The ATP Group

2020
Human Capital

Part of ATP's Responsibility

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Human Capital

We believe that companies that treat their employees as a valuable resource and comply with workers' rights will also deliver a better return in the long run.

Foundation

In ATP, social issues have always been an integrated component of our responsible investing approach. With a view to further refining this approach, we have carried out a number of initiatives in 2020 focused on our portfolio companies' work with their so-called human capital.

The international guidelines for responsible business conduct, laid down by the OECD prescribe that companies should not only focus on fundamental workers' rights but also make serious efforts relating to working environments and employee involvement.

ATP's view, based on existing research, is that companies with better management of their human capital are more productive and innovative, which ultimately results in higher returns.

Processes

In 2020, we identified the industries in which companies' work with human capital can be argued to be particularly important. We also conducted a mapping across asset classes with a view to determining how large a share of ATP's portfolio companies operate within these industries.

Our conclusion is that ATP has a rather high level of exposure towards human capital-intensive industries. In particular, ATP is exposed to industries in which companies are dependent on highly qualified labour. Accordingly, they compete against each other to attract, motivate and retain these high skilled employees. On the other hand, the portfolio has a rather low level of exposure towards industries with many, but less specialised workers.

Activities

In 2020, we examined the potential impact of expanding our stock selection model so that we could increasingly select portfolio companies according to their ability to professionally manage their human capital. The analysis found that it was likely that ATP could increase its return by incorporating human capital as a factor in stock selection. However, the results are not statistically significant, and we will therefore revisit the analysis once sufficient progress has been made on the data front to allow for more robust conclusions to be drawn.

As part of the current development of our voting practice, we have incorporated human capital considerations into our stewardship at companies' annual general meetings; for example, we now consider companies' so-called CEO/employee pay ratio in relation to voting items on salaries remuneration. In 2020, this has been a contributing factor to our voting against a company's pay policy in 22 cases.

Based on a major analysis of companies' exposure to countries with generally poor labour conditions, we identified three companies that did not appear to meet our requirements for conduct in such countries. Following dialogue with all three companies, ATP's Committee for Responsibility concluded that this was indeed the case for one of the companies, which has accordingly been excluded from ATP's investment portfolios.

#1 ESG is an Investment Belief

#2 We believe in effective ESG integration via customised processes

#3 Actual integration requires internal ESG competences

#4 We believe in capital stewardship - within limits

In 2020, ATP:

- discovered that **22%** of our portfolio companies operate in industries where human capital plays an crucial role
- conducted investigations on **3** companies with a view to identifying controversial working conditions and excluded one of these for breaching ATP's policy on responsibility in investments.
- voted against **22** companies' pay packages on the basis of human capital-related issues, among other reasons
- participated in an **international working group** to increase the integration of human capital factors into global sustainability standards
- engaged in dialogue on human capital with a total of **29** companies.

Human Capital is an Important Ingredient in Value Creation

Social issues are an integrated component of our work with responsible investments at ATP; we incorporate such issues into our processes for screening and fact-finding and identify relevant social issues to consider in our ESG due diligence process on illiquid investments. Building on this, in 2020 we implemented a number of new and proactive measures under a common theme revolving around how companies work with their human capital.

OECD's guidelines for multinational enterprises prescribe that companies should not simply respect the fundamental rights of their employees, but also take serious action on matters such as the working environment and employee involvement. In the ESG space, however, such considerations often fade into the background of a more narrow focus on the more basic labour rights. We at ATP believe that companies should maintain a strong focus on workers' rights while also considering the importance of human capital with respect to value creation.

> ”Enterprises should (…) respect the right of workers (…) to establish or join trade unions (…), the principle of equality of opportunity and treatment (…), promote consultation and cooperation between employers and workers (…), provide the best possible wages, benefits and conditions of work (…), provide training with a view to improving skill levels …”
>
> *OECD's Guidelines for Multinational Enterprises, 2011*

Research has found that it also makes good financial sense to consider portfolio companies' management of their human capital. The US labour market professor Mark Huselid has demonstrated that companies that prioritise good recruitment and performance management systems and prioritise involvement and supplementary training of employees achieve higher productivity and growth as a result. Additionally, the British finance professor Alex Edmans has demonstrated that companies with high employee satisfaction generate higher returns for their shareholders.

