

Nordea Asset Management

Materiality Assessment in Action – Samsung SDI

BY ARVINDER TIWANA, SENIOR ESG ANALYST

Executive Summary

Materiality is a crucial concept within ESG, and the SASB Standards and associated Materiality Map provides a clear foundation that can be used in different parts of the ESG investment process. At Nordea Asset Management (NAM) the SASB Materiality Map is an important foundation of both our proprietary ESG scoring and our engagement process. However, the following case study about NAM's engagement with Samsung SDI, a holding in Nordea's Emerging Stars Equity Strategy, illustrates how important it is for users of SASB Standards and the SASB Materiality Map to combine the comparable industry-based aspects of the Map with their own knowledge of company-specifics.

Introduction

Nordea Asset Management (NAM) is the largest asset manager in the Nordics with EUR 281bn (USD 325.7bn) in Assets under Management and a multi-cultural team of approximately 900 FTEs present at 19 locations across Europe, Americas, and Asia.¹ Since signing the PRI in 2007, as one of the early signatories, NAM has been on a responsible investment journey where we have continuously developed and enhanced our ESG model, increased our ESG and sustainable product offering to clients, improved our active ownership and engagement activities, and increased the penetration of ESG integration throughout the organisation and our funds.

NAM has developed policies and procedures to ensure that the companies we invest in meet our expectations of ESG performance, and that ESG and sustainability risks are managed in all our investment processes. These include responsible investment approaches both at the corporate- and product level. All of our funds are

screened for potential violations of international norms and have to follow the investment guidelines set forward in our responsible investment policy. Our active ownership activities – voting and engagement – also span across all of our products, since being an active owner is central to our understanding of ESG and Responsible Investing. Currently, more than 60% of our AuM is in ESG or sustainable funds.¹

In 2017, SASB invited NAM to write an ESG integration case study² describing how NAM used SASB Standards and their underlying materiality framework to inform fundamental analysis and identify attractive and responsible investments for inclusion in a unique, ESG-informed Emerging STARS Equity Strategy. This paper illustrated NAM's approach to ESG analysis and integration through a case study looking at the Chilean mining company Antofagasta. NAM has again been invited to write an ESG integration case on the Emerging Stars Equity Strategy and this paper will look into how we have done it with South Korean company, Samsung SDI. We will not only focus on how NAM is using the SASB Materiality Map in our ESG model, but we will also show how the SASB Materiality Map guides NAM's engagement activities with a company.

Nordea Asset Management's ESG STARS Range

NAM's ESG STARS range is built on the belief that companies and issuers that integrate both ESG and financial metrics into their strategic decisions will be tomorrow's winners. In these strategies, we aim to beat the benchmark by fully integrating ESG into our investment process

¹ Data as of 30.09.2021

² <https://www.sasb.org/knowledge-hub/case-study-nordea/>

and selecting companies or bonds that meet NAM's ESG standards. Within the ESG STARS strategies, every investment is examined through an ESG lens as well as on financial grounds. Our ESG analysts work closely with the investment teams to identify material risks and opportunities relating to the companies' medium- to long-term operational performance and market positioning, and the results of their analysis feed into proprietary ESG models that are integrated into the investment process.

Active ownership and engagement is an important part of the ESG STARS' investment approach. We engage in productive dialogues with many of our STARS companies, executed in close collaboration by the ESG analysts and portfolio managers. We believe this collaborative process creates value because it identifies companies that stand to improve strategically and financially from better managing and/or disclosing their key environmental, social and governance opportunities and risks. Engaging directly with the companies gives us not only an insight into their ESG risk management that goes beyond the standard external communication, but also the ability to assess the progress the companies have made on our previous ESG requests.

Nordea's Emerging Stars Equity Strategy

NAM launched the Emerging Stars Equity Strategy (ESES) in April 2011, with the aim of creating a unique emerging market equity strategy in which the stock-specific analysis and valuation fully integrate ESG factors, and therefore drive the level of conviction, the position sizing and portfolio construction.

