2018 Engagement Report

METROPOLE Gestion

1. Purpose of the engagement report

As a company committed to Responsible Value management and an ESG pioneer since 2008, we attach great importance to companies taking ESG criteria into account. We firmly believe that engaging with companies promotes long-term value creation and is of benefit to all stakeholders (shareholders, employees, customers, suppliers, etc.).

Value creation is all the more significant and enduring when it offers capital providers a fair return and contributes to social utility. With this in mind, we engage with the companies in which we invest and encourage them to improve their extra-financial practices. This process of engagement is now formally applied in two ways:

- Individual engagement with companies by means of:
  - ongoing dialogue with companies, through which we are able to detect ESG risks and influence corporate strategies.
  - dealing with controversies in accordance with our procedure whenever events occur that might have a significant impact on companies and their stakeholders.
  - exercising the voting rights attached to stocks held in our portfolios, in accordance with a voting policy published on our website.
- Thematic engagement: each year, we decide on a particular subject to be addressed across all the companies we engage with, in order to reach at an overview.

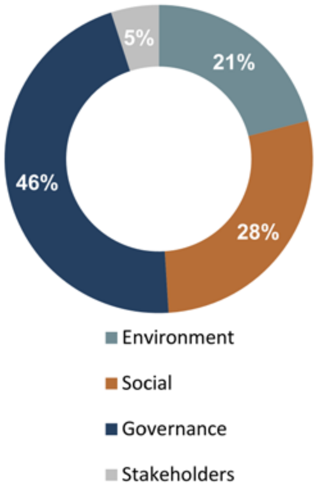
The purpose of this report is to present our interactions with the companies over the course of 2018 on our four pillars of extra-financial analysis: Environment, Social, Governance and Stakeholders.

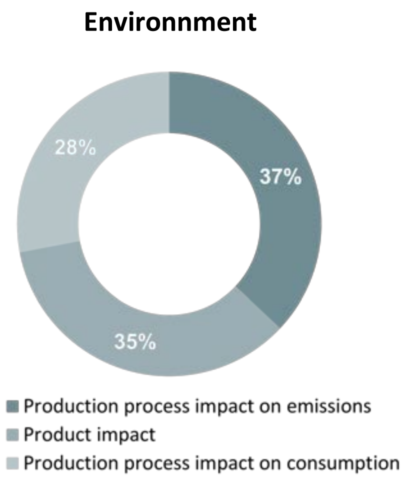
2. Individual engagement

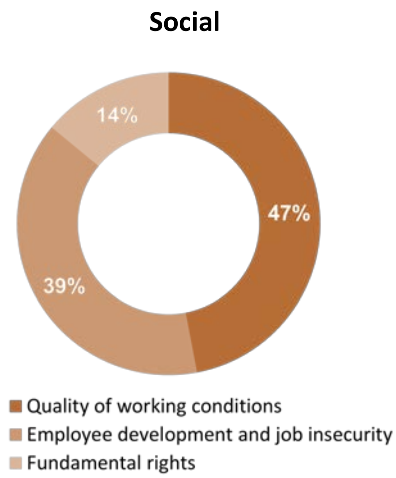
2.1 Dialogue with companies

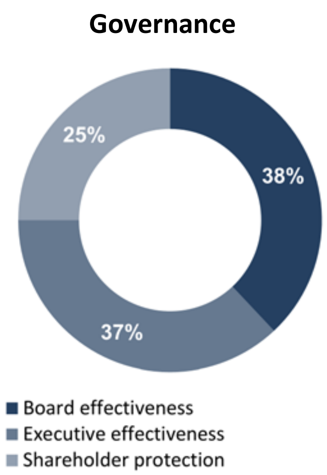
2.1.1 Our engagement in figures

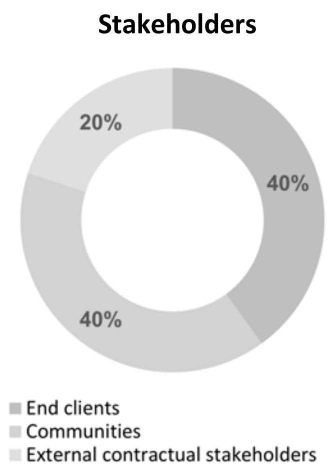
Over the course of 2018, we conducted 462 company interviews. We focus our ESG interviews on the issues specific to each company and to each business sector. We direct our questions primarily towards any weak points in the company, identified by means of our proprietary ESG rating model. In 2018, the issues discussed with companies were distributed as follows, by pillar and sub-pillar:





