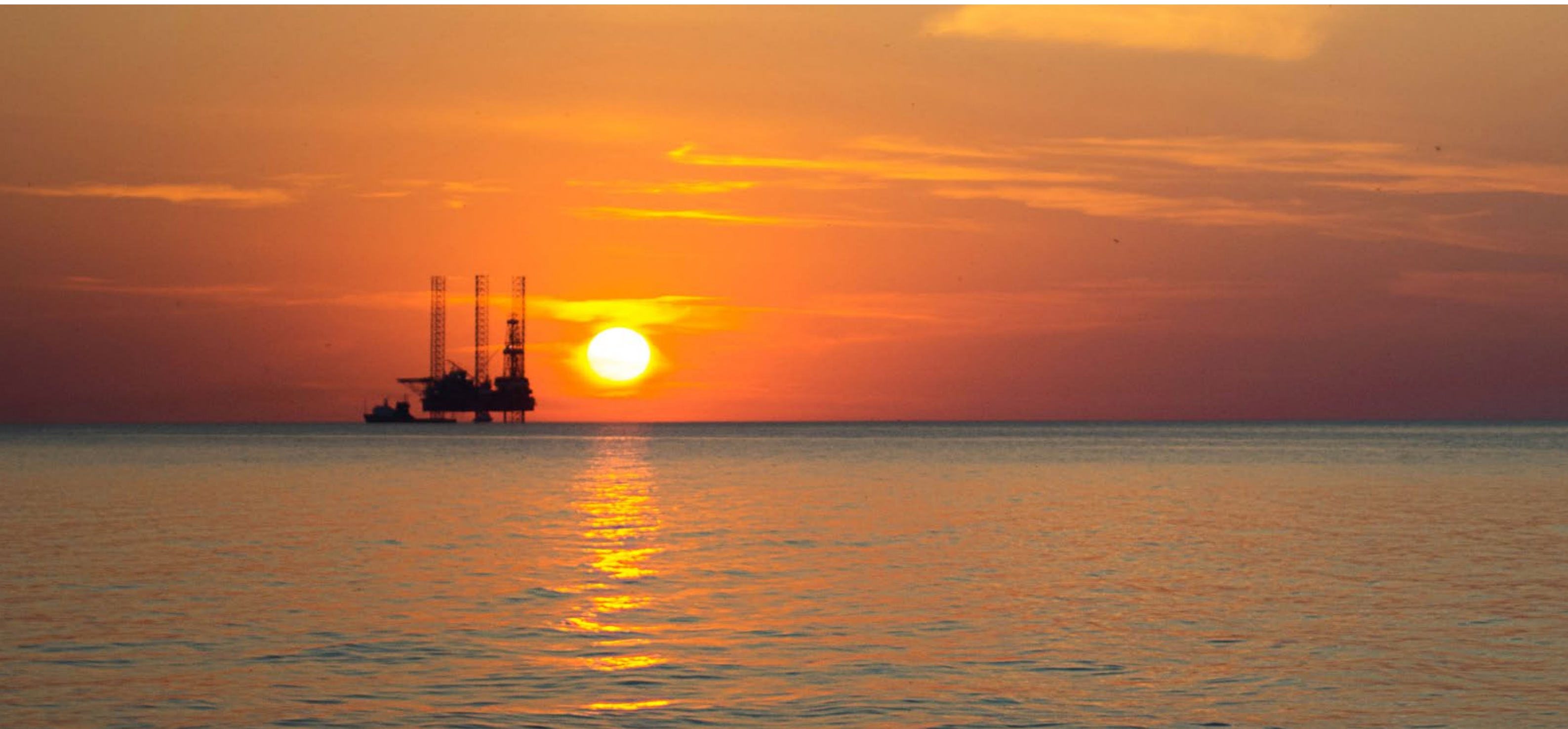
In such a framework, it is especially the *transitional risk* that will create tomorrow's winners and losers in the stock market. If we find that a company has significant *physical* or *liability risk*, it is typically a company we stay away from anyway. For banks and insurance companies, we nevertheless consider the possible effect on loan provisions and claims payments.

The concept of climate risk naturally leads to evaluating fossil energy, especially in Norway. Concepts such as *peak oil* and the need to reduce greenhouse gases make the transition risk well visible to oil and oil service companies.

