Pareto
Asset Management

Responsible investments

Report 2-2024

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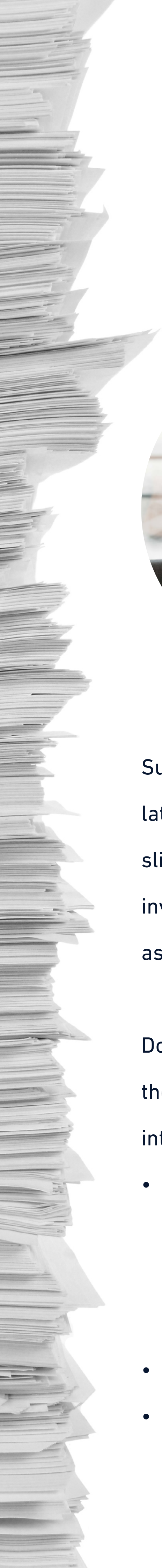
INTRODUCTION

The effect of increasing signage



BY
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Sustainable investment is an undisputed growth business. A rough estimate puts the latest number of ESG funds and ETFs globally at somewhere close to 9,000, given a slightly moderated growth rate of 15-20% over the past year. More than 75% of these investment vehicles are based in Europe, representing over €10 trillion in aggregate assets under management.

Does the regulatory framework keep up? In terms of sheer volume, it does. Not having the patience to collate and count myself, I asked ChatGPT about the scope. Here's an interesting run-through:

- The Markets in Financial Instruments Directive II (MiFID II). The full directive, including parts not directly pertaining to ESG, spans 1,500–2,000 pages. MiFID II requires financial advisors to assess and align investment strategies with their clients' sustainability preferences.
- The EU Taxonomy Regulation. 50 pages + over 400 pages of delegated acts.
- The Sustainable Finance Disclosure Regulation (SFDR). Approximately 120–150 pages, including the regulatory technical standards (RTS).

- The Corporate Sustainability Reporting Directive (CSRD). Roughly 100 pages in English (applies to approximately 50,000 entities in the European Economic Area (EEA)).
- The European Sustainability Reporting Standards (ESRS). Consists of 13 separate reports totalling approximately 1,100 pages, including technical appendices and explanatory notes.
- The Insurance Distribution Directive (IDD). The directive itself is roughly 50–100 pages, with additional guidelines and technical standards expanding its application.

This highlights a growing Atlantic divide. The EU functions as the only international legislator, with cross-border legislation relevant for all funds wanting to attract European investors, shaping ESG strategies and disclosure standards worldwide. But while the EU leads in regulatory volume, the US seems to be adopting a very different stance. Indeed, the very attempt to make sustainable investing a standard investor option has been met with resistance, being described as an outright backlash.

While we strongly disagree with the view that sustainable investment is detrimental to returns, which many US politicians seem to argue, we do see some relevance in the claim that the scale and scope of European regulation is counterproductive to economic growth.

In Europe, support for ESG is still strong. But the general view is getting more nuanced. For instance, this summer, the European Supervisory Authorities issued a joint opinion acknowledging that "the framework could be improved" – and not necessarily by piling on more pages of regulation (although they suggest "the introduction of a framework to assess the sustainability features of government bonds").

This joint opinion pointed out that the SFDR "may be complex by nature and difficult to understand, in particular for retail investors", which was confirmed through two consumer testing exercises. In addition, they noted that Article 8 and Article 9 classifications were used as "quality labels" for sustainability, posing risks of greenwashing. In the absence of another, possibly better classification system, I dare say this is not the least surprising.

EFAMA, the voice of the European investment management industry, responded to this opinion by among others strongly advocating alignment of Principal Adverse Indicators (PAIs) between SFDR and the CSRD/ESRS – and by strongly disagreeing "with the introduction of any new (social) PAI which lacks clear corresponding reporting requirements in the CSRD and ESRS".

In other words, it is both confusing, cumbersome and counterproductive to have related concepts defined differently in separate sets of legislation. And if part of this volume of text is rather impenetrable, it ought to be made clearer. We'll see if this also means that it will be made shorter.

We have even made our own voice heard in this legislative landscape, after our Frankfurt branch manager, Dr. Oliver Roll, was asked for expertise in the parliamentary hearing in the German state of Schleswig-Holstein, on their legislation on sustainability investment strategy. While we are clearly in favour of integrating such criteria in investment, we also pointed out that the proliferation of regulations makes it more difficult to achieve sustainability goals. We cannot expect a desire for "mathematical" precision to bring about optimal solutions, as this risks locking in solutions based on the current state of knowledge only.

Please allow a little detour. I fear that the scale and scope of this regulation may have an effect similar to increasing the density of speed limit signs: While it can reduce average speed on straight sections, it may actually increase speed in curves by leading drivers to treat posted limits as targets, instead of reducing speed in accordance with the actual road conditions.

As for sustainable investment, the increased burden of regulation has shifted the focus to regulatory compliance. We, as many others, have staffed up compliance and produced an increased number of documents as prescribed by European legislation. There are many good things to say about both the process and the resulting documents, but they do tend to shift the focus of this work:
Sustainable investing risks being transformed from a strategic priority to a mere compliance exercise, a kind of hygiene factor. It may assume the character of a “’check-the-box” exercise, rather than a strategic, value-driven approach.