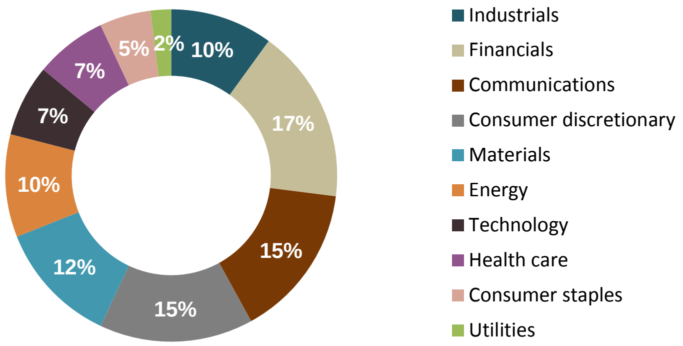






Issues around governance clearly predominated in 2018, due to the fact that this is currently the most heavily regulated of the pillars and therefore the most standardised. As a result this is the pillar for which the greatest number of metrics is available, and also the most common subject of shareholder voting at General Meetings. The Stakeholders pillar is the least well represented of the four, attributable to the fact that it encompasses issues that are external to companies and therefore harder for them to grasp.

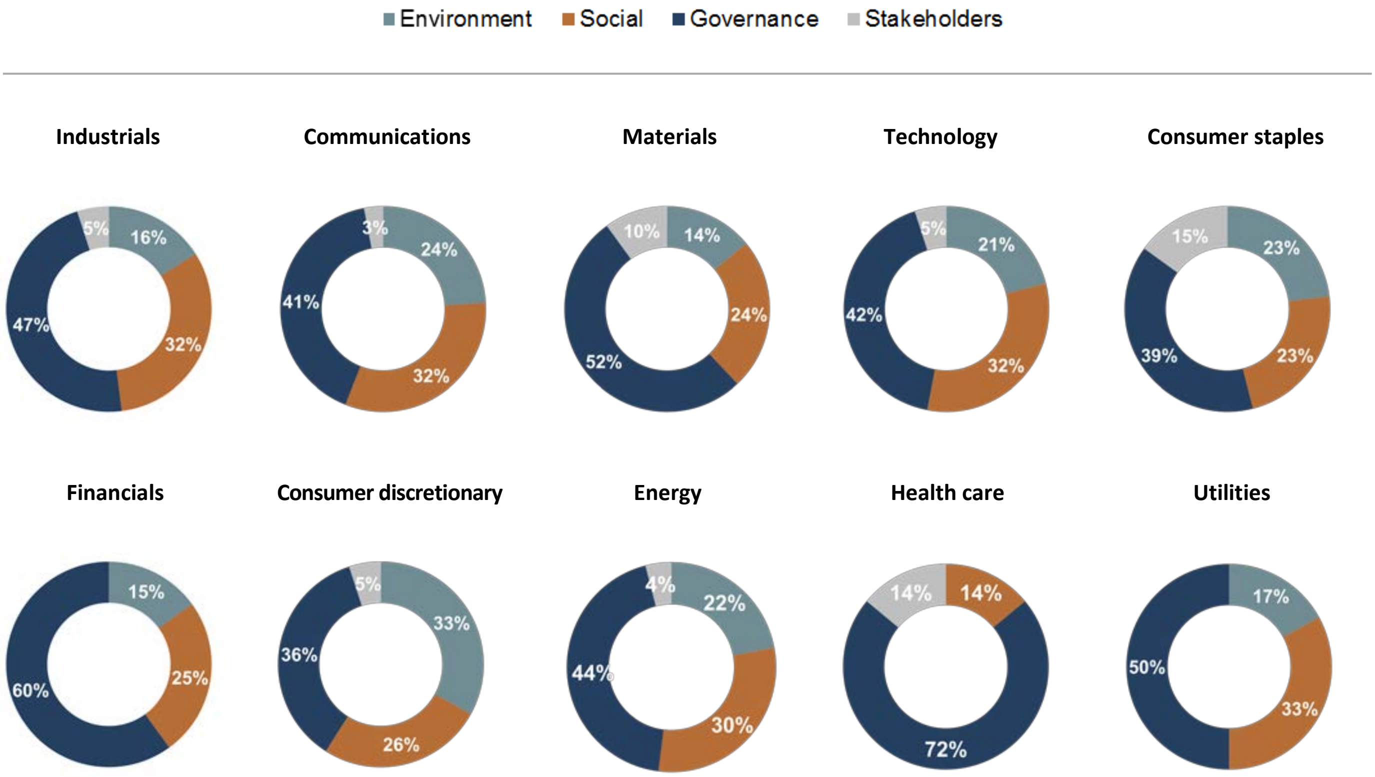
By sector, our interviews were distributed as follows:



Within each sector (see below), the distribution of issues by pillar follows a broadly similar trend, albeit with certain differences between sectors.