Two of our funds, Pareto Nordic Cross Credit and Pareto Global, exclude fossil energy producers. This is basically well justified financially, as Norwegian investors are directly or indirectly highly exposed to the oil industry. Global funds without the same exposure thus provide a better risk balance overall.

The same absence of fossil energy can also be found in the fund Pareto Global Corporate Bond. There it has a further function, since the fund has attained the Nordic Swan Ecolabelling – as the first bond fund in Norway and Sweden.

However, Pareto Asset Management has no principled objection to fossil energy. Oil and gas are central, integrated elements in all modern societies, and in many cases, they can replace significantly more polluting coal. At the same time, the work to limit climate change is one of humanity's biggest challenges, and CO_2 emissions from fossil fuels contribute significantly to such emissions. Thus, it is clear that the industry has a considerable social responsibility. We must consider whether we believe the companies we invest in take this responsibility seriously.



The oil sector, which is dominant in the Norwegian economy, is well represented in other of our funds, both in equities and in fixed income. In particular, we do believe that oil and gas are good substitutes for coal in the slightly shorter term, and we also see that Norwegian companies are often among the best at reducing emissions from the extraction itself. In this way, this sector is definitely part of the solution and not just part of the problem.

Note that climate risk is about much more than the ethical perspective. For example, companies with low greenhouse gas emissions will have a significant competitive advantage in the face of new regulation and changed consumer behaviour. It is likely that they will also have an edge in attracting investors, which may affect the future price trend in our favour.

An industry with an obvious climate risk is aviation. We have previously owned shares in both Norwegian Air Shuttle and Ryanair, and we have not imposed any ban on such investments. But the concept of *flight shame* is a reminder that there is a significant transition risk associated with such investments (in addition, of course, to the fact that the emissions themselves are a negative element). It is also not unlikely that airlines will face higher environmental taxes, which we must take into account in our analyses.

Relevant factors when investing in airlines include the age of the aircraft fleet and the load factor, which together are decisive for CO2 emissions. We then aim to uncover the *relative* climate risk, to find out which companies will do best.

In practice, it is demanding, not to mention difficult, to assess climate risk in our portfolio companies. Reporting on climate risk and other sustainability issues is little regulated, and the quality varies considerably. Many companies lack a systematic approach to reporting on sustainability, the Governance Group concluded in its previous analysis of the 100 largest companies on Oslo Børs (the Oslo stock exchange). In their latest analysis, however, they write that many companies have improved their reporting on sustainability.

Hence, we believe that by exercising active ownership and dialogue with the companies, we can help sharpen the focus on sustainability. Such a dialogue has been held with the American home builder *Lennar*. We have received very positive answers from them, and after our input they are now preparing a sustainability report.

However, we note that many companies are stepping up their sustainability efforts, thereby also working to reduce climate risk. From the Pareto Global portfolio, we can cite the following examples:

EssilorLuxottica
The environmental footprint of the production plants has been significantly reduced. Sharp focus on water consumption, energy efficiency, carbon footprint and waste management.

Michelin
Leading manufacturer of low rolling resistance tyres and long service life. Leading innovation in sustainable mobility and ambitious in recycling.

Microsoft
Invests heavily in reducing emissions and contributing to a sustainable future. Has been carbon neutral in its global operations since 2012.

Prudential
A life insurance company where managing climate risk and opportunities is a strategic priority; management's remuneration is linked to achieving this.

Schneider Electric
Has ambitious targets for the use of renewable energy in production and contributes to significant reductions in electricity consumption for its customers. Our position has now been sold, following strong appreciation.

In this sense, we have yet another reminder that with active portfolio management, there is no contradiction between profitable and responsible investments – on the contrary.

Company assessments

Previous mentions

In several reports now, we have discussed the problems at **Norsk Hydro**'s Brazilian alumina refinery Alunorte, triggered by heavy rain in February 2018. This was expensive for Norsk Hydro, with direct costs of approximately NOK 2.4 billion, major stock price reactions and a visible scratch in the green varnish. However, we have concluded that the company's follow-up has been satisfactory, that they have built a significantly better preparedness to deal with such problems, and that the case has been sufficiently described in these reports. Pareto Aksje Norge has owned shares in Norsk Hydro for many years and still holds shares there.

