Our Responsible Investment Journey 2022

Danske Bank

The journey continues

For some years now, our focus in Danske Bank has been to build a strong infrastructure to integrate sustainability into our investment management process and products. That was our quest four years ago and still is today. Everything we do must be anchored in our fiduciary duty to protect and grow our customers' investments in line with their sustainability preferences.

In 2021, we tied sustainability-related KPIs into our performance management framework for our investment teams. The teams now have an incentive to systematically address sustainability factors, and sustainability performance amounts to around 20% of their remuneration KPIs. Furthermore, we introduced a sustainability-risk challenger role as a supplement to the already existing investment-risk challenger role. The focus of the sustainability-risk challenger is to assess the extent that sustainability aspects impact the value of investments and how our investments impact society. In other words, the sustainability-risk challenger analyse to what degree the investment teams actively take into consideration sustainability issues, sustainability indicators and principal adverse impacts, and how this all affects the portfolio to support a strong risk assessment across investment and sustainability risks.

Like any asset manager these days, we have spent considerable amount of resources to implement the different aspects of the EU Action Plan on Sustainable Finance. Last year, we focused especially on climate benchmarks and SFDR, a focus that continue this year accompanied by MiFID II amendments and the implementation of the green taxonomy into our investment processes. As one example, we have enhanced our investment restrictions framework and voting guidelines to help promote the environmental and social characteristics of our products and to capture issues related to principal adverse sustainability impacts on society. We have also reinforced our proprietary ESG analytical tool mDASH® so that it supports product-specific sustainability characteristics and at the same time established our own tool, mSDG, to be able to assess any individual company's materiel contribution to the UN SDGs.

Our sustainability ambitions and targets set the course for our product innovation and the goal of accelerating investments that support the green and sustainable transition of society. In 2021, we reached our initial target of DKK 400 billion of AuM in funds disclosing according to Article 8 of SFDR and this target has therefore been discontinued as it in our view now represents a minimum requirement for investment funds in the Nordic market. We keep the DKK 150 bn AuM target for Article 9 funds by 2030 and our long-term 2050 target of net zero emissions from our investments, as laid out in the Net Zero Asset Managers Initiative (NZAM), which we signed in 2021. As part of our commitments, we have established interim targets that are described further in this report.

We continuously work to enhance and expand our product offering and our overarching ambition is to offer a wide range of ESG and sustainable investment products that fit the needs of our investors and can accelerate the journey towards a sustainable economy. We will achieve our mission by continuing to focus on building robust sustainability processes, expanding ESG data and developing analytical tools. This is our roadmap to building high-quality ESG and sustainable investment products that will have a real and lasting impact and deliver attractive investment performance.

Erik Eliasson
Head of Responsible Investment
Danske Bank Asset Management

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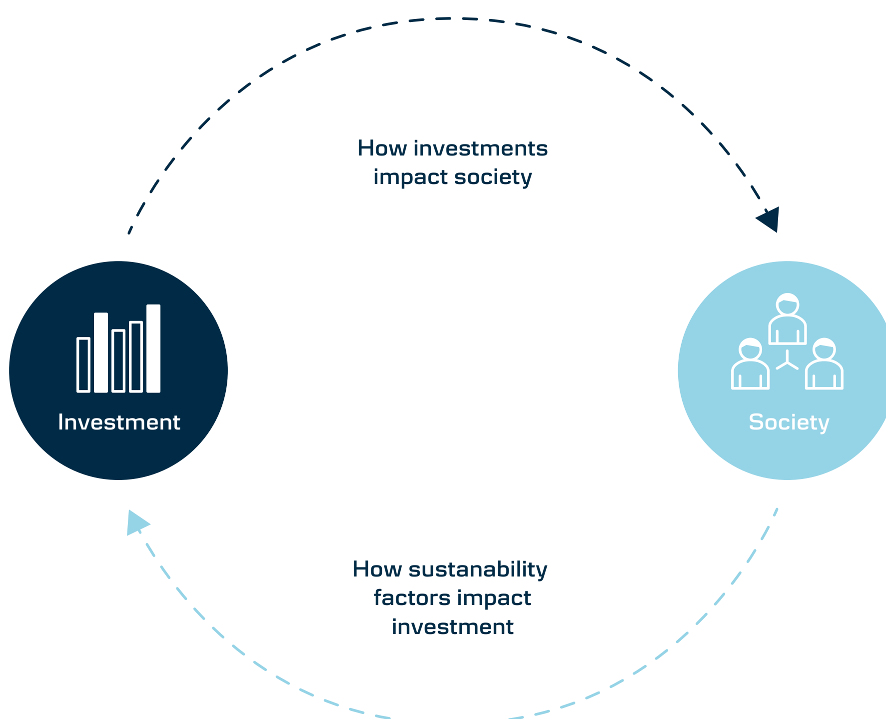
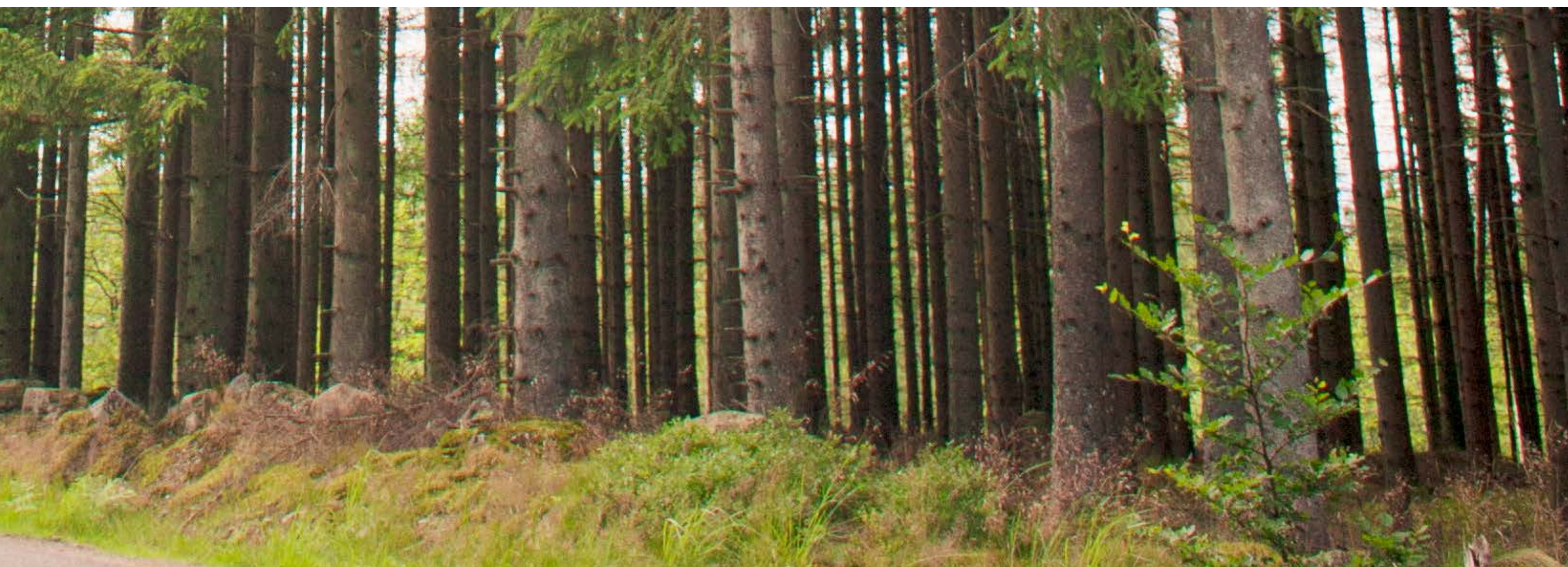
Ask what your investments can do for the society

Double materiality
As a responsible investor, we are mindful of not only how investment performance is affected by sustainability factors, but also the material impact on society that our investment decisions may cause. Applying this so-called double materiality assessment across our investment products – meaning the financially material topics that influence enterprise value as well as topics material to the economy, environment and people – is as an integral element of our investment business. The EU Action Plan on Sustainable Finance is a significant catalyst for the focus on double materiality. Below, we present the three most important concepts to assess the impact that our investments have on society.



Principal adverse impacts
We analyse and assess how a company addresses and tackles a series of sustainability issues, ranging from carbon emissions, fossil fuel exposure, waste levels to gender diversity and due diligence over human rights and a company's efforts to avoid corruption, bribery and other practices harmful to society. To address and reduce these *principal adverse impacts*, we, for example, restrict companies involved in harmful products or behaviour, including weak human rights or tax practices, carbon-intensive business models, water pollution or corruption. Moreover, as a responsible investor, we engage with companies with the goal of solving the matter and thus mitigating a company's negative impact on society. This underpins our ambition of mitigating our negative impact on society, fostering change and helping our investors invest in the sustainable transition while delivering strong investment performance.

Sustainable investment house view
According to Article 2(17) of the Sus-



tainable Finance Disclosure Regulation (SFDR), a sustainable investment is defined as:

"An investment in an *economic activity that contributes to an environmental objective*, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an *investment in an economic activity that contributes to a social objective*, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments *do not significantly harm* to any of those objectives *and that the investee companies follow good governance practices*, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance"

Over the past year, we have spent considerable resources on establishing a model that can define a sustainable investment, based on the definition in SFDR, down to an individual company level. The model encompasses the currently most important sustainability elements, such as UN Sustainable Development Goals (UNSDGs), as defined in our proprietary mSDG model (further described on page 10) and the EU taxonomy. It is a quantitative model with a qualitative overlay, where the latter allows for individual adjustments when, for example, data is unreliable or missing, or when we as an asset manager has in-depth knowledge about a specific investment that justifies a deviation from the quantitative assessment. Having our own model adds flexibility; something we assess to be desirable and needed, as the EU Action Plan in many ways is a moving target with many different aspects coming into play further down the road.

The taxonomy

The third applicable area is the green taxonomy, which in essence defines companies based on economic activities that contribute most to meeting the EU's environmental objectives within

- Climate change mitigation
- Climate change adaptation
- The sustainable use and protection of water and marine resources
- The transition to a circular economy
- Pollution prevention and control
- The protection and restoration of biodiversity and ecosystems

Compared to the definition of sustainable investment in Article 2(17) of the SFDR, the taxonomy has a narrower approach and the share of taxonomy-aligned companies within a given investment universe will typically be smaller compared to being classified as a sustainable investment. The level is expected to grow over time, as there will be delegated acts on all six objectives (the remaining four delegated acts will soon be implemented). Another aspect favouring higher taxonomy alignment in the future is the fact that the taxonomy analysis will not be based on a revenue perspective only, it can also be done by assessing the alignment from an opex or capex perspective.

"The taxonomy will become more and more financially material and hence more and more integrated into our investment processes and targets. We are at the beginning of an interesting journey that will take some time to fully materialize seen from an investment perspective.

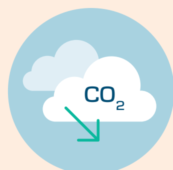
Thomas Otbo,
CIO, Danske Bank Asset Management

Net Zero Asset Managers initiative – 2030 and beyond

As part of our determination to play a part in supporting the goal of limiting global warming to 1.5°C and achieving corresponding net zero emissions by 2050, Danske Bank Asset Management in 2021 joined the Net Zero Asset Managers initiative (NZAM).

By joining this initiative, Danske Bank Asset Management aims to work consistently with an ambition to reach net zero emissions by 2050 or sooner across all assets under management. We start by focusing on our investment products (mutual funds, managed accounts and pooled investment vehicles), with the explicit aim of ratcheting up the proportion of AUM covered, until 100% of assets are included. This means we will continuously work in partnership with asset owner clients to establish decarbonisation goals for their portfolios as well. NZAM is a considerable commitment and requires – in addition to governments following through on their own pledges to ensure the objectives of the Paris Agreement are met – that we both engage and partner with our investee companies to help them achieve real economy emission reductions.

Two main interim targets:



50% reduction
in the weighted average carbon intensity by 2030

Engagement with the
100 largest emitters
by 2025

Interim targets

As one of the largest asset managers in the Nordics, part of our commitment is to implement a stewardship and engagement strategy with a clear escalation and voting policy that is consistent with the scale of these ambitions. In November 2021, we introduced our 2030 interim target to reduce the weighted average carbon intensity of our investment products by at least 50% against a 2020 baseline. We further supported this by a commitment to engage with the 100 largest emitters by 2025, thereby contributing to real climate impact and decarbonisation.

We will initially work with Scope 1 and 2 emissions, and Scope 3 from 2023 onwards. However, Scope 3 is already being considered now in relation to our engagement target.

We will continuously track these targets and be open about our progress.

Investment restrictions will also play a role

It would be easy to decarbonise a portfolio by reducing or eliminating exposure to companies in carbon-intensive sectors such as airlines, cement, steel and utilities. Apart from the fact that this would significantly limit our ability to deliver competitive risk-adjusted returns through diversified portfolios, there is no clear evidence such an approach would yield any real world impact and could even be considered counterproductive, as companies in high emitting sectors need investor capital to be able to innovate, decarbonise and transition. Investors can shape tomorrow's companies by taking a forward-looking view and choosing to invest in companies that are on an ambitious and credible transitional pathway. Many of these companies often have high CO_2 emission legacy profiles. As an investor and distributor of investment products, we have a vital role to play in driving the low-carbon transition, thereby helping society to reach its climate ambitions.

"By signing the Net Zero Asset Managers initiative, we have made an ambitious commitment for our own climate efforts – together with our peers we want to facilitate measurable, sustainable change."

*Christian Heiberg,
Head of Asset Management, Danske Bank*

Introduction::

Inclusion

2021 was the year when The Sustainable Finance Disclosure Regulation (SFDR) came into effect, meaning the sustainability agenda took a giant leap in terms of importance and relevance for the investment community, including both the manufacturer and the customer. Essentially, SFDR is all about increasing transparency on the sustainability-related aspects of financial products. It places a great deal of emphasis on describing our processes for managing various sustainability factors in our investment decision-making.

International societies have embarked on a journey to make economies more sustainable. Stricter regulation on companies, the Paris Agreement, the UN Sustainable Development Goals and consumers' increased demand for sustainable solutions and products are megatrends that influence companies and thereby our investors. This development is disrupting business models and altering the risks and opportunities that businesses and the financial sector face, making sustainability a key strategic business priority. We believe it is paramount to capture these sustainability risks and opportunities fuelled by the sustainable transition, as this supports our ambition of protecting and growing our investors' assets. Being an asset manager where incorporating sustainability risks has been part of many of our investments teams' investment processes for many years, we welcome this development. We continuously develop and enhance our sustainability analysis tools and infrastructures with the aim of having our investment teams making the best possible investment decisions based on holistic risk/opportunity assessments.

Addressing sustainability through a materiality lens

From an incorporation perspective, SFDR means that we as an asset manager is formally obliged to disclose the manner in which sustainability risk is incorporated in our investment decisions across our investment portfolios. It hence places a great deal of emphasis on describing our processes for managing various sustainability characteristics in our investment decision-making.

The relative importance and the impact on investment decisions of the sustainability risk incorporation are based on e.g. which category under SFDR the investment strategy falls within. Investment teams seek to identify and assess those sustainability factors that pose risks and could have a negative impact on the return potential of their investments, i.e. factors that are financially material.

Based on the unique characteristics of the individual investment strategy, our investment teams leverage our ESG data platform and proprietary ESG

analysis tool mDASH® to identify and analyse those sustainability factors that are likely to be business-critical for specific companies. Sell-side research, company discussions and other relevant sources of information are also utilized. In addition, our Responsible Investment team, consisting of ESG specialists and analysts, supports our investment teams across the Nordics in deploying a systematic incorporation of sustainability factors.

mDASH® is our proprietary sustainability research platform that enables investment teams to form a holistic view of companies' sustainability performance. mDASH® is therefore a key tool for complying with the requirements of SFDR regulation in terms of our investment decisions.

mDASH® explicitly identifies those industry-specific sustainability risks that are most likely to impact the financial or operational performance of companies, and scores how each individual company manages those risk exposures. mDASH® thus helps investment teams describe the manner in which sustainability risks are integrated into the investment decision-making process by assessing the likely impact of sustainability risks on financial return and explaining the reasoning for whether sustainability risk is deemed to be material or not.

Promotion of environmental or social characteristics

SFDR contains disclosure requirement for products promoting E/S characteristics. In Danske Bank we have a full array of promotional activities; in terms of investment inclusion criteria, we have developed screening processes that enable investment strategies to ensure low exposure towards investments with a negative impact on the climate or society as a whole and to ensure good governance in investee companies..

Furthermore, our portfolio managers can identify company-specific sustainability issues of interest and concern that they might want to address in their ongoing dialogue with investee companies. mDASH® embeds this information, including a portfolio manager evaluation of how a company has addressed a particular issue, and hence allows us to track progress within areas of interest and concern

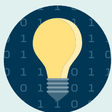
Moreover, investment teams regularly undertake training programmes to raise their sustainability competencies, so they can constantly improve and strengthen their ability to incorporate sustainability factors into the selection of investments. Many of our investment professionals have recently completed the European Federation of Financial Analysts Societies ESG Analyst training programme, CESGA (please see page 48 for more information about education programme). By building on what was already established a few years back in the form of robust sustainability processes, expanding ESG data and developing analytical tools, we continue to work towards enabling teams to systematically manage and mitigate the potential sustainability risks of investments – and unlock investment opportunities spurred by, for example, a company's ability to leverage the low-carbon transition to grow their business and achieve a competitive advantage.

mDASH® in brief

- To support our ambition of truly integrating sustainability factors into our investment decision-making, we have developed our own analytical tool mDASH®.
- mDASH® is a materiality dashboard that sources raw ESG data from company disclosures and a number of third-party data and rating providers to form the basis for assessing what is material to the companies we invest in.
- We can also transform scope and data inputs into a material sustainability risk score for each company in our universe – this we term an mSCORE®, which we have developed as one output from mDASH®.
- mDASH® helps us identify investment value in ESG data, make holistic assessments and take ownership of our sustainability integration, thus supporting better-informed investment decision-making.