There is a general predominance of governance-related issues, particularly in the health sector. We note, for example, that limited partnerships and family-owned companies such as Merck are often penalised in terms of governance, for failing to meet recommended guidelines (independence of the Board of Directors and special committees, shares with multiple voting rights, etc.).

It also emerges that environmental issues rank highest in the consumer discretionary sector, as a result of automobile manufacturing being included in this sector. There are numerous environmental issues relating to pollutant emissions (CO2, NOx etc.) in this sector, particularly since the "dieselgate" scandal.



2.1.2 Impact of dialogue with companies

In keeping with our ESG approach, our dialogue with companies gives us an opportunity to discuss and influence the Environmental, Social, Governance and Stakeholders aspects of their activities. For each pillar, we have noted the most striking effects of our engagement with the companies in our portfolio.

Responsible governance is the foundation on which a socially responsible company builds its growth. The status of those responsible for a company's CSR policy is a clear indicator of the importance the company attaches to the subject, but also confers legitimacy on that policy, both internally and externally. In our discussions with issuers, therefore, we encourage them to assign responsibility for these issues directly to senior management. In response, we have over recent years seen growing numbers of companies devolve CSR responsibility directly to the CEO, the Chair of the Board of Directors or, at the very least, to a special Board Committee.

Hotel group Accor illustrates this development and the impact of our engagement with companies. Until now, the sustainable development team had reported to the Group's Communication department. In response to criticism that this structure lacked the ambition to impose a credible ESG approach, the company overhauled its organisation so that the team now reports to the Group Executive Committee. All the Group's strategic decisions now include an ESG analysis. CSR policy has thus gained legitimacy through its positioning as a corporate priority. This has made the policy easier to implement internally and has given it greater credibility in the eyes of stakeholders, investors among them. Our engagement has thus contributed to put CSR at the heart of corporate priorities.

In order to avoid the simple display of token organisation charts that complies with our expectations but lack any real substance, we also analysed the extent to which these issues were taken into consideration in determining executive pay. The findings of this analysis are reported in the "Thematic Engagement" section.

On the Environment front, reducing greenhouse emissions, and CO_2 in particular, is the main aim of both public and private sector targets. It is important, however, to agree on the scope of this particular issue. Almost all companies currently measure and disclose their scope 1 and 2 emissions, i.e. their direct emissions as a result of the production process (scope 1) and their indirect emissions via the generation of energy to fuel the production process (scope 2).) These scopes cover only a fraction of corporate emissions, however, in that they do not include other indirect emissions, not included in scope 2, generated both upstream and downstream of the production process (scope 3). We constantly remind companies that, despite their usefulness, we still consider these measurements inadequate. The shortfall is all the more telling in that, for many industries, the majority of their CO_2 emissions fall within scope 3.

In response to our dialogue with them, we see more and more companies beginning to extend their emissions measurements to scope 3. Nokia, for example, has introduced a system for measuring its scope 3 emissions and has already set emissions reduction targets encompassing the entire lifecycle of their products. Despite the methodological difficulties encountered, many companies have started down the same path: Philips, Saint-Gobain, Royal Dutch Shell, Michelin and Merck to name but a few.

On the Social front, we push companies to abolish discrimination in all its forms and to promote both gender parity and diversity. While all the companies voice their support for this message, not all are as far advanced as others on these issues. Service industries such as banking or insurance tend to report women as making up over 40% of their headcounts, while industrial companies generally trail far behind at below 25%. While there is certainly a historical explanation for the discrepancy, we make every effort to encourage companies to narrow the gap, and a number of measures have been taken. Several companies, including Telefonica, have established a Diversity Committee to address these issues. Philips has set aside a seat on its Sustainable Development Committee for its Inclusion and Diversity Officer. Along with many companies employing a high proportion of engineers, Nokia is faced with a shortage of female talents and so has set up partnerships with schools to attract more women students into engineering, in addition to its own internal pro-diversity programmes.

Lastly, on the Stakeholder front, we believe that a truly responsible approach requires companies to consider their entire value chain, not merely its internal components, and we encourage them require the same standards from their suppliers as they adhere to themselves. This is of particular importance with companies operating in sectors where supply chain is a sensitive subject, such as in fashion or distribution.

