Engagement Topics 2020

For the engagement activities of the members of the **Responsible Shareholder Group (RSG)** the following topics were chosen in 2020:

Social
- Human Rights Due Diligence
- Psychosocial Risks at Work

Environment
- Scope 3
- Green Products and Services

Governance
- Competencies in the Board
- ESG Criteria in the Compensation System

Human Rights Due Diligence

Over the last few years, Human Rights Due Diligence (HRDD) has become a strategic topic for companies and their investors. Many companies are affected by human rights-related risks, particularly through their supply chains in emerging markets or their financing activities. The violation of human rights may cause severe risks for both companies and their investors, including reputational and financial damages, commercial losses and criminal sanctions.

At the international level, standards developed by the UN or the OECD are unanimously endorsed and are already being integrated by some leading companies in the field of Human Rights. Some countries, such as France, have issued laws on this topic and are binding national companies to HRDD specific requirements. In Switzerland, a popular initiative was launched in 2015, demanding greater responsibility for multinational corporations. The initiative would compel Swiss-based multinational companies to undertake human rights and environmental due diligence in all their business activities. A popular vote will take place in 2020 on these constitutional amendments.

According to the UN Guiding Principles on Business & Human Rights, HRDD is a way for enterprises to proactively manage potential and actual human rights risks in which they are involved. It consists of five core components on which the dialogue initiated by Inrate with Swiss companies predominantly focuses:

1. Policy Commitment and Governance: a company needs to show its commitment to address the issue, to formulate ad-hoc policies and to adopt proper governance system.
2. Human Rights Impact Assessment: a company identifies and assesses actual or potential adverse human rights impacts that it may cause or contribute to, either through its own activities or through its products and services.
3. Actions to Mitigate and Avoid Impacts: after having considered the findings from impact assessments, a company takes appropriate action according to its involvement in the impact.
4. Monitoring and Reporting: a company communicates on how impacts are being addressed and shows stakeholders that adequate programs are in place.
5. Grievance and Remedy: a company implements grievance mechanisms so that appropriate remedies can be provided to affected stakeholders.

Psychosocial Risks at Work

According to an OECD report published in 2014, mental illnesses cost CHF 19 billion per year in Switzerland. According to the Federal Office of Public Health (FOPH), mental illnesses can lead to disability if they are recognized too late and are inadequately treated. Furthermore, the FOPH states that approximately 43% of disability pensions are caused by psychological reasons, making them the most common cause of disability and this number continues to grow. As a result of this development, the European Union (EU) as well as the Swiss State Secretariat for Economic Affairs (SECO) have placed "psychosocial risks at work" (PSRW) at the center of their preventive activities.

Psychosocial risks occur at work and in society. The SECO describes PSRW as follows: Psychosocial risks refer to risks to health due to inadequate workplace design, work organization and unfavorable social environment. Psychosocial risks can affect mental health (e.g. depressions, anxiety disorders) and/or affect physical health (e.g. musculoskeletal diseases, cardiovascular diseases). Whereas group-related PSRW always involve at least two people (e.g. bullying, bossing, sexual harassment, violence), personality related PSRW (e.g. stress, monotony, burnout, bore-out, presenteeism) affect one individual (Fischer, 2016). PSRW can cause employees to lose motivation, become unsociable, increase their consumption of alcohol and/or psychoactive substances. For companies, these can lead to productivity losses and higher illness costs.

The measurement of KPI's (e.g. absenteeism rate, presenteeism rate, employee turnover) can provide valuable information about PSRW, which is why companies should monitor them.

Scope 3

Greenhouse gas emissions are divided into three "scopes" according to the most widely used internationalaccounting instrument, the Greenhouse Gas (GHG) Protocol:

Scope 1 emissions are direct emissions from sources that are owned or controlled by the company (fuel combustion, company vehicles [without electric cars]).

Scope 2 emissions are indirect emissions from the generation of purchased energy (purchased electricity, heat and steam).

Scope 3 emissions include all other indirect emissions resulting from the company's value chain activities, but that are not owned or controlled by it. Scope 3 emissions come from upstream and downstream activities such as:

- third-party distribution and logistics
- leased assets, franchises and investments
- purchased goods and services
- contracted solid waste disposal and wastewater treatment, use and disposal of sold products.