"No companies get a free pass in relation to sustainability"

One important input to our house view model for sustainable investments is to understand companies' contribution to the UN Sustainable Development Goals (SDGs). Our internal analytical tool – mSDG –enables us to not only assess what companies produce, but also how they produce it.



Facts about mSDG

- Our proprietary analytical tool, mSDG, assigns companies a score from -3 to 5 in relation to how well the companies contribute to fulfilling the 17 UN SDGs.
- mSDG is an integral part of our sustainable investment house view model and utilize data from the external suppliers MSCI, Util, Sustainalytics, TruValuelabs and ISS.
- Companies are assigned a score both for how their products or services contribute to fulfilling the SDGs and also for how their operations – in other words, the production of these products or services – contribute to fulfilling the goals. This gives a total overall mSDG score.
- A company's mSDG score is based on a combination of the company's absolute contribution to the UN SDGs and its relative contribution – in other words, its contribution relative to the other companies in its sector. Thus, a company will also be rewarded if it contributes positively to the transition towards increased sustainability within its sector.
- mSDG supplements our other proprietary analytical tool, mDASH, which identifies which risks are associated with the company's handling of sustainability issues.

When it comes to sustainability, focus is often mostly on a company's products and less on how the company makes those products – but what is the point of producing environmentally friendly electric cars, for example, if the manufacturing process is extremely detrimental for the environment and employees?

At Danske Bank, we have therefore developed our own internal analytical tool – mSDG – that includes both a company's products and its operations in our assessment of the company's sustainability profile. With mSDG, we focus not only on what a company produces, but also on how the company produces it.

"Our mSDG tool allows us to systematically assess the extent to which a company contributes positively to the UN's 17 Sustainable Development Goals," explains Camilla Adamsen Nielsen, portfolio manager in the credit team at Danske Bank Asset Management.

mSDG is now an integral element of our sustainable investment house view model (described on page 4) and as such an important tool for our credit

investment teams when analysing and selecting corporate bonds.

We consider the entire value chain
With mSDG, each and every company is assigned a score for how its products or services contribute to the UN SDGs and also a score for how its operations contribute to the SDGs – whether positive or negative. A company's operations often contribute negatively due to its consumption of various resources, such as raw materials or energy.

The two scores are combined to produce an overall result for the company's contribution to the SDGs.

"This ensures that no companies get a free pass in relation to sustainability just because they make products that contribute to sustainable development. With mSDG, we consider the entire value chain – and what is important for us is that companies both measure and have a strategy for how they can minimise the negative impact on the SDGs from their operations while at the same time optimising the positive impact of their products and services," says Camilla Adamsen Nielsen.

The overall score ranges on a scale from -3 to 5, with the highest score reserved for "Leading SDG contribution" (see table on this page). In our Global Corporate Sustainable Bond strategy, this is the case for US company Xylem. The company scores 5 on our scale and is thus a leading SDG contributor, mainly SDG no. 6 – clean water and sanitation.

How mSDG is used in practice
Camilla Adamsen Nielsen says that what she and the rest of the investment team normally would look for is an overall score of at least 1.

"A score of 1 means a company makes a very small positive contribution to the UN SDGs. However, bonds issued by companies with an mSDG score of less than 1 may also be included in the portfolio if our qualitative evaluation of the company shows, for example, that it has a clear strategy for reducing its negative impact on the SDGs, or it has a positive impact on a specific SDG that our mSDG tool does not capture. This way, we can support and reward companies that are on a positive development track," explains Camilla Adamsen Nielsen.

One example she mentions is the German company Volkswagen, which is includedin the European Corporate Sustainable Bond strategy. Volkswagen currently has an mSDG score of -1, but it plays a significant role in the transition from vehicles with internal combustion engines to electric-powered vehicles and has a target of 50 per cent of the vehicles it sells being electric by 2030.

"This transition has a positive impact on SDG number 13 – climate action," says Camilla Adamsen Nielsen.

A positive side effect
However, a company's mSDG score is never the sole foundation for the portfolio manager's decision on which investments to select – it is merely a single piece in a bigger jigsaw puzzle. Other important factors include a thorough analysis of the business, strategy, credit quality and capital structure of the individual companies.

A company's mSDG score also has a positive side effect.

"It provides a good starting point for a constructive dialogue with companies about how they can improve in terms of sustainability," concludes Camilla Adamsen Nielsen.

Our mSDG tool allows us to systematically assess the extent to which a company contributes positively to the UN's 17 Sustainable Development Goals (SDGs),

Camilla Adamsen Nielsen,
ESG analyst and portfolio manager at Danske Bank Asset Management.

Scale for a company's overall mSDG score

Score	Description
5	Leading SDG contribution
4	Significant positive SDG contribution
3	Moderate positive SDG contribution
2	Small positive SDG contribution
1	Very small positive SDG contribution
-1	Likely negative SDG contribution
-2	Moderate negative SDG contribution
-3	Significant negative SDG contribution

Deep-dive:

Understanding climate transition strategies among Nordic companies – opportunities and gaps

An important aspect of being an investment manager today is to analyse and understand material aspects of corporations' strategic approaches to handle greenhouse gas emissions. Being a Nordic based investment house we have a long tradition of in-depth knowledge of Nordic companies from many different investment perspectives. To enrich our understanding and further expand our knowledge base, we decided to analyse the current 'state of play' of 35 large Nordic companies from some of the highest-emitting industry sectors.

Derek Traynor, CFA
Chief ESG Analyst
Danske Bank Asset Management

Carla Steuer
First Year Analyst
Danske Bank Asset Management

What kind of perspectives will a focus on management quality and governance of company carbon practices among 35 of the largest Nordic companies give you? What would an assessment of these 35 companies' approach to greenhouse gas emissions reductions and their adaptability to the risks and opportunities stemming from the low-carbon transition bring to the table? By answering these questions, understanding where companies currently stand on carbon policies and processes, and most importantly, where they are lacking, we can not only better formulate and target our stewardship and engagement strategy. We will also have an applicable framework to consistently assess any kind of corporation from an overall carbon governance emission perspective. Net-zero policies are for the long run and we as an asset manager must understand and assess companies through solid and reliable long-term analysis and frameworks.

> *To enrich our understanding and further expand our knowledge base we decided to analyse the current ´state of play´ of 35 large Nordic companies from some of the highest-emitting industry sectors."*

The importance of developing a coherent climate transition strategy
Of the 192 countries that are Parties to the Paris Agreement, more than 130 countries have set or are considering a target of reducing emissions to net zero by 2050. However, according to the United Nations, their planned combined emissions reductions, as stated by their Nationally Determined Contributions still fall far below what is required in terms of ambition to achieve the 1.5°C goal[1].

The UN Environment Programme's Emissions Gap Report 2021[2] finds that NDCs only take 7.5% off predicted 2030 emissions, while 55% is needed to meet the 1.5 °C goal. In other words, countries need to increase decarbonisation commitments to more than seven-fold from current levels. Inconsistencies between long-term commitments and shorter-term actions and targets on decarbonisation are not a problem unique to countries or governments

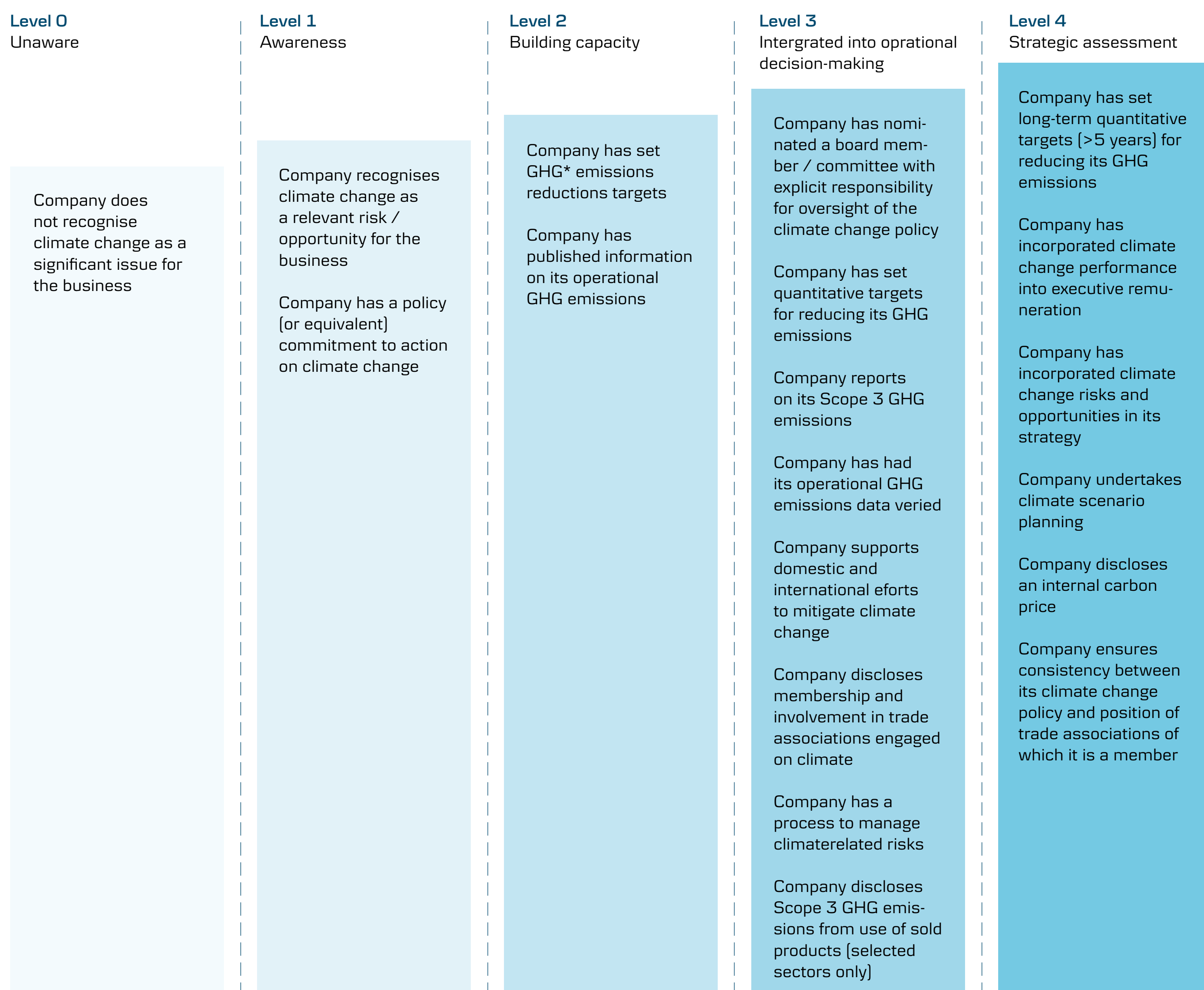
[1] Net Zero Coalition | United Nations
[2] www.unep.org/resources/emissions-gap-report-2021

however. Companies are often just as inconsistent when it comes to aligning words with actions, and the association with greenwashing often looms over corporate climate policies. A lack of incentives can drive this gap. The transition to a greener and more sustainable future requires significant investment, and adequate incentives need to be in place to drive change. Risks extend beyond greenwashing and reputational damage. By failing to fully integrate a coherent climate transition strategy into their businesses, these companies stand ill prepared to manage a broad range of financially material risks and opportunities related to the low carbon transition. Once such risk surrounds

Box 1: TPI Management Quality Assessment

The Transition Pathway Initiative (TPI) Management Quality assessment framework utilises 19 indicators that seek to determine whether a company has implemented a particular carbon practice, each assessed through a binary yes / no question. Each of these questions are mapped to five levels – from Level 0 through to Level 4 – reflecting a company's level of progress with respect to implementation of carbon management systems and processes. The assessment covers areas such as emissions disclosures, setting targets and strategic policy commitments. The questions begin at a high level, such as 'does the company acknowledge climate change as an issue for the business?', becoming more targeted and strategy specific as they progress up the ladder. A company that achieves a perfect score across all 19 questions is provided a 4 Star categorisation.

In order to progress from one level to the next, companies need to answer 'yes' to all questions relevant to that level. Ultimately, the higher a company places on the ladder, the more anchored and more credible their climate transition plan is, meaning the likelihood of a company actually delivering on the required emissions reductions is higher.



*Source: Transition Pathway Initiative . *GHG: Greenhouse Gas*

carbon pricing. Through implementing a carbon price, the EU hopes to incentivise businesses to use less carbon while placing a premium on decarbonisation in order to stimulate innovation and adaption. This can serve as a key mechanism to translate company inaction into financial risk and therefore companies need to factor such developments into their climate strategy. Lastly, and most crucially, companies have a critical role to play in helping the world avoid a climate catastrophe and all relevant stakeholders – investors, governments, society – expect them to act.

A framework for understanding company management of carbon transition risks and opportunities
While it is not feasible nor credible to assess a company's climate journey using a single number, the Transition Pathway Initiative's (TPI) Management Quality framework, which we leverage in our study, is amongst the stronger forward-looking methods of assessment[3]. This strength was recognised by Environmental Finance which awarded TPI 'ESG Assessment Tool of the Year 2020' at the Sustainable Investment Awards, crediting TPI with having been "instrumental in enabling asset owners to understand what the transition to a low carbon economy means for their major holdings in energy intensive sectors. It has simplified the message around climate change and has made it easier for asset owners to take action." In our analysis, we apply the framework to 35 large Nordic companies transcending some of the highest emitting sectors including oil and gas, shipping, autos, electricity utilities, aluminium, industrials, consumer goods, chemicals, construction, paper, mining and steel. We have grouped these sectors into broader categories of energy, industrials and materials, transport and buildings and consumer goods. The Management Quality assessment evaluates and tracks the quality of companies' governance and management of their greenhouse gas emissions as well as the risks and opportunities they face related to the low-carbon transition, in line with the Taskforce on Climate-related Financial Disclosures (see Box 1 and 2).

Enabling strong net zero stewardship and engagement
TPI's framework helps to align our obligations as members of the Net Zero Asset Managers Initiative by providing a tool that guides our understanding, analysis and stewardship of the companies that we invest in, focusing on real world change and accountability. Long-term ambition from companies is worthless without credible short-term action plans and targets. By assessing the management quality of a company's climate plan, using publicly disclosed data mapped to the TPI's Management Quality framework, we can better gauge the credibility of their action plans and the likelihood of meeting their long-term ambitions.

Box 2: TPI Management Quality Assessment

Level 0: Unaware of Climate Change as a Business Issue

1. Does the company acknowledge climate change as a significant issue for the business?

Level 1: Acknowledging Climate Change as a Business Issue

2. Does the company recognise climate change as a relevant risk and/or opportunity for the business?
3. Does the company have a policy (or equivalent) commitment to action on climate change?

Level 2: Building Capacity

4. Has the company set greenhouse gas emission reduction targets?
5. Has the company published information on its Scope 1 and 2 greenhouse gas emissions?

Level 3: Integrating into Operational Decision Making

6. Has the company nominated a board member or board committee with explicit responsibility for oversight of the climate change policy?
7. Has the company set quantitative targets for reducing its greenhouse gas emissions?
8. Does the company report on Scope 3 emissions?
9. Has the company had its operational (Scope 1 and/or 2) greenhouse gas emissions data verified?
10. Does the company support domestic and international efforts to mitigate climate change?
11. Does the company disclose its membership and involvement in trade associations engaged in climate issues?
12. Does the company have a process to manage climate-related risks?
13. Does the company disclose Scope 3 use of product emissions?

Level 4: Strategic Assessment

14. Has the company set long-term quantitative targets for reducing its greenhouse gas emissions?
15. Does the company's remuneration for senior executives incorporate climate change performance?
16. Does the company incorporate climate change risks and opportunities in their strategy?
17. Does the company undertake climate scenario planning?
18. Does the company disclose an internal price of carbon?
19. Does the company ensure consistency between its climate change policy and the positions taken by trade associations of which it is a member?

Source: Transition Pathway Initiative

[3] *The Transition Pathway Initiative is a global initiative led by asset owners and supported by investors globally. It seeks to support efforts to get companies to align themselves with the transition to a low carbon economy. See https://www.transitionpathwayinitiative.org for more information.*

Companies face unique sector-specific decarbonisation pathways

The importance of understanding sector dynamics The International Energy Agency (IEA) has produced the "world's first comprehensive study of how to transition to a net zero energy system by 2050 while ensuring stable and affordable energy supplies, providing universal energy access, and enabling robust economic growth". As the report makes clear[4], to reach the goal of limiting warming to 1.5°C and achieving net zero emissions by 2050, each sector is expected to transition, while pathways to net zero emissions differ considerably depending on sector. Each company faces its own unique sector-specific decarbonisation challenges that vary across many dimensions such as cost implications and the distribution of emissions concentrations across the value chain.

Figure 1 outlines the expected transition paths for different sectors according the IEA's Net Zero Emissions (NZE) scenario and serves as frame with which to understand the individual sector dynamics required to facilitate the transition. The heat and electricity utilities sector, for example, is expected to decarbonise rapidly, reaching net zero by 2040, driven by a switch to wind and solar PV renewables. With electricity generation being the single largest contributor to greenhouse gas emissions accounting for over a third of global CO_2 emissions, this rapid transformation is critical to the achievement of net zero emissions by 2050.

