

# Our Environmental and Social Risk Management Framework

## Comprehensive, Highest Industry Standards, Deeply Rooted in our Culture

- Our **comprehensive** environmental and social risk (ESR) standards govern client and supplier relationships and are enforced firm-wide and applied to all activities
- Our ESR practices meet the **highest industry standards** as confirmed by external auditors and recognized by environmental, social, governance ratings
- Our ESR framework is **deeply rooted in our culture**, management practices and control principles, overseen at Group Executive Board-level

### 1. Introduction

We live in a world that is more interconnected, more interdependent and more interactive than ever before. Rapid technological advances in particular continue to have a profound effect on the economic, political, cultural, environmental and social landscape. These advances have changed the way we think and act. They have altered the way we do business. They have transformed the products and services we consume, and reshaped the perceptions of the world around us. While this has brought with it significant benefits and opportunities, it has also created far greater awareness of the challenges we all face.

As a global company, and the world's largest wealth manager, UBS is in a unique position to help address these challenges, both together with our clients and through our own efforts. Our principles and standards clearly define how we want to do things at UBS. They apply to all aspects of our business and the ways in which we engage with our stakeholders. They firmly demonstrate that we recognize our firm's societal responsibilities and take these seriously. In our Code of Business Conduct & Ethics we have firmly documented our [corporate responsibility](#). Our work in key societal areas such as protecting the environment and respecting human rights are part of this. We firmly believe that living up to our societal responsibilities contributes to the wider goal of sustainable development. This is not a commitment to re-act – but to act. As a global firm we fully recognize our responsibility to lead the debate on important societal topics, contribute to the setting of standards and collaborate in and beyond our industry.

Managing environmental and social risks is a key component of our corporate responsibility. We apply an environmental and social risk framework to all our activities. This helps us identify and manage potential adverse impacts to the environment and to human rights, as well as the associated risks affecting our clients and us. We have set standards in product development, investments, financing and for supply chain management decisions. We have identified certain controversial activities we will not engage in, or will only engage in under stringent criteria. As part of this process we engage with clients and suppliers to better understand their processes and policies and to explore how any environmental and social risks may be mitigated. We avoid transactions, products, services, activities or suppliers if there are material environmental

and social risks that cannot be properly assessed. We will not do business with a counterparty/issuer who we judge is not addressing environmental or social issues in an appropriate and responsible manner.

The foundation of UBS's environmental and social risk framework is established in the [Code of Business Conduct and Ethics of UBS](#) and the [UBS Environmental and Human Rights Policy](#).

### 2. Our Focus

Our industry is playing an increasingly active role in addressing global issues such as human rights and the protection of our environment. Climate change will impact ecosystems, societies, and economies worldwide, and we are already working with our clients to ensure they achieve their goals in an increasingly carbon-constrained environment. Growing environmental and human rights concerns have resulted in a fast-changing regulatory and competitive landscape which is affecting our firm, our suppliers and our clients. In response to these emerging risks and opportunities, we are shaping appropriate solutions and commitments.

Over twenty years ago, UBS was one of the first financial institutions to sign the [United Nations Environment Programme's "Statement by Financial Institutions on the Environment and Sustainable Development"](#). We were also among the first companies to endorse the [UN Global Compact](#), we were an original signatory of the [CDP](#), and our Global Asset Management business is an Investment Manager signatory to the [Principles for Responsible Investment](#).

In 2000, our firm was a founding member of the [Wolfsberg Group](#) of banks which was originally set up to promote good practice in combatting money laundering. More recently, the firm was a driving force behind the development of the [Thun Group](#) of banks' discussion paper that seeks to establish a framework to facilitate the identification of the key challenges and best practice examples for the banking sector's implementation of the UN Guiding Principles on business and human rights. In 2012, we became a member of the [Roundtable on Sustainable Palm Oil](#), and joined its complaints panel in 2014. Also in 2014, we endorsed the Banking Environment Initiative's and Consumer Goods Forum's '[Soft Commodities](#)'

**Compact** which reconfirms our commitment to developing and implementing responsible business standards.

Our environmental and human rights policy is implemented through our global management system. We regularly report on the progress we are making in our annual reporting. This is reviewed and assured externally according to the requirements of the **Global Reporting Initiative's** (GRI) Sustainability Reporting Guideline. UBS is certified according to **ISO 14001**, the international environmental management standard.

