Framework for sustainable investments

Vita Collective Foundation

Table of contents

1 Introduction

The Vita Collective Foundation is one of the largest pension funds in Switzerland and aims to provide its insured members with a carefree financial future. As an active and responsible investor, the Foundation explicitly considers environmental (E), social (S) and governance (G) aspects in its investment decisions as part of its fiduciary due diligence obligations, provided that the value proposition is not compromised.

Climate change is bringing changes that will negatively impact certain business models, the global economy and investment portfolio returns. In line with the Paris Climate Agreement, the Vita Collective Foundation has committed to converting its investment portfolio to net zero by 2050 by joining the Net Zero Asset Owner Alliance. By aligning its financial flows in a climate-friendly manner, the Foundation is making a contribution to reducing greenhouse gas emissions in the interests of the insured.

1.1 Legal framework

The Vita Collective Foundation is subject to the Swiss Federal Law on Occupational Retirement, Survivors' and Disability Pension Plans (BVG). Articles 71 BVG and 51 BVV 2 provide the legal framework for asset investments. The Foundation is obliged to manage the assets in a fiduciary capacity and in the interests of its insured members and to achieve a return in line with the market. Apart from the obligation to exercise voting rights at Swiss companies, the legislation does not explicitly address the issue of sustainability. The Vita Collective Foundation fulfills its fiduciary due diligence obligations and considers the involvement of ESG factors in the investment process as an integral part of these obligations. In doing so, it ensures that the long-term retirement provision goal is not compromised.

1.2 Sustainability strategy of the Vita Collective Foundation

For the Vita Collective Foundation, sustainably investing pension funds' assets is an integral part of a fair system of occupational retirement provision that is fit for the future. The Foundation focuses on three areas of activity: It engages as an active shareholder, makes impact-oriented investments, and strives for the sustainable decarbonization of the economy.

There are diverse approaches to integrating sustainability considerations into a portfolio. In addition to exerting direct influence through dialog with companies and actively exercising voting rights in Switzerland and abroad, the Vita Collective Foundation integrates ESG criteria into its investment process.

1.3 Standards-based value definition

The Foundation Board represents the opinion of the insured persons from the Collective Foundation. Due to the large number of insured persons, it makes sense to follow the standards generally accepted in Switzerland. The Vita Collective Foundation therefore does not have its own normative basis. The Federal Constitution, laws and conventions ratified by Switzerland form the basis. In particular, the Foundation observes the ten principles of the UN Global Compact, a global initiative of the United Nations. This supports companies in voluntarily committing to responsible business practices in the areas of human rights, labor standards, environmental protection and corruption.

Standard-based exclusions of outlawed weapons are made by the Swiss Association for Responsible Investments (SVVK – ASIR) and by the UN Global Compact Principles on controversial weapons.

A judicious selection of exclusion criteria is essential, as complete exclusion can significantly limit the investment universe. If exclusion is based on a certain percentage of turnover, this prevents a negative impact on financial performance. To achieve this, it is important to carefully define the exclusion guidelines and consider optimizing factors when composing the portfolio.

1.4 Procedure for standard-based and more extensive exclusions

1. Compatibility with the values of the Swiss Confederation and objectives of the Vita Collective Foundation: Evaluation of the applicable laws and regulations
2. Identification of reputational risks and comparison with peers
3. Influence on performance / tracking error, value proposition
4. Risk consideration: evaluation of risk

2 Principles of sustainability

The Vita Collective Foundation pursues the following principles in the area of ESG:

1. Long-term investments
The vision of the Vita Collective Foundation is to provide a carefree financial future for all its insured persons. It invests sustainably with a long-term focus and delivers on its financial promises.

2. Responsible risk management
The Vita Collective Foundation actively performs its due diligence and takes both financial and sustainability criteria into account when making decisions. These are integrated into risk management, in which creates long-term added value.

3. Holistic implementation
The Vita Collective Foundation pursues the objective of integrating sustainability into all operational projects and initiatives. It takes sustainability criteria into account across all asset classes when implementing its investment strategy.

4. Active engagement
As a shareholder, the Vita Collective Foundation exercises its voting rights in Switzerland and abroad. If a company violates recognized standards, we enter into a dialog with it. If this interaction remains unsuccessful, we consider an exclusion.

5. Impact-oriented investment
The Vita Collective Foundation invests part of its assets in the environment, society and infrastructure with an emphasis on creating impact ("impact investing"). The topics of climate change and demographic development take center stage here.