At Pareto Asset Management, we are indeed conscious not to lose sight of the ultimate goal: finding investments where their very sustainability contributes to delivering better long-term risk-adjusted returns. Logically, our competitors would probably subscribe to a similar view and this would actually be in our own interest, as we do share the same world.

I do fear, though, that the increasing burden of regulation entails a risk of many participants losing sight of this ultimate goal. We should not make sustainability a hygiene factor.

Fund naming woes

In another example of regulation that may complicate true sustainable finance, ESMA steps on the toes of European regulation with new fund naming rules.

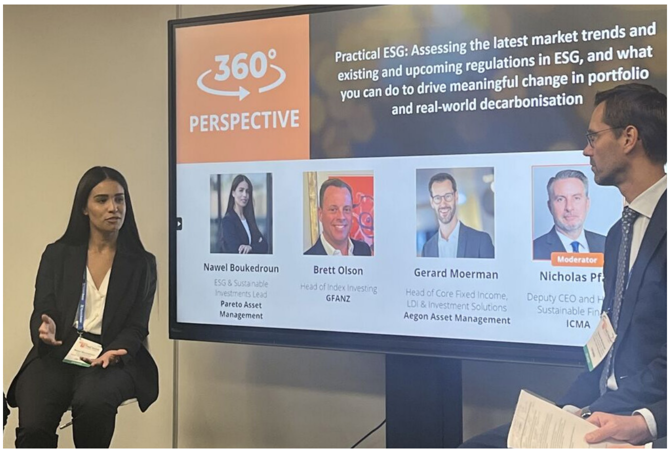
In a move that some industry experts are calling a step too far, the European Securities and Markets Authority (ESMA) has recently released guidance on sustainable fund naming—an initiative that appears to encroach on regulatory territory traditionally reserved for the European Commission.

While ESMA's role is to enhance transparency and protect investors, the timing of this initiative – coinciding with the ambition to revise the Sustainable Finance Disclosure (SFDR) framework – is far from ideal. With the SFDR framework already under potential restructuring, ESMA's guidance adds to the workload for fund managers, particularly because some exclusions set by ESMA differ subtly from current market standards, either in thresholds or in wording.

These seemingly minor variations lead to increased compliance costs and administrative burdens for financial market participants without adding real value, potentially reducing the time for sustainability professionals to core responsibilities like assessing, researching, engaging with companies etc.

Moreover, ESMA's exclusion criteria for fund naming introduce a further hurdle by requiring data that is often inconsistent or unavailable across the market. At the recent Fixed Income Leaders Summit in Paris, our Responsible for ESG and Sustainable Investments joined peers and panel moderator Nicholas Pfaff, Deputy CEO and Head of Sustainable Investments at the International Capital Markets Authority (ICMA), to discuss the practical difficulties these new guidelines pose.

One notable example is the integration of strict CO_2 thresholds for companies from power generating sector. Companies with a mixed energy portfolio that includes natural gas and other transitional sources face greater challenges.



Nawel Boukedroun at the Fixed Income Leaders Summit in Paris

Although these providers align with broader sustainability goals, they often lack the granular disclosures needed to
meet ESMA's stringent requirements. As a result, these issuers risk exclusion from sustainable funds, even when they meet sustainability requirements set by other reputable frameworks or ESG labels.

The panel suggested that a more prudent approach would have been to await the rollout of the Corporate Sustainability Reporting Directive (CSRD), which will enhance data availability across sectors. Releasing ESMA's guidelines prematurely adds not only bureaucratic burden but may also unintentionally exclude eligible companies, ultimately limiting investor choice and creating unnecessary obstacles in advancing sustainable finance.

Guidelines for responsible investments

1. BACKGROUND AND PURPOSE

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

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

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

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

Please note that the fund Pareto Total solely is subject to the exclusion criteria as provided in section 2.2 and not the guidelines in their entirety.

2. RESPONSIBLE INVESTMENTS

2.1 Priorities

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

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

2.2 Exclusion of companies

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

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

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

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

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

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

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

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

3. CORPORATE GOVERNANCE

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

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

4. RESPONSIBILITY FOR MONITORING AND CHECKING THE GUIDELINES

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

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

Twice a year, the Ethics Committee prepares a report on our guidelines for responsible investments and the practice of these. The report reviews specific topics we have worked with as well as relevant company assessments and dilemmas. It shall be available to our customers.
The chairman of the Ethics Committee shall annually provide the Board of Pareto Asset Management with an overview of the status of ongoing work for responsible investments in the company.

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

Signatory of:

PRI Principles for Responsible Investment

The UNPRI principles

Behind the UNPRI principles is the UN Environment Program Finance Initiative (UNEP FI). UNEP FI is a global partner-ship between the United Nations Environment Program and the financial sector. Among the goals for the collaboration is to identify, promote and realize best environmental and sustainability practices in the financial industry. Central to this collaboration are ESG questions, derived from the English concepts environmental issues, social issues and corporate governance.

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

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

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

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

Investing in a responsible and ethical manner

Pareto Asset Management aims at contributing to sustainable development of markets and long-term value creation by investing in a responsible and ethical manner.

We believe that responsible investments are important for achieving the best possible risk-adjusted return for our unitholders and clients. Sustainability and sound corporate governance give companies competitive advantages and contribute to long-term value creation.