In Switzerland, tracking scope 1 and scope 2 emissions are no longer a major challenge for companies. Most of them track, monitor and disclose these emissions in detail. Reporting on scope 3 emissions, on the contrary, is rare. Collecting and reporting on scope 3 emissions is challenging for most corporations, however their importance is substantial and growing. Between 1995 and 2015, global scopes 1, 2, and 3 emissions grew by 47%, respectively 78%, and 84%. In some sectors scope 3 emissions are by far larger than scope 1 and 2 emissions. For example, in the case of buildings (which includes the construction sector, real estate and housing), scope 3 emissions are twice as high as scope 1 emissions (Edgar G Hertwich and Richard Wood 2018, The growing importance of scope 3 greenhouse gas emissions from industry). The sector with the highest scope 3 emissions is the manufacturing industry.

For these reasons, reporting on scope 3 emissions is essential to fully understand the impact of a company on climate change. Without a complete GHG emissions disclosure that includes scope 3, investors may be misled. In addition, the progress of a country, investor or business addressing climate change and trying to contribute to the transition to a low carbon, may be hindered. Developing a scope 3 emissions inventory requires a joint effort between the company and its suppliers. This allows companies to better manage emissions-related risks and opportunities, to focus efforts where they can have the greatest impact and to efficiently reduce value chain GHG emissions.

Green Products and Services

Companies that do not adapt their business models to the challenges of sustainable development may face significant environmental risks. Sustainability challenges can turn into business opportunities if companies develop innovative products and solutions that directly address specific or global sustainability issues, such as climate change, energy efficiency or scarcity of natural resources. Among other characteristics, green products can save energy, be free of toxic compounds, be made of recycled or reused materials. Green services can help to reduce environmental impact through targeted technical and scientific expertise, for example in the financial industry or in the real estate sector. As customers have become increasingly sensitive to environmental issues, demand has increased significantly in recent years and the offer of "Green Products and Services" is increasingly becoming a strategic business issue and a competitive factor for many companies.

In the food industry, the supply of organic products, which comply with standards and ecolabels, meets an ever-increasing demand. Many investors today consider the offer of green products and services as a material ESG challenge that contributes to the financial value of a company. International initiatives, like the Sustainable Development Goals (SDGs), supported by a growing number of stakeholders, including investors, strongly encourage companies to offer green products/services.

Competencies in the Board

The board of directors plays a crucial role for a company's long-term success. The board acts as a sparring partner to the management board, sets and supervises the firm's strategy and long-term priorities, and provides critical advice to the management. As a result, investors ought to have a serious interest in appointing a board composed of skilled and experienced directors. Furthermore, diversity of employees is important so that corporate challenges are tackled with insights from various perspectives. Inrate identifies eight measurable competencies to evaluate board of directors and to identify potential know-how gaps:

(1) Industry experience
(2) CEO experience
(3) International experience
(4) Experience in emerging markets
(5) Financial knowledge
(6) M&A experience
(7) Legal education
(8) Experience in digitization
(9) Experience in listed companies

ESG Criteria in the Compensation System

For investors, sustainability is becoming increasingly important when considering their investment decisions. At the same time, companies are implementing comprehensive sustainability strategies. This is intended to take into account environmental, social and governance (ESG) impacts when making corporate decisions (e.g. reducing CO2 footprints, promoting employee health, increasing diversity at management level). An effective instrument for the implementation of such strategies is the design of remuneration systems. Incentives can influence the behavior of employees and in particular managers. The consideration of ESG criteria for bonuses in remuneration systems might have a potential leverage effect on the integration of sustainability in companies. An analysis by Inrate of 2320 companies in 2018 showed that 11.3% of the companies included ESG criteria in their remuneration systems. The analysis showed that the most used ESG criteria in management remuneration relates to employees: 6.9% of companies mention such criteria. In this context, occupational safety and health of employees, talent development, talent management, employee satisfaction and diversity are mentioned. 4.9% of companies mention environmental issues. They mention general environmental issues, energy savings, emission reduction and water. In the area of social affairs (4.7%), customer satisfaction, quality criteria, ethics and corporate values, as well as stakeholder commitment and social programs are included in the variable compensation. 3.1% of companies generally refer to a link between sustainability or CSR and remuneration systems.