At the same time, we believe that the manner in which companies manage their human capital will only become increasingly important in the future due in part to a growing number of industries becoming more knowledge-intensive, making companies dependent on having employees with the right skills and high job satisfaction. Additionally, we are far from being the only ones to reach this conclusion. For example, the organisation Sustainability Accounting Standards Board (SASB), recognised for its evidence-based approach to categorising financially material ESG topics within each industry, is currently working on expanding its incorporation of human capital-related issues into its standards.

However, it should be noted that examining companies' management of human capital is complex, and at ATP we have not previously worked with an explicit focus on human capital. Several of our new initiatives in 2020 have therefore related to obtaining knowledge and looking into the role we can play as an investor. We have carried out a major analysis of how ATP's investments are exposed to human capital, and we have examined the potential for integrating human capital as a factor in our quantitative model for selecting global equities.

However, we have also worked on other initiatives that go beyond simply obtaining more knowledge, and which we aim to build upon in the coming years. Among other things, we have integrated human capital-related considerations into our stewardship at companies' annual general meetings as well as mapped out potential human capital-related breaches of ATP's Policy of Responsibility in our current and potential investments.

WHAT IS HUMAN CAPITAL?

The logic behind human capital in the context of corporate management is based on the idea that employees play a value-creating role in the same way as financial and physical capital does. This way of thinking dismisses previous preconceptions of labour as an expense and instead considers it as an asset. In rather simplistic terms, a company's human capital can therefore be defined as the value-creation potential of the company's workforce.

Specifically, a company's human capital consists of the employees' collective competencies and productivity, including their education and experience as well as their level of motivation and well-being.

This means that a company has the ability to affect its human capital both positively, e.g. through training, workplace improvement initiatives or a strong organisational culture, and negatively, such as by treating its staff poorly and thereby harming their motivation and productivity.

Recruitment and retention
Well-being, safety, health and motivation
Remuneration
Human capital
Organisational culture and values
Training and competency development
Diversity and cohesion

Dialogue on Human Capital Requires Information on Exposure

Human capital is a complex topic, also when it comes to differences across industry sectors. On the one hand, research has found that the ability to manage a company's human capital is an important competitive factor regardless of what industry the company operates within. On the other hand, there are differences in how prominent the different aspects of human capital are in individual industries. That is why we carried out a survey in 2020 of our portfolio's exposure to human capital issues with a view to increasing our knowledge level on the subject, which we can utilise in our investment decisions and stewardship.

For example, it is a well-known fact that staff turnover varies considerably between industries, and in an initial dialogue round that we had with four Danish companies, we similarly found that recruitment ability, for example, greatly depends on the wage levels for the companies operating in low-wage industries, while employees in specialist industries more often prioritise a good match between the employee's personality and the company's culture.

There are industries in which it is especially important for companies to manage their human capital well. Determining the exact industries that this is the case for, however, is not all that simple.

Some believe that human capital-related work is most important in industries where the workforce intensity is high, i.e. where many workers are needed to generate turnover. Others believe that it is more about the competition for talent between companies within a given industry; that the more those companies compete for the same highly qualified employees, the more important it is for each of those companies to manage their human capital appropriately. In our view, both factors are important.

Based on that assumption, we have surveyed how our portfolio is exposed in relation to human capital. We have done so by first identifying the industries that have a high workforce intensity as well as high competition for competencies and talent. Depending on one's categorisation approach, there are approximately 100 different industries in the world, and 18 of these can be said to have an above-average workforce intensity and competition for talent. We have used a report from the organisation MSCI titled "Human Capital Risks in a Changing World" as the starting point for this review.

In some of these industries, it is especially the workforce intensity that is high, e.g. in the restaurant industry. Companies in such industries require a relatively high number of employees in order to generate the necessary turnover. In other industries, it is the competition for talent and expertise that is more important, such as the pharmaceutical industry. Pharmaceutical companies need to be good at attracting and retaining highly qualified employees who can help them grow. Finally, there are industries that score highly on both parameters, such as the industries for consumer services.

We proceeded to survey how large a share of our portfolio companies operate in one of these industries. Our analysis cuts across all the different types of assets owned by ATP, including listed investments such as equities but also unlisted direct investments and fund investments.

Our survey found that around 22 per cent of all of ATP's portfolio companies operate in industries where human capital plays a significant role.

Across the different asset classes, around 22 per cent of ATP's portfolio companies are active in one of the 18 industries where human capital plays a significant role.