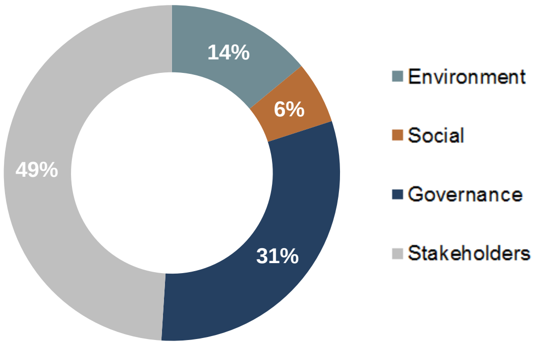
Hence, Hugo Boss has introduced a Code of Conduct to which all its suppliers, not just Tier 1 but Tiers 2 and 3 equally, must adhere. Regular audits are carried out to ensure compliance and corrective measures are introduced when a supplier fails to meet any of the German group's standards. Hugo Boss is also reducing the number of its suppliers to ensure better control of its value chain, another step in meeting the requirement for responsibility. Mass retailers Carrefour and Ahold Delhaize also carry out similar audits of their suppliers, and are making more use of short distribution channels than once was the case.

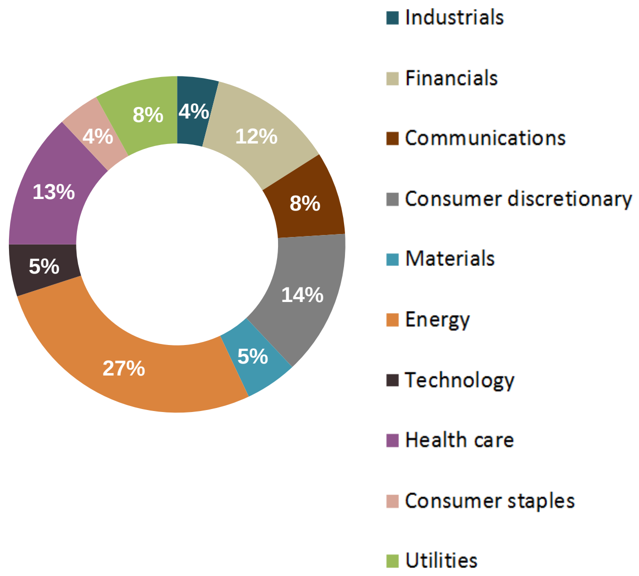
We are also continually looking for better and more precise ways of evaluating the impact of our ESG approach (see the Impact Report, available on our website) and, with that aim in mind, asking companies to provide more quantifiable information. In response to these needs, some companies have introduced new analytical frameworks. Schneider Electric has overhauled its ESG evaluation system, originally based on disclosed information, introducing specific indicators and setting targets for all of them. Philips has introduced an environmental profit & loss account to quantify the environmental footprint of its business. Steps such as these, although still patchy, nonetheless help make it easier to evaluate companies' CSR policies and thus the impact of our ESG approach.

2.1.3 Dialogue around controversies

Every week, the management team analyses any new controversies and evaluates their level of risk against an internal benchmark. In 2018, we analysed 106 controversies affecting our portfolios. Most of these proved to be of only minor importance. Figures show that almost half of the controversies identified related to the Stakeholders pillar, mostly to do with anti-competitive practices. The Governance pillar was also well represented, with a number of controversies relating to business ethics.

