



qic

GLOBAL
LIQUID STRATEGIES
ESG UPDATE
2018

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QIC RESPONSIBLE INVESTMENT

We believe Environmental, Social and Governance (ESG) factors can have a material impact on the long-term returns of investment portfolios. This was the motivation for QIC becoming a signatory to the United Nations backed Principles for Responsible Investment initiative (UNPRI) in 2008.

ESG factors are integrated into our investment decision-making processes as part of our commitment to delivering strong, long-term returns for clients. Our Responsible Investment (RI) policy outlines our commitment to the six UNPRI Principles. The six Principles are:

1. Incorporate ESG issues into investment analysis and decision-making processes.
2. Be active owners and incorporate ESG issues into our ownership policies and practices.
3. Seek appropriate disclosure on ESG issues by the entities in which we invest.
4. Promote acceptance and implementation of the Principles within the investment industry.
5. Work together to enhance our effectiveness in implementing the Principles.
6. Each report on our activities and progress towards implementing the Principles.

INTRODUCTION

QIC Global Liquid Strategies (GLS) is continuing to see ever increasing client interest in Responsible Investment driven by a variety of factors including influencing better corporate practices, increasing regulation, meeting fiduciary obligations and generating strong investment returns.

With an established and robust ESG framework, designed specifically for fixed income investors, GLS is well placed to offer solutions to clients in this sphere. We seek to be at the forefront in ESG practice and this requires a keen focus on continuing to advance our ESG capabilities.

Our more prominent activities since our last [update](#) are below and discussed further in this ESG Report.

- Ongoing ESG issuer engagement program
- Ongoing integration of our ESG research, views and strategies into GLS portfolios including selective investment in labelled bonds
- Continued strong collaboration with MSCI to enhance their coverage of Australian fixed income bonds
- Attendance at several Responsible Investment conferences and events, as either speakers, panel members or participants
- Commitment to enhancing fixed income and currency market governance through our representation on the BBSW Advisory Committee and the Australian Foreign Exchange Committee
- Contribution to the UNPRI's Global Bondholder Engagement Working Group and publications

GLS ESG FRAMEWORK

The GLS team has a robust and scalable ESG capability. We aim to enhance returns and protect value for clients by integrating ESG factors into the GLS investment process. The team's investment philosophy is based on the belief that fundamental factors drive fixed interest markets over medium to longer term timeframes, with other transitory and technical influences causing markets to deviate from 'fair value' over shorter timeframes. ESG is one of these important 'fundamental factors' that affects the operational and financial performance of bond issuers.

Our process and achievements are regularly recognised with thought leadership opportunities on investor panels, in callouts by industry bodies and in the press.

In addition, we are very proud of QIC and GLS' strong PRI assessment in 2017. GLS scored in the A+ band for Fixed Income Corporate Financials, Corporate Non-Financials and SSAs. We were scored in the A band for Securitised. These scores are amongst the highest in Oceania and in the Investment Manager peer group. Details of the PRI methodology can be found here:

<https://www.unpri.org/signatories/about-pri-assessment>

ESG is embedded
in our investment
process & values

- ESG is integrated into our bottom-up issuer and counterparty analysis
- Independent research (e.g. MSCI ESG) enhances our views
- QIC's dedicated Responsible Investment team together with GLS' ESG champions and process supports engagement/dialogue with companies

We tailor ESG
solutions
for clients

- Ability to screen countries, industries or companies
- At forefront of ESG research and developments
- Proprietary carbon analysis process

Transparent
ESG
disclosure

- QIC is a signatory to the United Nations backed 'Principles for Responsible Investment' initiative (UNPRI)
- QIC reports on its Responsible Investment (RI) activities to the QIC Board and clients annually. Reporting is also made to the UNPRI annually
- GLS analyses and discloses ESG ratings across portfolios

ESG ENGAGEMENT PROGRAM

Our ESG process – including our engagement program – has been developed specifically from a fixed income perspective.

As a key stakeholder in credit markets, we believe it is important to encourage continual improvement in corporate ESG practices to effect change.

We seek to understand and influence positive ESG practices from corporate bond issuers to deliver and protect investment returns. Where we do not see transparent or improving practices this influences our investment decisions.