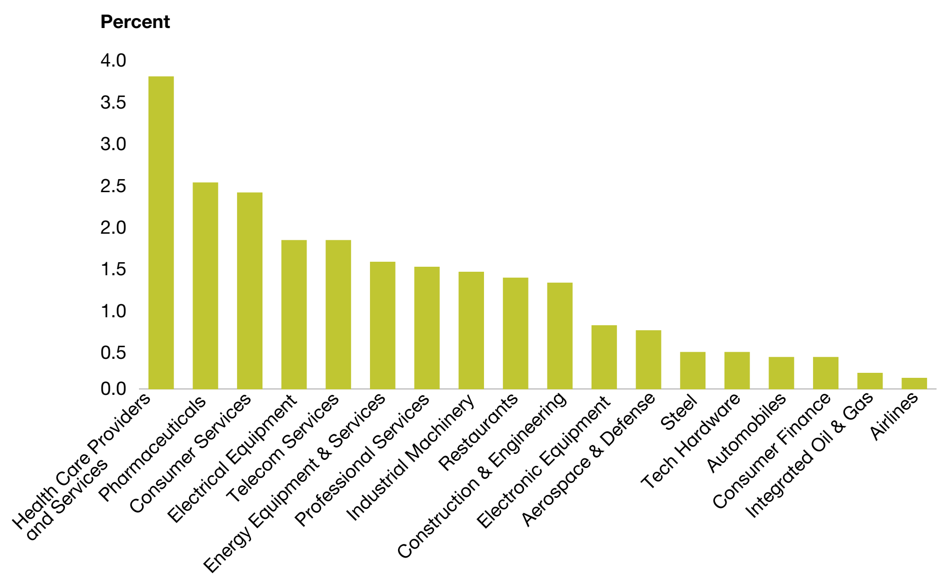
When delving further into the figures, however, some industries stand out more than others. In the portfolios with listed equities, it is especially pharmaceutical companies and telecommunications companies that dominate. On the other hand, in the portfolio for unlisted investments, it is private healthcare providers, electronics industries and various consumer services that stand out more. In ATP's portfolio, the latter includes private educational institutions, product comparison platforms and IT security companies.

In other words, ATP is qiute heavily exposed to industries in which companies are dependent on highly qualified employees, especially companies operating in healthcare and technology. However, the portfolio is not very exposed to industries that require large numbers of workers who are not as specialised, such as the airline and automobile industries. This appears to apply both to the listed and unlisted portfolios, meaning that the trend appears robust.

We can use that knowledge to assess what human capital-related issues are most relevant to our portfolio and to design relevant dialogues with our portfolio companies. Based on our dialogue on human capital with Danish companies, for example, we know that recruitment and retention in companies with highly educated employees is - among other things - a matter of cultivating a strong corporate culture, modern management approaches with a focus on employee involvement and a structured approach to working with each individual employee's career track. It will also be relevant to discuss diversity policies with companies in these industries to ensure that their ability to find the right employees is, for example, not hindered by unconscious biases in their recruitment processes.

For the five most prominent industries, our plan in 2021 is to enter into dialogue with companies that have significantly higher staff turnover than their industry average, as this could be an indicator that those companies ought to work more with their recruitment and retention processes to increase value creation.

SHARE OF ATP'S INVESTMENTS IN INDUSTRIES IN WHICH HUMAN CAPITAL PLAYS A CRUCIAL ROLE



Human Capital as a Factor in the Investment Process

In ATP's quantitative model for selecting global equities, we employ a climate factor on even footing with three financial factors. We do so because we believe that ESG can help increase the risk-adjusted return on our investments. That is why we also have an ambition to regularly assess new opportunities to employ ESG in our equity selection model.

Since research would indicate that it is financially sensible to also be attentive to portfolio companies' management of their human capital, we have looked into the likely consequences of expanding our equities selection model to also integrate this type of data.

Specifically, we have done so by performing a so-called back-test on historical data to determine what the portfolio- and return-related impact would are if we, up until now, had to a greater extent selected portfolio companies according to their ability to manage their human capital; in other words, how good they have been at creating employee groups with high job satisfaction and performance. This was possible thanks to our ESG data supplier MSCI, which has a data point that reflects companies' ability to develop, train, reward and retain talented employees while also maintaining high staff satisfaction and productivity.