6. Future-oriented goals
The Vita Collective Foundation sets itself measurable targets and reports the degree to which they have been achieved to the insured in a transparent manner. Investment decisions are well founded and based on high-quality data.

7. Cooperation and interaction
The Vita Collective Foundation is committed to the United Nations Principles for Responsible Investment (UN PRI) and seeks interaction and cooperation with various organizations and investors in the field of sustainability.

3 Climate risks

Climate protection is one of the greatest challenges of our time. At the Climate Conference in Paris at the end of 2015, several countries committed to reducing greenhouse gas emissions. The Paris Agreement signed by Switzerland in 2017 aims to limit average global warming to well below 2 degrees Celsius. An essential element on the way to this goal is to structure financial flows in a climate-friendly way.

3.1 Physical and transition risks

The physical effects of climate change are largely known and predictable. The transition risks associated with the process of decarbonizing the economy, on the other hand, are difficult to assess. These relate to changes in regulation, technology and market preferences, and legal and litigation risks. Companies and investors are exposed to such transition risks in various areas. Of course, risks can also be opportunities. Transition can, for example, help certain products, companies or technologies to achieve a breakthrough[1]. The extent to which individual companies are exposed to these climate-related financial risks and how share prices will behave in the longer term is difficult to estimate.
The Vita Collective Foundation recognizes physical risks and transition risks as high long-term risks that pose the following dangers to companies, among others:

Physical risks: Extreme weather events affect goods and production sites through damage. They can lead to business interruptions for companies or increased loss amounts for insurance companies. Physical risks can have a negative impact on agriculture in particular.

Strategic risks: Companies can be tangentially affected by changes in customer preferences or disruptive innovations. Government interventions to combat climate change can lead to higher costs for businesses. Regulations can make certain business models unprofitable or entirely redundant. Companies are developing different strategies for the transition. Some

[1] Communication on occupational retirement provision no. 152 of May 6, 2020, N 1033, page 13

companies are minimizing the risks from the transition, while others are trying to adapt their business model. Depending on the decarbonization path, the impact on companies can vary greatly and it may not be possible to determine the impact conclusively in advance.

New regulations: Financial institutions can expect increased regulation regarding transparency and climate-related risk analysis in the future[2]. This mainly concerns insurance companies and banks.

Liability and lawsuit risks: Those responsible for risks and their financing institutions can be held responsible by legal action (in a similar way to tobacco companies). As far as we know at present, this will primarily affect oil companies, financial institutions and utilities.

Stranded assets: The climate targets mean that a large part of the fuel reserves are no longer to be burned. The reserves of oil companies thus become partially worthless. There is a risk that companies may be valued too highly. If, for example, no more oil is allowed to be extracted from one day to the next, the valuation of an oil company may drop by 40 to 100 percent, according to the FOEN.

The Vita Collective Foundation is affected by climate risks through its business operations and its investment portfolio.

3.2 Assessment of return in line with the market

The Foundation Board recognizes that its fiduciary due diligence obligations also apply to financial climate risks. The Investment Committee sees the following return impacts and risks due to climate change:

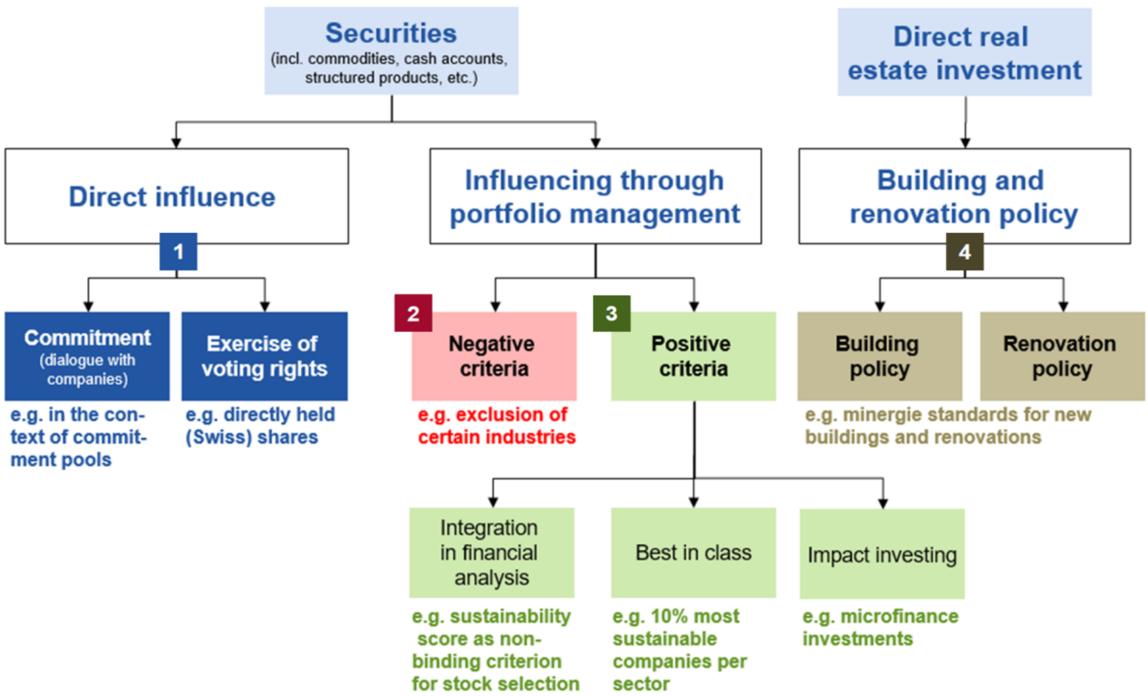
- Climate change is a key risk for the future of society and the future of the Vita Collective Foundation's investments.
- Transition paths are subject to great uncertainty and cannot be predicted.
- Financial markets are inefficient in pricing, which may have a potentially negative impact on returns.
- The risk of stranded assets should be controlled and regularly tracked.
- Regulations, public opinion and the preferences of insured persons have a relevant influence on the financial situation of the Vita Collective Foundation.
- In implementing the climate strategy, the management of the Vita Collective Foundation ensures that
  - the retirement provision objective is not compromised;
  - the influence on return/risk characteristics is low.

[2] Disclosure of climate-related financial risks: partial revision of FINMA circulars 2016/1 "Disclosure – Banks" and 2016/2 "Disclosure – Insurers (Public Disclosure)"

4 Implementation

There are diverse approaches to integrating sustainability considerations into a portfolio. In addition to direct influence (see point 1 in the figure below) via dialog with companies and the active exercising of voting rights in Switzerland and abroad, the Vita Collective Foundation integrates ESG criteria into the investment process. In the case of influence via portfolio management, a distinction is made between negative and positive criteria (items 2 and 3). The goal is to drive change to mitigate climate risks, and not to sanction companies or make one's own balance sheet look good ("window dressing"). If the engagement activities and the exercising of voting rights do not lead to the desired result, an exclusion or disinvestment may be realized as the final consequence. However, exclusions do not change behavior and should therefore only be implemented as a last resort.

Forms of implementation in sustainability



Source: PPCmetrics AG, www.ppcmetrics.ch

In the area of sustainability, the Vita Collective Foundation focuses on three fields of activity. It engages as an active shareholder, makes impact-oriented investments, and strives for the sustainable decarbonization of the economy. It integrates the established principles holistically into its investment process.

4.1 Active shareholder

"Active ownership" is a key element for the Vita Collective Foundation: from the active exercising of voting rights to dialog with companies. The Foundation attaches great importance to good corporate governance. It is committed to the highest standards of integrity and transparency, both in its own corporate governance and in its investments in companies.

Memberships and accession to international networks
The Vita Collective Foundation cultivates exchange with other investors and participates in various collaborations in order to further develop responsible investing:

- Climate Action 100+: Strengthening climate commitment
- Net Zero Asset Owner Alliance: Clear commitment to net zero by 2050 and driving decarbonization forward
- Swiss Sustainable Finance (SSF): Strengthening sustainable finance in Switzerland
- United Nations Principles for Responsible Investment (UN PRI): Commitment to expand governance and investment strategy to include ESG factors and reporting

Exercising of voting rights
The Vita Collective Foundation is an active shareholder and exercises its voting rights in Switzerland and abroad. Voting rights are exercised with a focus on governance and the environment. The Foundation invests through collective investment vehicles and exercises its right of co-determination in the Zurich Investment Foundation. It discloses its voting behavior on its website vita.ch. The exercising of voting rights must be taken into account when selecting an asset manager or a collective investment scheme.

Engagement
The Vita Collective Foundation is part of an engagement pool. Engagement allows the Foundation to participate in dialog with companies and express its preferences for change. This mainly relates to "problematic concerns." The dialog is used to propose improvements to the company that are in the long-term interest of the shareholder. Governance best practices are also used as a basis for engagement. The basis for dialog is established through portfolio analyses.

