Pareto
Asset Management

Responsible investments

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Contents

Active management and eyes wide open

You may not have thought about it, but you do influence business and industry. Through your investment in securities, directly or indirectly through our funds, you exert influence on companies' cost of capital. About time, then, to reflect on what you want to achieve by way of this influence.

It is easy to envision how we may influence borrowing costs. If a sufficient number of investors line up when a company issues a bond, the company gets away with a lower coupon (interest rate) – especially if those investors are big enough to take part in bond issuance pre-sounding, as we are.

In the stock market there is no fixed interest rate. However, if it is hard for a company to attract sufficient new equity or avoid extensive dilution of ownership, equity comes at at high cost. Given a low share price there is also a potential cost limiting future expansion, even if there are no immediate plans of issuing new equity.

In Pareto Asset Management we spend ever more time thinking about what we want our investment activity to achieve. We think of this as responsible investing. Inasmuch as our portfolio management has a decidedly 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, and they entail a clear ethical guidance: We shall not make investments which constitute an unacceptable risk of contributing to unethical acts or omissions.

In 2014 we decided to formalise our commitment to responsible investments by signing the UN PRI (United Nations Principles for Responsible Investment). In March 2017, we presented our first PRI report.

In 2017 we became a member of Norsif, the Norwegian forum for responsible and sustainable investments, and of its Swedish sister organisation Swesif. Later the same year Pareto Global Corporate Bond became the first fixed income fund in Norway and Sweden to receive the Nordic Swan Ecolabel. We have hired a dedicated analyst in order to fulfil the strict requirements of the Nordic Swan Ecolabel.

In our view, our management philosophy is well suited for this purpose. Active management, thorough analyses of a limited number of companies and a long-term perspective form a good starting point for sustainable investments. If you are serious about achieving something by way of your investments, you just can't invest blindly in a broad-based index.

Sustainable investment, however, is a demanding exercise. It raises a lot of dilemmas and provides no clear answers, and it requires a lot of subjective judgement. It also entails a lot of erring on our part. We make mistakes, we learn from our mistakes, and we have to admit that we still have a lot to learn.

The report that you are now reading is the eighth of its kind. This, too, is a work in progress. We want to provide steadily better transparency and understanding of the way we work with responsible investment.

Included in the report are our guidelines for responsible investments, which have been updated and approved by the board. 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 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 these decisions have come about.

As they say: The proof of the pudding is in the eating.

Bon appétit!

Kind regards
Finn Øystein Bergh
Chief Investment Officer

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 investment officer 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 2015, it was concluded that Saab does not belong in our investment universe. The reasoning was based on an assessment of production-based exclusion criteria; Saab's product range includes far more than the aircrafts the company is known for - including weapons of war and missile systems.

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, described in more detail on pages 15-16, is ranked as number 17.

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.

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

If we do not move, we may be able to move the companies we invest in.

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 in the past year engaged in dialogue with a total of 25 companies (almost the entire portfolio) on corporate governance, environment and (to a lesser extent) social conditions. These are companies we know well, with direct lines to top management.

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.

In Pareto Global we have also had direct dialogue with several companies on such topics. With Ralph Lauren we have addressed various ESG related issues; we have confronted Ryanair with labour relations and greenhouse gas emissions; and we have asked Polaris about damage and recall of vehicles. In our dialogue with Attendo, staffing at nursing homes and possibly "ghost staffing" in hourly lists have been discussed (the latter is strongly denied). With Michelin we have raised questions about both environment and corporate governance, the latter to understand both the structure and the corporate electoral system.

We do not vote at general meetings merely to vote. If the company has a completely uncontroversial agenda with an obvious outcome and our unconditional approval, we will gain little if we put our extra votes on the scale. If it is about securing a majority or protesting a proposal, things are different.

Thus, we have voted for the rights issue in Norwegian Air Shuttle, where the proceeds were necessary to ensure further freedom of action. We have also voted in Bonheur, where we have teamed up with other investors to clarify internal billing issues. And we have voted in both TGS and Spectrum, which earlier this year decided to merge.

Interestingly, we have voted on both sides of that issue. For Pareto Aksje Norge, which owned TGS, we voted in favour of the merger. For Pareto Investment Fund, which owned Spectrum, we voted against – not because it did not make sense commercially, but because our portfolio managers were dissatisfied with the exchange ratio.