In contrast, the likely decarbonisation path followed by heavy industry will be slower. Here CO_2 emissions are expected to decline 20% by 2030 and 93% by 2050 under the IEA forecasts. While an improvement in the energy efficiency of equipment and materials and advanced technological solutions for new capacity add-ons will contribute to this reduction, they will not be sufficient alone. The IEA estimates that the bulk of heavy industry's emissions reductions will thus need to come from technologies currently under development but not yet commercially viable today.

Identify those companies credibly in transition and those that are not

When setting our NZAM related interim targets for companies and sectors, we align our expectations based on what appears ambitious, yet feasible or achievable by 2030 utilising the IEA's Net Zero Roadmap and IPCC P2 as guiding references. The IPCC P2 scenario represents a very ambitious pathway allowing for only limited temperature overshoot while also considering very important social objectives in transition. This is a scenario with a broad focus on sustainability, including energy intensity, human development, economic convergence and international co-operation, as well as shifts towards sustainable and healthy consumption patterns, low-carbon technology innovation, and well-managed land systems with limited societal acceptability for BECCS (bioenergy with carbon capture and storage). Utilizing these pathways not only ensures that our targets are firmly rooted in science but also that we shape our net zero stewardship and engagement strategy for companies aware of the unique challenges they face.

> *We can utilise this framework to create a strong net zero stewardship and engagement strategy, while setting clear expectations, for those companies in which we invest*

We do not seek to exclude sectors outright, but rather seek to identify those companies that are credibly in transition and those that are not. For

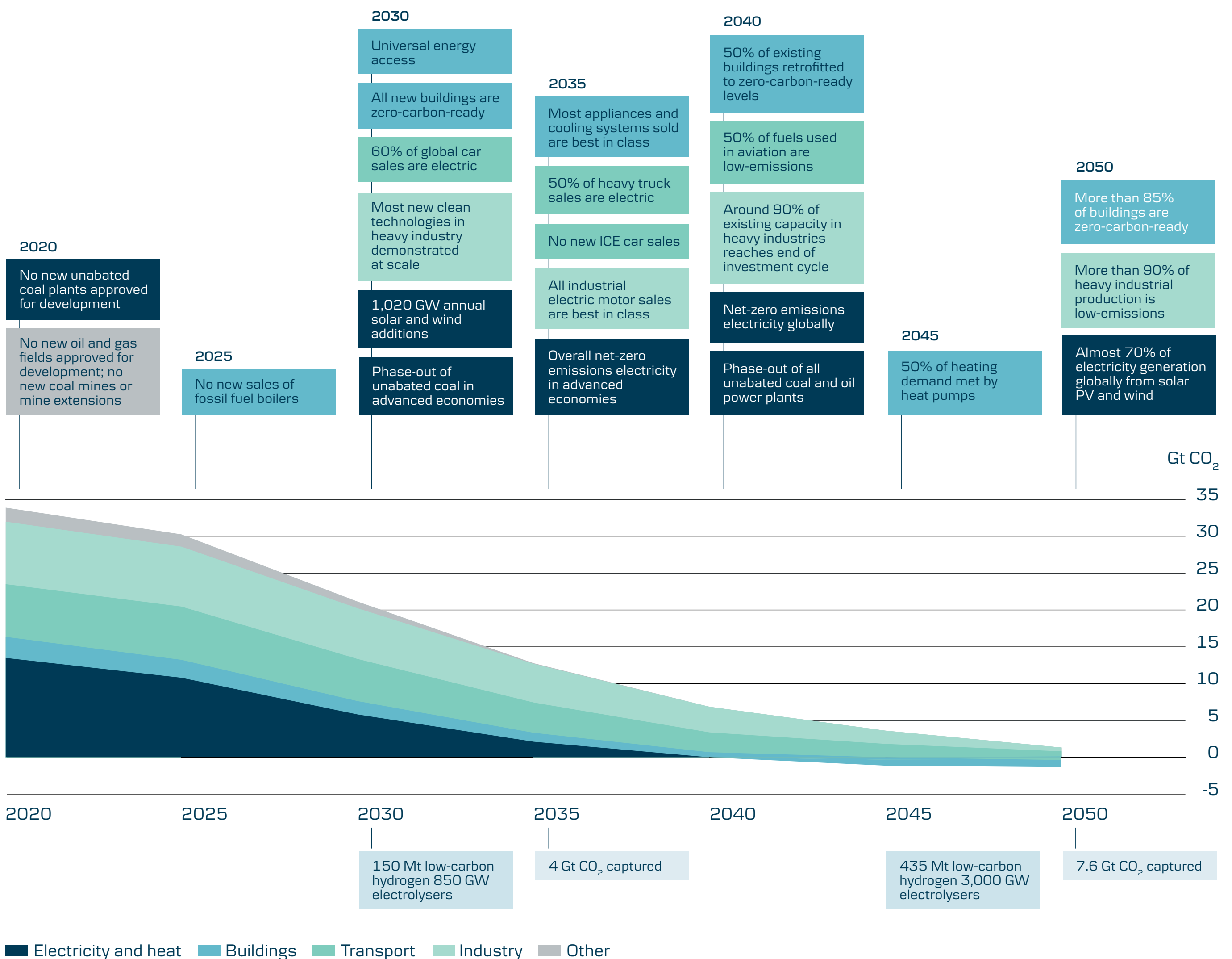
[4] *The IEA published its Net Zero by 2050 – A Roadmap for the Global Energy Sector paper in May 2021. It is the world's first comprehensive study of how to transition to a net zero energy system by 2050. The report can be accessed here: https://www.iea.org/reports/net-zero-by-2050.*

those companies deemed lagging, we can utilise the Management Quality framework as a tool to help frame a strong net zero stewardship and engagement strategy, whilst at the same time setting clear and reasonable expectations. We can monitor the progress of these companies through time and, if necessary, take corresponding action – including escalation, voting and as a last resort, eventual divestment.

By leveraging an open-source framework like TPI, we also support the Net Zero Asset Manager initiatives' spirit of "collaborative efforts for investors to have access to best practice, robust and science based approached and standardised methodologies, and improved data, through which to deliver these commitments".[5]

[5] *See the Net Zero Asset Managers Commitment at:https://www.netzeroassetmanagers.org/*

Figure 1 – IEA Net Zero Roadmap – the sectoral path to decarbonisation

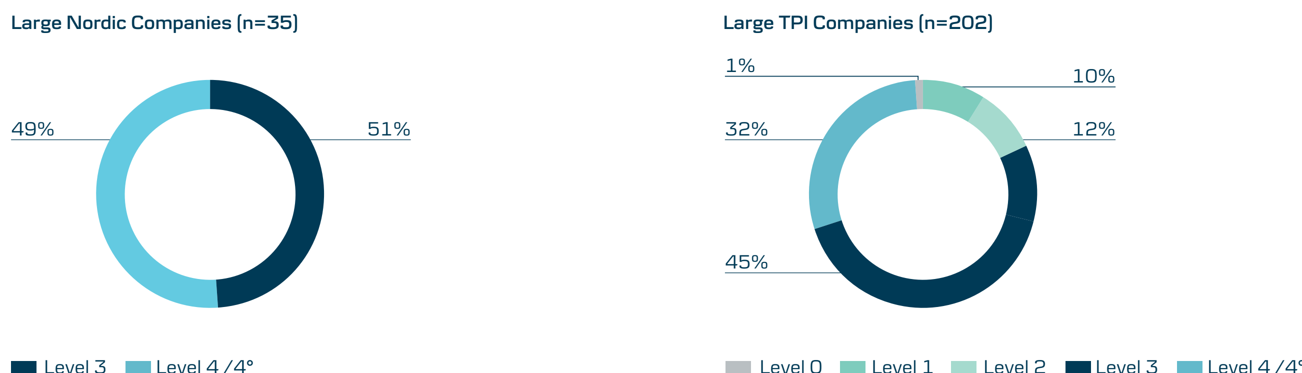


Source: International Energy Agency

Year	Total	Electricity & Heat	Industry	Transport	Buildings	Other
2025	-11%	-20%	-5%	0%	-17%	-11%
2030	-38%	-57%	-19%	-21%	-38%	-53%
2035	-63%	-84%	-39%	-43%	-59%	-95%
2040	-81%	-101%	-59%	-63%	-76%	-126%
2045	-93%	-102%	-79%	-79%	-90%	-142%
2050	-100%	-103%	-94%	-90%	-97%	-153%

Source: International Energy Agency, 2021

Figure 2 – Breakdown of Companies by Management Quality Level



Source: Danske Bank, TPI, November 2021

Destination 1.5°C: How are Nordic companies faring?

The 35 Nordic companies covered by this analysis are among the largest in the region and cover a number of high emitting sectors including oil and gas, shipping, autos, electricity utilities and industrials. These are high priority sectors accounting for a large proportion of emissions identified by the IEA under its NZE scenario. For each of these companies, the TPI's Management Quality framework was applied in order to assess the performance of company management and governance on greenhouse gas emissions as well as their degree of preparedness stemming from the risks and opportunities linked to the climate transition. Using disclosures from publicly available sources including company websites, annual reports, sustainability reports, and company climate disclosures to the Carbon Disclosure Project (CDP)[6] data was mapped to each question in the Management Quality framework. It should be noted that both the data gathered and company analysis undertaken in this study were neither produced nor reviewed by TPI.

Overall, Nordic companies compare favourably to global peers. In aggregate, the companies in our sample have reached Management Quality Level 3 or 4. More specifically, 18 (51%) of the companies are at Level 3, implying that they are now in the process of integrating climate change into their operational decision-making. They do this by building capacity into their management systems and processes, by assigning senior management or board responsibility for climate issues and by providing comprehensive disclosures on carbon practices and performance. The remaining 17 (49%) of companies have reached Level 4, implying they have fully integrated the climate transition into their operational decision-making, and are now pursuing a strategic level of integration through business strategy and capital expenditure decisions.

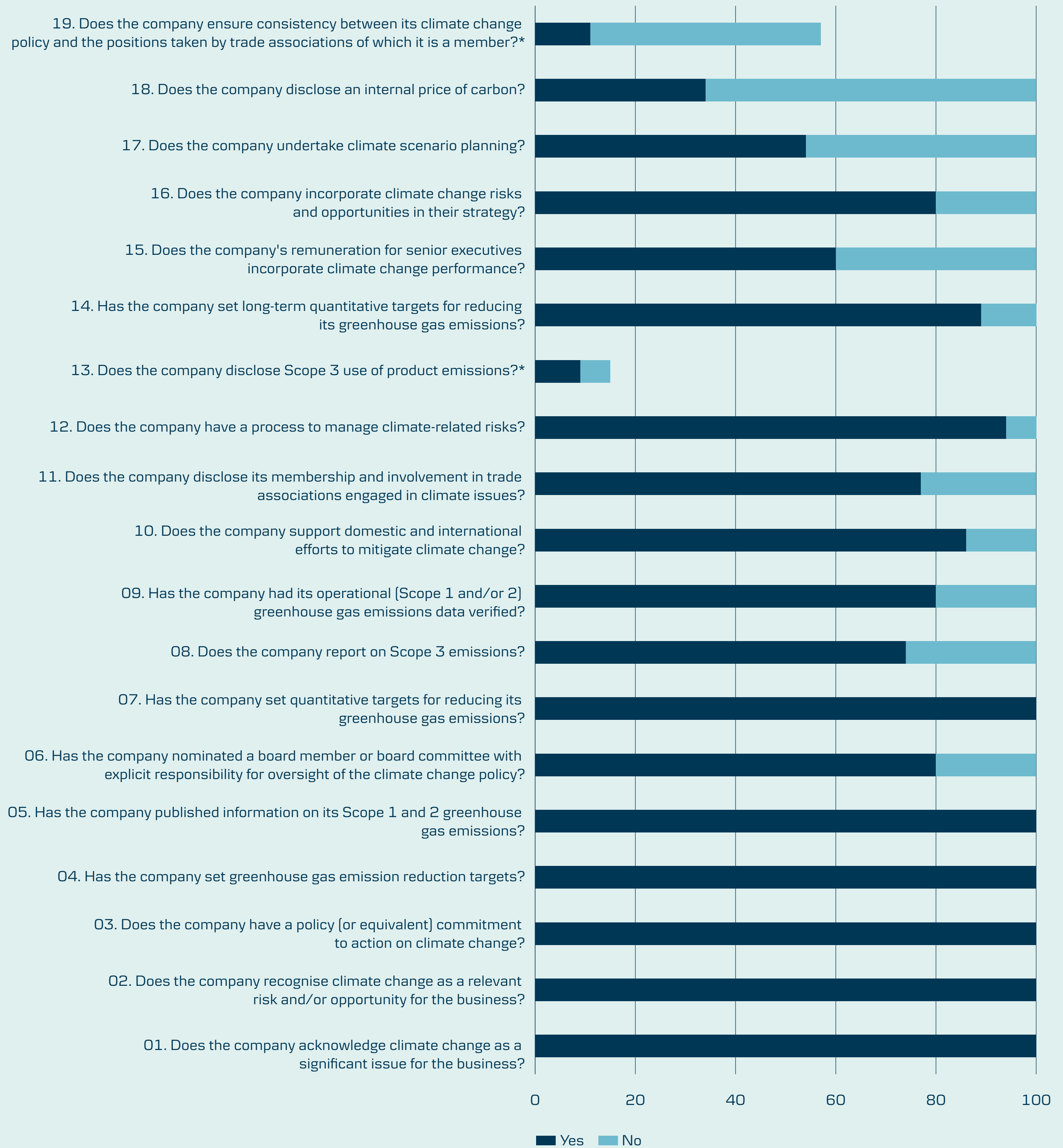
By way of comparison, referencing similar sectors from the TPI's global dataset of large companies, which includes 202 companies across 33 countries, 155 companies (77%) achieve Level 3 and above. Of the remaining companies, 20 (10%) have only reached Level 1, implying that they have just acknowledged climate change as a business issue, while 3 (1%) companies are Level 0, and thus are either unaware of or are yet to acknowledge climate change as a business issue. Relative to the global dataset therefore, large Nordic companies compare favourably in aggregate. There are potential reasons why this might be the case. Notably, the TPI's global dataset also includes companies from several emerging markets such as Indonesia, South Africa, Mexico and Russia, countries that are at a lower level of economic development. Despite this, the framework does not include any 'just transition' questions resulting in a potential gap in the analysis. While the application of the TPI's framework is global in nature, the process of transitioning away from fossil fuels to clean energy may be unique to each country, especially given differing levels of economic development.

The data highlights clear areas for engagement focus

With few companies in the dataset achieving a perfect score across all questions, the Management Quality framework serves as a useful tool in which to target our net zero stewardship and engagement strategy. Where gaps exist, we can use this framework to articulate clear expectations with the companies that we invest in, monitoring their progress and standing ready to take corresponding action including escalation, voting and eventual divestment in the event of inaction. Unsurprisingly, companies underperform most on Level 4 questions related to the integration of climate transition risks and opportunities into business strategy and capital expenditures (Figure 3). It should be noted that Question 13 – "Does the

[6] The Carbon Disclosure Project is a not-for-profit charity that runs the global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts. See https://www.cdp.net/en for more information.

Figure 3 – Management Quality Questions and mapping to TCFD recommendations



*Source: Danske Bank, TPI, TCFD November 2021. *Scope 3 use of product emissions are only applicable to certain sectors, including autos and oil and gas companies. Data for question 19 is incomplete owing to lack of clear disclosure.*

company disclose Scope 3 use of product emissions?" only applies to a small subset of companies, while for Question 19 "Does the company ensure consistency between its climate policy and the positions taken by trade associations of which it is a member?" our dataset is incomplete, due to insufficient corporate disclosure. Transparency is something we expect from companies on climate issues, and timely disclosure is key point of our engagement focus.

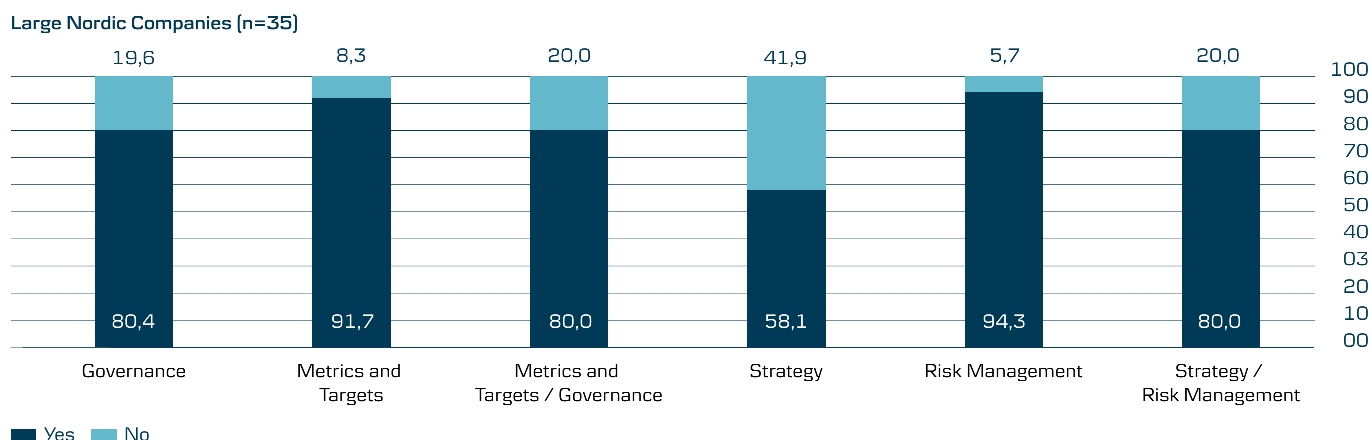
Mapping to TCFD

It is a useful exercise to map these questions to the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations (Box 3). TCFD climate disclosure recommendations are structured around four key thematic areas comprising the key areas of organisation operational focus: Governance, Strategy, Risk Management, and Metrics and Targets.[7] TCFD, the most-widely known and used climate risk reporting framework, is rapidly becoming the global standard for how companies disclose the risks they face from climate change. Increasingly governing bodies – including the European Union, United Kingdom, Switzerland and New Zealand – are incorporating the TCFD's requirements into formal disclosure requirements, while more than 2600 organisations and companies have now endorsed them.[8]

Analysing the companies through the TCFD lens (Figure 4), most gaps in company Management Quality performance relate to Strategy considerations, while companies largely perform well on Risk Management and Metrics and Targets.