### 2.1. Climate change

Climate change is one of the most significant challenges of our time. Population growth, energy security, loss of biodiversity and access to drinking water and food are all closely intertwined with climate change. This makes the transition to a low-carbon economy vital. Back in 2006, our Group Executive Board recognized that UBS should play its part in addressing climate change and endorsed a firm-wide CO<sub>2</sub> emission reduction target of 40% below 2004 levels by 2012. Steps taken towards achieving this target included adopting internal efficiency measures, increasing the proportion of renewable energy used and offsetting emissions we cannot avoid, such as business air travel. We achieved the reduction target in 2012 and have set ourselves a new target aiming at reducing our CO<sub>2</sub> emissions by a further 15% by 2016, resulting in an overall reduction of 50% below 2004 levels.

However as a leading global financial services firm we also acknowledge that we are well placed to help our clients as they prepare for the transition to a low-carbon economy. We have identified the areas where we believe we can make the greatest contribution to this transition. Our climate change strategy was therefore revised in 2013 and is now focused on investments, financing, research and risk management as well as in-house operations.

We recognize the transition will take time and that fossil fuels will be the dominant energy source for some time to come. Nevertheless, we are determined to understand the risks that our clients', and our own, assets are exposed to in the context of uncertain policy and technology developments.

In support of our climate change strategy, we:

- integrate responsible property investment strategies into the management of our real estate funds and measure the sustainability performance of individual properties with recognized external benchmarks. In 2013, six of UBS's real estate funds, with CHF 20 billion gross assets under management, obtained top ranking ("green star") by the Global Real Estate Sustainability Benchmark.
- offer institutional investors unprecedented access to a diversified portfolio of Swiss infrastructure facilities and companies in the field of renewable energies and energy efficiency.
- help Swiss SMEs save energy, as promoted by the Swiss Energy Agency's SMEs model. Clients benefit from the agency's energy check-up at reduced costs and are granted cash premiums for committing to an energy reduction plan within this scheme.

- support Investment Bank clients that provide a positive contribution to climate change mitigation and adaptation, either in equity or debt capital market transactions (total deal value in 2013: CHF 28.5 billion) or as financial advisor (total deal value in 2013: CHF 49.4 billion).
- assess transactions related to the construction of coal-fired power plants against technology used, energy efficiency and greenhouse gas emissions, and significantly reduced our exposure to mining companies that rely on mountain top removal coal mining as part of their production.
- are actively participating in the international efforts led by the Greenhouse Gas Protocol and the United Nations (UN) Environment Programme Finance Initiative to develop a greenhouse gas accounting and reporting guidance for financial intermediaries. In addition we are working to internally estimate our vulnerability to climate change risks.
- are supportive of the CDP, as a signatory as well as a questionnaire respondent, in their aim to improve company disclosure of risks and opportunities related to climate change.

### 2.2. Forests and biodiversity

Deforestation and forest degradation can cause biodiversity to decline. As approximately 80% of the world's documented species are found in tropical rainforests deforestation will impact global biodiversity. Deforestation is, in fact, second only to the energy sector as a source of global greenhouse gas emissions and accounts for up to 20% of emissions, more than the entire global transport sector. It is further estimated that more than 50% of tropical deforestation is due to the production of soy, palm oil, timber and beef.

In human terms, millions of people rely directly on forests (small-scale agriculture, hunting and gathering, and harvesting forest products such as rubber). Yet, deforestation continues to cause severe societal problems, sometimes leading to violent conflict.

Recognizing these risks, we:

- became member of the Roundtable on Sustainable Palm Oil in 2012, and joined its complaints panel in 2014;
- endorsed the Banking Environment Initiative's and Consumer Goods Forum's 'Soft Commodities' Compact. In doing so, we commit to support the transformation of soft commodity supply chains by expecting producers to be fully certified according to applicable sustainability certification schemes, such as the Roundtable on Sustainable Palm Oil, by 2020;
- have identified and will not engage in certain activities that contribute to deforestation and its related impacts (sections 3.1 and 3.2).

### 2.3. Human rights

UBS is committed to respecting and promoting human rights in all our business activities. We believe this is a responsible approach underlining our desire to reduce as far as possible potentially negative impacts on society. Our commitment in this important area is long-standing. In July 2000, UBS was one of 43 companies (and one of only three were banks) that pledged to adhere to the UN Global Compact's Principles on human rights, labor standards and the environment.

The principles of the Global Compact, today the largest corporate responsibility initiative globally, stem from the Universal Declaration of Human Rights, the International Labor Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development and the United Nations Convention Against Corruption. In the area of human rights, a major next step emerged in 2005 with the appointment of Prof. John Ruggie as UN Special Representative for Business and Human Rights. This started a process that ultimately resulted in the UN Human Rights Council approving the Guiding Principles on Business and Human Rights.