If this may seem paradoxical, it underlines our primary compass: the consideration of the best interests of unitholders. The portfolio managers discussed this with our chief investment offficer and were given the obvious advice that they should follow their beliefs, taking into account the best interests of the unitholders. For TGS shareholders, the merger was obviously profitable. For Spectrum shareholders, the exchange ratio appeared to be less than generous on the part of the big brother.

We have also cast votes in foreign companies. There 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 year Pareto Global has voted at general meetings in Ryanair (due to issues such as compensation and board election), CVS Health (compensation) and EssilorLuxottica (board election). Beyond this, we have judged the additional time spent on voting abroad would not be in the best interests of unitholders.

Incidentally, our chief investment officer is now elected as a member of the Norwegian Air Shuttle nomination committee. This represents a small extension of our work for good corporate governance in the companies we are invested in.

Climate risk in our portfolios

In our stock 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

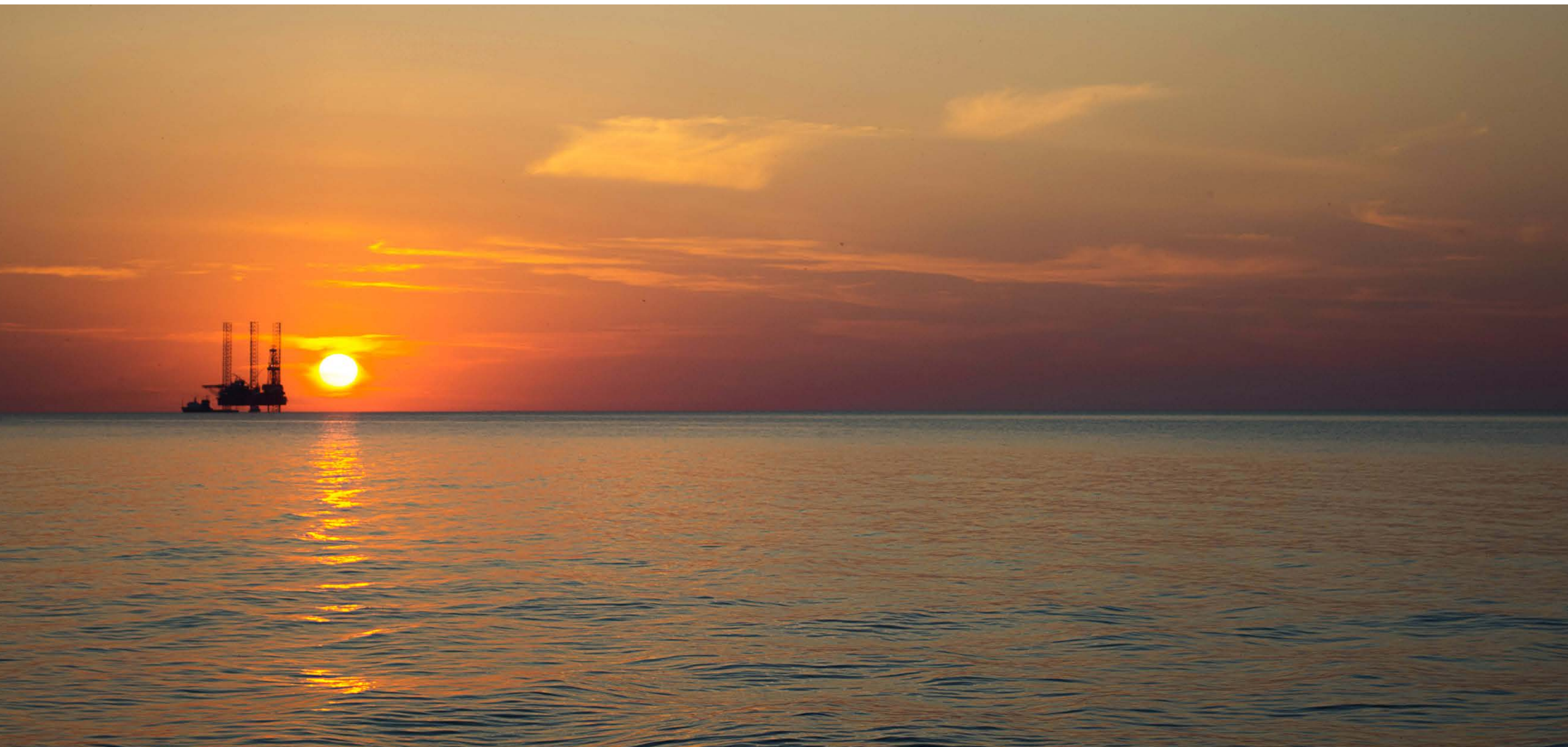
In such a framework, it is especially the *transitional risk* that will create tomorrow's winners and losers in the stock market. If we find that a company has significant *physical* or *liability risk*, it is typically a company we stay away from anyway. For banks and insurance companies, we nevertheless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

One of our equity funds, Pareto Global, excludes 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. On the contrary: 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.