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

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

Our product-based exclusion criteria

Weapons and ammunition
A variety of types of weapons, ammunition and warfare methods are prohibited under international law, such as the Geneva Convention. In addition, Pareto Asset Management may exclude companies involved in weapons production as a precautionary principle.

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

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

Pornography
Pareto Asset Management does not invest in companies producing pornography.

Our product-based precautionary principles

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

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

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

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

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

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

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

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

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

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

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

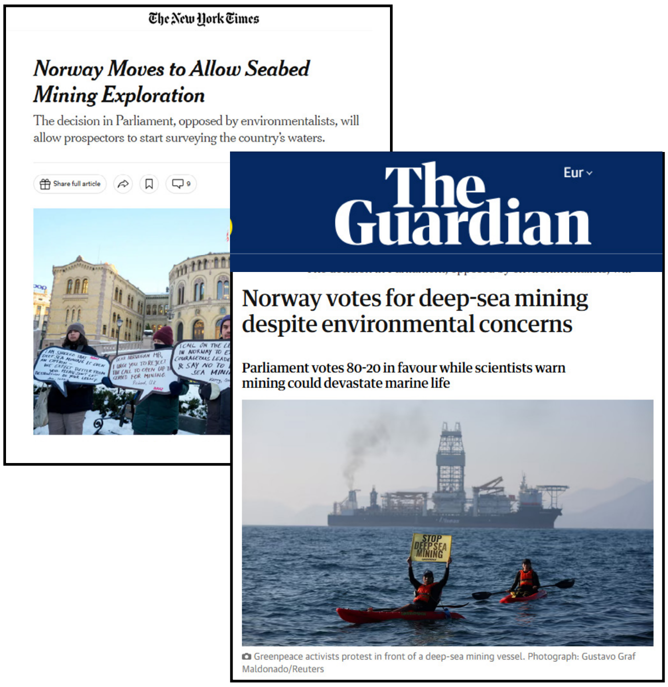
Deep sea mining
In responsible investing, we are often faced with dilemmas and paradoxes having no obvious solution. One such dilemma involves deep sea mining.

As the world weans itself off fossil fuels, the demand for critical minerals like cobalt, nickel, and manganese will increase sharply. These minerals are essential for the technologies driving the green transition, including solar panels, wind turbines, and especially electric vehicle batteries. According to the World Economic Forum, mineral requirements for clean energy could rise by as much as 500% in the coming decades.

One potential solution to meet this demand is deep-sea mining, a method of extracting minerals from the ocean floor, where resources can be found in abundance. Deep-sea mining is primarily focused on small, mineral-rich rocks found in oceanic regions. If fully utilised, these ocean reserves could ease dependence on terrestrial mining, which often leads to deforestation, water pollution, and abuses of human rights. Therefore, besides advancing clean energy progress, deep-sea mining is often viewed as a more sustainable alternative to land-based mining.

On the other hand, deep-sea mining presents significant environmental and ethical challenges. Not least, deep-sea mining poses significant threats to marine biodiversity. The disruption of fragile ecosystems, along with sediment plumes that smother marine life and noise pollution that affects underwater habitats, raises serious environmental concerns.

The EU therefore supports a precautionary approach to deep-sea mining. The European Parliament has called for a moratorium on commercial deep-sea mining until comprehensive regulations and sufficient scientific knowledge on the potential environmental impacts are available. The EU emphasises the need for a thorough understanding of ecosystems before any exploitation begins.


The New York Times

Norway Moves to Allow Seabed Mining Exploration

The decision in Parliament, opposed by environmentalists, will allow prospectors to start surveying the country's waters.

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The Guardian

Eur

Norway votes for deep-sea mining despite environmental concerns

Parliament votes 80-20 in favour while scientists warn mining could devastate marine life

Greenpeace activists protest in front of a deep-sea mining vessel. Photograph: Gustavo Graf Maldonado/Reuters

Norway, however, did not concur. In January 2024, the Norwegian parliament approved a plan to open a large part of its continental shelf to seabed mineral extraction. In April, dedicated parts were formally opened for seabed mining, and in June, the government announced plans for a first licensing round in 2025. The proposal would potentially cover 38% of the total area.

The parliament, not surprisingly, justified this decision by the need to secure critical minerals for the green transition. Norway aims to leverage its strong governance, human rights standards, and environmental regulations—factors often lacking in mineral-rich emerging economies.

However, this decision has raised significant concerns among environmentalists and indigenous communities. Protests have emerged, highlighting fears about the potential degradation of marine ecosystems and the long-term impacts on biodiversity. Critics argue that the risks associated with deep-sea mining could outweigh the benefits of securing mineral resources, calling for a more cautious approach and stricter safeguards before permitting such activities to proceed. WWF-Norway (the World Wildlife Fund) sued the government a few weeks before the latest decision to open up for licensing.

In our view, deep sea mining is an apt illustration of the dilemmas often embedded in responsible investment decisions. It serves a greater purpose, helping us become less dependent on fossil fuels. It would also reduce reliance on supplies from China, which now dominates the extraction of some of these minerals. On the other hand, the risk of damage to marine ecosystems seems incontrovertibly identifiable.

