

# Sustainability Risk Integration Instruction

<b>Owner</b>	CIO Danica Pension	<b>Date of approval</b>	June 2023
<b>Administrator</b>	Head of Responsible Investment Responsible Investment 33LH	<b>Next review date</b>	June 2024
<b>Associated Policy</b>	Responsible Investment Policy	<b>Instruction version</b>	Version 2.0

## 1. Objective

This Instruction aims to ensure an effective operationalisation of Danica Pension's commitment to integrate Sustainability Risks in investment management processes.

## 2. Definitions

The below definitions apply to the terms used throughout the Instruction. Any term not defined herein shall have the meaning ascribed to it in the Responsible Investment Policy.

<b>Active Ownership</b>	the use of rights and position of ownership to influence the activities or behaviour of investee companies based on financial and/or impact materiality considerations. Active ownership is exercised by taking an active interest as an investor in the investee companies' circumstances, development, and management, and by adopting a long-term focus in the company in line with, for instance, the EFAMA Stewardship Code and the Shareholder Rights Directive II.
<b>Double Materiality</b>	the determination of whether a sustainability factor is of relevance when investing from either the perspective of Financial Materiality and/or Environmental and Social Materiality
<b>ESG</b>	environmental, social or governance
<b>Environmental and Social materiality (also referred to as "Impact Materiality")</b>	the inside-out impacts that an issuer's/company's economic and financial activities may have on sustainability factors
<b>Financial Materiality</b>	the outside-in impacts that sustainability factors may have on a company's/issuer's economic and financial activities throughout their entire value chain (both upstream and downstream), affecting the value (returns) of such activities.

<b>Group</b>	Danica Pension A/S with its subsidiaries
<b>Principal Adverse Impact</b>	the negative impacts that investments might have on Sustainability Factors as measured through indicators defined in SFDR.
<b>Screening</b>	a process by which investments are reviewed to identify sustainability risks or sustainability related impacts, as identified in current regulation, industry best practice, international norms and voluntary frameworks for corporate responsibility
<b>SFDR</b>	Regulation (EU) 2019/2088 of the European Parliament and of the Council on Sustainability-Related Disclosures in the Financial Services Sector.
<b>Sustainability Factors</b>	environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters
<b>Sustainability Risk</b>	an environmental, social or governance event or condition that, if it occurs, could cause a material negative impact on the value of the investment
<b>Target Group</b>	means the group of people, subsidiaries, areas and/or functions, for whom the governing information is intended to be directly applicable.

### 3. Scope

The Instruction applies to investment management activities of Danica Pension as covered by the Responsible Investment Policy. As enshrined by the Responsible Investment Policy, our approach to responsible investment is based on the principle of Double Materiality.

From the perspective of Financial Materiality, we integrate sustainability factors by considering the negative and positive impacts that sustainability factors may have on our investments.

The consideration of **negative impacts** implies that we consider Sustainability Risks. It forms part of our fiduciary duty to integrate considerations of Sustainability Risks in our investment management processes and we manage such risks as an integral part of those processes.

The consideration of **positive impacts** implies that we can generate attractive returns by targeting investments well-positioned to manage and capitalise on the sustainable transition.

The Instruction covers the management of Sustainability Risks.

The management of positive impacts rests with the discretion of individual investments teams in accordance with the mandate granted under managed investment strategies, considering also our risk appetite and risk management framework. The investment teams are in that respect utilising adequate investment due diligence processes and procedures for the selection and monitoring of investments.

The Instruction is supplemented by our Exclusion Instruction, Inclusion Instruction and Active Ownership Policy.

For information on how we address Environmental and Social Materiality please refer to our Principal Adverse Impact Statement. For information on how Sustainability Risk is integrated in remuneration please refer to our Remuneration Policy.

All documents are available on [Vores arbejde med ansvarlige investeringer \(danicapension.dk\)](https://danicapension.dk).

### 3.1. Target group

The Instruction applies to all employees, all functions, and all units in Danica Pension that are involved in or oversee investment management activities. The Instruction is also applicable to any employee, function and/or units in Group subsidiaries subject to applicable governance rules.