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, concludes The Governance Group in its latest analysis of the 100 largest companies on Oslo Børs (the Oslo stock exchange).

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.

Ryanair
We should also mention our position in Ryanair, which illustrates an interesting dilemma. As Europe's largest airline, Ryanair causes not insignificant greenhouse gas emissions. To the extent that *flight shame* should spread across the continent, there is considerable transitional risk associated with this investment (in addition, of course, to the fact that the emissions as such are a negative element). Nor is it unlikely that the company will face higher environmental taxes, which we must take into account in our analyses of the stock.

On the other hand, Ryanair has the highest passenger load factor and one of the youngest fleets in the industry. It produces the lowest $CO2$ emissions among all major European airlines, with 66 grammes of $CO2$ per passenger kilometer. Emissions have been reduced by as much as 20 per cent over the past decade, and the company aims to reduce them by a further 10 per cent by 2030. Furthermore, the company is investing in carbon purification programmes in Africa, Portugal and Ireland.

We do not believe that the airline industry will disappear, nor do we believe it should. We also believe that *relative* climate risk is essential in determining which companies will do best. In this sense, a relatively new fleet with lower emissions (which also applies to domestic carrier Norwegian Air Shuttle) is a good competitive advantage.

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

Norsk Hydro – crisis rains

In 2011, Norsk Hydro acquired the aluminium business of the Brazilian mining company Vale in the northern part of Pará. This made Norsk Hydro the largest aluminium company in South America. Part of the Brazilian business is Alunorte, the world's largest alumina refinery, with an estimated capacity of about six million tonnes per year. Hydro owns 92.1 per cent of Alunorte.

In February 2018 a heavy rainfall caused floods in the region. External sources claimed there was overflow or leakage from the bauxite residue deposit in Alunorte, while Norsk Hydro had prepared a report that rejected leaks from that area. More than 90 investigations and inspections were conducted by the relevant authorities which confirmed that there were no leaks or overflow from Alunorte's bauxite residue deposit. Also, third party studies have reached to the same conclusion. However, other weaknesses were noted at the facility. Preventive measures were implemented to increase water treatment capacity in case of extreme rainfall.

At this time, there was still great uncertainty and a hazy information picture. We therefore invited Norsk Hydro to a presentation at Pareto Asset Management, where we had a good opportunity to ask critical questions and get a better understanding of the situation.

Following a legal injunction, Alunorte reduced production by 50 per cent on March 1. Consequently, the bauxite mine Paragominas and the Albras aluminium plant reduced their production by 50 per cent.

Alunorte in Brazil is the world's largest alumina refinery. Photo: João Ramid/Norsk Hydro ASA

Back in 2016 we visited a number of companies to get an impression of the regulatory framework and the view of the ethical standard among Norwegian companies. Our impression from the Rio regulators was that they perceived the ethical standard as being high. In the Alunorte case, however, Norsk Hydro has met a lot of criticism, and there has been an ongoing discussion with both authorities and interest groups.

Throughout the spring and summer of 2018 there was extensive contact with central and local authorities, before Alunorte in September signed agreements that enabled full production at a later stage. In return, the company committed itself to technical improvement and payment of food vouchers for families in the area, as well as various measures and investments in community development.

At the beginning of October 2018, Alunorte nevertheless announced full shutdown of production. The reason was that the old bauxite residue deposit approached full capacity, while the company was not allowed to use modern press filter technology and the new deposit area. This happened shortly before the Brazilian presidential election.

Just two days later – after major local demonstrations in support of Alunorte – came the rescindment that allowed Alunorte to use press filter technology. Thus, the company could resume production at half pace. In January 2019 environmental auhorities confirmed that Alunorte could operate safely at its installed capacity for effluent treatment.

Today, these acute problems are history. In September, the federal Brazilian court of Belem lifted the last embargo on the new deposit facility. Hence, all acitivities can be resumed.