Our ESG engagement program can be divided into three areas:

- Corporate bond issuers with highly regarded ESG practices – what can we learn from them? What insight do they give to different industries?
- Corporate bond issuers with weaker ESG practices – what are they doing to improve practices? Can we gain comfort around their commitment? If we hold their debt, is the market appropriately pricing their ESG risk?
- Thematic – issues that have the potential to impact returns such as climate change

We are also tying our engagement program to QIC’s six focus areas as these represent material ESG considerations for QIC as a business:

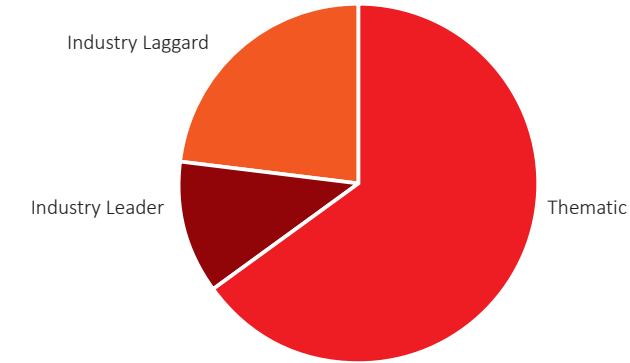
Climate risk	Enviro. Sustainability	People	Community	Corp. Governance	Active ownership
<ul style="list-style-type: none">• Adaptation to physical impacts• Impacts of transition to a low carbon economy• Policy and regulatory impacts	<ul style="list-style-type: none">• Environmental impacts• Resource efficiency• QIC’s own footprint	<ul style="list-style-type: none">• Workplace Health & Safety• Labour rights• Human rights in supply chains• Diversity & inclusion• Data privacy & protection	<ul style="list-style-type: none">• Asset level community engagement• Social license to operate• Contributing to net positive societal impact	<ul style="list-style-type: none">• Board composition e.g. tenure, skill, diversity• Ethical standards, conduct and culture• Transparency and disclosure• Evolving regulatory landscape• Appropriate internal controls	<ul style="list-style-type: none">• Active asset management• Corporate engagement• Proxy voting

Over the last 12 months we have undertaken ESG engagement meetings with senior management of five corporate issuers across four sub-sectors. We have particularly concentrated on engaging lower ESG rated issuers across automotive, industrial and US banking sectors and we have also continued our thematic and sovereign engagements.

Together with our proprietary relative value tool, which incorporates ESG ratings, our engagement meetings have helped inform portfolio positioning:

- In some areas we have gained comfort around initial areas of concern and have initiated trades where the market pricing had fallen too far; we have subsequently taken profit
- In other cases, we have not seen credible plans for improvement and have chosen to protect returns by exiting the position before we start to see evidence the market is pricing in this risk.

The majority of engagement meetings are on industry thematic but also focus on industry outliers



Source: QIC

INSIGHTS FROM RECENT COMPANY ENGAGEMENTS

INDUSTRY	KEY ISSUES	OBJECTIVE	DISCUSSION POINTS
Automotive	<ul style="list-style-type: none"> Clean tech opportunities Governance and risk management Product safety 	To gain insight into management of key ESG risks and validate third party ESG ratings	<ul style="list-style-type: none"> Compliance and integrity process improvements endorsed at Board level and rolled out through business Low stranded asset risk with high likelihood of meeting the EU's 2021 emissions target via electric vehicles, battery capabilities and over 10 years involvement in developing autonomous vehicles
Mining	<ul style="list-style-type: none"> Environmental impact Climate change Innovative funding 		<ul style="list-style-type: none"> Technologies to reduce emissions from fossil fuels Innovative funding measures to offset emissions Climate change scenario analysis post Paris to test the business against short term shock events that typically have longer term impacts
Financial	<ul style="list-style-type: none"> Financial system stability Financing sustainable solutions Social impact and corporate responsibility 		<ul style="list-style-type: none"> Controversies associated with poor controls and financial market manipulation ESG risk management framework with transparent internal risk control mechanisms, employee ESG training targets, and sector-specific ESG lending policies Primary focus is on human rights issues associated with operations in domicile
Sovereign bonds	<ul style="list-style-type: none"> Green bonds 	GLS assess "greenness" independently and do not rely solely on certifiers	<ul style="list-style-type: none"> Progress and growth of asset pool Monitoring process for existing projects; data collection and reporting challenges

We have gained some useful insight from our fixed interest ESG engagement program over the last few years and this wisdom has allowed us to refine our engagement approach.

