About PUBLICA

The Swiss Federal Pension Fund PUBLICA is an independent pension institution established under public law. It is organized as a collective institution that currently comprises 20 pension plans. PUBLICA serves around 65,000 active members and 42,000 pension recipients. With total assets in excess of CHF40 billion, it is one of the largest pension funds in Switzerland.

About Dr. Stefan Beiner

Stefan Beiner has worked for PUBLICA since 2008, initially as a portfolio manager and subsequently as Deputy Head of Asset Management. He was previously a project manager in McKinsey & Company's Corporate Finance unit. Stefan is currently a lecturer in finance at the University of St. Gallen and, since 1 January 2014, is deputy CEO of PUBLICA.

About Patrick Uelfeti

Patrick Uelfeti is Head of Portfolio Management and deputy CIO of PUBLICA. His responsibilities include portfolio management, the selection and monitoring of external managers, and the development and implementation of the investment strategy. Prior to joining PUBLICA Asset Management in 2010, Patrick held various senior positions in research at Clariden Leu.

Photos by Jan van Beusekom

Sustainability versus returns – a balancing act

PUBLICA is responsible for safeguarding adequate returns to finance members' pensions well into the future. The organization is an active voice on the sustainable investment landscape and is working to embed a sustainability approach across its asset classes. Dr. Stefan Beiner and Patrick Uelfeti discuss PUBLICA's sustainability journey, the challenges involved in striking the right balance, and their plans for more transparent climate-related reporting.

Interview by Erich Meier, Partner, Audit and Patrick Schmucki, Senior Manager, Financial Services

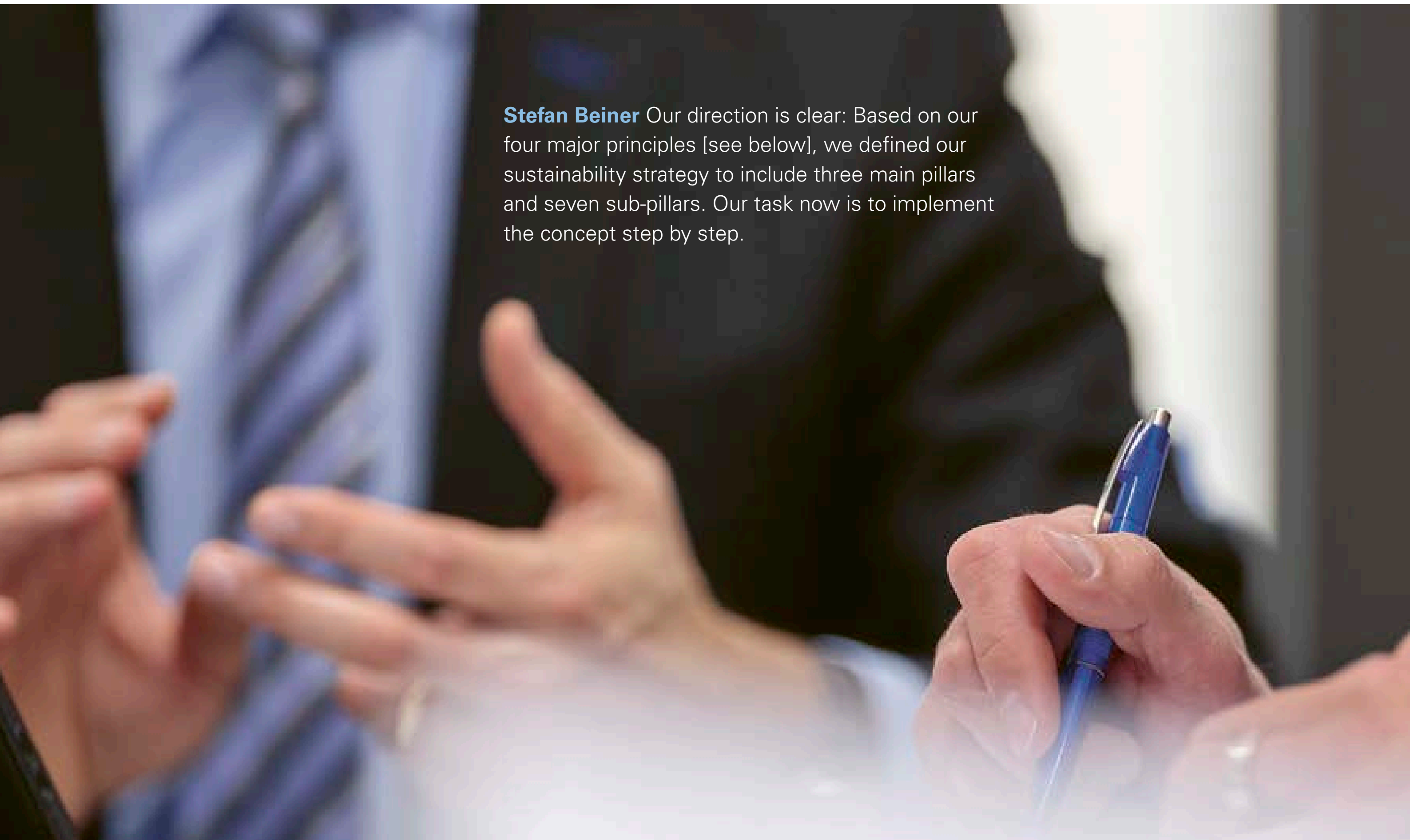
PUBLICA already incorporated sustainability aspects into its investments a decade ago. How does the approach back then compare to today's standard?