Given that the impact may depend to a large degree on the regulations adopted and the technologies chosen, we have decided that we simply don't have sufficient information at this point. Hence, as a precautionary measure, we will need to examine each case thoroughly before making an investment decision. In the first case brought to the table, the fund managers decided to exit our position (page 20). However, the company was not formally excluded from our investment universe. We just decided that we needed more information – which is of course what the precautionary principle is all about.

Conduct etc.

Human rights violations

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

Serious environmental damage

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

Based on this review, we are not aware of circumstances that indicate that any of our portfolio companies contribute to serious environmental damage. However, we have previously spent a lot of time assessing the situation for **Norsk Hydro**'s operations in Brazil, where heavy rain in February 2018 led to flooding and environmental damage. The company is no longer on our watch list.

Greenhouse gas emissions

The section on climate risk goes into further detail on our assessments in this area. Suffice it to say that we have no company-wide, principled objections to fossil fuel as such, but we do care that the companies in question work to limit emissions and other side effects of their business. Two of our funds have a stated policy of not investing in fossil fuels.

Gross corruption

It goes without saying that corruption is unacceptable to a responsible investor. The problem is generally one of discovery, which seldom takes place without criminal investigation and proceedings. Our challenge then is to evaluate the quality of governance going forward.

We have had instances of corruption also in partly government-owned companies in Norway. As a general rule, we don't necessarily sell our holdings simply because something unacceptable has happened. We will have to evaluate the risk of the problem repeating itself, whether it was a singular case or a consequence of a permeating problem, and of course what is being done in order to get their house in order.

Other particularly gross violations of basic norms

We have not identified other gross violations of basic norms.

Corporate governance

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

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

Requests from clients can also be grounds for engagement.

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

Please note that we don't vote just for the sake of voting. We see no point in casting the maximum number of votes. Most agenda items are standard, plain vanilla issues. Some may be of greater importance. In some of these cases, the outcome is far from given. If we feel that a certain outcome is important, we will contribute to attaining that outcome by voting.

However, casting votes has a cost. In some cases, more specifically with some global companies, it may be inordinately cumbersome. In that case, casting a vote may not be in the best interest of our investors or unitholders.

After all, that is our guiding light: We do what's in the best interest of our clients and unitholders.

Active ownership

Active ownership is not limited to voting or dialogues with portfolio companies. Sometimes, dialogues with other shareholders may be more effective.

We have stated time and time again that we believe concentrated portfolios limit idiosyncratic risk. The better we understand our portfolio companies, the more we can feel confident about their ability to deliver good risk-adjusted returns. Here, risk certainly includes sustainability risk factors.

Being in contact with key people in these companies is an obvious channel of information. For active fund managers like us, it is an indispensable tool. It is also a good way, in many cases the best, of letting our views be known to the same people. We may vote at general assemblies, but while our vote may tip the scale, it is not likely to make anyone change their mind. Dialogues, on the other hand, may initiate a process of reflection and influence future management decisions.

Admittedly, our share of the companies' equity or bonds is generally quite low. While we still believe that we have very good dialogues with a lot of portfolio companies, sometimes we need to coordinate our actions with other investors. And in a few instances, we can do both.

The company assessments in the following pages all involve communication with management on the subjects mentioned. In other instances, our dialogues are not triggered by specific incidents or problems, but rather a desire to understand these companies' sustainability efforts and ensure that we find their general progress acceptable – and, of course, preferably, push them a little bit in what we consider to be the right direction. Following are some examples of such dialogues in the past year.

EQT Partners

EQT Partners is a Swedish private equity firm that aims to develop sustainability practices within portfolio companies. The company is the first private equity firm to have received a Science-based target (SBT) approval. Both PNCC and PEGCB hold bonds in EQT Partners and in some credit issuers in their portfolio.

Engaging with privately owned issuers can present challenges, primarily due to lack of required transparency. Through direct communication with the owner of several of our holding companies, we ensure an impactful approach and overcome the limitations posed by conventional channels.

This time, the engagement with EQT was initiated to discuss the application of the Corporate Sustainability Reporting Directive (CSRD), the proportion of companies within the scope, and EQT's support for reporting requirements. The team reviewed the status and targets of GHG emissions, particularly from business travel, and progress on SBT, with a goal of 100% validation by 2030 of the portfolio companies. Additionally, we touched on EQT's policies for managing sustainability performance and actions taken if targets are not met.

EQT emphasised that, for them, sustainable investments drive better returns. To support their portfolio companies, EQT has developed tools, playbooks, and curated providers suitable for different sectors and company sizes. Their efforts include a sustainability forum and a CFO day with portfolio companies addressing CSRD. The first wave impacts around 50 portfolio companies, increasing to 70 in the second wave.

EQT shared that they provide dedicated sustainability teams and resources to support companies with legal assessments, regulatory compliance, and disclosure process. The company also mentioned that a single person or a small team is responsible for the same company over time to be able to provide the best support. EQT monitors ESG data through annual SFDR data collection and quarterly reviews and emphasises the frequency and quality of this data.

EQT also offers resources and tools for portfolio companies to enhance GHG reporting. EQT conducts reviews and progress tracking to ensure alignment with SBT goals and has a system for companies that fail to set or meet their SBT targets. Lastly, the team addressed disclosure gaps in EQT's portfolio companies and shared our insights on important issues to demonstrate our active engagement in the conversation.