[7] See: https://www.fsb-tcfd.org/recommendations/
[8] 2021 TCFD Status Report, available at: https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Status_Report.pdf

Figure 4 – Management Quality Questions mapped to TCFD recommendations



Source: Danske Bank, TPI, TCFD November 2021. Two Management Quality indicators map to more than one TCFD theme: 9. has the company had its operational (Scope 1 and /or 2) greenhouse gas emissions data verified? – Metrics and Targets / Governance; and 16. Does the company incorporate climate change risks and opportunities into their strategy – Strategy / Risk Management

Box 3: TCFD Framework

The TCFD's disclosure recommendations are centred on four interlinking core thematic areas related to how companies operate – Governance, Strategy, Risk Management and Metrics and Targets.

Governance: Disclose an organisation's governance around climate-related risks and opportunities.

Strategy: Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material.

Risk Management: Disclose how the organisation identifies, asseses, and manages climate-related risks.

Metrics and Targets: Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material

The 19 indicators comprising the TPI's Management Quality framework aligns with and complements the TCFD's disclosure recommendations. TPI has mapped each indicator to the four thematic areas specified by the TCFD:

TPI Management Quality Indicators	TCFD Themes
1. Does the company acknowledge climate change as a significant issue for the business?	Governance
2. Does the company recognise climate change as a relevant risk and/or opportunity for the business?	Governance
3. Does the company have a policy (or equivalent) commitment to action on climate change?	Governance
4. Has the company set greenhouse gas emission reduction targets?	Metrics and Targets
5. Has the company published information on its Scope 1 and 2 greenhouse gas emissions?	Metrics and Targets
6. Has the company nominated a board member or board committee with explicit responsibility for oversight of the climate change policy?	Governance
7. Has the company set quantitative targets for reducing its greenhouse gas emissions?	Metrics and Targets
8. Does the company report on Scope 3 emissions?	Metrics and Targets
9. Has the company had its operational (Scope 1 and/or 2) greenhouse gas emissions data verified?	Metrics and Targets / Governance
10. Does the company support domestic and international efforts to mitigate climate change?	Strategy
11. Does the company disclose its membership and involvement in trade associations engaged in climate issues?	Governance
12. Does the company have a process to manage climate-related risks?	Risk Management
13. Does the company disclose Scope 3 use of product emissions?	Metrics and Targets
14. Has the company set long-term quantitative targets for reducing its greenhouse gas emissions?	Metrics and Targets
15. Does the company's remuneration for senior executives incorporate climate change performance?	Governance
16. Does the company incorporate climate change risks and opportunities in their strategy?	Strategy / Risk Management
17. Does the company undertake climate scenario planning?	Strategy
18. Does the company disclose an internal price of carbon?	Strategy
19. Does the company ensure consistency between its climate change policy and the positions taken by trade associations of which it is a member?	Governance

Source: TCFD, TPI, Danske Bank

As concluded earlier, the Nordic companies included in this analysis perform well in a global context when it comes to their Management Quality. However, there are three areas in particular where companies should focus going forward, the internal price on carbon, climate scenario planning as well ensure that climate KPIs are integrated into Senior Executive Remuneration. This would position Nordic companies as global best practice.

Internal price on carbon

Two thirds of companies in the analysis do not appear to disclose an internal price on carbon. As discussed earlier, since the external pricing of carbon will become an important tool for bringing down emissions globally while incentivising investment into cleaner alternatives, companies need now to position for higher carbon prices in order to reduce climate transition risks. They can do this by setting an effective internal carbon price that may help to direct company investments towards lower emissions, while making carbon considerations more central to business operations and de-risking against future regulatory developments in this area. In short, by setting an internal price, companies can better position to achieve net zero targets.

Climate Scenario Planning

Nearly half of companies do not appear to undertake any form of climate scenario planning despite being a key recommendation from the TCFD. Climate scenario planning, using established climate change science as a guiding framework, incorporates potential adverse and positive impacts to a business stemming from both physical climate risks as well as those risks and opportunities linked to the climate transition. Climate scenario plans enable companies to get a better handle on the potential impacts of climate change across their value chain, while allowing investors to assess these consequences and their effect on the long-term viability and value creating potential of the business.

Climate KPIs in Senior Executive Remuneration

Incentive payment plans linked to emissions reductions serve to hold executives to account for the delivery of these objectives. By setting long-term quantifiable CO_2 reduction targets and utilising shorter-term rolling targets linked to executive compensation plans, companies can keep management aligned with these goals and increase the probability that these goals will be realised. Despite this, we find that 40% of companies in our analysis do not incorporate climate change performance into executive remuneration. In our view, compensation and incentive programmes linked to climate-metrics are important tools to encourage senior management to integrate climate change into the company's business strategy. This helps us ensure that company carbon reduction performance is consistent with the overall aim of achieving net zero emissions by 2050 or sooner.

Under the IEA's Net Zero scenario, the energy sector is expected to be the first to decarbonise, reaching that milestone by 2040.

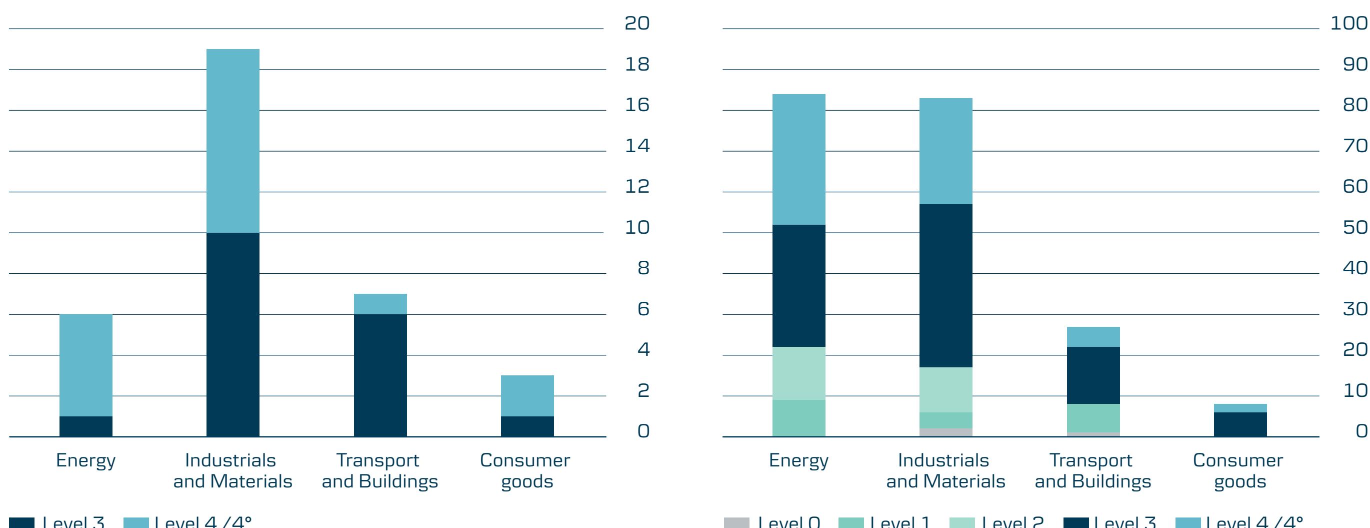
Sector analysis and considerations

Figure 5 details the distribution of Levels assigned to the 35 large Nordic companies from high emitting sectors in our analysis, as well as those Levels assigned to large global companies by the TPI across similar sectors.

Energy

Under the IEA's Net Zero scenario, the energy sector is expected to be the first to decarbonise, reaching that milestone by 2040. That is a considerable achievement, given that electricity generation was the largest source of global emissions in 2020. The IEA expects emissions to fall 60% in the period to

Figure 5 – Management Quality Level Distribution: Large Nordic Companies (n=35, LHS), TPI's Global Large Company database (n=202, RHS)



Source: Danske Bank, TPI, November 2021

2030 as coal usage winds down, before reaching net zero in 2040.

From our analysis of the energy industry, incorporating both electricity utilities and oil and gas companies, we can draw a number of conclusions. First is the strong performance of the electricity utilities companies, each of which have reached Level 4, reflecting the fact that these companies have fully integrated climate issues into operational decision-making. They have now reached the stage where they have a strategic understanding of the risks and opportunities related to the low-carbon transition, integrating these considerations into both business strategy and capital expenditure decisions. This performance is consistent with the TPI's findings at a global level. They find that electricity utility companies routinely feature as the top, or joint-top, performing sector, which can be somewhat explained by the extent of emissions regulation that sector faces, particularly in Europe.

There are however a number of areas where Nordic electricity utilities can improve performance further, and where we can thus target our engagement and stewardship activities as investors. This includes Strategy-focused areas including disclosing an internal carbon price and undertaking climate scenario planning, as well in Governance-focused areas such as ensuring consistency between company climate change policy and that of the positions taken by trade associations of which it is a member. Through constructive dialogue with electricity utilities companies in these areas, we can better ensure that they are prepared for the significant climate transition changes facing that industry.

Nordic oil and gas companies perform strongly across most indicators, seemingly reflecting a keen awareness from the sector that it stands significantly exposed to the risks and opportunities of the climate transition. Governance-focused areas are among those that weigh on performance, including disclosure of membership and involvement in trade associations engaged in climate issues, as well as in ensuring company and trade association climate policy alignment. Trade associations have a tremendous amount to bring to the table on climate matters, and can often be instrumental in moving policies forward. Through our engagement activities we encourage our investee companies to better disclose their memberships and to actively seek alignment of their climate policies with industry groups.

Industrials and Materials

Companies from the diversified mining, other industrials, steel, aluminium, chemicals and paper sectors typically produce materials and products that are critical components of modern economies. Yet these industries also tend to be highly reliant on carbon emissions in their production processes. According to the IEA, three heavy industries – steel, chemicals and cement – together account for 70% of emissions from the industry sector.[9] As the second largest emitter of energy emissions globally, these companies have a crucial role to play in ensuring we arrive at net zero by 2050. Similar to the energy industry, these companies falter when it comes to disclosing an internal carbon price and in undertaking climate scenario planning, two areas of Strategy focus under the TCFD framework. These companies also fall short within the

[9] *IEA – Net Zero by 2050: A Roadmap for the Global Energy Sector. Available here: https://www.iea.org/reports/net-zero-by-2050*

[10] *According to the Greenhouse Gas Protocol: Scope 1 emissions – Direct GHG emissions: occur from sources that are owned or controlled by the company – for example emissions from combustion in owned or controlled boilers, furnaces, vehicles etc. emissions from chemical production in owned or controlled process equipment. Scope 2 – Electricity indirect GHG emissions: accounts for GHG emissions from purchased electricity consumed by the company. Scope 2 emissions physically occur at the facility where the electricity is generated. Scope 3 – Other indirect GHG emissions: an optional reporting category that allows for all other indirect emissions. Scope 3 emissions are a consequence of the activities of the company, but occur from sources not owned or controlled by the company. Examples of Scope 3 include the extraction and production of purchased materials, transportation of purchased fuels and use of sold products and services.*

Governance theme, with many companies failing to link climate performance to executive compensation incentives.

For those industrials and materials companies failing to progress beyond Level 3, among the key areas impacting Management Quality performance include Scope 3 emissions reporting and verification of Scope 1 and 2 emissions[10]. Typically, most companies will focus on Scope 1 and 2 emissions given their ability to influence these directly. Companies that are more progressive may also extend their focus to encompass Scope 3 emissions, and use their influence to encourage supply chain counterparts to reduce emissions.

Transport and Buildings

Three sectors in our study fall under the Transport and Buildings category – autos, shipping and construction. The transport industry has historically been heavily reliant on oil products, which accounted for more than 90% of the sector's energy needs in 2020 according to IEA. In the coming decades, transportation will decarbonise with electricity, followed by hydrogen, set to become the dominant fuel input for road vehicles. Heavier transport modes such as shipping and aviation will likely rely increasingly on biofuels.

The auto and shipping companies in our analysis have been assessed at Level 3 in terms of Management Quality, with several indicators weighing on company performance and preventing progression to Level 4. Most companies analysed do not have either a board member or board committee responsible for the explicit oversight of climate change policy, while several companies do not report Scope 3 emissions. Further Governance issues also appear in terms of the lack of alignment between executive remuneration and climate change performance, as well as disclosure of memberships and involvement in trade associations engaged in climate issues. The construction companies in our analysis generally perform better – one company reaching Level 4, the other Level 3 but failing on fewer indicators. However, these companies are marked down due to lack of internal carbon price disclosures, climate scenario analysis planning and reporting of Scope 3 emissions amongst others – again key engagement areas of focus.

Conclusions

The stakes have never been higher. The world cannot reach net zero without companies – the lifeblood of economies – acting in concert to decarbonise. Every company has an important role to play. As asset managers, asset owners and investors, we also have a crucial role to play. We must actively engage with the companies we invest in, encouraging them when they implement important policy improvements, yet questioning them where they need to perform better. For those companies deemed lagging, the TPI's Management Quality framework serves as a powerful tool to frame a strong net zero stewardship and engagement strategy. We can assess companies' current state of play today, and where necessary, set clear and reasonable expectations of where we expect companies to go on their climate transition path. We can monitor the progress of these companies through time and, if necessary, take corresponding action – including escalation, voting and as a last resort, eventual divestment. Where the framework identifies gaps, we can utilise the framework to target these with our engagement activities. The road to 1.5°C is not an easy one, but it is a hugely necessary one.

The art of small cap investing

To invest in tomorrow's winner in the form of today's smaller companies is a natural part of many investors' portfolios. At Danske Bank, we have several equity strategies focusing on small cap investments, and here two investment teams share their views and perspectives from an engagement and impact perspective.

Christian Rasmussen, lead manager of the European Small Cap portfolio at Danske Bank Asset Management, calls himself a quality-driven portfolio manager. The quality parameters he looks for are absolute by nature and not related to any benchmark.

"Focus is on identifying changing dynamics in a company, its business model or competitive landscape. Quality in the form of business model, management, market position, balance sheet and cash flow dynamics is essential when selecting companies. As such we are benchmark agnostic and risk to us is investing in a poor-quality company."

Lack of quality ESG data

Talking about quality, Christian Rasmussen points to the lack of quality ESG data as one of the challenges but also opportunities when investing in European smaller companies. Short-term corporate disclosure and the low availability of high quality data requires knowledge and understanding of companies' business models and strategies – something that favours active management and makes fundamental bottom-up-driven investment processes highly suitable.

"An important aspect of the investment management process is to systematically compensate for the poor data coverage. Only around half of the companies in the investable universe report on material ESG data points, meaning that we as an investment team more or less need to build the sustainability analysis from scratch. We perform analyses and engage with the companies to get the ESG coverage we need for our assessments. Long-term relationships based on trust and open dialogue with each of the portfolio companies where the investment team act as a sparring partner are thus of fundamental importance to the investment process."

Given the poor ESG data coverage of European smaller companies, the investment team regularly conduct their own qualitative materiality assessment that effectively serves as the ESG score for the specific company.

This strategy calls for specific attention to governance-related aspects as a result of the investment team often owning significant stakes in companies, typically along with the CEO and/or founder. To give just one example, Christian Rasmussen points to the importance of understanding and mapping the second-level management team. If this level constitutes a solid structure in the company, it essentially makes it less vulnerable to and protects it from too much power being concentrated at the CEO/founder level.

Focus on selected PAIs

Starting last year, the investment team seeks to address three selected Principal Adverse Impacts indicators (PAIs) through bottom-up company analysis and active ownership activities. The PAIs are chosen according to materiality as well as applicability across the European small cap investment universe, which is very diversified both in terms of geography and sectors. One of these is CEO salary level, something that can become an issue if the governance structure of the company is sub-optimal.

Christian Rasmussen mentions the British company AB Dynamics as one example.

"A few months ago, AB Dynamics proposed a compensation plan that we found excessive. We could see no justification for a setup that would entail a significant bonus plan for the CEO and CFO of the company. In meetings with the board, we stressed that we found the plan far too excessive. While there

were definitely interesting aspects to the plan, for example some of the pay-outs were linked to ESG performance, it lacked details on specific ESG metrics and/or targets, so it was difficult to evaluate whether the ESG metrics were ambitious enough."

A few weeks after the meeting, Christian and his team heard back from the Chairman, who told them the company had amended the compensation plan. Apart from capping CEO and CFO rewards at lower levels, the response also included a clear intention to work further with the integration of ESG-based targets into future reward programmes.

"What was especially fulfilling in this process was not only the actual outcome, which was fully in-line with our suggestions and as such a great example of us influencing smaller companies directly – it was also the response we got whereby the chairman explicitly thanked us for our valuable input, acknowledging the role it had played in the company's decision. This is the kind of feedback where you really feel you make a difference on behalf of all our investors and their money, which we manage everyday to generate attractive returns and at the same time influence our investee companies."