ExxonMobil has also been highlighted in several reports, primarily due to an apparent reluctance to recognise the effect of fossil fuels on the climate and acknowledge the company's responsibility in this regard. It needs to be said that the company has shown significant progress, and we have not seen grounds for excluding ExxonMobil. However, we have assessed that the company's prospects – obviously a function also of climate risk – do not justify the current pricing of the share. Pareto Total has therefore sold its shares.

NetEnt is another stock that has been cleared from Pareto Total's portfolio. In this case, the company was simply the subject of an acquisition, in which the fund sold its shares with a significant gain. NetEnt delivers computer systems to internet-based gaming portals and thus requires care on our part; we have had to evaluate their work on preventing gambling addiction and adapting to regulations. In our view, this obstacle was passed by a fair margin, but we chose to realise a sweet profit.

Ryanair has been mentioned several times, most recently as an example of aviation challenges. Since it has been a while since Pareto Global sold its shares in the company, we see little reason for further mention in this report. We would like to add, however, that both social conditions (unionisation) and climate emissions required a certain amount of vigilance on our part.

Heico – undetonated ESG bomb?

During the Covid-19 market crash, Pareto Global invested in the American company Heico. This company supplies parts for passenger aircraft and electronic components for space travel, health care and telecommunication. It has an exceptionally good record since 1990: compound annual growth of 19 per cent in earnings and 23 per cent in total stockholder return.

As with all of our investments, we made a thorough review of the company's ESG qualities before buying. As part of this review, we detected that Heico has an admittedly very small part of its revenyes from a technology used in bort defence industry laser systems and health care scanning. Because this a dual use technology and the company does not produce weapons outright, the stock was cleared for investment.

Subsequently, new information emerged that the company also contributes to the production of a 'Small Diameter Bomb I'. For this, the company supplies electronic components. We have tried to obtain further information about the product and the company's role in manufacturing it, but Heico will not disclose this, pointing to confidentiality.

ESG reporting is high on the agenda of most companies now. Heico has a virtually non-existent reporting of such parameters, which we had hoped that the company wanted to improve. We therefore had a close dialogue with the company, calling for more transparent and complete reporting. Unfortunately, Heico has informed us that they do not intend to improve their practice in this field. Due to very weak ESG reporting and lack of critical information, we chose to put Heico on our observation list.

In September, Pareto Global decided to sell its stake in Heico. We nevertheless mention the item in this report, as it illustrates the challenges of mapping the quality of the companies we assess.

Playtech – a gamble?

In 2017, Pareto Global invested in Playtech. The company sells software to Internet-bases gaming portals. Playtech is a total supplier, meaning it provides a wide range of games in different game categories, as well as an integrated technology platform that includes customer accounts, risk management and IT operations. The finance website markets.com is also included in the product portfolio. In 2018, they acquired the Italian company Snaitech as a spearhead to penetrate the Italian market with new technology.

The company was established in Estonia, but is now headquartered and listed in London.

When it comes to games, we apply a precautionary principle: We want to prevent our investments from contributing to serious gambling addiction.

Playtech is basically a software company. However, the products significantly affect the experience that the players have, and the company also operates two casinos in Latvia and Romania, respectively. The question, therefore, is how the company handles these tasks.

Playtech is increasingly focusing on regulated markets. In 2019, the share of revenue from regulated markets was 88 per cent, versus 78 per cent in the same period last year.

The company itself emphasises designing games that do not challenge regulatory requirements or players' psychology. In the company's opinion, orderly and decent games are a market advantage in an industry that is becoming increasingly regulated and we second that assessment – which in fact is also relevant to our ethical assessment.

The fact that Playtech is primarily a software company, not so much a game provider, can not be a decisive argument. It does entail, though, that the company is a subcontractor to a wide range of game providers, each meeting a variety of requirements and regulations – and in such a market Playtech will have to satisfy the customers with the strictest regulations. In an industry where the marginal cost is very close to zero, economies of scale will be crucial. Playtech is a major player in this market, which requires that they comply with the highest standards.

After an overall assessment, we find that Playtech can be in our portfolios. We will nevertheless keep a keen eye on the company and look out for signs of problems arising from the company's products.

When it comes to games, we apply a precautionary principle: We want to prevent our investments from contributing to serious gambling addiction.