The strategy has fully integrated NAM's proprietary ESG scoring model, which is built around the SASB Materiality Map. In addition to investing only in companies that have an investible NAM ESG score, the strategy has also implemented certain sector restrictions with a 5% revenue threshold³. The strategy's exposure to fossil fuels is governed by NAM's Paris-Aligned-Fossil-Fuel

Policy⁴ (PAFF). This policy prohibits investments in companies that are not adequately making the transition to clean energy and fossil fuel phase-out, while allowing the strategy to invest in companies that help accelerate the transition. Companies with a transition strategy that is aligned with the 2°C target are put on a whitelist⁵. The ESEF is allowed to invest in companies on the whitelist as long as the company also has an investible NAM ESG score.

Every holding in the strategy undergoes a parallel fundamental and ESG evaluation before an investment is made, and this evaluation is continuously updated. Excellent ESG performance or unaddressed ESG risks will impact the financial DCF model, which is the primary tool used for company valuation. The findings from the ESG analysis that are deemed to have financial impact are reflected either in the first 10 years of explicit financial forecasts, and/or in the long-term fading of the profitability (ROIC-WACC spread), which takes place between year 10 and year 25. Companies with outstanding ESG profiles are given a larger long-term profitability spread and vice versa.

SASB integration into the NAM's ESG model

NAM's proprietary ESG scoring model attempts to identify stakeholder risks at the company level and is conducted from two perspectives. First, we assess alignment (or misalignment) of business models with the UN Sustainable Development Goals⁶ (SDGs). We assess whether the service or product the company offers contributes positively to society, how significantly aligned business activities are as a proportion of revenue, how much capex is directed into them, and whether they are a visible driver of growth. This is relevant both because the SDGs present large and durable business opportunities, and because SDG alignment – or the lack thereof – is an indicator of a company's material ESG impact on the world around it. In this way, our research takes into account both sides of the so-called "double materiality", e.g. the effect of climate change on companies' activities

³ Sector restriction: coal mining, military equipment, gambling, nuclear power, adult entertainment, tobacco and power generation from Coal (10% revenue threshold). For more information on the sector restrictions please see: https://www.nordea.lu/documents/static-links/Equity_STARS_Sensitive_Industries_Guidelines.pdf

⁴ <https://www.nordea.com/en/doc/nam-fossil-fuel-policy.pdf>

⁵ <https://www.nordea.com/en/doc/nam-fossil-fuel-policy.pdf>

⁶ <https://sdgs.un.org/goals>

Pillar	 Business Model	 Governance Quality	 Business & Governance Ethic	 Environment	 Social
Rating	A, B, C	A, B, C	A, B, C	A, B, C	A, B, C
ESG Risks			Risk Exposure 1-3	Risk Exposure 1-3	Risk Exposure 1-3
			Financial Risk 1-3	Financial Risk 1-3	Financial Risk 1-3
			Reputational Risk 1-3	Reputational Risk 1-3	Reputational Risk 1-3
	30%	10%	Variable (%)	Variable (%)	Variable (%)

Rating	Weighting
<ul style="list-style-type: none"> • Key sector issues are identified • These are complemented with key company-specific issues • Each pillar is rated – one overriding factor can not arbitrarily set the rating • Policy, strategy, performance are KPIs evaluated 	<ul style="list-style-type: none"> • Business model 30% • Governance Quality 10% (implicitly assessed in the remaining three pillars) • Business ethics, Environment and Social have variable weights based on <ol style="list-style-type: none"> 1. Risk exposure: Materiality Key risk if more than 30% of operations in high risk area 2. Financial Impact: Magnitude example fines 10% of revenue 3. Reputational: Impact on brand/reputation

Source: Nordea Investment Management AB. Note: For illustrative purposes only.

and the effect of companies’ activities on climate change alike. Our assessment of the business model is weighted at 30% in our internal scoring process.

Second, we evaluate a company’s ability to manage material ESG issues in relation to stakeholders, such as employees, suppliers, customers, communities, regulators, and the environment. A key part of our process is identification of financially material ESG issues – those which are likely to influence the financial performance of the company. We weigh these issues flexibly, according to their materiality for the specific sector. We use the SASB Materiality Map as a guideline to determine materiality, but we supplement it with our own insight into the workings of the company.

The SASB Materiality Map helps us to identify the key issues which are relevant for the company under the ESG Scorecard columns of business ethics, environment, and social. The company’s industry is used to identify the most material topics according to the Materiality Map. However, if the company has significant operations in other industries, then several different topics may be included in the scorecard.