UBS and other banks followed these developments with interest. It became clear that banks should develop a banking-specific understanding of the Guiding Principles as they were not focused on a particular business sector. At this point, a group of banks decided to jointly consider these developments and conclusions and, eventually, to share experiences and ideas regarding the implementation of the Guiding Principles.

To this end, in 2013, UBS co-launched the Thun Group of Banks' discussion paper on banking and human rights. The paper aims to support banks in mapping and analyzing their own potential adverse impacts in relation to human rights, and also looks at related risks including reputational, legal, operational and financial risks. The Group's discussions have been assisted by expert input from the University of Zurich Competence Centre for Human Rights, and we believe that this document will support the integration of the Guiding Principles into the policies and practices of banking institutions as well as helping to encourage constructive dialog with a wider group of stakeholders globally.

To address human rights issues, we:

- established a UBS Position on human rights in 2006. In 2013, we revised the firm's Environmental and Human Rights Policy Framework to reflect the Thun Group's discussion paper and to formalize accountability for human rights issues.
- stipulated that we will not engage in commercial activities that make use of child labor and forced labor, or that infringe the rights of indigenous peoples (section 3.1).
- will continue our work internally, and externally with the Thun Group of banks, to understand how best to implement the UN Guiding Principles across our operations.

### 3. Our standards

UBS has set standards in product development, investments, financing and supply chain management decisions, which include the stipulation of controversial activities and other areas of concern UBS will not engage in, or will only engage in under stringent criteria.

**3.1. Controversial Activities**-Where UBS will not do business UBS will not knowingly provide financial or advisory services to corporate clients whose primary business activity, or where the proposed transaction, is associated with severe environmental or social damage to or through use of:

- World heritage sites as classified by UNESCO;
- Wetlands: on the RAMSAR list;

- Endangered species of wild flora and fauna listed in Appendix 1 of the Convention on International Trade in Endangered Species;
- High conservation value forests as defined by the six categories of the Forestry Stewardship Council (FSC);
- Illegal fire: uncontrolled and / or illegal use of fire for land clearance;
- Illegal logging including purchase of illegal harvested timber (logs or roundwood);
- Child labor: according to ILO-conventions 138 (minimum age) and 182 (worst forms);
- Forced labor: according to ILO-convention 29; and
- Indigenous peoples' rights in accordance with IFC Performance Standard 7.

The same standards apply when UBS purchases goods or services from suppliers.

In addition, UBS does not directly or indirectly finance the development, production or purchase of controversial weapons of such companies determined to fall within the "Swiss Federal Act on War Materials". Specifically, UBS does not provide credit facilities to, or conduct capital market transactions for, companies that are involved in the development, production or purchase of cluster munitions and anti-personnel mines. UBS does not include securities of affected companies in its actively-managed retail and institutional funds and in discretionary mandates.

**3.2. Areas of Concern**-Where UBS will only do business under stringent criteria.

Specific guidelines and escalation criteria apply to transactions with corporate clients engaged in the areas of concern listed below. The guidelines and escalation criteria apply to loans, trade finance, securities and loan underwriting transactions, and investment banking advisory assignments.

Transactions in the areas listed below trigger an enhanced due diligence and approval process. In addition to the assessment of regulatory compliance, adherence to UBS's controversial activities standards, past and present environmental and human rights performance, as well as concerns of stakeholder groups, these transactions require an assessment of the following criteria:

#### 3.2.1. Soft commodities

- Palm oil: Companies must also be a member of the Roundtable on Sustainable Palm Oil (RSPO), and not subject to any unresolved public criticism from the RSPO. Companies must further have some level of mill or plantation certification and be publicly committed to achieving full certification by 2020 (evidence must be available).
- Soy: Companies producing soy in markets at high risk of tropical deforestation must also be a member of the Roundtable on Responsible Soy (RTRS), and not subject to any unresolved public criticism from the RTRS. Companies must further be publicly committed to achieving full certification by 2020 (evidence must be available).
- Timber: Companies producing timber in markets at high risk of tropical deforestation must also seek to achieve full certi-

fication of its production by 2020 according to the Forest Stewardship Council (FSC) or a national scheme endorsed against the 2010 Programme for the Endorsement of Forest Certification (PEFC) meta standard for timber products.