An important aspect of the investment management process is to systematically compensate for the poor data coverage. Only around half of the companies in the investable universe report on material ESG data points.

Christian Rasmussen,
Chief Portfolio Manager, Europe Small Cap strategy

The Swedish parallel

We move from Copenhagen to Stockholm, where Joel Backesten has his office and together with Max Frydén manages the Swedish Small Cap portfolio.

Not surprisingly, Joel shares many of Christian Rasmussen's views and thoughts on small cap investments.

"Smaller companies on the Swedish market are often run by innovative and entrepreneurial people who definitely do not lack creativity or the will to succeed. It is a privilege to have the job of analysing, meeting and investing in a selected range of these companies. The diversification at portfolio level in terms of business exposure is truly amazing. Having said that, when it comes to sustainability perspectives, we often see that many of the companies are a bit constrained or stuck in their way of thinking. While we are also seeing rapid changes in this area, we surprisingly often get the opportunity to help them with the fundamentals, such as presenting the business from a more optimal perspective with sustainability fully integrated," says Joel Backesten.

Having been part of the Swedish small cap team since it was established in 2018, Joel has met with many companies over the past 4 years. He mentions Balco and Nobina as two examples where engagement activities resulted in new sustainability-related company disclosures.

Small cap conglomerate

Another example, with a slightly different twist, is Ratos, an investment company consisting of 11 smaller companies. A small cap conglomerate if you like, in itself a bit of a paradox, but also part of the solution according to Joel Backesten:

"We invested in Ratos in March 2021. Much can be said about the company's history over the past many years and I could maybe sum it up in one word: turmoil. The short story is that the clear majority of the 11 companies constituting Ratos are growing nicely with attractive return levels. However, if you combine them into one unit and call it Ratos, that entity has been largely shunned by the market in recent years. The key to the turnaround case that we identified is as follows: Ratos in its current form does not present itself as a classic small cap case with the attractive focused investment exposure that the market usually looks for.

"While we are also seeing rapid changes in this area, we surprisingly often get the opportunity to help them with the fundamentals, such as presenting the business from a more optimal perspective with sustainability fully integrated"

Joel Backesten,
Chief Portfolio Manager, Swedish Small Cap strategy

Ratos reported on the 11 companies individually, so the market would always find something to be negative about. We focused instead on Ratos' stable balance sheet and strong returns, something we thought constituted a growth case."

Ratos' way of reporting at the individual company level differed from Swedish peers, and after investing into the company last year the investment team initiated a dialogue with Ratos about alternative ways of reporting. Joel Backesten and Max Frydén urged Ratos to move away from individual company reporting and instead report according to the different business areas Ratos represents.

"How a company presents itself can obviously have tremendous implications for the market as a whole, and to us this was an important governance-related dialogue to take. We were therefore very pleased to see that Ratos changed its approach to reporting in Q1 2022 and now presents itself as we suggested in our discussions last year. We are convinced this will help the company present itself in a more attractive way to the market, something that should ultimately be reflected in the valuation of Ratos", concludes Joel Backesten.

Introduction

Active Ownership

Pushing companies to adapt to a changing world and transition to more sustainable business practices is a natural part of our approach to active ownership. In the past year, we have focused on the social aspects and climate efforts of companies as well as expanding our ability to influence the sustainability strategies of more companies through our voting activities.

To enhance and protect the value of the investments, our investment teams to various degrees engage with investee companies on a regular basis about material ESG and sustainability issues to seek improvement in financial performance and processes. To ensure a structured engagement process, we log and monitor all company dialogue and progress, and we disclose data on our engagement and voting activities twice a year in our Active Ownership Report.

The outbreak of COVID-19 was a portentous event that changed the sustainability agenda for people, companies and the investment world. The unprecedented pandemic underlined that creating prosperous and resilient societies rests upon decisive sustainability actions from all parts of society, as the interconnectivity of the global community means that all business sectors across geographies and levels of wealth are affected.

As a global investor, we have a responsibility to push for better sustainability practices among companies. We embrace that task in the firm belief that increased sustainability practices leads to better and more robust companies, which in turn helps us protect and grow our investors' assets while propelling society in a more responsible and sustainable direction.

Sustainability is a business priority

In 2021, we engaged with more than 900 companies around the world on more than 100 ESG topics, ranging from employee health and safety, business ethics and the circular economy to energy efficiency, product quality and digitalisation. This illustrates how sustainability issues revolves not only around the climate agenda but concerns a wide range of issues that are important for companies to address, so they can take a holistic approach to creating a sustainable business that delivers long-term value for its investors and adds value to society. In our view, it is vital that companies continue to improve their sustainability performance, while being mindful of how their operations and practices influence society and could potentially cause adverse sustainability impacts. The sustainability path for the various sectors, geographies and specific companies is nuanced, but let there be no doubt – we are committed to being an active and responsible investor who supports and influences companies, and we are in it for the long haul. We believe this is the most effective roadmap for bringing about lasting sustainable change.

Spotlight on social issues

The unpresented pace at which societies take initiatives and adopt changes measures and regulation in the name of "climate" poses both opportunities and threats to us as an asset manager. Governments and corporations are creating a "change ecosystem" not always characterised by logic or cohesiveness but where the willingness to adapt and transform creates numerous opportunities also from an investment perspective. It is now more important than ever to discuss the readiness of companies for the green transition and how they can adapt their businesses to a world that is rapidly moving in a sustainable direction.

In the wake of COVID-19, the social dimensions and corporate citizenship aspects of companies have surfaced as weighty business-critical issues and taken up a larger portion of our company dialogues also in 2021. The crisis has heavily underlined society's expectation that companies should not only be profit-driven – they also have a broader social responsibility and should contribute to mitigating the consequences of the corona crisis.

If anything, COVID-19 has shown how determination and the right incentive structures can constitute the foundation for unprecedented change: when we entered 2021, only a very tiny part of the global population had received a jab – a few months into 2022 a majority has. This in itself is a huge success for the capitalistic, free market system and shows that markets can respond to crisis without regulative interference. This is also a great example of the intrinsic power to change that is built into the corporate world and as such an argument for active ownership and stewardship on a corporate level.

In the wake of the vaccine pro-

We exercise active ownership in three ways

To various degrees our investment teams engage in direct dialogue with the companies in which they invest with the aim of influencing the companies' behaviour, strategies and performance in relation to business-critical sustainability aspects and principal adverse impacts. Investment teams use their in-depth knowledge of the companies to, for example, influence them to reduce their CO_2 emissions, increase diversity on the board of directors, strengthen waste management processes, create safe and healthy working conditions for employees, or fight corruption. At the same time, investment teams focus on supporting companies' long-term value creation.

The dialogue also provides our investment teams with greater insight into companies – insights that the teams then use to make better-informed investment decisions that can benefit the potential return for our investors.

We use our voting rights at companies' annual general meetings to voice our opinion on key business issues. It is an important part of our efforts to support and influence companies to address business-critical aspects. We vote on a wide array of topics, including remuneration policies, capital structure and shareholders' rights, CO_2 emissions, energy efficiency, gender diversity, biodiversity, human rights and anti-corruption. Through voting, we seek to support a company's long-term growth potential, mitigate its sustainability risks and minimise companies' adverse impacts on society.

We are a member of several investor organisations and investor initiatives, and we collaborate with a range of other relevant stakeholders. By doing this, we aim to contribute to the development of responsible investments and to promote transparency and sustainability standards in companies and in the financial markets.

We work with other investors and stakeholders to exert active ownership and engage in joint dialogue with companies to contribute to positive change. By working together, we and the investment industry gain a stronger voice, and this enables us to put additional pressure on companies to address and improve on sustainability-related issues and have responsible business practices.

gramme Access & Affordability was one of the most discussed ESG topics in 2021. Indeed, this topic together with Employee Health & Safety was the two most engaged socially related topics last year.

Influencing more companies through voting

To maximise our ability to influence companies through voting at annual general meetings, we strengthened our voting infrastructure in 2020 and are now voting more extensively. As well creating our voting guidelines, we are now voting on passively managed assets. As a result of our robust voting structure, we exercised our voting rights as a shareholder at more than 3,800 company meetings in 2021. We have continued to strengthening our voting infrastructure and further updated our voting guidelines.

Principal adverse impacts also influence our active ownership activities so we have a clear position on topics related to principal adverse sustainability impacts, carbon emissions, biodiversity, water issues, employee safety, anti-corruption, etc.

We logged 79% more company dialogues in 2021

In 2021, we considerably ramped up our active ownership efforts and were in dialogue with almost 80 per cent more companies than in 2020. The number of dialogues on climate and environmental issues rose by more than 80 per cent.

We have increased our active ownership focus in recent years in order to exert even more influence on companies to raise their sustainability efforts, as our latest active ownership report attests. The report shows that while we engaged in dialogue with 525 companies in 2020, we engaged with 938 companies in 2021 – an increase of almost 80 per cent.

"We have established a dedicated department for the area and expanded our resources, as we have a clear ambition to influence the companies we invest in to constantly improve on sustainability. Companies need to minimise their negative impact for the sake of society generally, while they also have to incorporate sustainability factors into their core business to be an attractive investment," says Giedrė Šavinienė, Senior ESG Analyst at Danske Bank Asset Management, who adds:

"Themes like climate, diversity, the circular economy and governance have assumed a greater importance for companies' returns to our customers. We have therefore had to up our dialogue to maintain a firmer grip on the companies and so make a positive contribution to the bottom lines of both companies and society. For us, this is not about having as many dialogues as possible, but rather engaging in dialogue with relevant companies and making a difference."

For us, this is not about having as many dialogues as possible, but rather engaging in dialogue with relevant companies and making a difference.

Giedrė Šavinienė,
Senior ESG Analyst,
Danske Bank Asset Management

Active ownership highlights 2021

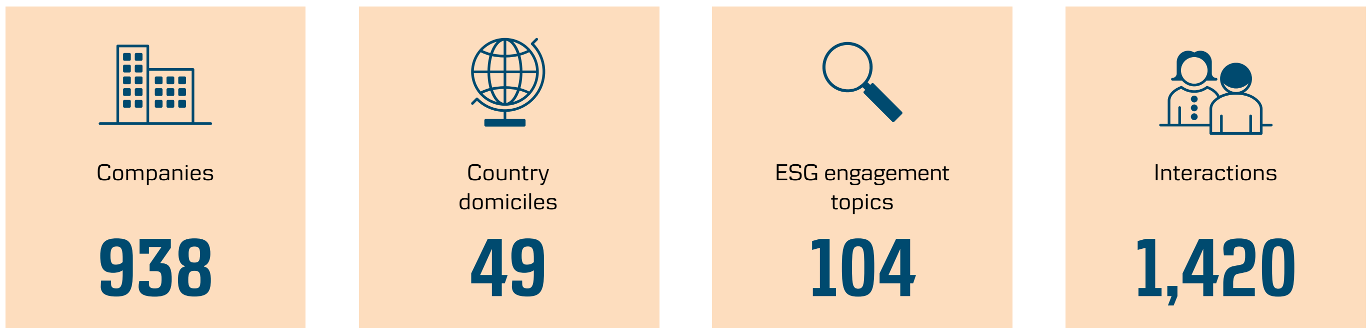
- 1,420 dialogues with 938 companies on 104 sustainability topics
- Environmental and climate issues accounted for 44% of the topics, 23% centred on social issues like diversity and inclusion or employee conditions, while issues related to governance accounted for 33%
- CO_2 emissions, energy efficiency & transition as well as the circular economy were the most often discussed topics in relation to the environment and climate

Company engagements in 2021

When customers entrust us with their assets and savings, it is our duty to serve their interests by providing investment solutions with the goal to deliver competitive and long term performance. Our firm commitment to responsible investment is an integral part of this duty. It is about making better informed investment decisions addressing issues of risk, problems, and dilemmas, and influencing portfolio companies through active ownership to contribute to a positive outcome.

Active ownership through direct dialogue, collaborative engagement and voting at the annual general meetings is an important part of our ability to create long term value to the companies we invest in and to our investors. We believe it is more responsible to address material sustainability matters as investors rather than refraining from investing when issues of concern arise, leaving the problem to someone else to solve. Our investment teams are the change agents who can impact companies to manage risks and opportunities.

The aim of our Active Ownership Report covering three parts 'Engagements', 'Collaborative Engagements' and 'Voting' is to provide our customers and stakeholders with regular updates on our progress and results.



Top 7 engagement subjects discussed across themes

E

Rank	Topic	Count
1	GHG Emissions	283
2	Energy Efficiency	103
3	Energy Transformation	98
4	Circular Economy	96
5	Climate Neutrality	77
6	EU Taxonomy	72
7	Environmental Issues	69

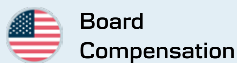
S

Rank	Topic	Count
1	Employee Health & Safety	98
2	Access & Affordability	84
3	Employee Engagement, Diversity & Inclusion	71
4	Business Model Resilience	61
5	Data Security	60
6	Supply Chain Management	42
7	Digitalisation	35

G

Rank	Topic	Count
1	M&A	147
2	Board Compensation	135
3	Capital Structure	91
4	ESG Integration	89
5	Dividends	65
6	Corporate Governance	61
7	Board Composition	44

ESG Issues In Fish Farming



We discuss sustainability matters with companies all over the world. Here are our most frequently discussed ESG topics with companies by country.

Access & Affordability

GHG Emissions

Dividends

M&A

GHG Emissions

GHG Emissions

GHG Emissions

Dividends

Capital Structure

GHG Emissions

Green Financing

Energy Transformation

GHG Emissions

Access & Affordability

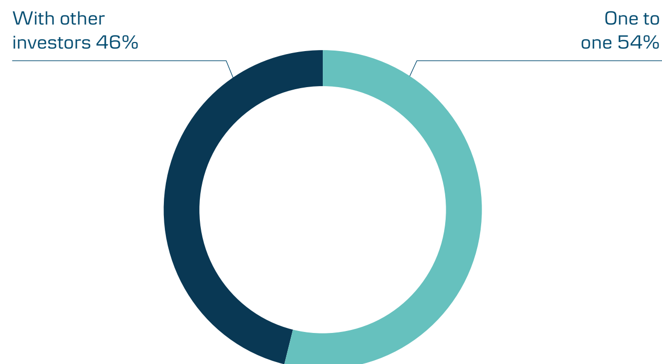
GHG Emissions

GHG Emissions

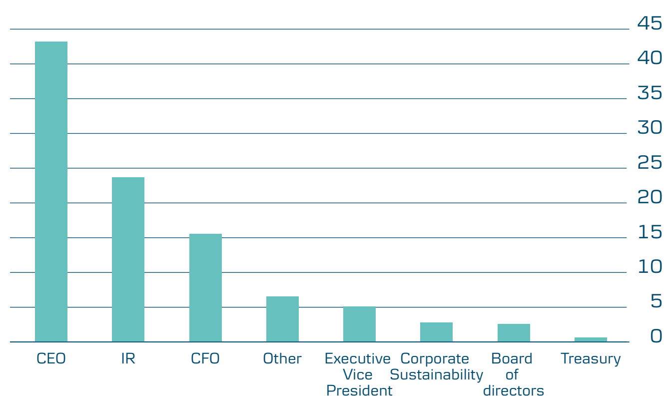
Climate Neutrality

Board Composition

Share of meeting types



Share of meetings by participants



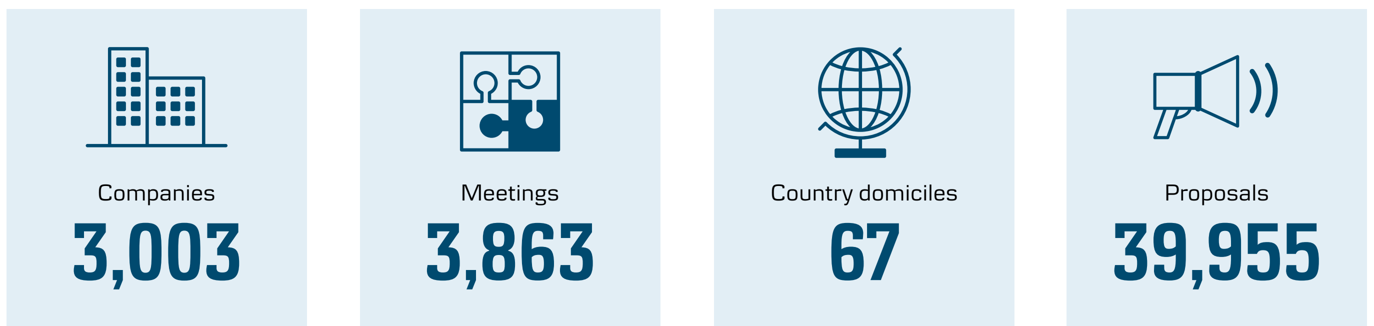
Learn more about our engagement activities in our Active Ownership Report at danskebank.com.

Voting in 2021

The general meetings of companies are an opportunity to voice our opinion, vote on issues of key importance, and contribute to the good governance of the company. We seek to vote on all shares held, under both passive and active strategies, while taking into account preconditions, resources, and the costs of exercising voting rights.