Lyse Energi

Lyse Energi is a leading Norwegian energy company, specialising in the generation and distribution of renewable energy, particularly hydropower, as well as natural gas, electricity, and fibre-optic broadband services, with a strong focus on environmental innovation. Lyse plays a pivotal role in the transition to a low-carbon economy, emphasising renewable energy sources and smart grid solutions. Lyse is also expanding its efforts in digital infrastructure, making it a significant player in Norway's digital transformation. The company is committed to reducing its environmental footprint through sustainable energy practices and has set ambitious goals to align with global climate standards. PNCC holds bonds in the company.

The engagement with Lyse Energi was initiated to enhance transparency in non-financial reporting and ensure alignment with global climate standards. Our objectives were twofold: The team sought to confirm the publication date and ensure the inclusion of Scope 1, 2, and 3 greenhouse gas (GHG) emissions data in Lyse Energi's 2024 climate report. The report, expected by Q1 2025, will adhere to the CSRD regulation, reflecting the company's commitment to full transparency in its environmental impact. Additionally, we aimed to ensure a formal commitment from Lyse Energi to join the Science-Based Targets initiative (SBTI) by Q4 2024.

Lyse confirmed that they will release an extended sustainability report in March 2025. This report will include detailed Scope 1, 2, and 3 emissions data, further enhancing transparency. The company is actively working on gathering and verifying Scope 3 emissions data.

The team will continue to monitor Lyse Energi's progress, ensuring the timely release of their March 2025 sustainability report, and proper inclusion of Scope 1, 2, and 3 GHG emissions data.

Sweden Timber

Sweden Timber is a privately owned Swedish company and a global supplier of wood and paper products. Operating two sawmills, two planning mills, a pulp and paper mill, and a wood granulate production facility, the company offers a diverse product range, including structural and impregnated timber, sawn wood products, exterior and interior cladding, flooring, paper and packaging solutions, and bio composites. Since its founding in 2014, Sweden Timber has expanded through both organic growth and strategic acquisitions. With annual sales of SEK 2.4 billion, over 400 employees, and exports to more than 45 countries, the company also maintains sales offices in the UK and the Netherlands.

Sweden Timber issued a SEK 700 million senior secured bond with a 3-year maturity. The proceeds from this bond will be allocated to general corporate purposes, refinancing existing debt, and financing the SEK 440 million acquisition of ASPA Bruk from Ahlstrom. Post-acquisition, Sweden Timber plans to invest approximately SEK 100 million in capital expenditures to ensure that the ASPA Bruk site complies with emission regulations by 2025.

Prior to the issuance, the team met with the CEO for an investor presentation. One of the issues discussed was Sweden Timber's acquisition of Aspa Bruk, a specialty pulp paper producer serving niche end markets. Aspa Bruk has struggled to meet updated water emissions standards and was granted a temporary exemption in 2019. Sweden Timber, in collaboration with external consultants and internal resources, has developed a plan to reduce emissions and ensure full compliance with EU regulations within a one-year timeframe.

Given that the acquisition of Aspa will contribute a significant 60% increase in revenues and 52% in group EBITDA, we are holding off on any further action until we can assess the effectiveness of their emissions reduction strategy. Additionally, the team raised questions about Sweden Timber's sustainability objectives and development. As a newly established company, they have not yet allocated sufficient resources or time to tracking non-financial data, particularly emissions. Some of the published metrics appear to be inaccurate or only partially reflective of the company's activity.

The company has indicated that they plan to release their first sustainability report in Q1 2025. The team recommended that the company use established standards, such as the GHG Protocol for data calculations, and the GRI standards for reporting, to ensure more accurate and interpretable data.

The fund managers decided against investing in the bond, mainly due to uncertainties related to the Aspa Bruk acquisition. Additionally, the absence of ESG data from Sweden Timber has hindered our ability to conduct a thorough ESG analysis. We will, however, continue to monitor Sweden Timber closely, especially to evaluate the success of their investment in Aspa Bruk and any advancements in their ESG reporting.

Climate-related portfolio assessments

Greenhouse gas emissions have a wide range of consequences for the global economy. This opens up new investment opportunities, while changing the risk and return profile of companies that are more exposed to the physical impacts of climate change, climate policies and new technologies.

Against the backdrop of such concerns, the Financial Stability Board (FSB) a few years ago, at the request of the G20, considered how the financial sector can take its share of responsibility. The conclusion, not unexpectedly, was that financial markets need better information about the impacts of climate change in order to make informed investment decisions, understand material risks and engage in dialogue with companies about their strategies and investments.

The FSB therefore established the Task Force on Climate-related Financial Disclosures (TCFD), which has developed a framework with recommendations on reporting on corporate governance, strategy, risk management and metrics and targets. The aim is to help organisations report climate-related risks and opportunities in a more effective way.

The TCFD was launched in December 2015, but it has taken time to operationalise the objectives in the various markets. Now we are starting to see more applicable results in Pareto Asset Management and probably several of our competitors.

Carbon analysis
Pareto Asset Management has now prepared climate-related assessments for the portfolios of all funds classified as Article 9 or Article 8 funds. We have prepared some of these assessments in the past but have now changed data provider and created comparable reports for all these funds.

