Novartis Pension Funds

Sustainability Report 2023
Novartis Pension Fund 1

NOVARTIS | Reimagining Medicine

Introduction

The Novartis Pension Fund 1 was one of the first pension funds in Switzerland to incorporate ESG criteria into its investment strategy. We see it as our fiduciary duty to invest sustainably and responsibly in order to safeguard the pensions of our insured members for the future. For this reason, sustainability considerations, particularly the impact of climate change, are integrated into our investment approach. This report provides information on how we do this and what we have achieved so far.

Daniel Weiss, Chairman of the Board of Trustees

Highlights

ESG is integral to the selection of financial investments and external asset managers

Reduce greenhouse gas emissions in equities, corporate bonds and Swiss real estate by 50% until 2030 (compared to 2019) to limit global warming to 1.5C

Actively promote climate solutions through targeted allocation within equities, bonds (green bonds) and infrastructure (renewable energies)

What does ESG mean for the Pension Fund Novartis 1?
The acronym ESG refers to the consideration of sustainability criteria in the selection of financial investments. These include the impact on the environment (*Environment*), relations with the company's social partners (*Social*), and ethical aspects of corporate management (*Governance*).

Climate dialogue with companies and external asset managers

Membership of the UN Principles for Responsible Investment initiative

Membership of the Net Zero Asset Owner Alliance

Membership of Climate Action 100+

The "Novartis in Society" report provides information on ESG at Novartis.[1]

[1] Novartis in Society 2022 - Top 10 Takeaways.pdf

ESG and climate strategy in financial investments

April 2023 (investment portfolio at end of Q1 2023)

The pension fund's assets are invested in accordance with sustainability criteria with the aim of ensuring a responsible use of financial resources and effective management of ESG risks. For this reason, the pension fund has joined the PRI initiative sponsored by the UN, which has developed six principles for the practical implementation of fiduciary responsibility. In this context, climate change represents a significant risk and can potentially affect all asset classes. To counteract the financial aspects of climate risk and take responsibility for the climate impact of the investments made, the pension fund has joined the Net Zero Asset Owner Alliance and Climate Action 100+.

PRI Responsible Investment Initiative

The implementation of the six principles serves as the basis for successful long-term value creation of the investments. These include the inclusion of ESG issues in the assessment of investment opportunities and risks, active involvement as a shareholder, the demand for transparency, the acceptance of the PRI principles by the external asset managers commissioned by the pension fund, the exchange with other investment institutions, and reporting on the implementation of the principles. The latter is available under the title "Transparency Report of the Novartis Pension Fund" and can be accessed via the PRI website.

Ethically based investment exclusions

A key element in limiting sustainability risks is the exclusion of companies with ethically questionable products or business practices. Therefore, no direct investments are made in companies that (a) repeatedly commit human rights violations, (b) maintain business relationships with totalitarian regimes, and (c) engage in armaments or tobacco production as their core business. A core business is considered to be one that accounts for more than 10 percent of sales. Directly held shares and bonds are affected by the exclusions.

Investment exclusions based on sustainability risks

As energy companies, utilities, industrial companies and basic material manufacturers contribute to climate change in a particular way and are exposed to uncertainties regarding their business models, companies in these sectors must have sufficient sustainability ratings. Only MSCI ESG ratings in the AAA to BB range are considered eligible, i.e., no investments are made in the two lowest rating categories (B and CCC). If a company already represented in the portfolio is downgraded to B or CCC, the investment is sold if that is in the best interest of the fund. Directly held shares and bonds of companies are affected by the exclusions.
Furthermore, within the bond portfolio, no investments are made in sovereign or quasi-sovereign issuers if they have an MSCI ESG Sovereign Rating of B or CCC.

Decarbonization of the investment portfolio

According to the Intergovernmental Panel on Climate Change (IPCC), global warming can be limited to +1.5C by reducing net emissions of carbon dioxide to zero by 2050, and those of all other greenhouse gases to zero by 2070 – provided that at least a 50% reduction is achieved within the current decade. To contribute to this target, to which Switzerland has also officially committed, greenhouse gas emissions from key asset classes (equities, corporate bonds, real estate) are to be reduced by a net 50% until 2030 compared to 2019. The reduction target relates to operational emissions (Scope 1) and emissions associated with energy purchases (Scope 2). Emissions from the entire value chain (Scope 3) are insufficiently reported and must be estimated by models. Due to high estimation uncertainty, setting a reduction target for scope 3 emissions is therefore not appropriate.