### 3.2.2. Power Generation

- **Coal-fired power plants (CFPP):** Transactions related to the construction of new or upgrading existing CFPPs are also assessed against technology used, energy efficiency and greenhouse gas emissions as recommended by the IFC EHS Guidelines for Thermal Power Plants and the International Energy Agency Technology Roadmap. Also assessed is the company's strategy to reduce coal exposure over time.
- **Large Dams:** Transactions directly related to large dams also include an assessment against the recommendations made by the World Commission on Dams (WCD) and the International Hydropower Association Sustainability Assessment Protocol.
- **Nuclear Power:** Transactions directly related to the construction of new, or upgrading existing nuclear power plants also include an assessment on whether the country of domicile of the client / operation has ratified the Treaty on the Non-Proliferation of Nuclear Weapons.

### 3.2.3. Extractives

- **Hydraulic fracturing:** Transactions with companies that practice hydraulic fracturing in environmentally and socially sensitive areas are also assessed against their commitment to and certification of voluntary standards, such as the American Petroleum Institute's documents and standards for hydraulic fracturing.
- **Oil sands:** Transactions directly related to oil sand assets (open pit and in situ operations) are also assessed against the company's commitment to reducing energy use, greenhouse gas emissions and land footprint, reclamation activities, tailings management, water management and community relationships, as well as commitment to and certification of voluntary standards, e.g. good practice according to the IPIECA-OGP Biodiversity Working Group, the IPIECA Water Management Good Practice Guidelines and membership to industry initiatives such as COSIA and SCI).
- **Arctic drilling:** Transactions involving oil and gas exploration and development in the Arctic (onshore and offshore) are also assessed against the company's safety management capacity and track record as well as adequacy of the company's spill response plans.
- **Mountain top removal (MTR) coal mining:** Coal mining companies that rely on MTR as part of their production are also assessed to what extent they rely on MTR mining for their revenue generation, and UBS needs to be satisfied that the client is committed to reduce over time its exposure to this form of mining. Any potential transaction with a company involved in MTR fully depends on whether the company's environmental and social performance complies with our environmental and social risk framework and associated processes. Our firm's overall exposure to MTR companies has declined substantially since 2010.
- **Precious Metals:** Transactions directly related to precious metals assets that have a controversial environmental and social risk track record are also assessed against the client's

commitment to and certification of voluntary standards, such as the International Council on Mining & Metals ICMM, ICMM Management Code.

- **Diamonds:** Transactions with companies that mine and trade rough diamonds are also assessed on the client's commitment to and certification of voluntary standards, such as the International Council on Mining & Metals ICMM, and rough diamonds must be certified under the Kimberley Process.

## 4. Our Processes and Governance

UBS applies an environmental and social risk framework to all transactions, products, services and activities such as lending, capital raising, advisory services or investments that involve a party associated with environmentally or socially sensitive activities. The framework seeks to identify and manage potential adverse impacts to the environment and to human rights, as well as the financial and reputation risks of being associated with them.

### 4.1. Integration in risk, compliance and operations processes

Procedures and tools for the identification, assessment and monitoring of environmental and social risks are applied and integrated into standard risk, compliance and operations processes.

- **Client onboarding:** potential clients are assessed for environmental and social risks associated with their business activities as part of UBS's know-your-client compliance processes.
- **Transaction due diligence:** environmental and social risks are identified and assessed as part of transaction due diligence processes. Industry sector guidelines are available to support risk identification and assessment in certain high risk sectors (chemicals, forestry products and biofuels, infrastructure, metals and mining, oil and gas, and utilities). These guidelines provide an overview of key environmental and human rights issues that arise in the various life cycles of the sector, and summarize industry standards in dealing with them.
- **Product development and investment decision processes:** new financial products and services are reviewed before their launch in order to assess their compatibility and consistency with UBS's environmental and human rights principles. Environmental and social risks are also considered in investment decision processes and when exercising ownership rights like proxy voting and engagement with the management of investee entities.
- **Own operations:** our operational activities and employees, or contractors working on UBS premises, are assessed for compliance with relevant environmental, health and safety, and labor rights regulations.
- **Supply chain management:** environmental and social risks are assessed when selecting and dealing with suppliers. UBS also evaluates goods and services which pose potential environmental, labor and human rights risks during lifecycle (production, usage, and disposal) as part of its purchasing processes.

- **Portfolio review:** we also undertake portfolio level reviews of sensitive sectors and activities where there are emerging or heightened environmental and social risks. We assess exposure and revenue to clients in such sectors and attempt to benchmark the quality of the portfolio against regional and or sector averages. Such portfolio reviews provide a current aggregated exposure profile and insight to the transaction and client onboarding process. It allows us to examine ways to improve the future portfolio profile along a range of risk dimensions.