Data has now been supplied by Stamdata, so we are assured of consistency in these assessments. Since not all companies provide or enable the kind of good and detailed data we need for such a comparison, the data set includes estimated sizes. For Pareto Global, 13 per cent is based on estimates, while the rest mainly publish good data that can be used as a basis.

The aim is to be able to quantify greenhouse gas emissions in a portfolio. Master data normalises these emissions by measuring them against revenues or total enterprise value (EVIC). Comparable figures are not yet available for all the benchmark indices. This applies, for example, to Pareto Global, where very extensive data must be collected to obtain comparable figures for the world index.

However, some conclusions are very clear. For example, we see that the emissions intensity in Pareto Global has a score of 11 for Scope 1. Scope 2 is even lower, with a score of 8. Scope 3, on the other hand ... there the number is 478. In other words, the lion's share of emissions caused by the companies in Pareto Global's portfolio originate from their overall value chain, not from themselves.

This makes the collection of good data even more demanding. In this respect, it is an advantage that the fund does not have too many companies in its portfolio. Pareto Global now has 27 companies in its portfolio.

Complement to Norwegian business and industry
Our Norwegian equity fund, Pareto Aksje Norge, has a larger element of energy and heavy industry. Here, the emission intensity is significantly higher than for our global equity fund. Total intensity (1+2+3) is measured at 958, compared to 496 for Pareto Global. Even here, however, it is the value chain that accounts for the largest share, almost two-thirds.

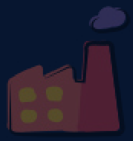
And in this case, we have figures for the benchmark index, Oslo Børs Fondsindeks. There, the total emissions intensity is measured at 1015.

In any case, it is interesting to note how our global equity fund also functions in practice as a complement to Norwegian equities. There are otherwise plenty of emission-intensive companies in the global stock market too.

In a slightly longer perspective, it will be interesting to get more robust data that can be compared from year to year. In this way, we can also quantify the development and – hopefully – the progress of our portfolio companies, as well as communicate quantitative data to our investors. We expect this to become more sought-after information over time.

What are scope 1, 2 and 3 carbon emissions?

The three scopes categorise the different types of greenhouse gas emissions created by a company, its suppliers and its customers:



Scope 1
Direct emissions from sources owned or controlled by the company

Scope 2
Emissions from energy consumption including estimated emissions from the construction of energy sources

Scope 3
Indirect emissions through the company's value chain, including subcontractors

Company assessments

Rockwool – cloudy on coal
The Danish company Rockwool is probably best known for rock wool for insulating houses, but also produces, among other things, facade panels and roof panel systems intended to reduce noise and fire hazards. Most are products that provide a factual basis for the company's unrelenting emphasis on sustainability and the circular economy. For example, rock wool makes a good contribution to reducing energy needs in homes and offices.

The problem is that the production of these products consumes a lot of energy. And Rockwool bases part of its production on coal. How much?

Well, that's information that the company will not divulge. – Due to the competitive nature of our industry, we do not disclose this information, the company replies. For Pareto Asset Management, this is a problem, as our policy does not allow companies that base 30 per cent or more of their business on thermal coal.

We have not taken the step of excluding the share, letting three arguments decide. Firstly, management is very clear that they are going to reduce the use of coal. There are ongoing, credible plans to shift to cleaner energy sources. In 2023, a quarter of capital expenditures went towards sustainability, with a focus on sustainable energy. The company's index for absolute GHG emissions (Scope 1+2) index fell in 2023 by 13 per cent.

Secondly, the share is not on the exclusion list of the Norwegian Government Pension Fund Global, which has the same restriction on coal use.

And thirdly, the products are obviously sustainable.

This is not just about focusing inquisitorially on the problems. Sustainability is about opportunities, and here they are good. Rockwool itself believes that the products they sell will save 100 times the energy consumed in production during their lifetime. We therefore think that Rockwool is a good company to own, which we do in the Pareto Nordic Equity fund.

Danske Bank – a decade of cleanup efforts
In 2014, information emerged on money laundering in Danske Bank's Estonia branch. The following years would see the bank engulfed in criminal investigations, litigation, loads of bad publicity – and extensive cleanup efforts.

In December 2022, final coordinated resolutions were reached with the US Department of Justice, the US Securities and Exchange Commission and the Danish Special Crime Unit, resulting in a total settlement of DKK 15.3 billion, covered by earlier provisions. All amounts have been paid. The bank remains subject to a criminal investigation by authorities in France, and it is placed on corporate probation from the US Department of Justice until December 2025.

In 2021, the Danish FSA appointed an Independent Expert whose role, amongst other things, was to monitor and report on the progress in delivering on the Financial Crime Plan. The Danish FSA has extended the appointment.

The extent and duration of the cleanup efforts illustrate the pervasiveness of the problem and the amount of work needed to ensure something like this does not happen again. We were astonished to see the extent of the misconduct in the first place, we were surprised to see new revelations of an even bigger problems, and we are still monitoring progress – but we are convinced that the massive efforts undertaken by Danske Bank will place it among the best in class when this is over.

Pareto Nordic Corporate Bond, Pareto Nordic Cross Credit, Pareto Obligasjon and Pareto Likviditet all hold bonds in the bank.