Danske Bank – the cleanup that was not over

Pareto Nordic Return invested in Danske Bank in August and early September 2018, and the stock is also in the portfolio of the subsequently established Pareto Nordic Equity. Danske Bank had a relatively weak development since the stock peaked in May 2017, and it appeared to be much cheaper than the other major Nordic banks. Pareto Nordic Corporate Bond also had bonds in the bank, while Pareto Global Corporate Bond had just sold for commercial reasons.

At the time of this last purchase, Danske Bank was conducting an internal audit of its Estonian branch. Already in May, the Danish FSA had announced that it would impose fines on the bank as a penalty for the money laundering that had been going on for several years in Estonia.

However, the culpable department was shut down in 2015. We thus figured that we invested in a bank fully engaged in cleanup and self-questioning.

The bank submitted its internal review in September 2018, revealing much more comprehensive money laundering than we had assumed. Worse yet, the report exposed a pervasive culture of unacceptable attitudes in the bank, in the sense that top management and the Board should have acted several years ago. For a long time, the bank trusted the reporting from the Estonian branch and the group's overall money laundering routines. The reporting later turned out to have been deficient and misleading, and group routines failed.

The first internal whistleblowing came late in 2013. It put the case on the agenda for both group management and the Board. Measures taken in 2014 proved to be insufficient. Towards the end of 2014, there came a highly critical report from the Estonian supervisory authority, and the business was finally shut down in 2015.

The report and subsequent events indicate that the bank will receive fines from the Danish and possibly US authorities. Its former CEO, Norwegian Thomas Borgen, had to resign and is now charged in the case.

There is no doubt that Danske Bank has been a bad investment for Pareto Nordic Equity/Return. This way it is a regrettably striking illustration of the risk inherent in ESG issues.

In the present situation, our assessment is that it is appropriate to keep the Danske Bank securities. The bank itself has put all its cards on the table – although we have been inclined to draw the same conclusion earlier – and prematurely. The Danish Financial Supervisory Authority, which on a more general basis has praised the bank, criticises eleven members of management in its report. All of these eleven have now left the bank. Much indicates that we have now passed the ethical nadir. There is no doubt that, going forward, the bank will and wants to focus on ethics and law and order in its business conduct.

In 2019, the bank hired many people in compliance and IT services to prevent money laundering. A lot has been invested in IT systems related to this. All of the bank's employees have undergone training to both prevent money laundering and correct errors in a proper manner. In addition, the Board has appointed a separate sub-committee for Conduct & Compliance.

Swedbank – shorting a scandal

In an earlier report, we highlighted reports of possible money laundering in Swedbank. The bank engaged a US law firm to check transactions between 2007 and 2019. The report came in March this year. It concludes that the bank has exhibited "serious deficiencies in its management of money laundering risks", to which the bank does not protest.

It involves transactions totaling €37 billion through Swedbank's subsidiary in Estonia, where there is a high risk – albeit no certainty – that the company has laundered money. Swedbank has accepted a fine of SEK 4 billion from the Swedish Financial Supervisory Authority for lack of control routines. In addition, the bank is still being investigated in both Sweden and Estonia, to see if anything criminal has taken place. Furthermore, the US law firm has disclosed approximately $5 billion in transactions that may represent "sanctionable conduct". The U.S. The Treasury's Office for Foreign Assets Control (OFAC) is investigating the matter.

Pareto Nordic Omega has retained its short position in Swedbank. We do not object to shorting companies with a lousy ESG record, which we know is a point of discussion in the investment community.

This short position was initiated before the scandal became public, so it has been a profitable position for the fund.

Wells Fargo – remains of a culture problem?

In 2016, it was revealed that bank accounts in Wells Fargo were created without the approval of the clients. The audit firm PwC was engaged by Wells Fargo to uncover the scope. Their review documented that this involved up to 3.5 million deposit accounts and 565,000 credit card accounts.

In comparison, the bank had 82.8 million accounts with deposits of less than $ 250,000 (estimates of the number of accounts for retail customers and small businesses) and 8.5 million active credit card accounts. It was further revealed that this had been going on from 2011 to the end of 2015.

The review pointed all the way to the top: Management's sales goals were so aggressive that some customer service representatives saw no other way of meeting their goals than going beyond their instructions.