The role of engagement

We believe that improved management of sustainability risks and opportunities is vital to creating returns with responsibility, and that engagement can result in a

competitive advantage, increasing the likelihood of the companies being successful in the long run – benefitting companies, clients and society at large. Engaging with our investee companies enables us to address material sustainability risks and opportunities and provides us with the possibility to contribute to real world impact. The dialogue allows us to put forward our expectations on corporate behaviour and to support companies in enhancing their sustainability performance. During the engagement period, we conduct regular meetings with the company and track progress against our pre-defined engagement objectives. As the engagement is conducted as a collaboration between the RI team and investment team, the outcomes have direct impact on the investment decision. Progress reports and outcomes of the engagement are also communicated to clients.

One of the companies we are engaging with in the Emerging Stars Equity Strategy is Samsung SDI.

Introduction to Samsung SDI

Samsung SDI is a South Korean company which specializes in developing lithium ion battery technology. The company produces liquid crystal display (LCD) components and rechargeable batteries for cellular phones, electric vehicles, energy storage systems and solar panels.

The company is well positioned to contribute to and benefit from decarbonisation, which is needed to combat climate change and the transition to a low carbon society. Samsung SDI is not only part of the electrification of the global car fleet, but can also help address one of the fundamental challenges with renewable energy: storage. Wind and solar energy creation is not always timed with the demand for energy. Samsung SDI's energy storage systems can ensure that renewable energy is available when there is a demand for energy.

Samsung SDI has an investible ESG score and NAM has engaged with the company since 2017. The engagement has been guided by the SASB Materiality Map, while we have used our knowledge of the company to focus on topics that we believe are most relevant for this specific company.

Engagement guided by SASB Materiality Map

The following section gives a brief overview of the issues that the SASB Materiality Map identifies to be the most material for Samsung SDI's industry. The company's sustainability reporting is aligned with the recommendations set by the SASB Standards, which allows an easy review of the company's performance. The issues identified by the SASB Materiality Map give a good direction for our engagements, but are not the sole drivers of our engagement topics. We use our knowledge about each company to tilt the engagement to aspects which we view as the most material for the specific company in question – while still keeping an alignment with the material issues identified by SASB.

Samsung SDI published an index mapping the SASB Materiality Map to its 2020 Sustainability Report, which allows investors to easily assess its performance according to the Materiality Map.

Product Security

The SASB Materiality Map's focus on the product security topic is mainly related to data security, as hardware products and related software offered by companies in the hardware industry can have vulnerabilities that expose consumers to data security threats. However, when we look at issues around Samsung's products, our greater concern is product quality, so this is where NAM has specifically focused the product-related engagement with Samsung SDI.

ISSUE: Quality control is a process where companies review the design and manufacturing of their products to ensure that the product quality is maintained or improved. In 2016, Samsung SDI delivered batteries for the Samsung Galaxy Note 7 phone which had a design fault that resulted in the phones overheating and combusting. The incident ended up costing the client around USD 5bn in losses and lost sales.

PERFORMANCE: In 2016, Samsung SDI enhanced its quality management by establishing a Quality Assurance department. Samsung SDI has now implemented a comprehensive quality management system which is certified in accordance with ISO9001 and IATF 16949.

SAMSUNG SDI Sustainability Report 2020

SASB Index

SASB Sustainability Disclosure - Hardware Industry

Accounting Metrics

Topic	Code	Accounting Metric	Page (Reference)
Product Security	TC-HW-230a.1	Description of approach to identifying and addressing data security risks in products	Samsung SDI Privacy Policy https://www.samsungsdi.com/privacy-policy.html
Employee Diversity & Inclusion	TC-HW-330a.1	Percentage of gender and racial/ethnic group representation for (1) management, (2) technical staff, and (3) all other employees	76p
Product Lifecycle Management	TC-HW-410a.1	Percentage of products by revenue that contain IEC 62474 declarable substances	Samsung SDI complies with global regulations such as EU RoHS and REACH and national laws. In addition, strict pre-inspection and follow-up management is implemented for all components and raw materials used in products.
	TC-HW-410a.2	Percentage of eligible products, by revenue, meeting the requirements for EPEAT registration or equivalent	N/A
	TC-HW-410a.3	Percentage of eligible products, by revenue, meeting ENERGY STAR® criteria	N/A
	TC-HW-410a.4	Weight of end-of-life products and e-waste recovered, percentage recycled	N/A * Please refer to 31p for Samsung SDI's efforts regarding Recycling and Reuse
Supply Chain Management	TC-HW-430a.1	Percentage of Tier 1 supplier facilities audited in the RBA Validated Audit Process (VAP) or equivalent, by (a) all facilities and (b) high-risk facilities	40p
	TC-HW-430a.2	Tier 1 suppliers' (1) non-conformance rate with the RBA Validated Audit Process (VAP) or equivalent, and (2) associated corrective action rate for (a) priority non-conformances and (b) other non-conformances	40p
Materials Sourcing	TC-HW-440a.1	Description of the management of risks associated with the use of critical materials	42-43p