## 4. Danica Pension's approach to Sustainability Risk Integration

In Danica Pension, Sustainability Risks are addressed in accordance with an overarching framework ensuring that the relevant infrastructure and processes are in place to:

- 1) identify Sustainability Factors leading to Sustainability Risks
- 2) manage and mitigate potential Sustainability Risk exposures
- 3) monitor Sustainability Risk levels

Investment teams are primary responsible for this life cycle management of Sustainability Risks, meaning that investment teams shall:

- screen investments to analyse available financial information and sustainability-related information and identify financially material sustainability factors
- assess the potential impact of material financially material Sustainability Factors on economic, country, sector, and company performance, and thus assess the likely impact of Sustainability Risks on the return of the investment product
- make investment decisions that consider Sustainability Factor, alongside other material factors
- ensure that Sustainability Risks once identified as financially material are captured by the general risk management of the portfolio and sought mitigated

This approach to integration of Sustainability Risks in the investment process enables the investment teams to:

- meet regulatory requirements related to integration of Sustainability Risks in investment management processes and assess the likely impact of these on investment returns
- abide to fiduciary duties owed to clients
- gain a better understanding of the quality of companies/issuers and how they manage risks and opportunities
- make better-informed investment decisions based on a holistic assessment of the investments
- meet client demands for an integrated responsible investment approach.

When managing Sustainability Risks, investment teams are supported by the Responsible Investment team for SME advice, tooling and general assistance, and the Portfolio Risk Advisory Team for the evaluation and challenging of Sustainability Risk integration and assessments of impacts on the value of returns.

## 5. Identification of Sustainability Risk factors

The process for identifying Sustainability Factors leading to Sustainability Risk is defined by the relevant asset class as further set out in this section.

As general principle, however, for a Sustainability Factor to be considered financially material it needs to translate into investment performance, meaning it should have a positive or negative impact on either the revenue/expenses of an investment, the value of its assets/liabilities, its cost of capital or the risk/return characteristics of the investment.

The identification of such factors is generally challenged by the lack of standards and coherence in respect to disclosures and the backward nature of data. Hence, for the screening, investment teams should to the best of their ability leverage on data from multiple data sources (including but not limited to company reports and third-party investment research). Investment teams may include this information into existing models or the development of new valuation models.

Sustainability-related data sources and data providers are continuously monitored and updated to be able to serve the needs of the investment teams. The Responsible Investment Team is further responsible for developing and managing the sustainability analytical tools to be used by its investment teams, e.g. Danske Bank’s proprietary analytic tool (mDash).

**5.1. Investments in Equities and Credit**

For actively managed equity and credit strategies, investment teams must as part of their due diligence of an investee company, issuer and/or issuance screen, review and consider sustainability-related data alongside other financial information to understand the linkages to investment performance.

While a definitive list of ESG issues does not exist investment teams can apply the Sustainability Accounting Standards Board’s (SASB) materiality map as a framework to focus on the material topics for each company and industry. The SASB framework does not provide a Sustainability Risk rating or a scoring, but fosters an understanding of the relative importance of different Sustainability Factors across various industries facilitating a consistent approach to Sustainability Risk impacts. In instances where SASB cannot be applied the investment teams can work in collaboration with the Responsible Investment team to identify financially material sustainability-related information. Further, investment teams may use mDash with its materiality dashboard to complete their analysis.

Below list provides a non-exhaustive list of factors that under given certain circumstances can become financially material and thus lead to sustainability risks for investments in equity and credit investment:

Access & Affordability	Customer Privacy	Human Rights & Community Relations	Selling Practices & Product Labeling
Air Quality	Customer Welfare	Labor Practices	Shareholder Rights
Audit & Controls	Data Security	Management of the Legal & Regulatory Environment	Supply Chain Management
Board of Directors	Ecological Impacts	Materials Sourcing & Efficiency	Systemic Risk Management
Business Ethics	Employee Engagement, Diversity & Inclusion	Physical Impacts of Climate Change	Waste & Hazardous Materials Management
Business Model Resilience	Employee Health & Safety	Product Design & Lifecycle Management	Water & Wastewater Management
Competitive Behavior	Energy Management	Product Quality & Safety	Selling Practices & Product Labeling
Critical Incident Risk Management	GHG Emissions	Remuneration	Shareholder Rights

### 5.2. Investments in Sovereigns

The financial importance of effectively managing ESG issues for sovereign issuers is increasing. We believe that identifying and understanding relevant Sustainability Risk issues and assessing how challenges are met, aid our long-term analysis of sovereign risk. We approach sovereign analysis by applying a quantitative framework and a qualitative overlay.

Below list provides a non-exhaustive list of factors that under given certain circumstances can become financially material and thus lead to Sustainability Risks for investments in sovereigns:

Co2 emissions from land use change and forestry	Minority rights	Torture and other ill-treatment	Democratic governance
Environmental regulatory framework	Right to privacy	Child labor	Rule of law
Low carbon economy	Sexual minorities	Forced labor	
Freedom of assembly	Women's and girls' rights	Migrant workers	
Freedom of opinion and expression	Arbitrary arrest and detention	Modern slavery	
Indigenous peoples' rights	Extrajudicial or unlawful killings	Occupational health and safety	
Land, property and housing rights	Security forces and human rights	Corruption	

### 5.3. Third party manager selection and investments in externally managed funds

Danica Pension uses also external asset managers to manage assets on behalf of clients both through white-labelling and by investing into externally managed funds.