Financing of climate solutions

In order to enable a shift away from fossil fuels (as well as from other economic activities causing greenhouse gas emissions), investments are increasingly made in companies offering so-called climate solutions (e.g., energy generation from renewable sources, products and services to improve energy efficiency, etc.). The allocation of the equity portfolio in favor of climate solutions shall therefore exceed that of the global benchmark (MSCI World). In addition, 15% of the total bond portfolio is to be invested in green bonds. For the infrastructure investments, there is also a target to invest 15% of the sub-fund in activities related to the production and distribution of renewable energies.

Climate-related dialogue with companies (Climate Action 100+)

Dialogue with the companies represented in the investment portfolio plays a key role in their willingness to eliminate the greenhouse gas emissions for which they are responsible as completely as possible (net zero) and to set appropriate interim targets for this purpose. In the interest of effective influence, the pension fund has joined the *Climate Action 100+* investor group as a Support Member and thus supports its demands for a rapid decarbonization of the real economy, meaningful climate reporting, and direct management responsibility for the material climate aspects of corporate policy.

Climate-related dialogue with external asset managers

External asset managers who manage sub-assets or fund products on behalf of the pension fund should support the pension fund's climate strategy wherever possible. To this end, their profile with regard to climate targets, financed emissions and stewardship activities is developed in direct dialogue with the managers and taken into account when commissioning such mandates.

Exercise of shareholder voting rights

The pension fund attaches great importance to the exercise of shareholder voting rights, in particular with regard to climate-related voting proposals. As the indirect equity investments are made in the form of actively managed investment funds or passive exchange-traded funds, the voting rights are held by the respective fund companies and are therefore not exercised directly by the pension fund. Voting behavior is reviewed periodically, particularly regarding climate-relevant shareholder decisions flagged by Climate Action 100+. For the shares held directly, voting rights are exercised on behalf of the pension fund by Credit Suisse Asset Management (CSAM), taking climate criteria into account.

Net Zero Asset Owner Alliance

Since 2022, the pension fund has been a member of the Net Zero Asset Owner Alliance, an investor initiative promoted by the UN and PRI, which aims to decarbonize the real economy and thus also the investment portfolios on the basis of a jointly developed action plan. All the elements of the climate strategy described above – decarbonization, financing of climate solutions, and dialogue with companies and external asset managers – are components of the common action plan (Target Setting Protocol) to which the pension fund has committed itself vis-à-vis the Net Zero Asset Owner Alliance.

Swiss Climate Scores

In 2022, the Swiss Federal Council adopted the Swiss Climate Scores, a best practice recommendation for climate reporting by financial institutions. The present sustainability report largely complies with the minimum criteria in terms of scope of information and data presentation. The (optional) calculation of the "global warming potential" is exempt. Ideally, this indicator would be used to determine the global temperature increase if the greenhouse gas emissions financed by the investment portfolio were representative of the global economy. However, the methodological uncertainties that currently exist do not permit to make a reliable statement on the climate compatibility of the investments.

Key climate metrics of the investment portfolio

The presentation of climate indicators is based on the Swiss Climate Scores. Details are provided under "Explanations of the climate metrics".

(1) Greenhouse gas emissions in relation to the economic output of companies

tCO2e per CHF million sales (emissions intensity)
Target is to reduce the emissions intensity (Scope 1+2) by 50% until 2030 compared to 2019

Asset class	Portfolio	Covered assets	Reduction compared to 2019	Benchmark
Developed markets equities				
Scope 1+2	132.1	99.8%	-19.6%	139.7
Scope 3	780.8	98.0%	-10.0%	802.2
Emerging markets equities				
Scope 1+2	236.4	97.8%	-39.1%	336.7
Scope 3	840.9	75.0%	-22.1%	968.8
Corporate bonds				
Scope 1+2	131.6	97.3%	-16.5%	191.8
Scope 3	738.3	93.0%	-1.0%	769.2

(2) Greenhouse gas emissions in relation to the capital invested in companies

tCO2e per CHF million invested (financed emissions)
Target is to reduce the financed emissions (Scope 1+2) by 50% until 2030 compared to 2019.