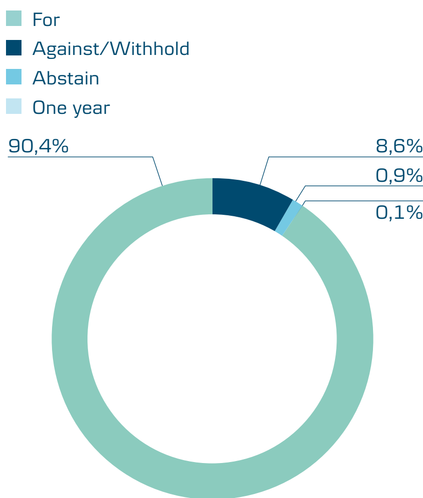
Our Danske Bank Voting Guidelines serve as our default position for all proposals, but our investment teams managing our active portfolios can deviate based on case specific details. As enshrined in our Active Ownership Instruction, voting must always be carried out for the benefit of the investors.

In order to ensure a structured and transparent process, we log and publish records of the vote that we have conducted either by ourselves or through a service provider.



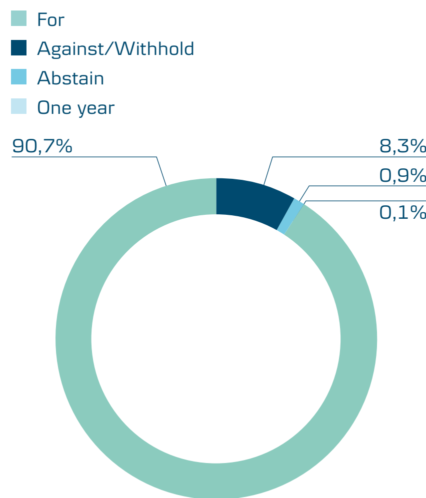
How we voted on proposals from company management and shareholders

All voted proposals



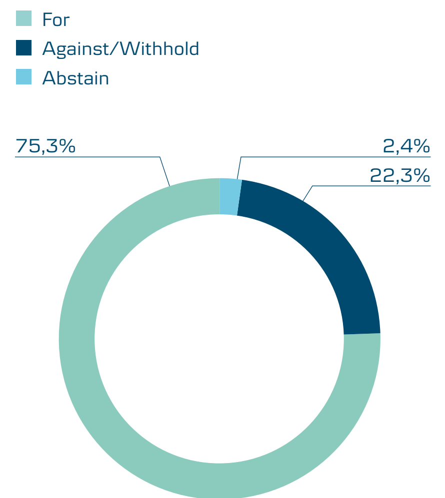
For	36,094
Against/Withhold	3,445
Abstain	363
Total	**39,902**

Management proposals



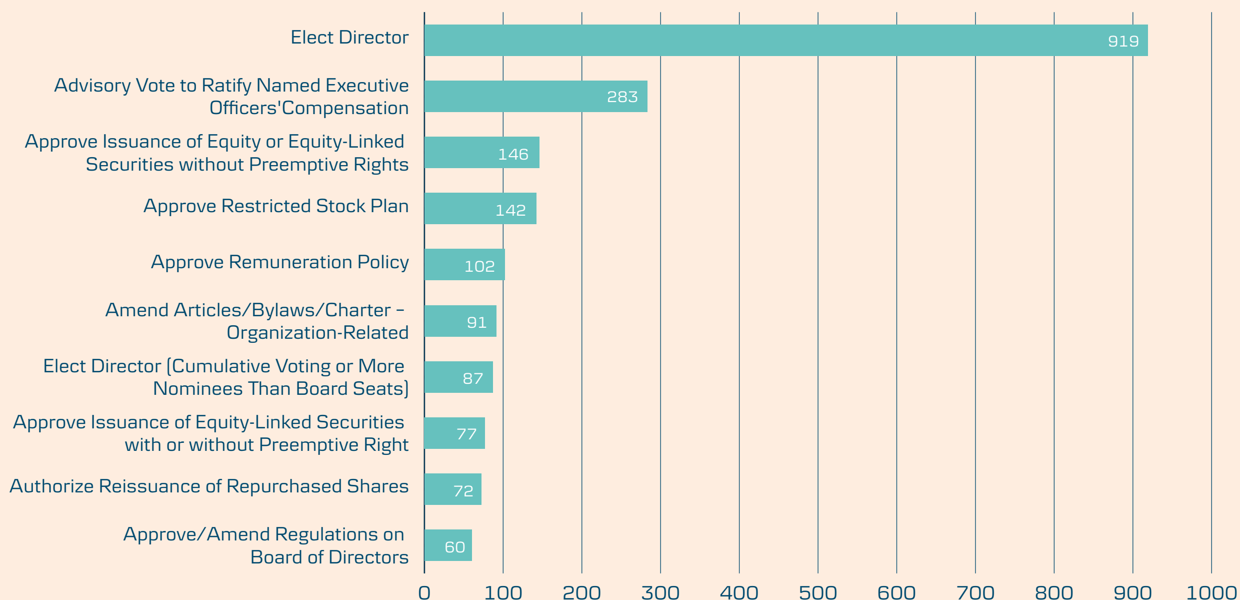
For	35,344
Against/Withhold	3,229
Abstain	339
Total	**38,906**

Shareholder proposals

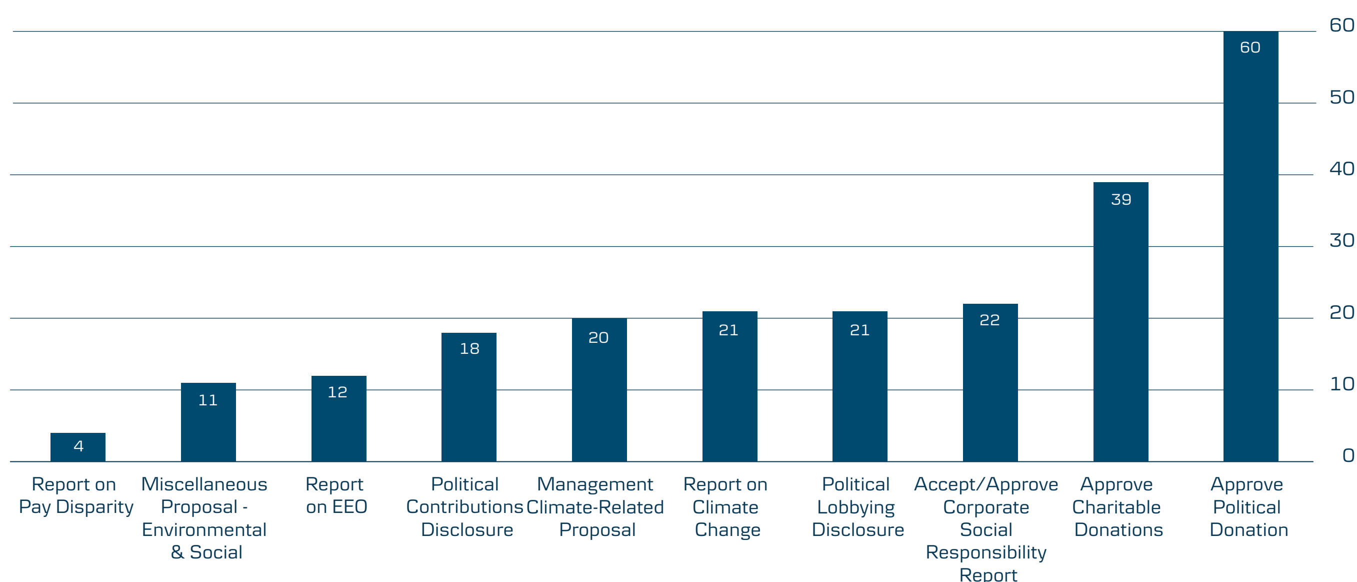


For	750
Against/Withhold	222
Abstain	24
Total	**996**

Top 10 voted proposals against Management recommendations



Most common Environmental & Social proposal items voted 'For'



Learn more about our engagement activities in our Active Ownership Report at danskebank.com.

Voting on the green transition

We have upped our engagement with several of the world's largest banks to urge them to stop financing new fossil energy projects. This also marks the start of our targeted pressure on the bank sector to set CO_2 reduction targets and accelerate the green transition.

As an asset manager and active investor, we have begun to put additional pressure on banks to contribute to the green transition. This includes Citigroup, Goldman Sachs, Bank of America, Wells Fargo and Credit Suisse. At their AGMs, we therefore vote for those proposals that will get them to stop financing new gas, coal or oil projects. More specifically, this means they have to adjust their lending so they follow the climate plan of the International Energy Agency and contribute to achieving the climate targets of the Paris agreement.

"We are stepping up the rhetoric and right now increasing the pressure on banks, as they have to scale back the financing of fossil fuels to slow climate change. The banks have to move in a greener direction and increase the financing of renewable energy and green technologies. Confronting US banks in particular is important, as they are huge lenders to the fossil fuel industry – turning them around would be a very significant victory for the green transition," says Mads Steinmüller, Chief ESG Specialist at Danske Bank Asset Management, who adds:

"The goal of becoming independent of Russian oil and gas does not mean the rest of the world should increase fossil energy production. On the contrary, we need massive investment in renewables and in solving the climate crisis – and the banks should have the same focus."

Accelerating the green domino effect

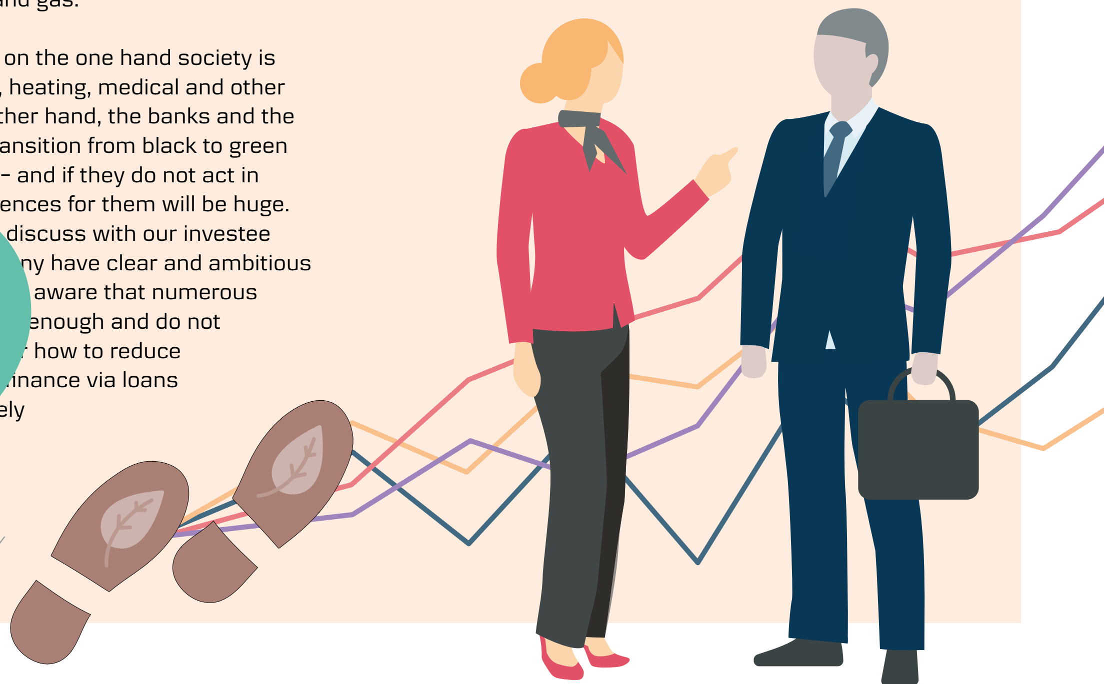
Achieving the goals of the Paris Agreement requires investing several trillion DKK annually in climate technologies and renewables, and much of this has to come from the banks. That is why we are now kicking off a targeted dialogue with US and European banks, in particular, urging them to set CO_2 reduction

The banks' green dilemma

The green transition requires huge investments, with the EU estimating that EUR 180bn[1] is needed annually from the private sector if it is to achieve its climate targets. Hence, the banks play a key role in the green transition, as they lend the money that enables companies to invest in the green transformation of their businesses. However, the banks also lend money to the fossil fuel industry, for example, and so finance oil and gas.

This presents a dilemma, as on the one hand society is still dependent on oil for fuel, heating, medical and other everyday products. On the other hand, the banks and the fossil fuel industry have to transition from black to green to help slow climate change – and if they do not act in time, the economi[illegible]equences for them will be huge. It is a complex iss[illegible] discuss with our investee banks – and indee[illegible]ny have clear and ambitious climate plans. Ho[illegible] aware that numerous banks have not pr[illegible]enough and do not yet, for example, h[illegible] how to reduce the CO_2 emissions[illegible]inance via loans to companies and[illegible]tely achieve CO_2-neutr[illegible]ing. Our focus is on su[illegible]pporting the banks in their transformation, so they take responsibility for driving the green transition. We do this by voting at their AGMs or via direct dialogue with bank management. Our aim is to influence them to commit to being climate neutral and to set reduction targets for the carbon footprint of their loans and investments.

[1] https://ec.europa.eu/newsroom/intpa/items/658782



That many banks want to be CO_2 neutral is positive, but a good deal of them do not have specific plans for how to achieve this – and many are simply not ambitious enough.

Mads Steinmüller, Chief ESG Specialist at Danske Bank Asset Management

targets and increase green financing.

"That many banks want to be CO_2 neutral is positive, but a good deal of them do not have specific plans for how to achieve this – and many are simply not ambitious enough. That is why we are now putting additional pressure on them to set specific and ambitious reduction targets for the amount of CO_2 they help finance across various sectors. This could set off a green domino effect in other industries," says Mads Steinmüller.

The upshot is that companies with high CO_2 emissions will find it more difficult to finance their businesses via the banks, forcing them towards greener alternatives.

"Banks will make greater demands on companies, who will be forced to cut their CO_2 emissions so they can continue to persuade the banks to finance their businesses. This will pressure companies to energy-renovate factories, develop products with a low climate impact or encourage the energy sector to more quickly transition from black to green energy. Our aim is to speed up this shift, which will help enable us to achieve our CO_2 reduction targets," concludes Mads Steinmüller.

Capturing the investment opportunities in carbon capture & storage

An important aspect of containing and regulating the future level of CO_2 in the atmosphere is to protect and expand the earth's natural carbon sinks where forests, grass lands and oceans all have a significant part to play. Then there is the growing area of artificial carbon sinks where technology rather than nature will help capturing CO_2 in the atmosphere.

Artificially created carbon sinks, more often referred to as Carbon Capture & Storage (CCS) is an area undergoing rapid change these days. Both companies and governments invest heavily to establish capacities to both capture and store carbon on a large scale in the future. According to Lars Erik Moen, Head of Nordic Equities and lead portfolio manager of Danske Bank's investment strategies focusing on Norwegian equities, this is a necessary key component in order to deliver on something that is close to the 1.5 degree target as stipulated in the Paris agreement.

"In my view, we will not fulfil the Paris targets without CCS, and even taking CCS into account I still doubt whether 1.5 degrees will be reachable. Investors and governments therefore turn more and more focus towards CCS and current investment levels are unprecedented. In my view, CCS should be viewed as supplementary technology with potentially enormous implications for future CO_2 reductions. Within my investment area in the Nordics and particularly the North Sea, we have oil companies with great knowledge of and access to the underground. They are hence key players in terms of storing liquefied carbon subsea in depleted oil wells."

There are several ways to capture and store carbon and the area is undergoing rapid technological changes. The common denominator is to capture the carbon through some kind of chemical process, transport it and then store it in the underground.

"As an investor you should take an integrated and diversified approach to investments related to climate change and expose your portfolio to many different aspects at once and in this context we see CCS as an extremely interesting area. Societies in different shapes and formats do numerous initiatives to preserve the natural carbon sinks today, but it won't be enough, we also need to put technology to work", says Lars Erik Moen.

Today, the capacity stemming from current CCS plants are capturing 40 mn tonnes of CO_2 worldwide and to get an idea of future needs it is interesting to quote the Global CCS Institute[1]:

"The IEA's Sustainable Development Scenario describes a future where the United Nations energy related sustainable development goals for emissions, energy access and air quality are met. The mass of CO_2 captured using CCS goes up from around 40 Mt of CO_2 per

How CCS works[1]

CCS involves three major steps; capturing CO_2 at the source, compressing it for transportation and then injecting it deep into a rock formation at a carefully selected and safe site, where it is permanently stored.

- **Capture:** The separation of CO_2 from other gases produced at large industrial process facilities such as coal and natural-gas-fired power plants, steel mills, cement plants and refineries.
- **Transport:** Once separated, the CO_2 is compressed and transported via pipelines, trucks, ships or other methods to a suitable site for geological storage.
- **Storage:** CO_2 is injected into deep underground rock formations, usually at depths of one kilometre or more.

www.globalccsinstitute.com/about/what-is-ccs/

annum today to around 5.6 gigatonnes (Gt) in 2050 – a more than hundredfold increase".

One of the more important CCS initiatives in the Nordics is "Northern Lights", a partnership between Equinor, Shell and TotalEnergies that was incorporated in 2021. According to the company "Northern Lights enables the mitigation of industrial process emissions for which there is currently no scalable solution, accelerates the decarbonisation of European industry, and facilitates the removal of CO_2 from the atmosphere. […] Phase one of the project will be completed mid-2024 with a capacity of up to 1.5 million tonnes of CO_2 per year."[2]

Northern Light is the transport and storage component of Longship, the Norwegian Government's full-scale carbon capture and storage project, where around half of the stored CO_2 will come from a cement factory and waste-to-energy plant in Norway.

Outside the Nordics, the Northern Endurance project in the North of England is an even larger initiative, reflecting the British government's ambitious plans within this area. For there should be no secret, CCS projects requires massive investment also from governments in order to create the necessary economy of scale to take on the CO_2 of the future. In the case of Northern Lights, the Norwegian government pays 80% of the capex.