From the very beginning, senior management has signalled by various means, including personal presence, that it is taking the problems in Brazil seriously. Our understanding is also that the desire for cleanup, learning and improvement is genuine and significant, which we emphasise. However, there is little doubt that the company has been consistently behind, and questions can certainly be posed about management's understanding of the risks in advance.

For Norsk Hydro, total direct costs amount to 2.4 billion kroner, of which about 1.5 billion in upgrading water treatment and several hundrer million in social measures including housing. Fines constitute a very limited part, while one may claim that the stock market punishment is considerably tougher – although it is near impossible to ascertain Alunorte's contribution to the market cap decline of about 50 billion kroner. During this period, aluminium prices have fallen.

On a separate note, we observe that Norsk Hydro is no longer included in the Dow Jones Sustainability World Index (DJSI World). However, the company is still included in the DJSI Europe.

ExxonMobil – a fossil case

Many of our funds and discretionary management mandates have positions in oil companies or the oil service industry. We do not have fundamental objections to the industry as such. Oil and gas are key, integrated elements in all modern societies, and in many cases, they can replace significantly more polluting coal.

As a matter of fact, however, limiting climate change is one of humanity's biggest challenges, and CO2 emissions from fossil fuels contribute significantly to global warming. Thus, it is clear that the industry has a major social responsibility. We must consider whether we believe the companies we invest in take this responsibility seriously.

Pareto Total has had shares in ExxonMobil since September 2017. Much of the criticism of the company has been about its reluctance to acknowledge the effect of fossil fuels on the climate; some even claim that the company has attempted to refute such assertions against its better judgement. Similarly, ExxonMobil has devoted considerable resources to supporting groups or institutions that have argued against the concept of man-made global warming.

For several years now, the company has been involved in lawsuits, countersuits and legal tugs-of-war with its own shareholders over these issues. After, in fact, shareholder pressure, ExxonMobil in 2018 published a comprehensive analyses of measures to cut emissions. The company emphasises that it supports efforts to reduce greenhouse gas emissions in general and the Paris agreements in particular.

It is clear that ExxonMobil has little reason to boast of the company's contribution to understanding global warming or its own information about the same. But it is also clear that the company today demonstrates a significantly better understanding – or willingness to understand.

We have also evaluated the extraction method known as fracking, which involves drilling wells with hydraulic fracture – "blasting" in the reservoirs to allow recovery of hydrocarbons. This is done by means of a drilling fluid which is placed under high pressure in the well. The liquid consists of 90 per cent pure water, nine per cent sand and up to one per cent chemicals to adjust the liquid properties.

Pollution and the use of water is a repeated topic. The United States Environmental Protection Agency (EPA) found in 2016 that fracking in some cases had contaminated drinking water. In addition, the high consumption of water can pose a problem in areas with vulnerable water supply.

ExxonMobil does not seem to stand out in this area. The business is kept within the relevant legal framework and active efforts are made to reduce or minimise environmental damage. For us, then, the question is whether the technology as such constitutes an unacceptable risk. As Equinor also uses fracking, this has a broader relevance for us. We may add that Equinor has produced a document describing how these environmental challenges are handled.

Whereas fracking has been done since 1949, technological advances in recent years have enabled the immense increase in US oil production. The potential damage should now be well mapped, meaning that regulatory authorities have the necessary information and motivation to impose stricter requirements on specific projects. At the same time, technology is still developing rapidly, which makes it possible for ExxonMobil (as well as Equinor) to be heard in its declared will to limit or minimise adverse effects.

We have concluded, on previous occasions, that this does not give rise to exclusion, but we keep the company under observation. It will be interesting to keep track of what the company is saying and doing.

Playtech – a gamble?

In November 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.

The company was established in Estonia and now has offices in 17 countries. The stock is listed on the London Stock Exchange.

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

Now, 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 the first half of 2019, the share of revenue from regulated markets was 87 per cent, compared with 69 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.

Ryanair – a matter of negotiations

The Irish low-fare airline Ryanair has met a lot of criticism for its relationship with unions. For a long time, the airline was accused of breaking principle number three of the UN Global Compact. This principle is formulated as follows: "Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining."

Ryanair has never denied employees the right to organise but refused to relate to external unions. Instead, it negotiated with employees through so-called Employee Representation Committees (ERC), affiliated with the airline's various bases. Following a lawsuit in the Irish Supreme Court and a conflict in the Danish Labour Court, our conclusion has been that Ryanair has not broken with the UN Global Impact, but we thought it would be appropriate to place the company under review.