Asset class	Portfolio	Covered assets	Reduction compared to 2019	Benchmark
Developed markets equities				
Scope 1+2	48.5	95.1%	-27.1%	50.1
Scope 3	406.2	97.8%	0.7%	420.1
Emerging markets equities				
Scope 1+2	163.6	87.2%	-51.8%	169.7
Scope 3	577.6	74.7%	-46.6%	571.7
Corporate bonds				
Scope 1+2	59.5	93.9%	-9.3%	65.4
Scope 3	425.5	92.4%	-6.9%	394.1

(3) Greenhouse gas emissions related to real estate (excluding construction/conversion).

kgCO2e per usable area (m^2)
Target is to reduce the emissions per usable area (Scope 1+2) by 50% until 2030 compared to 2019.

Asset class	Intensity (Scope 1+2)	Covered assets	Reduction compared to 2019	Energy source fossil / renewable
Swiss real estate	15.1	87%	-6%	62% / 38%

(4) Exposure to fossil fuels

Weighting of companies with more than 5% share of sales (entire value chain)

Asset Class	Coal	Benchmark	Oil & Gas	Benchmark
Developed markets equities	1.4%	1.5%	5.9%	6.0%
Emerging markets equities	0.8%	1.5%	1.0%	1.5%
Corporate bonds	1.2%	2.4%	9.0%	6.6%

(5) Share of companies with verified plans for full decarbonization (net zero).

Weighting of companies with climate strategies declared to SBTi or validated by SBTi

Asset class	Declared plans	Benchmark	Validated plans	Benchmark
Developed markets equities	17.9%	18.1%	41.4%	40.5%
Emerging markets equities	12.9%	17.0%	7.5%	7.6%
Corporate bonds	18.0%	13.7%	32.8%	25.3%

(6) Exercise of voting rights 2022 in the equity portfolios

Voting rights for directly held shares delegated to CSAM

Asset class	Number of GMs	Participation quota	For management	Against management
Directly held shares	333	79%	73%	27%
Developed markets equities (Funds)	approx. 4'500	97%	91%	4%
Emerging markets equities (Funds)	approx. 3'350	98%	85%	13%

The Pension Fund's voting mandate with CSAM includes all directly held shares.
The participation rate at the AGMs shows the (weighted) coverage by our service providers.
"For" and "against" management is related to the number of agenda items at the AGMs attended.

(7) Exercise of voting rights 2022 for climate-related agenda items

Agenda items related to Climate Action 100+ engagement goals

Asset class	Number of agenda items	Proposed by management	Proposed by shareholders
Directly held shares	17	6x pro 2x against 1x abstention	8x pro
Developed markets equities (Funds)	38	26x pro	5x pro 7x against
Emerging markets equities (Funds)	No climate-relevant agenda items in 2022		

(8) Climate engagement with companies via Climate Action 100+.

Weighting of investee companies in dialogue with Climate Action 100+ and their share of portfolio emissions (Scope 1-2).

Asset class	Weighting Portfolio	Weighting Benchmark	Emissions share Portfolio	Emissions share Benchmark
Developed markets equities	13.3%	13.7%	58.7%	59.1%
Emerging markets equities	3.6%	5.8%	22.0%	33.7%
Corporate bonds	20.4%	16.8%	70.4%	60.8%

(9) Financing of climate solutions

Climate solutions include products and services that contribute to emissions reductions

Asset class	Target allocation	Actual exposure
Developed markets equities	Sales share of climate solutions higher than MSCI World	Portfolio: 5.4% MSCI World: 5.1%
Emerging markets equities	Sales share of climate solutions higher than MSCI Emerging Markets	Portfolio: 2.4% MSCI EM: 3.8%
Bonds	15% Green Bonds	11.8%
Infrastructure	15% Renewable energies	16.1%

Explanations of the climate metrics

(1) Greenhouse gas emissions in relation to the economic output of companies
The emissions intensity measures emissions relative to corporate sales.
Economic sectors can be compared directly, as can shares versus corporate bonds. Greenhouse gases are recorded in terms of their warming effect (*radiative forcing*) equivalent to carbon dioxide (tCO2e).
For the base year 2019, company emissions in 2019 were weighted by their portfolio share as of year-end. For current data, the latest available emissions data were weighted by portfolio share as of March 2023.
MSCI ESG estimates for Scope 3 emissions (not available for 2019 base year).
Source: MSCI ESG, FactSet