"There is no doubt that these projects need to be subsidised in order to be properly established. Establishing infrastructure where carbon can be shipped off-shore and stored in the underground is extremely cost intense. What we need in the longer run is an effective and well-functioning carbon credit market where the pricing of 1 tonne of CO_2 ultimately needs to be higher than the cost of capturing, transporting and storing the same amount of CO_2."

One of Lars Erik Moen's CCS investments is Aker Carbon Capture that uses amino solvents to capture carbon. By heating and cooling the amino gases the CO_2 gets captured and released and then liquefied, ready to be transported to the storage site. Aker Carbon Capture has a technology that allows for up to 90% carbon capture but as the process is energy consuming through the heating process, a capture level of 50% has so far been found optimal from a total energy perspective.

In my view, we will not fulfil the Paris targets without CCS, and even taking CCS into account I still doubt whether 1.5 degrees will be reachable.

Lars Erik Moen,
Head of Nordic Equities and lead portfolio manager

Lars Erik Moen has engaged with the company numerous times and he mentions the focused exposure the company offers as one major perspective:

"We like Aker Carbon Capture because it is a pure carbon capture play. Not only is this attractive from an investment point of view, it also means that the engagement we have with them is very focused and down to the point. We have spent time to really understand the company and in my view, they have an attractive proprietary technology solution that in an effective and flexible way captures carbon with limited negative side effects. These plants can be used both on and off-shore and be scaled according to the specific needs."

Lars Erik Moen points out that an investment like Aker Carbon Capture constitutes high risk. The uncertainties related not least to future level of governmental subsidies and also how the pricing model for CO_2 emissions will evolve over time are two important aspects. The fact that the technology has not been tested on a larger scale is another a significant risk aspect to take into consideration.

Develop through engagement

One important aspect of the investment into Aker Carbon Capture is how the company can commercialise its product. Lars Erik Moen points at the fact that Aker is not doing any carbon storage, only focusing on the capturing part of the value chain.

"In my view this is one of the strengths of Aker Carbon Capture, as it allows them to stay really focused in terms of product development. However, without storage capacity, Aker's solution will not fly commercially, so I was naturally very pleased to see that the company entered into a joint venture with Northern Light here in the beginning of 2022. Together these companies represent the full value chain in terms of CCS, operating in very benign markets with significant government support."

As Jon Christopher Knudsen, Chief Commercial Officer of Aker Carbon Capture puts it: "Northern Lights is a first-mover in enabling open-source CO_2 transport and storage infrastructure across north-west Europe. With operations starting in 2024 they are an essential player in enabling the accelerated deployment of the CCS industry. Their ambitious plans link very well with Aker Carbon Capture's ambition to have 10 million tonnes of CO_2 on contract by 2025. Together with Northern Lights and with our 'Carbon Capture as a Service' offering, we can now develop source-to-storage decarbonization on a pay per tonne of captured CO_2 model".[3]

Lars Erik adds that he in his future engagement with Aker Carbon Capture will continue to push for the commercialisation of the company. He points towards the "Just Test" concept Aker is offering as a way to penetrate new market areas and demystify the concept of CCS as this is a fully mobile capture plant that enables focused test campaigns to reduce the initial risks of large-scale implementation.

"To me Aker Carbon Capture is very well positioned in a growing market where technological developments combined with governmental investments and high society demand constitute the foundation for significant growth opportunities."

[1] Global-Status-of-CCS-Report-English.pdf (globalccsinstitute.com)
[2] https://norlights.com/what-we-do/
[3] Aker Carbon Capture and Northern Lights JV to collaborate on accelerating the carbon capture and storage market through full value-chain offerings - Northern Lights (northernlightsccs.com)

Copper from Chile contributes critically to the future

The transition to a net-zero economy will be metal-intensive and one of those metals will be copper. That is the very simple yet compelling fact constituting the investment appetite for Antofagasta, a Chilean mining company with a focused approach towards copper.

"Copper (Cu), chemical element, a reddish, extremely ductile metal of Group 11 (Ib) of the periodic table that is an unusually good conductor of electricity and heat."[1] That is how Encyclopedia Britannica in a very precise way shed light on the role copper plays in the ongoing transition away from a carbon dependent economy. Already a few years ago, the Economist assessed the amount of copper in electric vehicles to be 4 times higher compared to cars with combustion engines[2], whereas Fitch Solutions expect the copper consumption in the renewables sector is 12 times higher than in traditional energy systems[3]. According to Bloomberg, the copper industry needs to spend upwards of $100 billion to close what could be an annual supply deficit of 4.7 million metric tons by 2030[4].

Even though no one can foresee the exact future demand curves for different raw materials as a result of the green transition, it seems to be a fair assessment that copper has a high probability to be one of the winners. In this article, Simon Christensen, lead portfolio manager of the Global Sustainable Future strategy gives his view on his investments in Antofagasta, a Chilean mining company and one of the 10 largest copper mining companies on a global stage

The fundamental perspective

The fundamental perspective with copper being well-positioned in a future low-carbon economy, is one of the reasons why Simon Christensen and the team has invested in Antofagasta over the past three years. Simon gives his view:

"It is important to understand that we never invest in a company on the basis of ESG or sustainability perspec-

1 copper | Uses, Properties, & Facts | Britannica
2 Mining companies have dug themselves out of a hole | The Economist
3 Copper: How Much Will The Green Transition Impact Demand? (fitchsolutions.com)
4 The World Will Need 10 Million Tons More Copper to Meet Demand - Bloomberg

tives alone. Sustainability and competitive returns have to go hand in hand in our view and within all sectors we are looking for attractively priced companies of high quality that have growth opportunities stemming from the sustainable transition."

"In the case of Antofagasta their assets are located in some of the best mining districts in Chile and their focus on unit cost, technological innovation and exploration combined with a solid demand backdrop secures an attractive trajectory of profitable growth. At the same time, we think management has struck a good balance between shareholder remuneration, maintaining solvency strength and executing on growth opportunities. All of these aspects are a sign of fundamental attractiveness"

The sustainability perspective
Growth and profitability cannot come at any price and mining is a resource intensive sector, especially with respects to energy and water consumption. Simon Christensen continues:

"For every company in the portfolio we define unique specific sustainability targets that each individual company has to progress towards. We call them critical contribution points, which is our process for securing that the company has an impact and contribute to sustainability. In the context of Antofagasta: it is not enough that Antofagasta mines copper to support a future low carbon economy, it is equally important how they do it."

For Antofagasta, the investment team has defined three critical contribution points.

The first one relates to production. Unsurprisingly the team wants copper output to grow since that is an essential contribution to the green transition. The past two years have however seen a drop in output primarily due to Covid and a drought in Chile, limiting the access to water.

Hence, the second critical contribution point is related to water-usage. Antofagasta operates in a part of the world where water is a scarce resource and the company has worked towards using desalinated sea water or reused water in the operational process.

"They have taken significant steps to have 90% of their water consumption stemming from seawater or recycled water and has spent hundreds of millions of dollars on securing access to seawater and building desalination plants. We are very impressed with the progress", says Simon Christensen.

The third sustainability target for Antofagasta applies to the use of renewable energy in the mining operation.

"By the end of 2022, Antofagasta will be able to run their mining operations on renewable energy alone. This is pivotal for them to reach a 30% emission reduction by 2025 and net-zero by 2050 or earlier and would mean a fulfilment of our third sustainability target."

Engagement as a tool for reaching real impact
Over the past two years, portfolio managers and analysts from Danske Bank Asset Management have met with Antofagasta five times to discuss ESG related topics, something that points to the heart of the team's sustainability process.

"The fulfilment of the critical contribution points is to a large extent based on engagements with the 30-40 companies that we invest in. Over the past years, we have discussed all of the specific critical contribution points with Antofagasta and we will continue to do so going forward."

Although Antofagasta has failed to show progress in increasing their copper production over the past two years and thus missing their primary critical contribution point that is far from the case for the Global Sustainable Future strategy in general.

"In 2021 close to 90% of all companies in the portfolio either progressed or reached their primary sustainability target. This is something we and the companies can be very proud of and a testament of real sustainable impact."

As soon as a specific sustainability target is met, a new one is established and communicated to the company. In the case of Antofagasta, there are a few options should the company for example meet the third sustainably target related to renewable energy.

There are several important social aspects of running a mine, primarily related to the safety and health of the employees. According to Simon Christensen, the company is doing well when it comes to for example salaries and payments of workers.

"What is important is that whatever we chose to go with it must be company specific and something where we can see a possibility for us to make a difference through direct dialogue with the company", finishes Simon Christensen.

It is important to understand that we never invest in a company on the basis of ESG or sustainability perspectives alone. Sustainability and competitive returns have to go hand in hand in our view.

Simon Christensen,
Lead portfolio manager of the Global Sustainable Future strategy

Our engagement with Total leads to sustainable action

As a result of the repeated investor engagement in Total as well as the pressure from a broad stakeholder group, including civil society organizations, Total announced in early 2022 that it has suspended their activities in Myanmar.

Danske Bank Asset Management has been invested in the energy company TotalEnergies for many years. Through the exposure in several of our actively managed strategies, numerous of portfolio managers have engaged with the company, primarily focusing on questions related to greenhouse gas emissions and energy transformation.

Our approach is based on the belief that addressing challenging issues through active ownership and dialogue is the more sustainable path rather than divesting and thereby losing an opportunity to make a positive impact and act as a responsible investor.

Oshni Arachchi,
Head of Active Ownership at
Danske Bank Asset Management

However, in 2021 an additional topic was brought to the table, relating to Total's operations in Myanmar, where a military coup took place in early 2021. The country has been subject to years of unrest, dating back to the year of independence in 1948[1].

Being an investor in Total, the coup in 2021 meant that we engaged with the company to understand its operations in Myanmar but also to advocate for a withdrawal from the country. As a result of the repeated investor engagement in Total as well as the pressure from a broad stakeholder group, including civil society organizations, the company announced in early 2022 that it has suspended their activities in Myanmar. The withdrawal from the country will take effect from July 2022.

"Myanmar has a long and troubled history of violations of human rights, which escalated last year. We have repeatedly engaged with Total on e.g. human rights due diligence processes and the company's efforts to support a resolution of the situation. It is very satisfying that this has now led to concrete action," says Oshni Arachchi, Head of Active Ownership, Danske Bank Asset Management.

The more sustainable path

Oshni Arachchi contrast the dialogue with Total and the subsequent outcome with another big energy company that was in the spotlight during 2021: ExxonMobil. Due to lack of progress within its contribution to the sustainable transition of society, Danske Bank decided to exclude the company from our investment funds. The reason is lack of progress in its contribution to the sustainability area, including lack of dialogue and shady lobbying methods that work against the green transformation of society.

Oshni Arachchi comments the decision to exclude in the following way:

"In fact, we think it's a shame to have to exclude Exxon Mobil, as we would prefer to be active owners and try to influence companies into a more sustainable transition. But in recent months, we have had discussions with ExxonMobil about their lobbying work and work with sustainable change, and we do not believe that the company has lived up to our requirements and wishes for transparency and other aspects, which is why we have now chosen to exclude"

Oshni Arachchi points at the stark contrast between the two cases.

"Our approach is based on the belief that addressing challenging issues through active ownership and dialogue is the more sustainable path rather than divesting and thereby losing an opportunity to make a positive impact and act as a responsible investor. Having said that, in extreme situations like this one with Exxon Mobil, exclusion of the company can become a necessary step to take. We will of course continuously review the development of this case but here and now the decision to exclude was in line with our fiduciary duty as an asset manager."

[1] *History May Not Repeat Itself In Myanmar Military Coup (forbes.com)*

Introduction

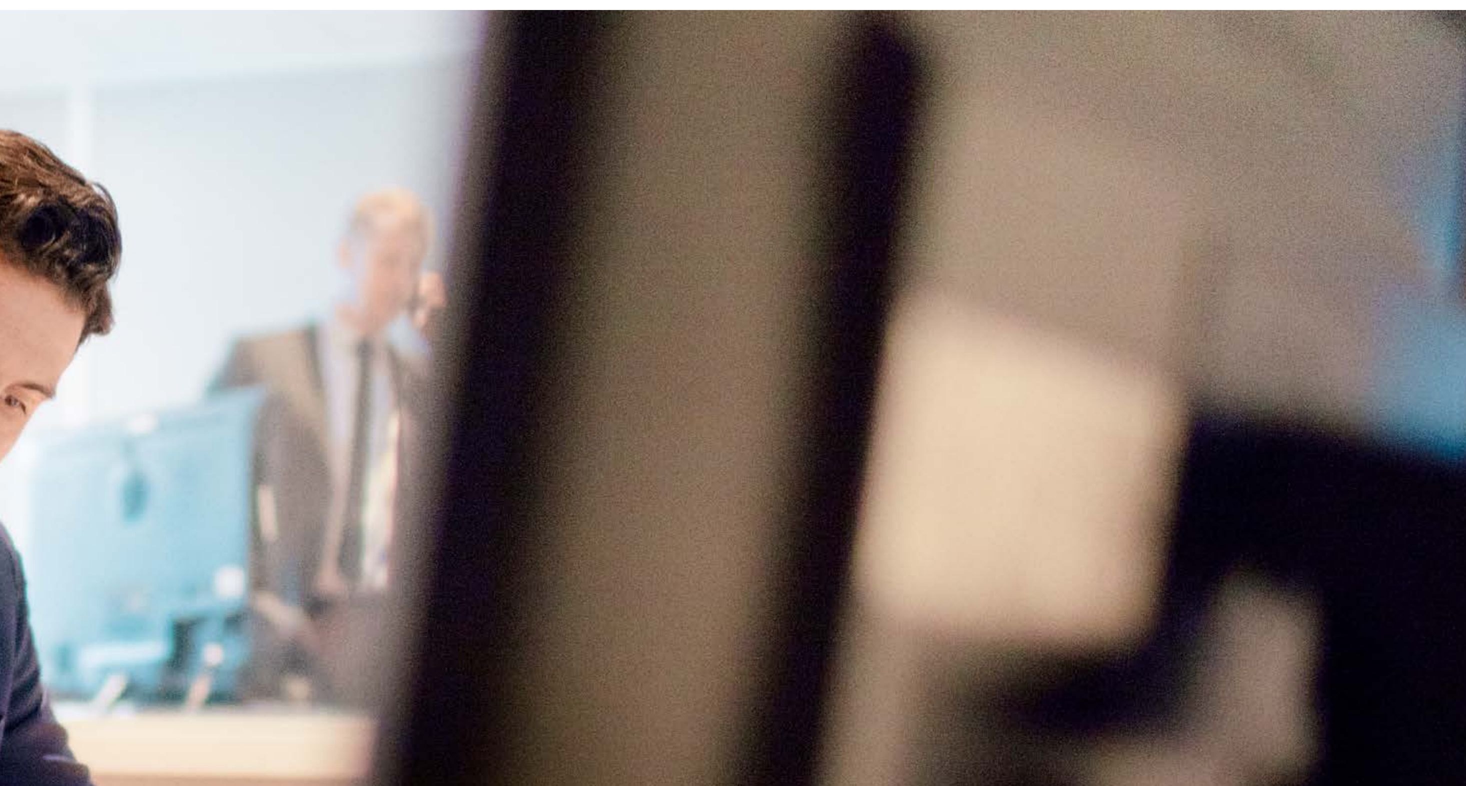
Exclusions

We screen our investments on an ongoing bases to identify sustainability risks and to address the negative impact on society that our investment decisions may have (referred to as principal adverse impacts). Screening gives our investment teams a deeper knowledge of how companies work with sustainability, while also enabling the teams to mitigate sustainability risks.

Moreover, screening can help identify positive investment opportunities that would benefit our investors. Screening and consequent restrictions is also employed to ensure that our ESG investment products promote relevant environmental or social characteristics. In addition, we last year introduced a "Sustainability risk challenger", a role that spars with investment teams on a wide range of sustainability-related issues. Screening is an integral part of this process.

Screening according to frameworks for corporate responsibility
Based on information from a number of ESG data providers, investments are screened with reference to current regulations, industry best practice, international norms and voluntary frameworks for corporate responsibility. Among other things, screening is based on the principles set out in the UN Global Compact and the OECD Guidelines for Multinational Enterprises.

Promoting environmental or social characteristics
Our investment products disclosing under article 8 and 9 of SFDR use restrictions to reduce the Principal Adverse Impact, related to for example climate change, harmful environmental or weak human rights practices, inadequate labour standards or insufficient anti-corruption measures (see page



4 for more information). Investment restrictions are thus utilised to ensure that investment products have a minimum level of sustainability-related materiality to meet the demands of clients in terms of sustainability preferences and to comply with SFDR product requirements. Investment restrictions promote:[1]

"Enhanced Sustainability Standards" which is a multidimensional characteristic imposing minimum standards/safeguards on the portfolio in terms of both environmental materiality as well as social materiality. By promoting enhanced sustainability standards, the relevant investment products commit to exclude companies and countries that a) are involved in activities, or with a conduct, leading to significant principal adverse impacts and/or as relevant significant harm on sustainable investment objectives b) otherwise express weak sustainability practices c) do not have minimum social safeguards. These exclusions are a result of assessments made under the proprietary screening model.

"Reduction of involvement in Non-Ethical & controversial activities" which constitute an ethical overlay to the environmental and/or social characteristics otherwise promoted by the investment product as per this framework. The reduction of involvement in Non-Ethical and controversial activities applies binding investment restrictions that exclude companies involved in involved in tobacco and controversial weapons as further governed by the Responsible Investment Instruction. For certain funds the exclusions are expanded to cover other types of Non-Ethical & controversial exposures (e.g. Alcohol, Gambling, Military Equipment).