In December 2017, Ryanair announced that the company now recognises unions. At the beginning of October 2019, the company had signed collective labour agreements with 70 per cent of its cabin crew and 60 per cent of pilots. UK pilots are the largest outstanding pilot group (about 25%) waiting to sign, but a recognition agreement has been signed.

Going forward carbon emissions will be more important (see page 12 for a further discussion). The long and the short of it is that the airline has a generally new and fuel-efficient fleet of aircraft. It releases a lot of CO2 due to the sheer volume of air traffic, but is, arguably, best in class. On a separate note, the company has pledged to become plastic free by 2023.

However, we still want to keep the company under observation.

Danske Bank – the cleanup that was not over

Pareto Nordic Return invested in Danske Bank in August and early September 2018. The share had been relatively soft since the price 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 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.

We note in passing that the Norwegian Government Pension Fund Global seems to share our assessment, having bought heavily into the bank.

Swedbank – shorting a scandal

We noted the following in our last report in 2018: There have been indications that other Nordic banks have been involved in similar money laundering in Estonia and the other Baltic countries. We will not rule out the possibility that other banks will have to join Danske Bank on our observation list.

Indeed. In February Swedish television revealed extensive money laundering, with suspicious accounts being used to transfer about 40 billion Swedish kronor. An investigation was initiated.

The scandal raised obvious questions about management's ability and willingness to investigate the issue, after an internal inquiry was brushed off too easily, and CEO Birgitte Bonnesen was forced to resign. In June, Göran Persson was appointed new chairman of the board and in October, a new CEO was hired.

Pareto Nordic Omega has a 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 broke, so it has been a profitable position for the fund.

Wells Fargo – remains of a culture problem?

At the end of 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.

In March, the company announced that its CEO had resigned. Although the announcement did not say so, it was generally believed that the resignation was a consequence of political and/or stakeholder pressure. A new CEO is now appointed. He has experience as CEO of both Bank of New York Mellon and Visa Corporation.

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 fund 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.

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 0.9 per cent of customer service inquiries in 2018 were about game addiction in one way or another, compared to 1.2 per cent in 2017.

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.

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 the Malaysian state investment fund 1 Malaysia Development Bhd ("1MDB") for a total of $6.5 billion. The transaction fee totalled around $600 million, which is higher than normal. Admittedly, these issues could be considered riskier, but still the fee was very high.

According to Malaysia's summons to two former GoldmanSachs employees, Tim Leissner and Rogner NG, and an independent financier, Jho Low, $2.7 billion were improperly transferred to bank accounts in 17 tax havens. Part of the money was allegedly used to bribe public employees in Malaysia and Abu Dhabi, including Malaysia's then prime minister.

Goldman Sachs has always claimed that the company has had no insight into the use of the borrowed money and, accordingly, that they have done nothing wrong.

In November 2018, however, Tim Leissner, former chairman in South East Asia, declared guilty of money laundering and bribing public officials. The next day, Goldman Sachs wrote in their quarterly report that "any proceedings (...) could result in the impositions of significant fines, penalties and other sanctions against the firm".

The following week we could read that former CEO Lloyd Blankfein had met Malaysia's former prime minister in 2009 together with Leissner and Low. This meeting laid the basis for the relationship with the bank.

Leissner blamed Goldman Sach's culture when he declared guilty. He claimed there was a culture in the company of circumventing internal rules. The company claims, on its part, that Leissner deliberately withheld information from the company to circumvent internal regulations. The company has not made further comments on the matter, pointing to their cooperation with the US Department of Justice.

Pareto Global owns stock in Goldman Sachs. Stock market reactions to news in this case seem to exceed foreseeable fines and reparations by a wide margin, indicating it is a more basic assessment of the company from the stock market – and the possible price of poor governance.

At the time of writing this report, it is uncertain whether the reprehensible actions represent a few individuals circumventing internal rules and regulations, if they reflect a pervasive company culture, or if they have been downright approved from top management.

After April 2019, no decisive new information has been published. Hence, we are not closer to a conclusion beyond the fairly obvious assessment that the company must be kept on our observation list.

We do note, however, that accounting provisions for "reasonably possible aggregate loss" have been increased to $2.6 billion in the latest quarterly report, for the second quarter of 2019. This represents an increase of $1.1 billion from the close of 2017, presumably reflecting an assessment of possible legal reparations.

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 have not excluded the share. However, 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.

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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