The due diligence process when selecting an external manager for white-labelling ensures that the external manager's approach to integrating Sustainability Risks is presented and duly assessed in the initial assessment of the manager. The initial assessment caters for diversity in responsible investment approaches and focuses on the fact that Sustainability Risk should be integrated in a meaningful way by the manager.

Conclusions from the initial assessment also forms the baseline for ongoing monitoring and evaluation of the managers in order to ensure that Sustainability Risks considerations are consistently integrated in their investment process. Relevant observations made can in that respect form part of feedback to the external managers with potential recommendations for initiatives to strengthen their responsible investment efforts in respect to Sustainability Risk integration.

For investments into externally managed funds, the assessment of the external manager is complemented by an assessment of how the relevant fund integrates Sustainability Risks, and, if disclosed or otherwise reported, the likely impacts that sustainability risks might have on the returns of the fund.

The Responsible Investment Team is responsible for the external manager evaluation and ongoing manager assessments.

#### 5.4. Passively managed strategies

Passively managed strategies are managed through the tracking and replication of performance of a designated index. This implies that the investments in passively managed strategies in principle reflect the investments that are in the benchmark. Accordingly, the approach to Sustainability Risks integration in our passively managed products does not constitute a one-to-one match to that of the actively managed ones.

Instead, for passively managed strategies we identify and address Sustainability Risks through the approach in the respective benchmark construction. Further, Sustainability Risks are managed by exclusions applicable to the given passively managed strategy. Exclusions are part of how we address Environmental and Social Materiality in our investment products, however, by screening investments in the benchmarks for exposure to Sustainability Factors, such as thermal coal, and controversial weapons, the exclusions at the same time mitigate Sustainability Risk exposures deriving from these activities.

For more information on exclusions, please see our Exclusion Instruction.

#### 5.5. Derivatives

Sustainability Risks are determined by the underlying exposures, meaning that no specific approach is applied for this asset class.

## 6. Management of sustainability risks

### 6.1. Materiality and impact assessment

Sustainability Risks are assessed and measured alongside other material financial risk factors in the investment management process. The assessments consider whether Sustainability Factors relating to the investments are likely to impact the returns of the investment product, and whether such impact is deemed material.

The practice of assessing Sustainability Risks is still at an early stage, with statutory qualitative and quantitative indicators and methodologies yet to be developed. Further, although duly mapped, identified and managed in the investment processes, the following elements can from a general perspective affect the degree to which Sustainability Risks are likely to impact the value of returns and thus influence assessments on how Sustainability Risks should be integrated:

- Sustainability Risks are often complex and interlinked, which can make it difficult to assess them in their entirety
- Sustainability Risks are usually difficult to quantify and are long-term in nature, and the probability of materialisation thus also depends on the investor's time horizon.
- Sustainability Risks, such as risks stemming from changes in physical climate, political action, societal expectation, consumer demand or technological development, can occur at an unexpected scope and magnitude or at an unanticipated pace, which may not be reflected to a full extent when investment decisions are made.
- Lack of ESG market standards in general and a lack of comprehensive or standardised ESG data can make it difficult to uncover all sustainability risks or cause investment decisions to be based on faulty grounds.
- The Sustainability Risk assessments can be inaccurate, which may cause the sub-fund to become exposed to greater sustainability risks than anticipated, or to miss investment opportunities, or buy or sell investments at a sub-optimal time.

- Sustainability risk profile is dynamic and impacted by dimensions such as asset class, investment universe, investment strategy, specific investments, geographical exposure, responsible investment processes and investment horizon. This means that the sustainability risk exposure will evolve over time.
- The impact of Sustainability Risks can increase in magnitude in combination with other risks, especially in relation with market, credit, emerging and frontier markets, illiquidity, concentration and tax risks.

The financial position of investments may deteriorate due to Sustainability Risks materialising. The exact impact of a Sustainability Risk materialising is difficult to model due to the aspects mentioned above. Therefore, the impact of Sustainability Risk on returns may be both higher and lower than expected based on the exact nature of the situation and context.

If sustainability-related issues are identified and considered potentially material for the company/issuer's financial, operating or sustainability performance, an assessment of their impact must be carried out by the investment team. This assessment includes considerations of:

- Adjustments to the investee company's forecasted financials
- Valuation-model variables
- Valuation multiples
- Forecasted financial ratios
- Internal credit assessments
- and/or portfolio weightings are necessary

If sustainability factors are analysed and found not to be potentially material, an assessment is not conducted and adjustments are not made.