Activity Metric

Code	Activity Metric	Page (Reference)
TC-HW-000.A	Number of units produced by product category	74p
TC-HW-000.B	Area of manufacturing facilities	8-9p
TC-HW-000.C	Percentage of production from owned facilities	2020 Annual Report 19-20p

Source: Samsung SDI – 2020 Sustainability Report¹

¹ https://www.samsungsdi.com/upload/download/sustainable-management/2020_Samsung_SDI_Sustainability_Report_English.pdf

Samsung SDI performs complete verifications on safety factors from the product development phase - including the selection of raw materials - through the whole manufacturing process.

ENGAGEMENT: NAM has engaged with the company on this issue since 2017. We have required that the company invests in improved quality control mechanisms and gives transparency around this to its shareholders. Our assessment concludes that Samsung SDI has improved its quality control system and continues to improve the system. This has increased our conviction in the investment case as the quality improvements reduce the risk of future recalls and provisions, which can be very costly for Samsung SDI, and therefore impact the valuation of the company.

Human Capital

Human capital is an important topic that we considered in our analysis and engagement with Samsung SDI. The SASB Materiality Map's focus within the hardware industry is on the employee diversity & inclusion topic is mainly related to workforce diversity of gender and minority groups, and the company reports on these issues in their sustainability report. However, NAM has chosen to focus on a different topic within the issue of human capital. NAM sees unionisation as an unaddressed issue in Samsung SDI as well as in the wider Samsung Group, thus we have focused our engagement on this topic.

ISSUE: NAM supports the core ILO conventions, which include employees' right to organise and have collective bargaining. While Samsung Group has not had an official anti-union policy, historically there have been several cases of anti-union activities throughout the group, some of which have resulted in legal cases against senior management.

PERFORMANCE: Samsung SDI has for many years supported freedom of association in its supply chain through its supplier code of conduct, but these rights have never been officially applicable for its own employees. However in 2019, Samsung SDI officially announced in a policy that it supported and would respect its employees' freedom of association.

ENGAGEMENT: NAM has engaged with the flagship company of the Samsung Group on the issue of labour

rights within the group. The group has established an independent global compliance committee, which has the mandate to review and monitor the group's compliance. Since its establishment, the committee has selected three issues -- the group's union, management succession and communication with civic organisations -- as key points on its agenda to improve the conglomerate's business compliance. NAM will continue to review and engage to ensure that the corporate culture is changed to be more accepting of employees' union activities. It is very positive that the company now has an official policy on the topic. NAM believes that a balanced and harmonious relationship between workers and the company is likely to increase the attractiveness of Samsung SDI as an employer and strengthen its brand and standing in South Korea, ultimately increasing the longevity and value of the company.

Product Lifecycle Management

NAM's view and engagement on this topic is aligned with and follows the issues identified by SASB Materiality Map.

ISSUE: Samsung SDI's products are used in various tech products, some of which get obsolete and replaced by consumers after only a few years. While the collection and recycling of smaller batteries can be complex because the end users discard batteries in many various ways, the move towards larger batteries in electric vehicles and energy storage systems will make it more efficient to create a recycling process for used batteries.

PERFORMANCE: The company ensures that scraps from the manufacturing process are collected and sent to a recycling company which can then send it back in the value chain. It also works with battery recovery companies, which can send the batteries for recycling. The company is looking for potential partnerships with car manufacturers to develop a closed-looped battery recovery system.

ENGAGEMENT: NAM has engaged with the company on the issue of recycling. While it is already addressing the issue of recycling scrap material from its production process, there is room for improvement in relation to the end-of-life recycling. Samsung SDI could build recycling considerations into the design of its products and

make easier the separation of raw materials in discarded batteries. We view it as essential that the company succeeds in its efforts to create partnerships to recycle its discarded electric vehicle batteries, as this would reduce the negative externalities that arise from their use.