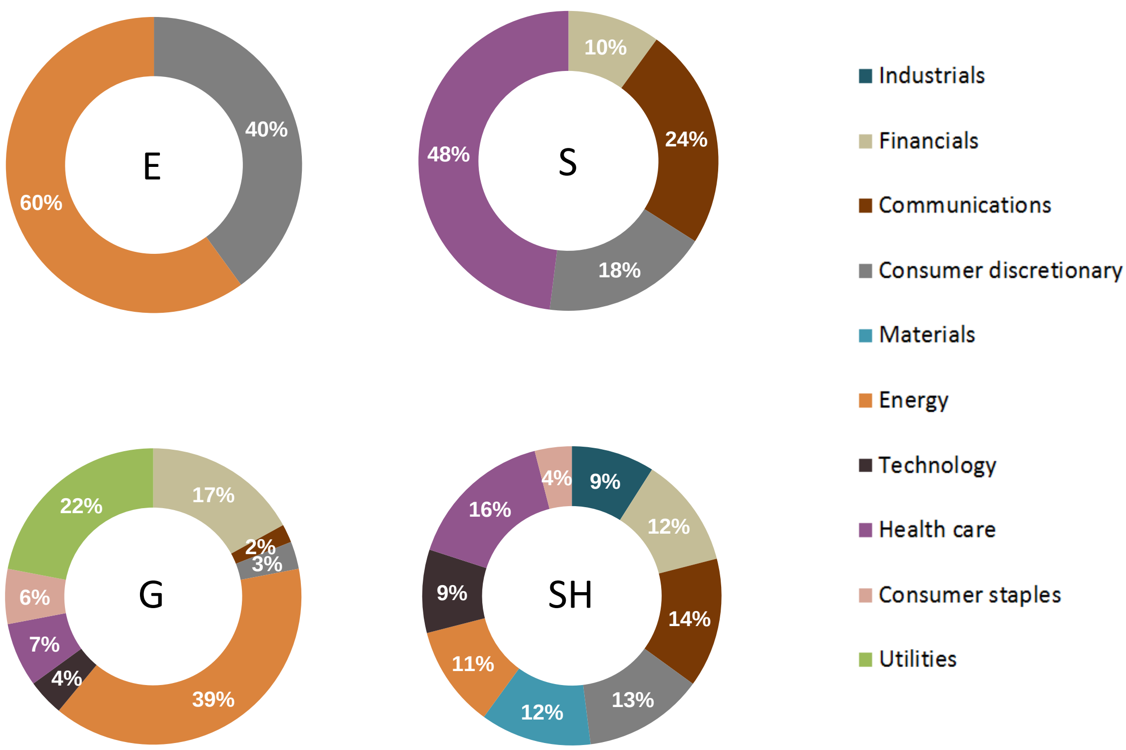
The controversies broke down as follows:





In terms of sectors affected by controversies, three stood out:

- Energy: the sector is traditionally prone to numerous controversies affecting the Environment and Governance pillars (see chart below). Oil and gas companies featured as some of the sector's most exposed companies this year, hit by oil spills and corruption scandals.
- Consumer discretionary: the sector was a major source of controversies in the Environment and Social pillars, with airline companies hard hit by deteriorating industrial relations and the automotive industry still embroiled in the pollutant emissions scandals.
- Health: the sector was affected by a number of scandals in the Social and Stakeholders pillars, in particular by health scandals and by accusations of drug price-fixing.



Among the most significant controversies encountered in 2018, two examples involving companies in our portfolios provide an illustration of our approach:

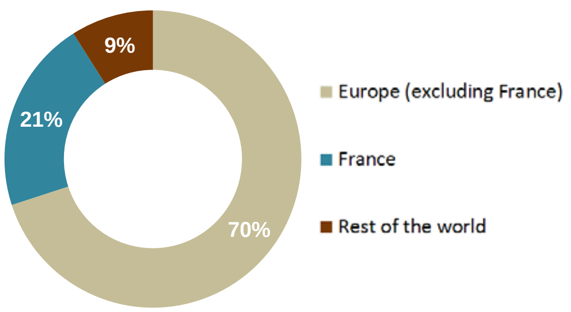
- Sanofi: an environmental protection group reported releases of hazardous substances at levels well in excess of authorised limits from a Sanofi Group production site. The pharmaceutical group immediately halted production at the site in order to make the necessary technical upgrades. Our evaluation of this controversy identified a high level of associated risk, which prompted us to contact the company given that the risk was directly linked to its production process and called into question its environmental management systems. It emerged from our discussions with Sanofi that the company had taken the measures necessary to deal with the incident, and that its organisation was structured in such a way as to mitigate the risks to which it was exposed. The regulatory authorities have now authorised Sanofi to resume production at the site.
- Veolia: suspicions of corruption in the awarding of public contracts prompted us to question the company on this particular issue and on its overall organisation. It emerged from the interview that, even if the emergence of disputes of this nature is inherent to the Group's business, given the tens of thousands of contracts in place in so many jurisdictions, business activities that rely on public contracts appear to be increasingly exposed as a result of keen competition and increased pressure from regulators. The frequency of such controversies at Veolia prompted us to liquidate our portfolio holdings.