Scatec Solar – supply chain issues
Scatec solar is a Nordic leading renewable energy supplier that develops, owns, and operates renewable power plants with a focus on solar, hydro, wind power projects and related activities, including financial and physical power trading. Scatec, as well as the entire solar panel industry, is exposed to a risk of human rights abuse within their supply chain. According to the International Environmental Agency, more than 70% of polysilicon – a key component of the solar panel wafers – is produced in China. Of the Chinese production, Xinjiang represents 63%, or roughly half of the global polysilicon capacity. The province Xinjiang in China is constantly alleged to have widespread use of forced labour.

In 2021 we had our initial conversation with Scatec, during which the company explained that they were reviewing all their contracts and had engaged specialists to develop a strategy for improving traceability with suppliers and reducing the risk of human rights abuse. In 2022, Scatec undertook a three-year programme with EcoVadis, a global management platform dedicated to assessing suppliers on key ESG aspects, including labour and human rights. This is a tool enabling Scatec to engage with suppliers. In addition, the company was collaborating with peers in order to align approaches and escalate supply chain engagement to ensure compliance.

In 2023, Scatec continued efforts a by entering a collaborative alliance with Position Green, an advisory firm renowned for its expertise in fostering resilience through implementation of ESG software to track sustainability advancement. Scatec proactively collaborates with both their supply chain and insurance experts to formulate a strategy and tracking system that incorporates the management of human rights risks. This approach enables the company to enhance its monitoring and follow-up mechanisms for these risks at both project and corporate levels. The effectiveness of this action will be assessed in the upcoming year, as outlined in their updated Transparency Act Statement.

We appreciate the company's efforts in this field, while also noticing that precisely these efforts are a demonstration of the challenges inherent in their business. For that reason, we have decided that Scatec deserves to be on our watchlist, and we will continue to follow the progress.

Stora Enso – wildlife area damage
Stora Enso is a leading global company in sustainable materials, headquartered in Helsinki, Finland, and Stockholm, Sweden. Dating back to the 13th century, the company is one of the oldest in the world with operations in over 50 countries. PNE owns shares in the company, while both PNCC hold bonds.

In August, it was discovered that forestry machinery had caused damage to an area in Hukkajoki, Finland, inhabited by endangered freshwater pearl mussels. The company promptly halted all harvesting activities at the site.

Following an investigation initiated by Finnish authorities into the environmental damage, we engaged with Stora Enso to address the situation. During our discussion, we raised several critical questions to understand the nature of the incident, the implications and the measures taken by the company.

Stora Enso confirmed that the environmental violation is currently under investigation by the police, other authorities, and their internal team. They emphasised that the incident was entirely against their values, policies, and guidelines, and reassured us of their commitment to preventing such occurrences in the future. They also work to uncover further details about the awareness and compliance of their subcontractor, particularly regarding the endangered species in the area.

The company has also launched internal investigations of other sites located near protected areas and is collaborating with authorities in cases where irregularities are identified. Furthermore, Stora Enso has initiated additional training programmes for employees, contractors, and subcontractors focused on environmental compliance. To further strengthen their processes, the company will conduct internal and third-party audits aimed at improving planning and control, while ensuring adherence to environmental regulations.

Regarding the financial impact of the incident, Stora Enso declined to comment on compensation matters including a media-estimated amount of €1 million, as these issues remain under review pending the outcome of the investigation. However, the company has stated that they bear responsibility for remediation efforts initiated to restore the affected river and prevent further damage.

Neither fund decided to sell their holdings as a consequence of this event, but we will continue to assess the progress of their remediation efforts and internal reforms.

Nexans – allegations of Anti-Competitive Practices

Nexans is a global leader in the design and manufacturing of advanced cabling systems and solutions. The company specialises in cables for the energy, telecommunications, and transportation sectors, providing innovative solutions that support sustainable energy transition and renewable projects. Both PNCC and PEGCB hold bonds in the company.

Our engagement with Nexans was initiated due to allegations of anti-competitive practices. The UK Competition Appeal Tribunal has approved a class action lawsuit against Nexans, Prysmian, and NKT for allegedly forming a power cable cartel. This action follows a 2014 European Commission finding that they inflated high-voltage power cable prices from 1999 to 2009. Issued in May 2024, the decision allows a claim for £790 million in damages on behalf of about 30 million British consumers. A full hearing is expected in late 2025.

We engaged with Nexans to understand their perspective on the allegations and how they are addressing the issues. We also wanted to touch upon GHG emissions issues which we will not detail here.

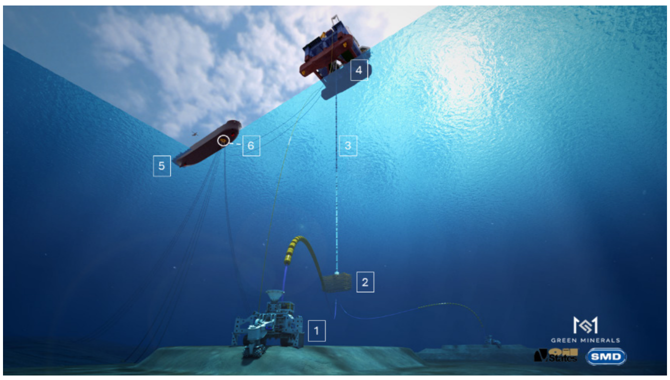
Nexans remains open to investor discussions but has not provided recent trial updates. Internal investigations suggest the allegations lack material elements. Nexans has set aside €65 million since 2014, exceeding potential penalty costs. As a precautionary approach, the individuals implicated in the issue were dismissed. Since then, a Chief Compliance Officer oversees risk management and compliance training. Nexans claims its defence is strong, with a decision expected by 2025/2026, and views its response as responsible.