Supply Chain Management

Supply chain management is an integrated part of NAM's ESG analysis and follows the issues identified by SASB Materiality Map.

ISSUE: Samsung SDI has a complex supply chain, with production among suppliers as well as its own facilities. Its supply chain is also diverse, which means that its suppliers have different ESG challenges and the company has to adjust its supply chain audits accordingly.

PERFORMANCE: Samsung SDI has a relatively good process of supply chain management. The company utilises a combination of self-assessment and onsite audits of all new and major suppliers to assess its supply chain's ESG risks. The company has a comprehensive Supplier Code of Conduct⁷, which describes its policies on issues such as human and labour rights, health and safety, environment, and ethics. Samsung SDI also provides ESG awareness training to suppliers and supports manufacturing innovations in partnership with major suppliers. It is transparent with the result of the audits in relation to how many had to make improvements and how many failed the audit.

ENGAGEMENT: NAM has not had any specific engagement with Samsung SDI on its supply chain management of its direct suppliers, as our assessment is that the company generally manages this issue quite well. Our engagement on this topic is focused further up the supply chain around the raw materials used in production, specifically its cobalt supply chain.

Materials Sourcing

SASB Materiality Map flags raw materials as one of the challenges for companies within the industry where Samsung SDI operates. NAM has focused its engagement on the company's sourcing of cobalt.

⁷ https://www.samsungsdi.com/upload/download/sustainable-management/Supplier_Code_of_Conduct_v1.01.pdf

ISSUE: Cobalt is a metal which is often used in rechargeable batteries because of its unique properties which improve the performance, safety and longevity of the batteries. Cobalt mining does not face any significant different ESG risks to those which are inherent in other types of mineral mining. However, the challenge around cobalt is that 70% of the annual global supply comes from the Democratic Republic of Congo and an estimated 25% of it is mined in artisanal way. Artisanal mining refers to informal and unregulated mining, which is often done in abandoned mining pits or old mining tailings. The health, safety and working conditions of artisanal cobalt miners are poor, and because it is unregulated there is a high risk of environmental pollution.

PERFORMANCE: Samsung SDI has addressed its exposure to artisanal-mined cobalt by assessing all of its suppliers that use cobalt through the application of the Responsible Mining Initiative's Cobalt Reporting Template, to ensure traceability and transparency of its cobalt supply chain. In 2017, 23% of the company's suppliers complied with the requirement, and this has increased to a 91% compliance rate in 2020. To further reduce its reliance on artisanal cobalt and to secure its cobalt supply, Samsung SDI has made a direct cobalt purchase agreement with an industrial miner in the DRC, which will ensure that the company has full traceability of all its cobalt. At the same time, the company has implemented several initiatives to address the reliance on mined cobalt, such as recycling programmes to recapture cobalt from used batteries and product design to reduce the amount of cobalt used in its batteries.

The work the company is doing, through intense research and development, to reduce and even eliminate the cobalt content in its batteries is highly beneficial here. Newer batteries have ever lower cobalt content and the company is working on developing so-called solid state batteries that don't use cobalt at all. This would not only reduce the overall cost raw materials and thus improve the profitability outlook of the company, but also improve its standing versus competitors and proposition to customers, and help the company stay ahead of potential future regulation.

ENGAGEMENT: NAM's main engagement focus with Samsung SDI has been on cobalt for several years. NAM has requested that the company increases the transparency of its cobalt supply chain and has it audited.

The end goal for NAM is to ensure that Samsung SDI accesses a critical raw material in a sustainable way, and that utilises responsible cobalt in its products, which we believe will be future requirement from its clients and regulators. While Samsung SDI is well on its way to addressing its exposure to artisanal cobalt, NAM will continue to engage with the company around cobalt. The new engagement focus will be to address the ESG risks that are prevalent in large scale Congolese mining operations, such as labour rights and corruption.

Conclusion

Materiality is a crucial concept within ESG, and the SASB Standards and associated Materiality Map provides a clear foundation that can be used in different parts of the ESG investment process. However, since the SASB Standards are developed at an industry level, for some purposes users may find it useful to add their own company-level knowledge onto the industry-based framework provided by the Materiality Map to ensure that they are focusing on the most relevant topics for each company, particularly where the company's operations may differ from the industry norm.