Clients, transactions or suppliers potentially in breach of UBS's position, or otherwise subject to significant environmental and human rights controversies, are identified as part of UBS's standard risk and compliance processes. Advanced data analytics on companies associated with such risks is integrated into the web-based compliance tool used by our staff before they enter into a client or supplier relationship, or a transaction. The systematic nature of this tool significantly enhances our ability to identify potential risk. In 2013, over 1700 cases were referred for assessment to our environmental and social risk units, of which 42 were rejected or not pursued, and 196 approved with qualifications.

## Environmental and social risk assessments

		For the year ended			
		GRI	<sup>1</sup> <b>31.12.13</b>	31.12.12	31.12.11
<b>Cases referred for assessment</b>	<sup>2</sup>	FS2	1'716	1'039	416
<b>by region</b>					
Americas		FS2	367	288	111
Asia Pacific		FS2	296	222	136
Europe, Middle East and Africa		FS2	373	225	119
Switzerland		FS2	680	304	50
<b>by business division</b>					
Wealth Management		FS2	298	157	59
Wealth Management Americas		FS2	46	5	5
Retail & Corporate		FS2	598	223	22
Global Asset Management		FS2	14	12	n/a
Investment Bank		FS2	657	533	330
Corporate Center	<sup>3</sup>	FS2	103	109	n/a
<b>by sector</b>					
Metals and mining		FS2	418	217	n/a
Oil and gas		FS2	239	136	n/a
Agribusiness	<sup>4</sup>	FS2	155	45	n/a
Utilities		FS2	95	38	n/a
Chemicals		FS2	67	29	n/a
Infrastructure		FS2	51	15	n/a
Other	<sup>5</sup>	FS2	691	559	n/a
<b>by outcome</b>					
approved	<sup>6</sup>	FS2	1'462	812	n/a
approved with qualifications	<sup>7</sup>	FS2/FS3	196	171	n/a
rejected or not further pursued	<sup>8</sup>	FS2	42	56	n/a
pending	<sup>9</sup>	FS2	16	0	n/a

<sup>1</sup> Global Reporting Initiative (see also [www.globalreporting.org](http://www.globalreporting.org)). FS stands for the Performance Indicators defined in the GRI Financial Services Sector Supplement.

<sup>2</sup> Transactions and onboarding requests referred to environmental and social risk (ESR) functions.

<sup>3</sup> Relates to procurement / sourcing of products and services.

<sup>4</sup> Includes since 2013 e.g. forestry products, biofuels, food and beverage.

<sup>5</sup> Includes e.g. financial institutions, aerospace and defence, telecom, technology.

<sup>6</sup> Client / transaction / supplier subject to an ESR assessment and considered in compliance with UBS's ESR framework.

<sup>7</sup> Client / transaction / supplier subject to an ESR assessment and approved with qualifications. Qualifications may include ring-fencing of certain assets, conditions towards client / supplier or internal recommendations.

<sup>8</sup> Client / transaction / supplier subject to an ESR assessment and rejected or not further pursued.

<sup>9</sup> Decision pending.

#### 4.2. Escalation and approval processes

Where business or control functions responsible for identifying and assessing environmental and social risks as part of due diligence processes determine the existence of potential material risks, they refer the client, supplier or transaction to a

specialized environmental and social risk unit for enhanced due diligence. If identified risks are believed to pose potentially significant environmental or social risks, they are escalated for approval to senior management, at divisional, regional, or Group level, depending on their significance.

### Environmental & social risk (ESR) escalation process



#### 4.3. Governance and oversight

In view of the many environmental and social challenges globally, these topics will continue to increase in relevance for banks. These developments therefore require regular and critical assessment of our policies and practices, based on an accurate monitoring and analysis of societal topics of potential relevance to UBS.

This process is the responsibility of a committee at Group Executive Board-level, the Global Environmental & Social Risk Committee, which resolves transactional and policy matters relating to environmental and social risks and their associated reputation risks. It is chaired by Philip Lofts, Group Chief Risk Officer, who is responsible for the development and implementation of principles and appropriate independent control frameworks for environmental and social risks within UBS.

In addition, UBS considers environmental and human rights topics in its Environmental & Human Rights Committee, which includes, among others, the Group and the business division environmental human rights representatives.

Lastly, all corporate responsibility developments at UBS are monitored and reviewed by the UBS Corporate Responsibility Committee, a Board of Director's committee. The Committee supports the Board in its duties to safeguard and advance UBS's reputation for responsible corporate conduct. In this capacity it reviews and monitors the implementation of UBS's Environmental and Human Rights Policy.