If one were to draw a cautious conclusion from our survey, it is that the results generally point in the same direction as financial research on human capital: Companies that are good at maximising their human capital by attracting, retaining and developing their staff appear to fare slightly better financially than companies that manage their human capital poorly. In other words, ATP would possibly be able to slightly increase its expected return by overweighting companies with good management of their human capital.

However, we must stress that these results are still not statistically significant according to the criteria we have set. We are therefore cautious about concluding too much on the basis of the trends found in the analysis.

We have concluded that one of the reasons why more robust results cannot yet be achieved is because the quality and quantity of the available data remains limited. We have only had access to a few years' worth of data on companies' management of their human capital.

However, we believe that the results as a whole are uplifting, and ATP therefore intends to monitor these developments as the data foundation matures, revisiting the analysis when sufficient progress has been made on the data front.

PILOT PROJECT - A DIALOGUE WITH FOUR DANISH COMPANIES

With a view to testing the viability of human capital as a concept for dialogue with companies and learning more about positive corporate measures and potential pitfalls, we embarked on a pilot project at the start of the year which entailed knowledge-sharing meetings with four large Danish companies that are committed to the areas of HR and working environment.

All four companies were familiar with the potential value of working with their employees on the basis of a human capital approach, and ATP's overall observation was therefore that a focus on human capital is a sound basis for dialogue with companies.

In addition, we obtained specific input from the meetings which we have utilised in subsequent contexts, including our dialogues with foreign companies. Among other things, this input relates to the importance of working on the culture, working conditions, staff turnover, modern management approaches as well as the diversity and inclusiveness of a company if it wants to have employees who are happy in their jobs and perform at their peak. ATP also obtained new knowledge on when it becomes particularly important to pay competitive salaries and when companies instead ought to focus more on their organisational culture and management approach, for example.

CAN HUMAN CAPITAL CONTRIBUTE TO ATP'S EQUITIES STRATEGY?

ATP employs four factors in our global equities investment strategy, and in 2020 we have investigated the potential for including human capital data in our selection of equities.

√	**Low Risk**	On average, equities with few price fluctuations have a high, low-risk return.
√	**Momentum**	Equities that within a short period of time have generated a good return will also have an averagely good short-term return going forward.
√	**Value**	Equities that are sold cheap (equities with a high risk premium) generate good returns on average.
√	**Climate**	Companies in CO_2 emission-intensive industries where management focuses on reducing CO_2 emissions will outcompete competitors in the long run.
?	**Human Capital**	There are some indications that companies with a focus on human capital fare better financially. We are keeping an eye on the development of data on human capital.

NEW INPUT FOR INVESTING AND STEWARDSHIP IN THE AREA OF ILLIQUID INVESTMENTS

We have also begun to incorporate human capital-related factors more systematically in our stewardship vis-á-vis unlisted portfolio companies. In 2020, we introduced a new ESG questionnaire in which we ask all our unlisted portfolio companies to answer a number of questions about their ESG-related work. With respect to human capital, we ask the companies questions on a variety of topics such as their health & safety efforts, recruitment and retention, staff turnover, collective agreement coverage, diversity and staff satisfaction.
We believe that collecting this information will better equip us to assist these companies in their efforts to improve value creation as well as identify and manage human capital-related risks in the portfolio.

Additionally, we also expect that in the longer term, having more information on our companies' efforts/performance relating to these areas will improve our ability to identify and select the high-performing companies of the future for our illiquid portfolio.

ATP PART OF INTERNATIONAL WORKING GROUP

We support international initiatives to increase the level of knowledge and information on ESG, as this gives ATP and other global investors the opportunity to make more informed and long-term investment decisions.

In 2020-2021, we are part of a working group under the organisation SASB's Human Capital Management Project, the purpose of which is to develop a framework to ensure even better integration of human capital-related topics into SASB's standards. We believe this work is important, as many investors the world over use SASB's standards in their ESG-related work.

Among other things, our involvement in the project entails providing user-oriented feedback on SASB's ongoing efforts. The project is wide-ranging, covering a variety of topics ranging from employee composition and management of vulnerable workers to safe working environments and workplace cultures.

Activities

Companies Should Ensure Reasonable Working

Even though ATP screens its portfolio companies for controversial practices and investigates serious accusations, we are conscious of the fact that there may be companies among our current or potential investments that are not living up to their basic responsibilities in relation to their human capital. In other words, there may be companies that do not respect the rights of their employees and which we have not yet managed to uncover through our existing processes.