Stefan Beiner Ten years ago, we relied heavily on index providers to decide which companies to invest in. Our approach was to diversify as widely as possible. At that time, we very rarely excluded a particular company from our investment universe. In Switzerland, we were also exercising our shareholder rights and including sustainability aspects in our real estate investments. We were certainly doing more behind the scenes than we communicated publicly.

Awareness of sustainability has increased in recent years. Today, we seek to justify every investment we make. Quantifying some factors that have the potential to affect our portfolio is difficult, however. That's why we run an ESG risk analysis process every year. The starting point is 30 to 40 risks in areas such as water shortages, cyber risk, migratory streams, and climate change. We then analyze and work on the topics that emerge as particularly relevant to our portfolio. Our focus is on the aspects which could impact the risk-return profile. If a given factor could generate a significant negative impact, we have to reduce the exposure to that factor.

Looking ahead, what is PUBLICA's sustainability vision and how far are you on your journey?

Patrick Uelfeti In terms of vision, we would ideally like to cover all asset classes. We have started with the most straightforward ones – shares and corporate bonds. Real estate is next on our list and we have already done quite a bit in this area in Switzerland. Standardized reporting on our activities is something else we are aiming for. Unfortunately, there is no common reporting standard available at the moment that covers all asset classes.



Stefan Beiner Our direction is clear: Based on our four major principles [see below], we defined our sustainability strategy to include three main pillars and seven sub-pillars. Our task now is to implement the concept step by step.

PUBLICA's sustainability approach

PUBLICA's sustainability approach is defined within its responsible investment concept and is based on the following four principles:

1. It is formulated in a holistic fashion so that, as far as possible, all asset classes can be taken into account.
2. It is integrated into, and thus forms part of, the investment process.
3. It is based on criteria that are as objective as possible.
4. It is transparent and comprehensible.

Integration into investment process

- **Excercise of shareholder righs**
  - Engagement
  - Excercise of voting rights
- **Integration into securities porfolio**
  - Negative criteria
  - ESG risk analysis
  - Positive criteria
- **Integration into direct real estate investments**
  - New builds
  - Renovation projects

Source: PUBLICA

Why is it important to you to make such significant changes?

Stefan Beiner Up until about seven years ago, many people still had the mindset that sustainable investments cost more, without a related benefit. And that if this were the case, we shouldn't do it. Then there was a realization that it can actually have a positive effect on the risk-return profile. Today, sustainable investment has become an integral part of portfolio management.

Patrick Uelfeti We see it as part of our fiduciary duty. The question really needs to be whether there are good reasons not to do it. We have so much more information at our disposal today than in the past that we can incorporate into the definition and implementation of our investment strategy.

What are the cornerstones of how PUBLICA implements its sustainability approach?

Patrick Uelfeti One major cornerstone for us is a commitment to exercising our ownership rights to the extent possible. This means actively exercising our voting rights in Switzerland and engaging in dialogue with the companies in which we invest. We've been doing both in Switzerland for more than ten years. As co-founders of the Swiss Association for Responsible Investments (SVVK - ASIR), our international focus is on dialogue with companies abroad and on excluding certain companies from our investment universe under certain circumstances. We're also working on ways to exercise our voting rights abroad for certain companies starting the next few weeks. We have also developed a strategy for real estate investments in Switzerland which is being implemented as part of each individual property strategy across our portfolio. Fortunately, the properties in our portfolio are comparably young, so the standard is already very high.