The unauthorised accounts did not contribute to enhancing the bank's profitability or earnings and most likely was rather a net expense due to incorrect bonuses. Wells Fargo has paid $185 million in settlements with public oversight bodies and reimbursed fees of $2.6 million to customers associated with these accounts. The settlement in the class action suit was set at $480 million. In comparison, net profits in 2017 were $22 billion.

Retail sales goals were cancelled. In the future, customers will receive a confirmation email when bank accounts are created. All customers with deposits at the bank have been contacted to make sure they are satisfied with the accounts they have.

Management should have known that the aggressive sales targets could create an undesirable culture and should have changed incentive schemes. After the breaches were uncovered, management should have taken steps to demonstrate accountability through organisational changes and reclaim bonuses. This realisation led to CEO John Stumpf being asked to leave the company. A total of 5,300 employees were terminated as a result of the scandal, of whom 10 per cent were considered managers.

In the wake of this scandal, new cases appeared of lesser scope. In 2017 it was revealed that 570,000 customers had paid for car insurance they did not need. Other issues have been related to credit card fees, seizure of mortgaged cars, sale of complicated savings products and excessive fees in asset management.

Following these revelations, new regulatory restrictions were imposed, limiting the size of Wells Fargo's balance to the level reported at the end of 2017. The injunction will be lifted when new control and risk systems are implemented and considered to be satisfactory by the U.S. Federal Reserve.

Traditionally, Wells Fargo has been considered a rather staid bank with high ethical standards. The bank has a long and good history with a solid balance sheet and low loan losses. We do believe that it is fully possible for Wells Fargo to win back the trust of both customers and investors.

And we have doubted our way to the conclusion that they deserve our trust as well, even though we have repeatedly had to realise that the cleanup was not completed after all.

At the end of last year the company got a new CEO with extensive experience. Although this was not stated in the announcement, it was generally believed that the resignation was a consequence of political and/or stakeholder pressure.

Pareto Total and Pareto Global holds shares in Wells Fargo.

Betsson – apt to create gambling addiction?

As stated on page 8, we have not chosen to enact a general ban on investment in gambling. However, we have declared that a precautionary principle must be applied when assessing such investments. Central to this assessment is the risk of gambling addiction.

The funds Pareto Nordic Equity and Pareto Nordic Return has invested in the Swedish gaming company Betsson. The company offers online casino, poker and other games with money bets. It is obvious that we must assess the risk of gambling addiction.

The company holds public licenses in regulated markets, which of course implies an incentive to operate in such a way that the licenses can be regarded as commercially safe in the long term. Betsson's most important markets are Sweden and the Netherlands, where there are clear rules for obtaining a license. We also note that the advocacy group Spillavhengighet Norge has opened up to the idea of licensing foreign gambling companies as an alternative to the Norwegian gambling monopoly. The idea is that the market is better regulated through a license-based regulatory framework.

This, however, is not sufficient. We need to investigate how Betsson manages this responsibility – and how it turns out. And, not least, whether investor leverage can influence the company's prioritisation of this area.

As of the quarterly report for the last quarter of 2017, Betsson has reported key figures for responsible gaming. The company expresses that providing gaming in a controlled and responsible manner is the key to satisfied, safe and loyal customers. We might add that it is also the key to keeping both government and investors satisfied and loyal.

The company has established its own department for responsible gaming. This department works closely with functions such as customer service and payments. In addition, they have developed software to monitor customer gaming activity and identify players who may have gambling addiction issues. Custom tools have been developed that customers can use to control their own gambling, and all employees are coached annually in order to recognise signs of gambling addiction. In 2017, the company also had an external review of procedures and tools for addiction management. It cooperates with the Global Gambling Guidance Group (G4) and Sustainable Interaction.

During the lockdown, there was a significant increase in the company's responsible gaming activities. Due to great interest from the gamers sitting at home, it was necessary to monitor and intervene to a greater extent than usual. The company thus showed that they are serious when it comes to responsible gaming.

Such measures show the increasing commercial necessity of limiting the risk of gambling addiction; they also reveal that the problem is not eliminated. Betsson reports that roughly one per cent of customer service inquiries are about game addiction in one way or another. With a large number of contacts, this means that there are many conversations about the subject. It also means that the company monitors and works to manage this problem. These conversations are referred to a team of specialists who are claimed to have extensive training in the field.