We have therefore performed a proactive mapping of our entire equity universe to identify any companies that do not meet our requirements. We have based our scrutiny on one of the most fundamental human capital factors, namely the companies' health and safety conditions. For most companies, having robust safety conditions is a competitive advantage, but in some industries there can be companies that take a more careless approach or seek to reap short-sighted benefits from not making the necessary investments in safety.

EXCERPT FROM THE ILO CONVENTION ON HEALTH AND SAFETY

1. Employers shall be required to ensure that (...) the workplaces, machinery, equipment and processes under their control are safe and without risk to health.

2. Employers shall be required to ensure that (...) the chemical, physical and biological substances and agents under their control are without risk to health when the appropriate measures of protection are taken.

3. Employers shall be required to provide, where necessary, adequate protective clothing and protective equipment to prevent (...) risk of accidents or of adverse effects on health.

ILO's Occupational Safety and Health Convention (No. 155).

This is simply not acceptable, as the right to a safe working environment in which one's life and working ability is not in danger is part of the foundation that many other workers' rights are premised on. It is therefore also a right which has been enshrined in numerous ILO conventions and standards.

Specifically, our approach has been to first order data from an international expert agency on the work-related health and safety conditions in every country in the world. We have subsequently performed a major mapping exercise of where every single company in our equity universe is commercially active, identifying those that are most active in countries with very poor enforcement of safe working conditions.

Out of the approximately 30 countries with the worst health and safety conditions, it is especially in Ecuador, Honduras, Bangladesh and above all India that many companies in ATP's equity universe are active. In the immediate future, we will be utilising this knowledge in our ESG-related efforts.

On the basis of this mapping, we have investigated whether any of these exposed companies are not adequately managing their increased risks.

Our survey found three companies that did not appear to meet ATP's expectations, and we therefore initiated a dialogue with each of them. In our dialogue with one of these companies, we were unable to obtain a satisfactory response to what the company is doing to live up to its responsibilities and rectify issues that have cropped up in recent years. ATP's Committee for Responsibility therefore chose to exclude the company from its investment universe.

At ATP, we expect that companies doing business in countries with poor enforcement of health and safety conditions take independent action to ensure that conditions in their workplaces are safe and do not pose any health risks.

Engagement with Companies on Health & Safety

Gildan Activewear

The Canadian clothing manufacturer Gildan has manufacturing facilities in Honduras and Bangladesh, both of which are countries with some of the poorest work, safety and health conditions in the world. Gildan's clothing manufacturing facilities in Honduras have been accused of poor working conditions with long workdays, working their employees to the point of exhaustion and being unwilling to cooperate with labour unions.

In our dialogue with Gildan, the company advised us that the work schedule in the Honduran factories actually follow the industry's common practices. The employees work a full working week in four days, making each working day longer. However, after those four workdays, the employees are off for four days, meaning that over a two-week period the working norm is comparable to what is typical in Europe. The work schedules are also agreed upon with the workers and union representatives.

Gildan also advised that they are highly aware of the risk of physical tear and have introduced measures focusing on the ergonomic conditions at the manufacturing facilities. Additionally, they have made health care facilities and clinics free to visit for employees.

Finally, Gildan emphasised that the company fully respects the workers' right to collective bargaining via labour unions, for example, and that the majority of the employees are covered by a collective agreement. ATP's overall assessment was that Gildan is living up to its increased responsibility in the aforementioned risk countries.

Bolloré

The French conglomerate Bolloré is active in a number of countries that have the lowest work-safety standards in the world, such as Benin, Guinea, Sierra Leone and India. Additionally, Bolloré has a 39 per cent stake in the company Socfin, which operates palm oil plantations in Africa and Asia.

Hazardous working conditions in the plantations have been documented by the media on several occasions; for example, workers - including minors - have been found to handle dangerous chemicals without protective equipment. ATP has on several occasions requested that Bolloré explain what initiatives they have taken in response to these cases, but the company has not wished to accommodate that request.

According to Bolloré, the company only owns a minority stake in Socfin and therefore holds no responsibility for the operation of the plantations. At ATP, we believe that Bolloré's ownership interest is so large that they have a responsibility for and influence on Socfin's operations. Bolloré therefore has an obligation to ensure that the working conditions in the plantations are proper. On the basis of the information available to us and our dialogue with the company, ATP's assessment is that Bolloré is not taking adequate responsibility on this issue, and ATP's Committee for Responsibility therefore elected to exclude the company from its investment universe.