PUBLICA is also licensing a new climate-efficient equity index that was developed in close collaboration with MSCI. The index takes into account a number of climate-relevant attributes for each company. This diversifies the various models used to assess the opportunities and risks associated with climate change, making the index overall less susceptible to errors in individual models and their assumptions.

Stefan Beiner, PUBLICA

Patrick Uelfeti, PUBLICA

Erich Meier, KPMG

Patrick Schmucki, KPMG

Have national or international developments helped inform this implementation?

Patrick Uelfeti PUBLICA has gained a lot from exchanges with large pension funds abroad that are further along on their journeys. Scandinavia and the Netherlands are particularly relevant in this context. At the national level, we are actively involved in exchanges on various platforms, including some that are organized by the federal government. And, of course, we engage in dialogue with other institutional investors.

Stefan Beiner Regulatory developments abroad, especially within the EU, have supported our initiatives indirectly. However, I don't think we have done anything so far purely because it was required by a regulator. Ultimately, a deciding factor was that there could be financial risks that could negatively impact our portfolio if we do not proactively address them.

To what extent are you able to quantify your sustainability goals and success?

Stefan Beiner Some success factors are easier to quantify than others. If you look at our sustainability approach, we have various ways that we implement it in practice. One example is exercising shareholder rights. It's not easy to say how a vote at the Annual General Meeting ultimately affects our return on investment though. As mentioned, we do also exclude certain companies. In that case, measuring the effect on our overall performance is quite easy. Looking at the last two years the performance impact from our exclusion policy was positive. Our new equity index will enable us to regularly analyze the performance impact and whether we really reached the goal of improving climate efficiency by 50 percent. In addition, we are currently increasing the use of certain metrics within real estate; for instance we are currently developing a reduction path for the volume of CO2 emissions per square meter.

Patrick Uelfeti If you break ESG down into E, S and G, I would say that we can measure E best. S and G relate primarily to issues that we are exploring through dialogue with companies. They are not easily measured, nor is it straightforward to specify what success we achieved.

What are your experiences regarding the performance impact of incorporating sustainability risks into your portfolio?

Stefan Beiner Excluding certain companies has led to a slight increase in return. Of the 8,000 to 9,000 companies, we exclude around 40; therefore, the impact is quite small.

Patrick Uelfeti When we first discussed this, it was important to us to highlight that our approach would incur certain setup costs. One example of a significant cost driver is access to relevant data to improve our risk management process. We never used the argument that our approach would boost returns.

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That would have been a promise we couldn't keep. What we can say, however, is that our investments do not damage the risk-return profile according to the indicators available to us. Whether returns will actually improve is a hypothesis that we can only test retrospectively. Robust statements can only be made once we have observed an entire investment cycle. The last cycles tended to be longer and flatter. It's not unusual for a cycle to last 15 or 20 years.

How do you typically keep your stakeholders informed, for instance through reporting?

Stefan Beiner We have been committed for a few years now to being as transparent as possible. It's especially important for us because our members don't really have a choice about investing with us. We communicate through our website, the annual report and our client magazine. We're becoming better and clearer in how we present information. In the future, we need to consider how to show our impact on the 17 Sustainable Development Goals.

Patrick Uelfeti The next big step is publishing specific climate-related reporting. In 2020, we intend to publish our first report with figures as of the end of 2019. The Task Force on Climate-related Financial Disclosures initiative helps guide us in this regard.

To conclude, could you please choose one of the options to complete each statement below and briefly explain your choice.

Sustainability is mainly the responsibility of
1] investors or
2] companies?

Stefan Beiner Neither. As we see it, consumers are primarily responsible. But of course all stakeholders take a share in responsibility.

Deviations from benchmarks are
1] taken into account without limits through a refusal to invest in non-sustainable targets or
2] limited, even if that means investing in non-compliant companies?

Patrick Uelfeti We look to limit benchmark deviations because we take a holistic view of responsibility. This is something we do through dialogue. As exclusion just shifts the problem to someone else, we exclude companies only if we feel that there's not much to discuss from a product perspective, e.g. in the case of banned weapons.

For pension funds, sustainability is more important for
1] investment (asset side of the balance sheet) or
2] contributions and benefits (liability side of the balance sheet)?

Stefan Beiner The second option is more important given the nature of what we do. PUBLICA is already quite sustainable given that we use technical parameters that are targeted reasonably fairly for the different generations.

Implementation of a sustainable investment strategy should be
1] voluntary or
2] required by the state, otherwise not enough investors would get on board?

Stefan Beiner In principle I believe in a voluntary approach. A certain level of regulation or standardization in terms of reporting could be helpful though.