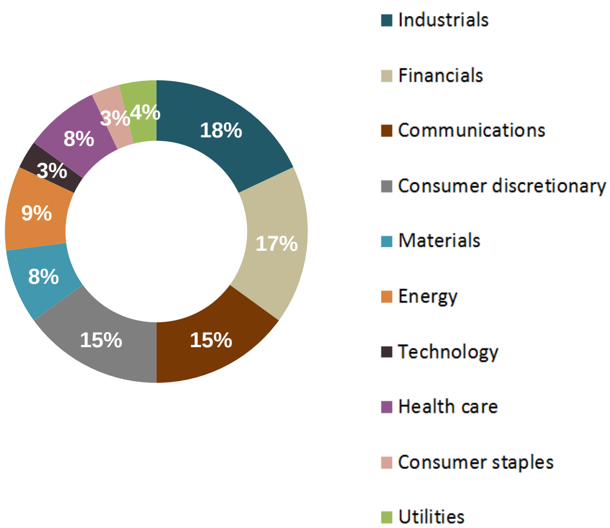
2.2 Engagement through voting

- *Our voting record in 2018*

Our individual engagement is also expressed through our voting process at company General Meetings. We take the view that the exercise of voting rights is an essential part of the relationship between a company and its shareholders and, when exercising these rights, we are vigilant as regards compliance with Environmental, Social and Governance criteria.

In 2018, we cast our vote at 148 General Meetings, giving a participation rate of 92.5%. The General Meetings we attended break down as follows:

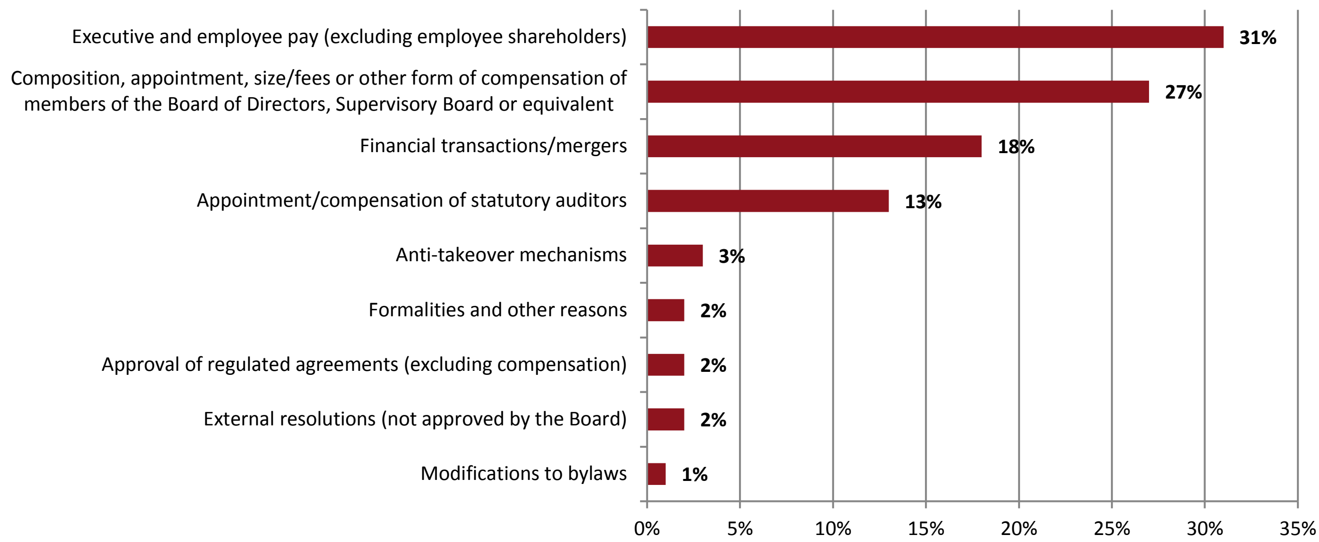




In terms of the ESG pillars, it is noteworthy that most of the resolutions put to the vote of shareholders once again related to matters of governance. Within our investment universe, 98% of the 2018 resolutions related to this pillar alone. Resolutions concerning the Environmental pillar emanated exclusively from activist shareholders. In view of this, we are increasingly introducing more environmental and social issues into our dialogue with companies, so as to encourage them to make progress on these fronts.

The main themes put to the vote at General Meetings in 2018 related to composition of the Board of Directors (40% of resolutions), executive pay (13%), approval of financial statements (12%) and mergers & acquisitions (10%).

Our engagement with companies requires us to oppose any resolutions put to the vote of shareholders that do not, in our view, comply with best practices or best serve the interests of our clients. In 2018, we voted against at least one resolution at 111 General Meetings, i.e. 75% of the General Meetings we attended. The votes against were cast on the following issues:



Resolutions on executive pay were the main catalyst for our opposing votes, representing a third of all resolutions contested. We continue to deplore a lack of transparency on the details of awards of variable compensation, stock options and free shares.