LafargeHolcim

ATP's survey found that the Swiss-based LafargeHolcim, which manufactures building materials, is active in a number of countries including India, Bangladesh and Honduras and has a history of several controversial cases regarding poor health and safety conditions for its employees.

In our dialogue with the company, however, ATP got the clear impression that LafargeHolcim is seriously addressing those safety issues. For example, the company is working on an initiative which has reduced the number of significant workplace accidents by 62 per cent since 2016. They have also incorporated health and performance into senior management remuneration schemes. LafargeHolcim is also carrying out a structured inspection of its own operations and subcontractors and generally able to demonstrate relevant policies, structures and processes aimed at rectifying past health and safety issues. ATP therefore determined that LafargeHolcim is living up to its responsibilities in the aforementioned risk countries.

Human Capital in the Boardroom

In our stewardship efforts within the context of global listed companies' annual general meetings, we have implemented a new layer to our approach as a result of our focus on human capital. At an annual general meeting, the shareholders vote on the Executive Board's and Board of Directors' pay, and from a human capital perspective, pay policies can be important to a company's development; specifically, how the senior management's remuneration compares to that of the employees.

According to a human capital logic, it is not just the absolute pay levels that matter; what also matters is whether the pay policy in the company is perceived as fair by the employees. If that is not the case, it can have implications on the company's performance.

We believe that if an investor wishes to work with human capital, it is equally important to invest in the right companies as it is to divest from the wrong ones. That is why we have not only looked into integrating human capital directly into our equity selection model, but also looked at the other end of the scale, i.e. whether there are companies in breach of ILO rights and should therefore be entirely excluded from our investment universe.

However, it is just as much a matter of making a positive difference during our ownership period. This year, we have primarily done so through our voting power at the companies' annual general meetings, and in 2021 we aim to continue working on incorporating human capital more broadly into our stewardship.

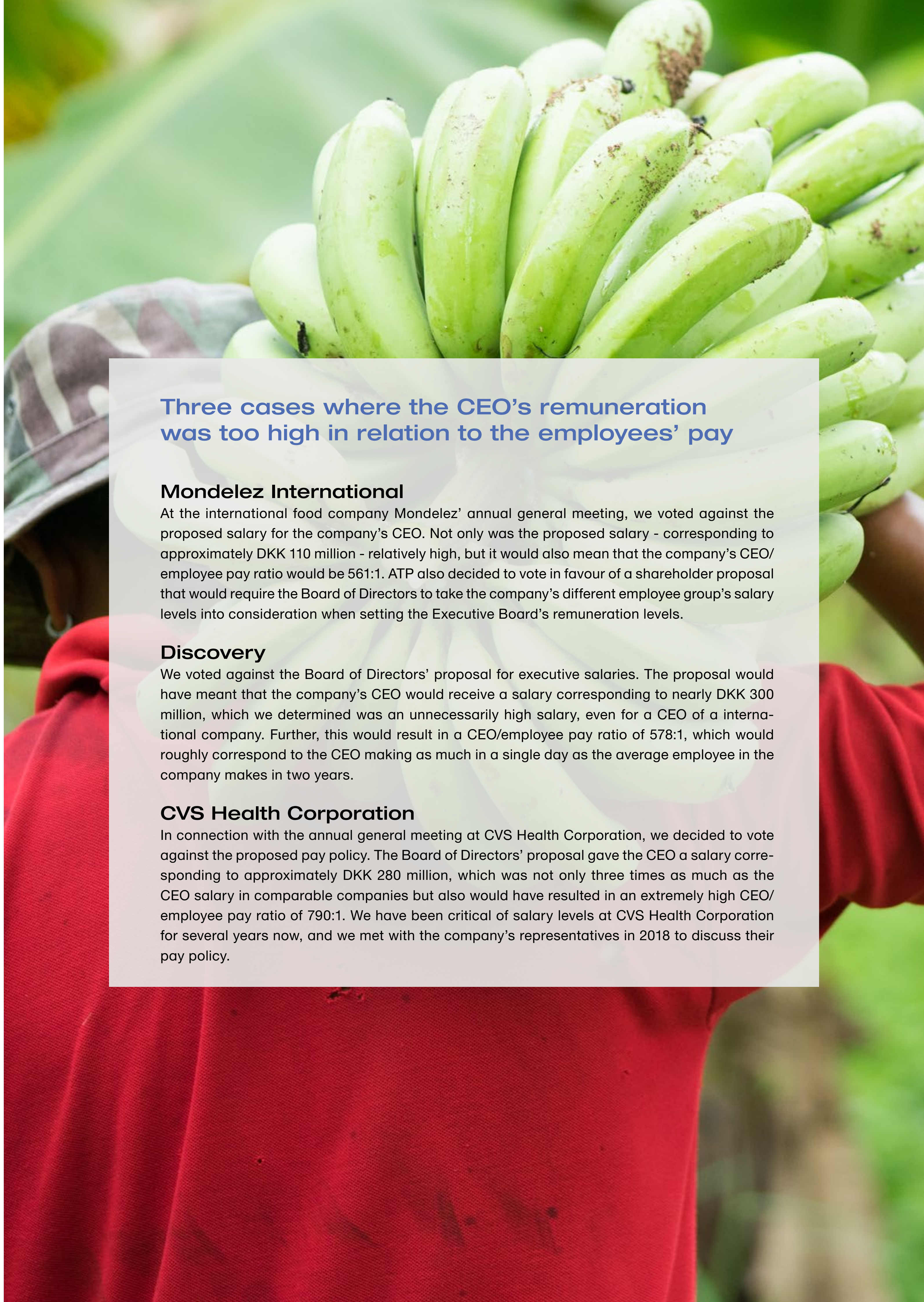
Simon Leicht Nielsen, Senior Analyst at ATP's ESG Team