- **Seat on decision-making bodies:** The Vita Collective Foundation has a seat on the Foundation Board and the Real Estate Investment Commission of the Zurich Investment Foundation. This enables it to specifically represent the interests of the insured.
- **Institutional Shareholder Services (ISS):** The Foundation is in dialog with companies that violate international standards (environment and corruption).
- **External asset managers:** The Foundation encourages its appointed asset managers to engage with emissions-intensive companies or those that violate governance best practices.
- **Climate Action 100+:** The Vita Collective Foundation engages with the world's 100 largest CO_2 emitters according to the MSCI All Country World Index as well as 66 additional companies identified by investors (climate-related risks or significant contribution to the transition to clean energy).

Active shareholder versus exclusion

Owning securities allows the investor, through the exercising of voting rights and engagement, to positively influence the business practices of companies in an ideal scenario. The exclusion of a company and the sale of the associated securities result in a loss of influence. The corresponding securities are then acquired by other investors. The companies excluded by the Vita Collective Foundation will not change their behavior and will continue to exist. Possible investors are other institutions, private investors or the state. Disinvestment by the Vita Collective Foundation alone will not cause the company to rethink its conduct. If, on the other hand, disinvestment is supported by many other investors, the demand for this company's securities will decrease, with the result that this security will lose value in the short term. The financing costs of this company will be increased by the lower demand. For example, this company will have to pay more interest to raise capital. The higher financing costs will lead to lower investments by this company. This is in line with the investors' objective. Exclusions, if carried out collectively, can have an impact on a company.

The Vita Collective Foundation must pay attention to its returns and the risk characteristics of the portfolio. The exclusion of securities will only be implemented when ongoing dialog (engagement) and the exercising of voting rights have not led to a change, or the company is not in a position to refrain from controversial activities due to its primary business model. Exclusions should therefore only be realized as a last resort and only make sense if

- the return of the portfolio is not negatively affected by the exclusion;
- the risk is not increased by the exclusion;
- many other investors also exclude this company and thus the success of an exclusion or the financing costs of the excluded company increase;
- the Vita Collective Foundation wants to clearly distance itself from the activity (violation of norms);
- and there is a reputational risk for the Vita Collective Foundation. (The Vita Collective Foundation could lose affiliation contracts. This could have a negative financial impact on the Foundation.)

Exclusions are decided on by the Investment Commission and taken note of by the Foundation Board.

The Vita Collective Foundation has adopted the following exclusion criteria:

Coal: The Foundation excludes companies that

- generate more than 30 percent of their sales from the mining of thermal coal;
- produce more than 20 million tons of thermal coal per year;
- generate more than 30 percent of their electricity from coal;
- are in the process of developing new infrastructure projects for coal mining or coal-fired power generation.

Oil sands: The Foundation excludes companies that

- generate more than 30 percent of their revenues from the production of oil from oil sands;
- operate transportation infrastructure to move thermal coal or oil sands products.

Oil shale: The Foundation excludes companies that

- derive more than 30 percent of their revenues from oil shale mining;
- generate more than 30 percent of their electricity from oil shale.

Controversial weapons: The Foundation does not invest in controversial weapons and nuclear weapons. These are excluded from the portfolio. This is based on the exclusion list of the Swiss Association for Responsible Investments (SVVK – ASIR) and the UN Global Compact principles for controversial weapons.

Commodities: The Foundation has not invested directly in commodities since 2014. It excludes investments in futures on oil, gas and agricultural products from its portfolio.

Countries: The Foundation does not invest in countries that are on the UN sanctions list (arms embargo).

4.2 Impact-oriented investments

The Vita Collective Foundation makes investments in assets with the aim of achieving a measurable, positive impact on the environment or society as well as a positive financial return. In doing so, the Foundation takes care to generate added value in subject areas that coincide with its own understanding of value. The Vita Collective Foundation considers the following investments to be the most effective:

- Infrastructure (investments in renewable energies, schools, wastewater treatment plants)
- Green bonds (financing of ecological projects)
- Senior housing (provision of living space and modern forms of housing)

4.3 Sustainable decarbonization

The Vita Collective Foundation strives for a balanced mix of complementary measures and approaches for sustainable decarbonization. These include, among other things, the continuous and sustainable reduction of CO_2 emissions. The Foundation has set itself clear sustainability goals, which it reviews regularly.