"Reduction of activities resulting in significant negative on impact on the climate" which promotes environmental sustainability factors means restricting investments in companies involved in thermal coal, tar sands and peat-fired power-generation unless they have a credible transition plan. For certain funds the exclusions are expanded to cover other types of activities resulting in significant negative on impact on the climate (e.g. Fossil Fuels).

[1] More information about our investment restrictions can be found here: https://danskebank.com/-/media/danske-bank-com/file-cloud/2019/3/danske-bank-investment-restrictions.df?rev=85b6402bb32443bea448cd18083ec757

Restriction of Russian investments

On 28 February 2022, the Responsible Investment Committee did after careful consideration and a thorough analysis of sustainability factors decide to exclude Russia and Russian state-owned enterprises from investment portfolios and products. As a consequence of this, investment funds with a significant Russian investment focus were subsequently terminated. Please visit https://www.danskeinvest.lu/articles/liquidation-of-danske-invest-russia-and-danske-invest-eastern-europe for more information.

Reduction of activities resulting in a significant negative impact on the climate

The credibility of the individual company's transition plan now plays an even more vital role in our process for investment restrictions

Danske Bank restricts a multitude of companies that are deemed to have a significant negative impact on the climate. More specifically, companies that derive 5% or more of revenue from thermal coal mining and/or coal-fired power production are restricted as well as companies deriving more than 5% of their revenue from peat-fired power generation. Furthermore, the products for which this criterion is applicable also refrain from investing in companies expanding thermal coal mining, coal-fired power generation or peat-fired power generation.

Within the same restriction criterion (i.e. reduction of activities with a significant negative impact on the climate),

certain investment products also have general restrictions related to fossil fuel activities.[1]

These restrictions are all part of our commitment to phasing out investments in companies involved in the three fossil fuel types by 2030 in the EU and OECD, and by 2040 in the rest of the world – in line with the requirements of the Paris Agreement.

A key element to achieving the climate goals set out in the Paris Agreement is that companies reduce their climate footprint. As a responsible investor, Danske Bank has a vital role to play in driving the low-carbon transition and in shaping tomorrow's companies. By excluding companies, we lose the opportunity to influence them through active ownership. The number of transition cases –companies that are currently in-scope in terms of restrictions which can present a credible pathway towards decarbonisation – is currently increasing, so Danske Bank has recently established a framework for taking this into account from an engagement perspective.

"Danske Bank Asset Management wants to encourage and support companies transitioning from a carbon-intensive business model, so we have therefore chosen to provide exclusion exemptions for companies that can credibly demonstrate their commitment to phasing out thermal coal, tar sands and peat activities in alignment with the Paris Agreement", says Alexander Lindwall, Chief ESG Analyst at Danske Bank Asset Management.

The exemption analysis is an important part of our commitment to the Net Zero Asset Manager initiative, where we try to strike the right balance between working with active ownership on the one hand and restrictions on the other. The assessment of a company's transition plans is carried out against the Transition Pathway Initiative (TPI) management framework, presented on page 12 of this publication.

"By using the TPI framework, we can assess whether companies have credible transition plans and thus target our engagement with those companies that are in a transition phase and use our power to support their journey. This enables us to actively foster change and encourage companies to, for example, increase the production and use of renewable energy sources, embrace the business opportunities sparked by the transition and help achieve the climate goals of the Paris Agreement. Only companies that are assessed by Danske Bank Asset Management as meeting level 3 criteria of the TPI framework are granted exemptions."

As all decisions related to exclusions are anchored in the investment organisation, an analysis of the individual company cases together with a recommendation on how to approach each individual case is presented to the ESG Integration Council. Danske Bank's ESG Integration Council, which comprises Heads of investment strategies, was created to support ESG integration into the core of our investment processes. Recommendations are discussed and endorsed by the ESG Integration Council and approved by the Responsible Investment Committee prior to implementation.

Not only is this important from a net zero perspective, where we are committed to the long-term decarbonisation of our investment portfolios, it is also part of our fiduciary duty, where we work to protect our customers' investments and to generate attractive returns while also paving the way for change and contributing positively to society.

*Alexander Lindwall,
Chief ESG Analyst at Danske Bank Asset Management.*

The application of restrictions under this category is conducted on an annual basis, but is subject to quarterly reviews to integrate any dynamic events that may occur over the year.

"This is a significant step towards anchoring the concept of exemption cases in our processes. Not only is this important from a net zero perspective, where we are committed to the long-term decarbonisation of our investment portfolios, it is also part of our fiduciary duty, where we work to protect our customers' investments and to generate attractive returns while also paving the way for change and contributing positively to society."

[1] *See Danske Bank Group Policies, Instructions and SOPs: https://danskebank.com/sustainability/sustainablefinance/responsible-investment*

How to read the SFDR annexes

Funds categorised under SFDR Article 8 and 9

We welcome the SFDR's ambition of harmonising sustainability disclosures, preventing 'greenwashing' of investment products and ensuring investors have the information they need to make investment choices in line with their sustainability ambitions. We believe that the regulation will make it easier for our investors to navigate the wide range of investment products with sustainability features.

Stine Lehmann Schack,
Head of Frameworks and Governance,
Responsible Investment in Danske Bank

This year, Danske Invest, being the umbrella term for all investment funds manufactured in the Danske Bank Group, has started to include SFDR related disclosures in its yearly reports' annexes. The reporting outlined in the SFDR annexes supplements the financial statements of the funds and is prepared in accordance with reporting requirements outlined in the Sustainable Finance Disclosure Regulation. The reporting captures only funds categorised under Article 8 and/or, as relevant, Article 9 of SFDR.

The SFDR annexes provide information on the extent to which the funds have promoted environmental and/or social characteristics (Article 8) and/or met their sustainable investment objective (Article 9) as outlined in the prospectuses.

The reporting is outlined in tables and figures using sustainability indicators (metrics). For ease of reference, the reporting contains information on the so-called binding element relevant to the exact characteristic/objective. For example, an ESG score might be a relevant sustainability indicator with the binding element being that the fund aims to have an ESG score higher than the benchmark.

For further information on how the funds promote environmental and/or social characteristics, or attain their sustainable investment objective, please refer to the SFDR Annexes of the funds' prospectuses.

For further information on sustainability indicators, data and monitoring, see the information available on the website for each fund in the document named "Sustainability-Related Disclosures".

The reporting seeks to provide a transparent and easily read presentation of the funds' performance in respect of the relevant sustainability parameters. The reporting parameters applied for the funds may vary, depending on the SFDR categorisation as such but also specific characteristics such as lack of data, data quality, asset class categorisation, benchmark availability etc.

For instance, the "number of restrictions" for funds with an applicable benchmark indicates the number of restrictions made in comparison to investments in the benchmark. For funds without an applicable benchmark, the number of restrictions in the report equals total number of restrictions seen from a Danske Bank Asset Management perspective. That number will not necessarily be illustrative of the number of investments restricted from the eligible investment universe of the funds.

The SFDR annexes cover the period 1 January-31 December 2021 and thus contain information relating to the time before the funds were categorised as Article 8 and Article 9 funds.

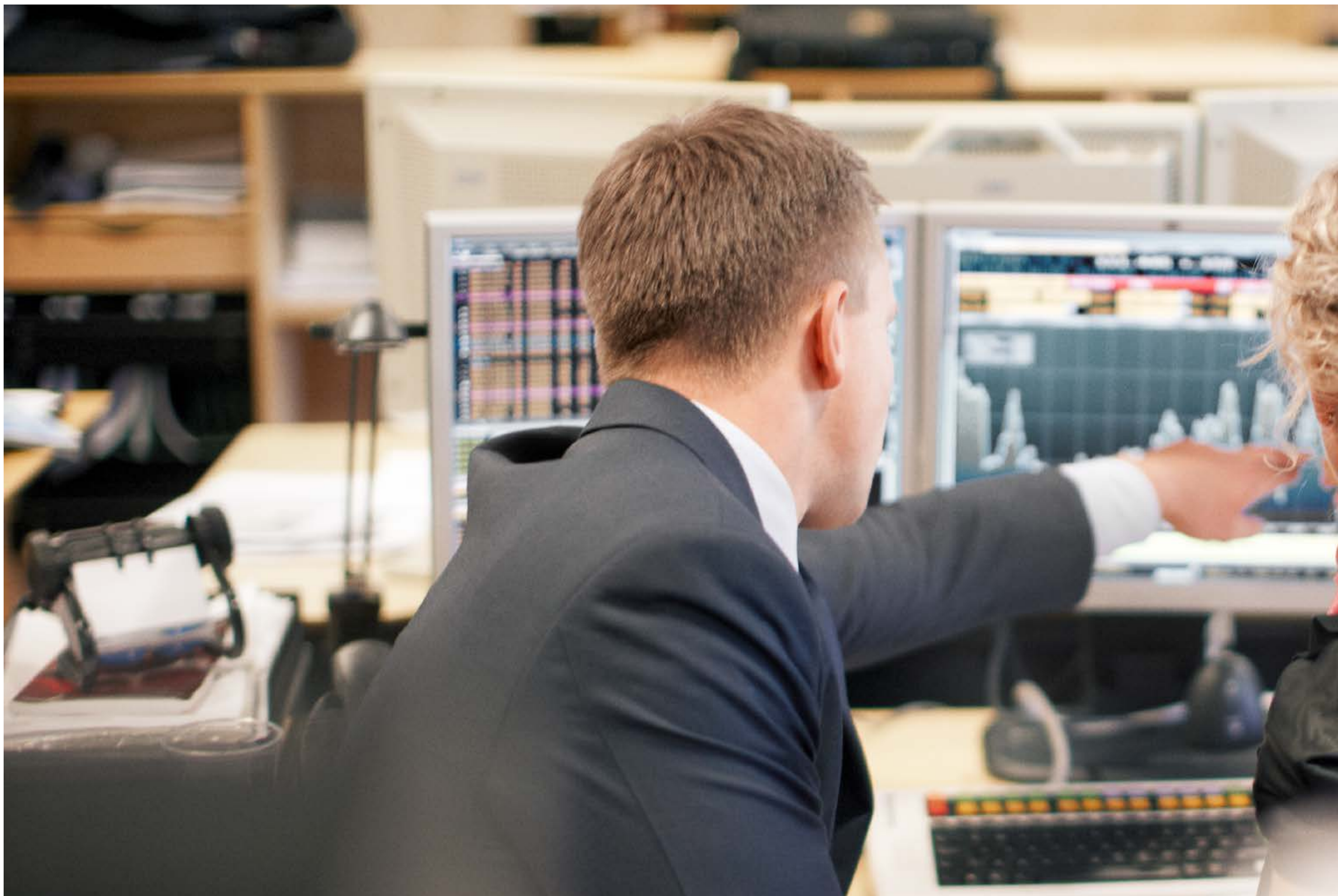
LuxFlag

In 2021, Danske Invest again received an 'ESG label' from LuxFLAG for most of our funds. We continue to be the fund manager in Europe with most certified funds.

Some 70 funds across Denmark, Luxembourg and Finland have been certified with an ESG label from LuxFLAG – a stamp of approval for Danske Invest's many years of work with responsible investments. This was the second year in a row that Danske Invest funds qualified for the certification and we are of course happy that one of Europe's leading research houses has performed an external validation of our processes and funds and decided that we could again be awarded their ESG label.

To us, working with responsible investments is an ongoing process and Danske Invest will continue to strive to be one of the leading Nordic suppliers of responsible funds. To constantly work on developing relevant and sought after investment products that have a strong focus on sustainability is an important part of our value proposition.

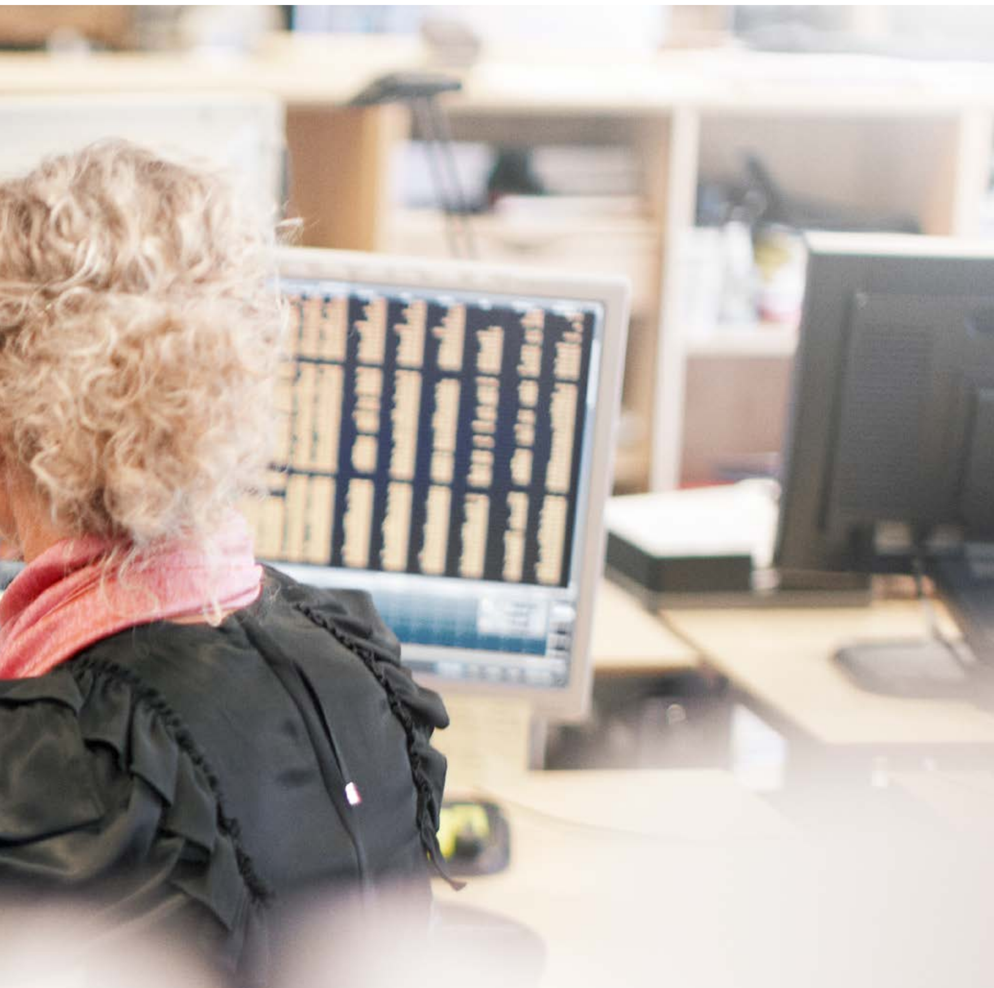
The LuxFLAG ESG label is one of the oldest certifications of its kind in Europe. The certification has extensive requirements including that responsibility is an integrated aspect of the investment process, that active ownership is practised via dialogue and voting at AGMs and that investment restrictions are applied.



A long-term ESG education programme for investment professionals

How do we as an asset manager respond to the increased regulation of the responsible investment area combined with expanding and more complex demands from our customers? Investing in the competence of portfolio managers across our strategies and portfolios to ensure they are ready to live up to the increasingly complex agenda of responsible investment is a definite must. A recent analysis puts Danske Bank in pole position when it comes to the training of investment professionals. Chief ESG Specialist Peter Lindström, CFA, who is responsible for the ESG education programme for investment professionals at Danske Bank, expounds on this.

It h as been said many times before but is worth repeating: The EU Action Plan on Sustainable Finance will reshape the financial industry completely in the coming years. The unprecedented scale and scope of regulatory initiatives affects all of us in the asset management industry. This is not least true for the portfolio managers responsible for making investment decisions, who in recent years have spent a considerable amount of time becoming familiar with SFDR, the taxonomy, climate benchmarks, etc.



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Peter Lindström, CFA
Chief ESG Specialist, Danske Bank

Two tracks
At Danske Bank, we have worked systematically with the training and education of portfolio managers in recent years. In 2018, we established an education programme with the long-term aim of ensuring a level of sustainability competence among our investment professionals.

Our programme essentially adopts a two-track approach. The one serves to ensure competence and knowledge related to specific aspects of responsible investments, most often related to Research & Insights and Data & Tools. This track is organised internally, featuring focused sessions with an internal or external trainer. The other track ensures a more comprehensive understanding of responsible investment in general, with an integrated approach that incorporates the 'full package' being the main goal.

In 2020, we decided to opt for the EFFAS Certified ESG Analyst® (CESGA), which we thought offered the most comprehensive and relevant programme on the market. We also initiated preparation classes for the CESGA exam, led by Professor Alexander Bassen from the University of Hamburg, who is one of the founders of the certification. As per end of 2021, close to 40% of all portfolio managers at Danske Bank Asset Management have passed the CESGA exam. According to a recent analysis made by sustainAX, Danske Bank CESGAs represent no less than 36% of all CESGAs in the Nordics.[1]

The future
In the coming years, we will definitely continue to work with CESGA and to have even more portfolio managers certified. We have also evaluated other external certifications as a potential complement to CESGA, and are now offering the SASB Fundamentals of Sustainability Accounting (FSA) credential to portfolio managers and are in the midst of assessing other options. In terms of the more internally oriented training (i.e. the first track mentioned above), we will seek to make some parts mandatory for all investment professionals within Danske Bank Asset Management in order to support the regulatory developments. This will not fundamentally change anything, however, as we have seen great participation rates in our training programmes in recent years. Nevertheless, this is also an important step from a compliance and risk management perspective, and sends a clear signal to our customers that this is something we view as an integral part of our asset management business.

[1] *https://www.sustainax.com/index.php/2022/03/08/nordic-certified-esg-analysts-danske-bank-in-pole-position-and-norway-missing-the-race*

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