Professor Ethan C. Rouen at Harvard University has examined this issue more closely in a study published in 2020. Rouen investigates the so-called CEO/employee pay ratio, which measures the distance between the CEO's pay and that of an ordinary worker in a company. He found that companies whose CEO/employee pay ratio is very high (and cannot be explained by standard economic factors) experience generally higher staff turnover and poorer financial performance. Rouen's explanation for this is that the employees of such companies can lose motivation and trust in the management team, which can make them less productive or even leave the company.

In the USA, it is no longer out of the ordinary to see CEO wages exceeding DKK 150 million, which is also often more than 300 times higher than the median pay in the company. This may negatively impact cohesiveness and thus also the company and its shareholders.

Therefore, when we vote on pay policies at the annual general meetings of global companies, we have begun to incorporate the company's CEO/employee pay ratio into our decision-making basis in those markets where the ratio is reported. High ratios are included as a factor in our assessment of the executive board's remuneration in relation to the company's financial performance and the pay levels in comparable companies. In 2020, a high CEO/employee pay ratio has been a contributing factor to our decision to vote against a company's pay policy in 22 cases, and we intend to employ this ratio as a component in our decision-making basis in the future as well.

STEWARDSHIP AT ATP
You can read more about our stewardship work, both at companies' annual general meetings and via continuous dialogue, in our report Stewardship 2020.



Three cases where the CEO's remuneration was too high in relation to the employees' pay

Mondelez International

At the international food company Mondelez' annual general meeting, we voted against the proposed salary for the company's CEO. Not only was the proposed salary - corresponding to approximately DKK 110 million - relatively high, but it would also mean that the company's CEO/employee pay ratio would be 561:1. ATP also decided to vote in favour of a shareholder proposal that would require the Board of Directors to take the company's different employee group's salary levels into consideration when setting the Executive Board's remuneration levels.

Discovery

We voted against the Board of Directors' proposal for executive salaries. The proposal would have meant that the company's CEO would receive a salary corresponding to nearly DKK 300 million, which we determined was an unnecessarily high salary, even for a CEO of a international company. Further, this would result in a CEO/employee pay ratio of 578:1, which would roughly correspond to the CEO making as much in a single day as the average employee in the company makes in two years.

CVS Health Corporation

In connection with the annual general meeting at CVS Health Corporation, we decided to vote against the proposed pay policy. The Board of Directors' proposal gave the CEO a salary corresponding to approximately DKK 280 million, which was not only three times as much as the CEO salary in comparable companies but also would have resulted in an extremely high CEO/employee pay ratio of 790:1. We have been critical of salary levels at CVS Health Corporation for several years now, and we met with the company's representatives in 2018 to discuss their pay policy.