Climate indicators
The measurement of CO_2 emissions at companies is divided into three categories, known as Scopes, and defined as follows:

- **Scope 1:** Direct emissions generated within the company
- **Scope 2:** Indirect emissions caused by the energy sourced from outside the company
- **Scope 3:** Other indirect emissions, for example from purchased products and from the consumption of manufactured products

Most well-known data providers (MSCI and S&P Global Trucost) attempt to report all three Scopes. The estimates are subject to large uncertainties and are made with a substantial delay. In addition, Scope 3 emissions are difficult to measure and, at best, are estimates without a uniform standard. Organizations such as the TCFD (Task Force on Climate-Related Financial Disclosures) are positively influencing the standardization of emissions reporting. Due to the current data situation, the Vita Collective Foundation focuses on Scope 1 and Scope 2 emissions and follows developments with respect to Scope 3.

The climate indicators reported by companies measure climate performance from past years. They may be up to two to three years old, or if not available they may be estimated by the data providers. These indicators cannot be used to make any statements about the company's future climate-related opportunities and risks. The price of a share or bond is generally based on future cash flows. The future behavior of a company has an impact on its transition risks. As part of the engagement process, the Vita Collective Foundation takes into account future-oriented indicators wherever possible in order to better assess the extent to which a company is exposed to transition risks and how it is dealing with them.

CO_2 reduction targets
The Vita Collective Foundation has committed to net zero by 2050, thus contributing to the sustainable decarbonization of the economy. The Foundation sets longer-term reduction targets so that it can monitor the impact of its measures. Based on the current data situation, CO_2 reduction targets are defined according to data availability for the respective investment category. To date, the Foundation has formulated CO_2 reduction targets for the following investment categories:

- **Swiss real estate:** Reduction of greenhouse gas emissions by 20 percent by 2025 (2020 baseline)
- **European real estate:** Reduction of greenhouse gas emissions by 14 percent by 2025 and by 36.6 percent by 2030 (2019 baseline)
- **Shares:** Reduction of greenhouse gas emissions by 20 percent by 2025 (2019 baseline)
- **Corporate bonds:** Reduction of greenhouse gas emissions by 22 percent by 2025 and 40 percent by 2030 (2019 baseline)

Expansion to other investment categories will be subject to data availability and quality.

4.4 ESG integration

The Vita Collective Foundation monitors asset managers with regard to their sustainability efforts and thus ensures that ESG aspects are complied with in the investment process.
Active asset management
The effect of climate change on a company cannot be fully captured by a model. An active asset manager takes a holistic view of a company and considers financial as well as ESG aspects. Climate risks can be integrated into the portfolio through active management.

With the choice of an appropriate asset manager, climate risks can be fundamentally factored in, resulting in a forward-looking perspective. An asset manager weighs up risks and opportunities. They identify companies that are at high risk from the transition.

When selecting asset managers, it is important to focus on their ability to generate value over the longer term and to properly assess ESG as well as climate risks. The selection of the manager requires them to integrate ESG criteria into their investment strategy. In addition, UN PRI membership (or similar membership) is mandatory.

Selection of asset managers
When selecting an asset manager, their application of ESG criteria is examined. The following is addressed:

- ESG philosophy
- Integration of ESG criteria into the investment process
- ESG risk management
- ESG training
- Engagement and dialog with portfolio companies (especially with CO_2-intensive companies)
- Exercising of voting rights
- UN PRI membership or similar membership (asset manager must be a member of UN PRI)
- UN PRI reporting

The ESG criteria have their own weight and are incorporated into the selection of the asset manager.

5 Monitoring and reporting

The Vita Collective Foundation specifies its objectives and makes them publicly available.

Portfolio analysis of the Vita Collective Foundation: The management of the Vita Collective Foundation receives and analyzes a quarterly ESG analysis of its overall portfolio as well as the equities and bonds sub-portfolios.

The ESG analysis pays particular attention to the following criteria:
- Overall ESG rating
- Proportion of companies with an insufficient rating
- Share of controversial weapons (must be 0 percent)
- Proportion of stranded assets
- Exposure in countries against which the UN has imposed sanctions
- CO_2 indicators

These metrics are part of the investment controls implemented by the Vita Collective Foundation. The investment committee considers them on a quarterly basis.

Asset manager portfolio analysis
In coordination with Zurich Invest Ltd, the Vita Collective Foundation conducts annual portfolio analyses in which it analyzes the ESG integration of asset managers and portfolio risks. In addition, regular climate analyses of the portfolios (with regard to the Paris Climate Agreement) are carried out. The aim is to achieve a high standard in the ESG area among asset managers and in the portfolio, as well as to increase the contribution to sustainable development. Dialog with asset managers allows risk to be addressed, analyzed and monitored.