## 6.2. Management of Sustainability Risks

Sustainability Risk exposures should be well managed and, as needed, lead to and/or influence a decision to either buy/increase weighting, hold/maintain weighting, decrease weighting, or sell/divest or to engage through our Active Ownership activities.

When a portfolio is subject to Sustainability Risk exposures, investment teams shall ensure that such risks are monitored at an ongoing basis and as relevant take action to mitigate the risks through weighting, engagements and/or as a last resort divesting when needed to protect the value of the portfolio.

Appreciating that investments have different characteristics and are affected differently by Sustainability Factors; the investment team tailors management of Sustainability Risks to the specific investment strategy and asset class. In order to manage Sustainability Risks, three processes are applied, Inclusion, Active Ownership and Exclusions. This is done through processes leveraged both in the investment team and in other supporting functions.

### Inclusion

Sustainability Risk considerations are included in the selection of investments in the same way as other risk considerations. Appreciating that investments have different characteristics and are affected differently by Sustainability Factors, the investment team tailors the Inclusion of sustainability factors potentially leading to Sustainability Risks to the specific investment strategy and asset class. The time horizon in which the investment is held is also to be considered.

For more information on inclusions, please see our Inclusion Instruction.

## Active Ownership

Investment teams and the Responsible Investment team can use 1) Engagements, 2) Voting and 3) Collaborative engagements to manage Sustainability Risks. Through the use of rights and position of ownership we aim to impact activities or behaviour of our investments based on financial materiality considerations.

The Investment- and Responsible Investment teams engage on a regular basis with investee companies about financially material sustainability matters in order to seek improvement in performance and processes with the aim of enhancing and protecting the value of Danica Pension's investments.

A company's general meeting is an opportunity for Danica Pension as an investor to voice opinion on issues of key importance to corporate governance and to contribute to a company's sustainability performance.

When appropriate, Danica Pension collaborates with peers, like-minded investors, and other relevant parties to exercise Active Ownership by engaging through joint dialogue and contributing collectively to make a positive impact. It might be appropriate to raise the issue with others in instances where Danica Pension's own engagement may have proven to be unsuccessful.

For more information on active ownership, please see our Active Ownership Instruction.

## Exclusions

Due to considerations of Environmental and Social Materiality certain investments are excluded. These investments often also come with elevated Sustainability Risks, meaning that the Exclusions serve dual purposes. Based on data from a number of ESG data providers, the investments are screened to identify business-critical sustainability risks. The Exclusions cover equity, corporate bonds and sovereign bonds for the investment universe.

For more information on exclusions, please see our Exclusion Instruction.

## 8. Monitoring of Sustainability Risks

When Danica Pension trade in liquid assets, we exclude all companies from the Group's ESG exclusion list. In this context, the assessment does not clarify whether the asset in question can be classified as complying with Articles 6-7, 8 or 9, but a screening of whether related sustainability risks affect the overall risk to an extent to which it must be disqualified.

If DKF exceptionally wants to trade an asset on the exclusion list, this must be approved by the Head and DKF as well as the responsible ESG team at Danica Pension.

## 9. Training & Resources

Management in Asset Management ensures that sufficient resources are allocated for work concerning sustainability risk integration in the Asset Management organization.

The Investment teams must obtain and maintain an appropriate level of competence to carry out their responsibilities and be aware of relevant requirements that are applicable to a specific asset class and investment strategy. The Responsible Investment team is responsible for managing an ESG education



program, enabling a sufficient understanding of these dimensions across the investment management organization provided by the Responsible Investment department to support sustainability integration processes.

## 10. Escalation

The administrator of the Sustainability Risk Instruction must report to the Executive Leadership Team the following significant breaches to the Instruction.

- Overdue Instruction exemptions
- Instruction not approved annually

Any potential problematic case concerning the Group must be escalated in accordance with the Escalation Policy.

Instruction owner must escalate to the governing body in case of breaches to their instruction and if the maintenance of their instruction is not able to be completed in accordance with the Responsible Investment Policy.

## 11. Review

Responsible Investment team will, in cooperation with the relevant business unit or group function, evaluate and adhere to the Sustainable Risk Instruction. In case of any differences in views or in case of material decisions related to this instruction, these can be addressed by the Responsible Investment Committee who decides on the issue, and who can choose to report to the Business Integrity Committee.

The Responsible Investment Committee and the ESG Integration Council will annually receive an update on the implementation of this Sustainability Risk Instruction.

## 12. Change Log

Date	Version number	Comments/changes
02.12.2022	Version 1.0	Instruction created
xx.06.2023	Version 1.1	Instruction updated to include section on sustainability risk profiles with further enhancement made to existing sections.