We also remained highly vigilant regarding any measure that might risk undermining the rights and interests of minority shareholders, and paid particular attention to resolutions relating to financial transactions, mergers and anti-takeover mechanisms.

A report on the exercise of voting rights and on shareholder dialogue is available on our website.

- *Dialogue ahead of General Meetings*

Since our approach is designed to encourage companies to improve their practices, we also engage with them ahead of General Meetings in order to address, and even influence, the content of resolutions to appear on the agenda. In this way we can ensure that this content is aligned with minority shareholder interests and complies with our principles of governance. Our most notable discussions in 2018 were with Capgemini and Total.

- ❖ Capgemini: as part of the succession plan for Group Chairman and CEO Paul Hermelin, Capgemini decided to appoint two Chief Operating Officers (Aiman Ezzat and Thierry Delaporte) for a period of three years, only one of whom would be confirmed in the role at the end of this period. To insure against the unsuccessful candidate departing immediately to a rival firm, the Group invited shareholders to vote on a severance package in return for a non-compete clause. We took issue with the company on:
    - o The dual succession plan, which we considered less than optimal.
    - o The conditions for the granting of the severance package, which lacked transparency.
    - ⇨ Our dialogue with the company provided us with a clearer understanding of the Group's motivations and justifications. Ultimately, we voted in favour of this controversial resolution at the shareholder meeting.
- ❖ Total: we held discussions with Total on a number of resolutions that caught our attention:
    - o Reappointment of Patrick Pouyanné as Chairman and CEO: the company argued that a single individual with combined powers constituted an advantage in the strategic negotiations characteristic of the sector, and emphasised the presence of a senior independent director.
    - ⇨ We therefore voted in favour of this resolution.
    - o Capital increase by private placement: we made clear to the Group, as to any other company submitting a similar resolution, our opposition in principle, since such measures are dilutive for existing shareholders.
    - ⇨ We therefore voted against this resolution.
    - o Change in the rules for election of the employee representative (shareholder resolution): this proposal limited the rights of any employee to stand for election to this position.
    - ⇨ We therefore voted against this resolution.

2.3 Difficulties encountered

Overall, we encountered no significant difficulty in implementing our engagement process. The only dialogue to present any difficulties was with TechnipFMC, since the company was unable to provide us with a contact person responsible for ESG issues and its reports contained little information on these matters. Since helping to promote more meaningful and frequent dialogue on companies' CSR policies is also part of our approach, we encouraged the company to take more initiatives in this direction.

We did not cast our vote at 12 General Meetings due to administrative problems encountered with depositories or with the documentation of the meetings. As a result of the geographic location of certain issuers, it is sometimes difficult to take part in certain General Meetings (local and/or regulatory constraints, etc.), as is the case with certain Eastern European countries, for example.

3. Thematic engagement

Thematic engagement is an integral part of our approach to engaging with companies and involves focusing on a theme selected each year by the management team, by a collegial process.

3.1 Presentation of the theme chosen for 2018

For 2018, we decided to concentrate on executive pay, and particularly the inclusion of ESG criteria in the determination of variable executive compensation.

As a management company exercising voting rights on behalf of our clients, our role is to ensure that companies put in place mechanisms that align the interests of executives with those of shareholders. From our standpoint, including extra-financial criteria in the determination of executive pay is an effective lever for improving corporate management practices. Indeed, it is one of the recommendations made in a report entitled "*L'entreprise, objet d'intérêt collectif*" (business and collective interest) drawn up by Nicole Notat and Jean-Dominique Sénard and submitted to the French government in March 2018. Following the report's publication, Afep and Medef revised their corporate governance codes to include recommendations on incorporating ESG criteria into considerations of corporate governance. The inclusion of ESG criteria in the determination of medium and long-term executive pay is one of the recommendations on executive and director compensation made in the report.

While we certainly see the inclusion of extra-financial criteria in the determination of executive pay as an essential component of effective governance, the weighting given to these criteria is just as crucial. We believe that the weighting should be significant, given that it reflects the importance the company attaches to CSR issues.

In the course of our ESG interviews with companies in our portfolios, we systematically asked the following two questions:

- Is variable executive pay dependent on extra-financial criteria?
- What proportion of variable pay is dependent on these criteria?

While some companies provide the answer to these questions in their annual report or compensation policy, others disclose no information whatsoever on the subject. Even among the companies demonstrating transparency on these issues, the level of detail varies (individuals concerned, criteria employed, percentage of pay concerned, etc.).