The company has a reputation problem. In an ESG ranking of 326 Swedish companies, the company comes out worst (alongside one competitor) in terms of reputation. The industry has a major challenge when it comes to communicating what it does to reduce gambling addiction issues. The company does not allow playing on credit, people under the age of 18 are not allowed to play, gambling addicts are closed out, efforts are being made to find out if customers are addicted, and so on. This has not left much of a mark in people's perception of Betsson and the industry.

Last year, there was a law change in Sweden that limited the scope of gambling bonuses to customers. The company has received a minor fine for not complying with the new rules. However, like their competitors, they have appealed to a higher authority.

An investment in Betsson shares is not unproblematic and we have had discussions about the issue. Our preliminary conclusion is that we do not eliminate the company from our investment universe, where the company's obvious self-interest in limiting the problem – for both licensing and marketing and investor interest purposes – has been a weighty argument.

However, we will monitor how things develop and what is being done in the company.

Goldman Sachs – circumvention or a culture problem?

In the period 2009 to 2014, Goldman Sachs organised the issue of bonds for Malaysia's Government Investment Fund 1 Malaysia Development Bhd ("1MDB") for a total of $ 6.5 billion. The goal was more active management of government investments along the lines of Singapore's government investment fund Temasek. The fund was given free reins, with no independent supervision.

According to Malaysia's lawsuit against two former Goldman Sachs employees, Tim Leissner and Rogner NG, and an independent financier, Jho Low, $2.7 billion was illegally transferred to bank accounts in tax havens. The money was used for art, luxury boats and funding for the Oscar-nominated movie The Wolf of Wall Street. Part of the money was allegedly used to bribe civil servants in Malaysia and Abu Dhabi, including Malaysia's then prime minister. Both Malaysian and US authorities are of the opinion that the bank could have done more to prevent the embezzlement and bribery. They have also questioned the size of the commission, $600 million. Although these issues were risky, the fee was very high in relation to industry standards.

Goldman Sachs has now entered into a settlement with Malaysia whereby Goldman Sachs pays $2.5 billion against Malaysia withdrawing the lawsuit. In addition, the bank guarantees $1.4 billion related to the recovery of assets, which should be within reach.

Furthermore, Goldman Sachs has entered into a settlement with the US Department of Justice which entails a fine of $2.2 billion. The settlement means that Goldman Sachs avoids being found guilty, which would be detrimental to future business, as many customers demand impeccable conduct from their counterparties. We would probably also have had to go an extra round ourselves.

Pareto Global owns shares in Goldman Sachs.

Attendo – easy care?

Attendo describes itself as one of the leading private care providers in the Nordic region, caring for the elderly, the disabled and children/families. The company has approx. 24,000 employees in Sweden, Finland, Denmark and Norway.

In Sweden, the company has received negative media coverage of the conditions at some nursing homes, and in Finland a public inspection has been initiated – where 280 of the company's total 300 nursing homes have been inspected. Publicly run nursing homes have also been subject to inspection, but to a lesser extent.

The reason for the case in Finland was a revelation that the main competitor Esperi had used ghost staffing, meaning that they used fictitious work logs and wrote up people who were not at work. Next, it turned out that the CEO had extracted huge dividends, with money ending up in tax havens. This became a major media issue, reinforced by election campaigns in Finland.

No fictional hours were revealed in Attendo and no case was raised there. However, the company has increased staffing, partly in response to stricter demands from the authorities. This step-up, as well as problems filling both staffing and beds at newly opened nursing homes, has burdened the company's finances. In a sense, then, this is a good example of social challenges becoming financial challenges.

Privately operated care has been a political topic of discussion throughout the Nordic region. In Pareto Asset Management, we have no objections to private care as such; rather, we think that this can be a useful supplement and a source of competitive innovation. Both Finland and Sweden have a massive shortage of nursing homes, and many municipalities prefer private operators on grounds of both costs and responsibilities. The Finnish authorities' own surveys establish that quality has been better in the private sector than in the public sector, despite the fact that it is also cheaper.

We have no reason to believe that Attendo is exploiting the situation or providing services of systematically poor quality, and we still have not excluded the share. Individual incidents and the poor reporting ability of the ultimate customers explain why we have raised the topic for discussion and are monitoring new information. Through the past six months, however, we feel strengthened in our belief that the company runs its business in a sensible way. Staffing has been increased in Finland, in line with public guidelines, and some middle managers have been replaced. There are no pending cases with regulatory authorities.