(2) Greenhouse gas emissions in relation to the capital invested in companies
Financed emissions are emissions relative to the value of invested assets.
Otherwise, the explanations given in (1) apply.
Source: MSCI ESG, FactSet

(3) Greenhouse gas emissions related to real estate (excluding construction/conversion).
Data coverage for the emissions of the seven Swiss real estate funds and foundations ranges from 54% to 100% of usable space. Weighted by the respective investment amount, this results in an average coverage of 85%.
For the energy mix, the data coverage is 50% of the investment amount.
Source: Fund companies, data as of 2020/2021

(4) Exposure to fossil fuels
The value chain of energy suppliers includes the fuel mix used to generate electricity and district heating.
Source: MSCI ESG, FactSet, fuel mix data as of March 2023.

(5) Share of companies with verified plans for full decarbonization (net zero).
Companies can make a commitment to SBTi to achieve a net-zero target (declared plans) and must submit corresponding decarbonization business plans within one year. SBTi then assesses whether the level of emission reductions is in line with the scientific guidance of the Intergovernmental Panel on Climate Change (validated plans).
Source: MSCI ESG, FactSet, SBTi data as of March 2023

(6) Exercise of voting rights 2022 in the equity portfolios
Source: CSAM, fund companies

(7) Exercise of voting rights 2022 for climate-related agenda items
Climate-relevant agenda items are those identified by Climate Action 100+ as relevant to the organization's climate policy goals (*flagged votes*).
Source: Climate Action 100+, data as of March 2023

(8) Climate engagement with businesses via Climate Action 100+.
Readers' note: In the "Developed markets equities" subportfolio, Climate Action 100+ focuses on companies that together account for 13.3% of the subportfolio's market value. These companies account for 58.7% of the subportfolio's greenhouse gas emissions (Scope 1-2).
Source: MSCI ESG, FactSet, data as of March 2023

(9) Financing of climate solutions
In the case of equities and infrastructure investments, climate solutions include business activities (measured in terms of sales) that make it possible to replace fossil fuels or reduce the use of fossil fuels (through improved energy efficiency). In the case of bonds, on the other hand, the earmarked use of funds for green bonds can be taken into account directly.
Source: MSCI ESG, FactSet, UBS, each as of end of March 2023

Glossary

Climate Action 100+
Investor initiative aimed at ensuring that the world's largest greenhouse gas emitters take the necessary measures to combat climate change

Decarbonization
Shift to an economic model (energy procurement, industrial production, agriculture) that sustainably reduces greenhouse gas emissions with the long-term goal of a largely emission-free economy

Green Bonds
Bonds earmarked exclusively for the financing of climate-positive investments

Climate solutions
Percentage of sales that a company generates with products or services related to renewable energy, energy efficiency, green building or sustainable agriculture

MSCI ESG Ratings
Systematic assessment of financially relevant ESG risks of a company, and how these risks are managed by the company

Net Zero
Economic activity without increasing greenhouse gas concentrations in the atmosphere (unavoidable emissions to be captured and stored using technical processes)

Net Zero Asset Owner Alliance
Network of institutional investors committed to reducing greenhouse gas emissions in their portfolios to net zero by 2050

PRI Initiative (Principles for Responsible Investment)
Investor initiative in partnership with the UN, whose participants commit to six fundamental sustainability principles

SBTi (Science-Based Targets Initiative)
Initiative that uses scientific criteria to assess whether corporate emissions targets are sufficient to limit global warming to +1.5C or 2.0C

Swiss Climate Scores
Reporting standard recommended by the Federal Council on the climate compatibility of financial investments

Greenhouse gas emissions (Scope 1, 2, 3)
Carbon dioxide and methane are the main contributors to global warming; releases occur during operational production (Scope 1), during the production of purchased energy (Scope 2), and above all in the upstream and downstream value chain (Scope 3)

Intergovernmental Panel on Climate Change (IPCC)
Committee set up by the UN to compile the findings of global climate research and present them to political decision-makers