3.2 Summary of our interviews

As a result of our engagement with companies, 76% now include extra-financial criteria when determining the variable component of executive pay. Our impact was once again demonstrated in the case of Italian bank Intesa Sanpaolo, the target of repeated reminders from us of the importance of factoring extra-financial criteria into executive pay. In 2018, the company informed us that the topic had been included on the agenda of the Compensation Committee, which had reached an agreement in principle.

For companies that do take extra-financial criteria into account, the average weighting assigned to these criteria is 19%.

- *Good practices observed*

Among the good practices we noted, we see the introduction of extra-financial performance indicators as particularly promising, particularly in setting clear, transparent performance targets for executive compensation.

Schneider Electric, for example, introduced "Schneider Sustainability Impact", a composite indicator providing quarterly reporting in the form of a score out of 10 for the group's sustainability performance. As a quantitative tool for steering the group's sustainable development, it sets precise targets for the 2018-2020 period across 21 indicators divided into 6 themes: climate, circular economy, health, equity, ethics and development.

Some companies have even opted not to limit the use of ESG criteria to executive pay alone. Repsol and Royal Dutch Shell have both introduced ESG criteria as factors in the variable compensation of group employees (a proportion of 10% in the case of Repsol, and 20% for Royal Dutch Shell). We consider this to be good practice, and a step in the direction of greater collective awareness of the importance of CSR issues to the group's business. Our view is that establishing a sustainable development strategy in an organisation depends first and foremost on involving every player in the chain.

- *Potential improvements*

Of the sample of companies with which we held ESG interviews, 76% include extra-financial criteria in their determination of executive pay, which is lower than the level found by a recent PWC study of CAC 40 companies. According to this study, published in June 2017, 83% of CAC 40 companies already used ESG criteria in determining variable executive pay. The results of our study show that Eurozone companies still have further progress to make. Some of the companies we met with have, in fact, undertaken to start including extra-financial criteria in their compensation policy as from next year.

While some of the companies we met with are highly transparent as regards the ESG targets they have assigned to themselves (as witness the indicator introduced by Schneider Electric), others are much less so, and do not disclose targets. This lack of transparency makes it difficult, not to say impossible, to assess these targets and the results achieved. We therefore encouraged the companies we met with to adopt greater transparency on this point.

The PWC study published in June 2017 also showed that, for those CAC 40 companies that had incorporated ESG criteria into their compensation policy, the weighting accorded to these criteria varied between 10% and 30%. We, on the other hand, found that the weighting given to extra-financial criteria in determining executive pay was sometimes much lower (as little as 5% in certain cases). We take the view that the weighting attributed to ESG criteria should be commensurate with the stakes these issues represent for society and that, below a certain level, ESG criteria are not sufficiently compelling.

Lastly, some companies incorporate ESG criteria into executive pay on matters that do not reflect the key CSR issues they are faced with. Some, for example, fail to include environmental criteria. Among the companies we met with, some use criteria relating to ethics, employee wellbeing or safety, yet fail to include the environmental issues that are, for most of them, absolutely central to the challenges of sustainable development. The absence of these criteria may reflect a lack of engagement or a lack of maturity in corporate sustainable development strategies. Depending on the circumstances, we therefore encouraged certain players to take a broad view of the strategies to be implemented in order to incorporate CSR issues, and to show greater transparency in their sustainable development programmes.

4. Conclusion

Over the course of 2018, our engagement policy enabled us to discuss and advocate improvements in corporate ESG on all four pillars of our ESG approach. The measures introduced by companies as a result of this ongoing dialogue illustrate their readiness to subscribe to our message and embark on a more responsible path. These changes are, obviously, gradual, but real advances have been made in recent times. It is interesting to note that most companies do indeed subscribe to our message. As a result of which, they are taking a more holistic vision than ever of their activities, as regards both the other players involved in their value chain and the life cycle of their products. As companies increasingly adopt quantifiable indicators in the future, this will bring about greater transparency and allow for a more accurate and uniform analysis of their performances.

As far as we are concerned, our engagement with companies over the course of 2018 has enabled us to sharpen our analyses and improve our dialogue skills. We will be continuing our approach of encouraging companies to improve their practices in 2019. As the outlook for the climate becomes bleaker, overshadowed by political disagreements, we believe it is important to put the issues squarely before companies. Regulation may be a key catalyst for the adoption of certain measures but, regulation aside, companies have a vital role to play in meeting society's expectations and needs in this respect. Our thematic engagement in 2019 will therefore focus on measures to reduce CO_2 emissions, and companies' stance on the 2° trajectory announced in 2015 at the COP21 in Paris.

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