We are monitoring the development of Nexans' legal case regarding alleged anti-competitive practices, with the class action lawsuit set for trial in late 2025. Additionally, the team is tracking Nexans' progress on reducing Scope 3 GHG emissions and preserving and restoring submarine biodiversity.

Green Minerals divestment

Pareto Nordic Corporate Bond has been invested for several years in the company Green Minerals, a business which focuses on exploration and environmental assessments of potential mining sites on the seabed. Their approach includes research into the ecological impact of mining activities, gathering baseline data on marine ecosystems, and developing technology for responsible extraction.

After Norway allowed commercial deep sea mining (see page 10), Green Minerals applied for a license. The fund managers then reached out to the company to gather more information. In conclusion, given insufficient research and uncertainty as to how the company would implement adequate measures to protect marine biodiversity, they found the situation too immature to remain invested.



As a result, the fund sold this position.
We will continue to assess the situation and may, having gained greater visibility, invest in this company again at a later stage.

Common acronyms in ESG investment and regulations

The emergence of ESG investing and related regulations has spawned a myriad new acronyms. If you don't work in this field, you probably don't know all of them.
Here is a short overview that may come in handy:

- **CDP:** CDP (the Carbon Disclosure Project) is a non-governmental organization (NGO) that runs a global disclosure system to manage the environmental impact for private and public institutions. Nearly 10,000 of companies, cities, and governmental institutions report on their risks and opportunities related to climate change.

- **CSRD:** The Corporate Sustainability Reporting Directive. In order to help the financial industry to better assess company extra-financial aspects, the EU Commission requires large public-interest companies with more than 500 employees to report information on how they manage environmental, social and governance issues in their business operations. Companies that fall under the scope of CSRD will have to disclose EU Taxonomy-related information.

- **EU Taxonomy:** The EU Taxonomy regulation, which entered into force in the EU in January 2022, has established a classification system of environmentally sustainable activities that translates the EU's climate and environmental objectives into criteria or specific economic activities purposes. The EU Taxonomy recognizes 'environmentally sustainable' economic activities that make a substantial contribution to at least one of the EU's climate and environmental objectives:
    - Climate change mitigation
    - Climate change adaptation
    - The sustainable use and protection of water and marine resources
    - Transition to a circular economy
    - Pollution prevention and control
    - The protection and restoration of biodiversity and ecosystems

  In addition, the investment must respect the do no significant harm criteria and be in line with the minimum safeguard.

- **GHG:** Greenhouse gases (GHG) are gases that absorb and emit radiant energy within the thermal infrared range, causing the greenhouse effect. Greenhouse gases shall be calculated according to the GhG protocol or similar official standard.

- **GRI:** The Global Reporting Initiative publishes GRI Standards, which provide guidance on disclosure across environmental, social and economic factors for all stakeholders including investors. These standards are used by organizations worldwide.

- **PAI:** According to SFDR, Principal Adverse Impacts (PAI) are impacts of investment decisions or advice with material, negative effects on sustainability factors. Sustainability factors mean environmental, social and employee matters, respect for human rights, anti-corruption, and anti-bribery matters.

- **PRI:** Principles for Responsible Investment is an international network of investors/signatories working together with a common ambition to foster ESG ownership decisions in investment. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

- **RTS:** Regulatory Technical Standards are a set of technical compliance standards that, once endorsed by the European Commission, need to be met by all parties. Under the SFDR, RTS are the rules that financial market participants need to obey to comply with regulations.

- **SBTi:** The Science Based Targets initiative ("SBTi") is an alliance created between CDP, the United Nations Global Compact, the World Resources Institute (WRI) and the World Wide Fund for Nature (WWF). The initiative ensures that companies' net-zero targets are consistent, by assessing the robustness of climate action plan via science-based methodologies.

- **SDGs:** The Sustainable Development Goals ("SDGs") are 17 goals developed in global partnership to achieve the plan of actions for peoples, planet and prosperity as set out in the 2030 Agenda for Sustainable Development.

- **SFDR:** The Sustainable Finance Disclosure Regulation (SFDR), applied in the EU from March 2021, is a European regulation introduced to improve transparency in the market for sustainable investment products, to prevent greenwashing and to increase transparency around sustainability claims made by financial market participants. SFDR sets different kinds of disclosure requirements for three types of funds or other financial products within the scope of the regulation:

    - Article 6: Funds that do not integrate a sustainability focus into the investment process.
    - Article 8: Funds that promote environmental and or social characteristics, referred to as "Light Green" funds.
    - Article 9: Funds that have 'sustainable investment' as their objective, referred to as "Dark Green" funds.

- **TCFD:** Task force on Climate-related Financial Disclosures is a market-driven initiative developed to establish and recommend a general framework for identifying, assessing and reporting climate-related financial disclosures. TCFD focuses on four key areas: governance, strategy, risk management, and metrics and targets.

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