Pareto Global and Pareto Nordic Alpha owns shares in Attendo.

And some general remarks ...

Our guidelines are based upon the presumption that responsible investment is essential to achieving the best possible risk-adjusted return for our unitholders and clients. Likewise, we believe that sustainability and good corporate governance provide competitive advantages and contribute to long-term value creation.

Now, some problems seem to come out of the blue, like Norsk Hydro's flooding in Brazil or Wells Fargo's excessive creation of bank accounts. Such events typically produce a sharp stock price decline which is hard to avoid without perfect foresight. Unless the problems are so grave that the company needs to be excluded from our investment univeser, we have the choice between remaining invested, expecting or hoping for improvement – and we'd be happy to push them – or selling, based on an assumption that the problems are of a rather chronic nature.

Well ... how does this look in practice?

For two years in a row we have used very competent summer interns to examine such questions. Last year's conclusion was of a more general nature, but nevertheless very instructive: When such ESG shocks appear, the entire loss is not realised up front. These stocks keep on producing negative excess return for a long time, at least on average – and with a significant margin.

This year we concentrated on our own portfolios. We calculated the return on companies that had been selected for critical review in our RI reports. These stocks formed an equal-weighted portfolio with inclusion when they were first reviewed. The return was calculated both with and without companies that were later sold.

Either way, the conclusion was the same: This portfolio had a lousy return. We had singled out potential problem stocks, but we had not gone on to sell them – which, generally, we should have done, at least from a commercial point of view. We would like to add, however, that the return would have been even worse if we had not excluded the American company Fluor Corp., which we found to be engaged in a joint venture producing tritium, a radioactive substance that is a key component in nuclear warheads.

We still hold, as you will notice, stocks that have been reviewed in previous RI reports. This of course is because we believe that these particular companies are improving, both in terms of sustainability and financially. It remains to be seen whether we will be right this time, but these are judgments that are made for each individual company – we do not manage securities based on averaging.

Nordic Swan Ecolabelled fixed income fund

On 26 September 2018, Pareto Global Corporate Bond became the first fixed income fund in Norway, Sweden and Finland to receive the Nordic Swan Ecolabel.

In order to receive the Nordic Swan Ecolabel, a fund must fulfil 25 obligatory requirements that cover: disregarding poor companies (exclusion), choosing the better companies (inclusion) and operating openly (transparency) in order to receive a Swan label. The fund must also exclude or limit investments in certain industries and companies that are particularly problematic (fossil fuels, weapons and tobacco).

The Nordic Swan Ecolabelling requires the fund to include companies that work actively with sustainability, which entails:

- At least 90% of the fund's direct holdings must have been subject to a sustainability analysis/Environmental Social Governance analysis
- At least 50% of the fund's holdings must be investments in companies that have a good ESG rating
- Investments in green industries, such as renewable energy, wastewater treatment, etc. are rewarded

The Nordic Swan Ecolabel does not imply that all of the fund's companies are sustainable or without problems or challenges. The aim of the requirements is to make investments in a Nordic Ecolabelled fund move markets, industries and companies in a more sustainable direction.

Pareto Global Corporate Bond is highly selective when including companies in its investment universe. We take into account environmental, social and corporate governance factors by excluding any company included in the Norwegian Government Pension Fund exclusion list, as well as excluding companies based on our own assessment and the Swan Ecolabel requirements. In addition, we believe that combining this with "positive screening" towards sustainable companies and more defensive industries contributes to better long-term return for our clients.

The aim of Nordic Swan Ecolabelling of funds is to use the power of capital and ownership to steer companies in a more sustainable direction, and also to be an instrument for fund management companies to show that their funds fulfil stringent requirements.

The label was founded by the Nordic Council of Ministers in 1989, to assist consumers in making active choices that would benefit the environment. A Swan labelled fund is expected to be a sustainable alternative for both retail and professional fund investors, and means that the fund will include/exclude holdings and work in a transparent way to influence companies to support sustainability.

The application of the Swan label is conducted by Miljömärkning Sverige AB, which works on behalf of the government, and which does not represent any fund industry interests.

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