- Issuers want to engage with providers of capital – fixed income investors are an important provider of capital and this gives us an influential voice at the table
- Companies typically want to educate the market on the positive ESG practices they are undertaking and how they are addressing risks
- As and until ESG data improves in quality, direct engagement serves as a useful bridge for gathering intelligence

GREEN AND SOCIAL BOND INVESTMENTS

Green Bonds provide funding for projects that support environmental sustainability (e.g. low carbon transport and renewable energy) and the market will be a vital source of capital required to achieve the global transition to a low-carbon economy.

The Green Bond market has taken off globally with record issuance of USD81bn in 2016 compared to less than USD5bn in 2012 (see chart below).

The Australian Green Bond market has lagged in comparison, with \$3.7bn of certified bonds on issue, but also looks ready to flourish if Q1 2017 is anything to go by. March and April witnessed significant activity in the domestic Green / Social / Climate Bond market.

GLS invested in three of the four issues in March and April namely QTC's 7yr Green Bond, NAB's 5yr Social Bond and CBA's 5yr Climate Bond. These bonds priced either on the issuer's curve or with a small concession. We didn't participate in a fourth deal, Investa Office Fund's 7yr Green Bond, due to idiosyncratic credit / event risks.

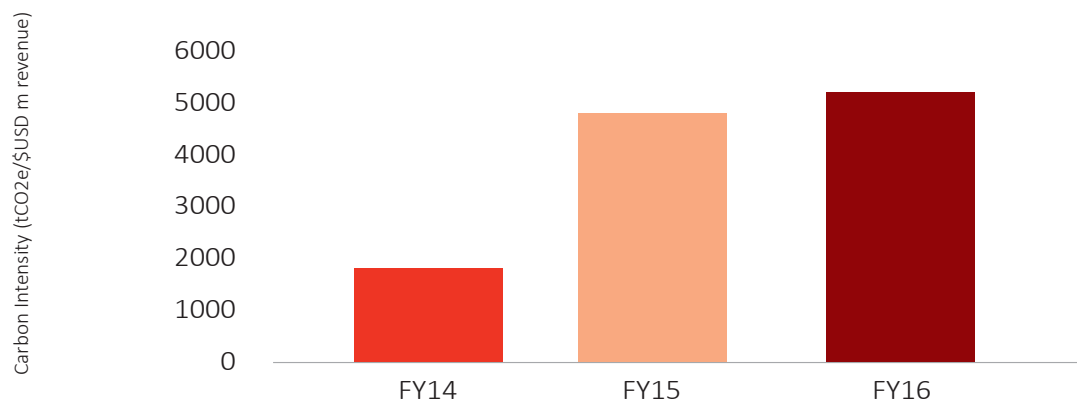
Our Australian Fixed Income fund now has a 5% weight to certified ESG bonds*. To date, GLS' Green Bond investments have either contributed to outperformance or not detracted from performance of our portfolios (relative to holding the traditional bonds of the same issuers).

INTEGRATION OF OUR ESG VIEWS INTO PORTFOLIOS

GLS has further strengthened its ESG framework with an emphasis on integrating our ESG views into portfolios. Critically, both our own research (outlined in The Liquid Markets' Brief of 28 October 2016) and empirical evidence support the notion that excess returns are possible for those that discern ESG strengths and risks. Important enhancements since GLS' last ESG update designed to further integrate our ESG research into portfolios include:

- Improved mapping of MSCI ESG ratings to portfolio holdings. We have worked closely with MSCI to boost their ESG coverage of the domestic bond market and this has seen our ESG rating coverage across portfolios increase to between 73% and 100% at 30 April from less than 50% 18 months ago
- Inclusion of ESG ratings in our proprietary relative value tool and formally discussing ESG strategies at GLS' Micro Credit monthly meeting
- Anecdotal comparison of the spread moves show green or social purpose bonds have performed in line with or slightly outperformed similar maturity general purpose bonds of the same issuer.

Assess individual issuers' trends over time – Company XYZ



QIC for illustration purposes



INTRODUCTION

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CONFERENCES AND EVENTS ATTENDED

QIC's ESG champions attended various prominent conferences since the previous report. These are valuable sources of knowledge in relation to market developments as well as ESG themes and trends. A particularly important development since the December quarter of 2016 has been QIC's participation, as the only delegate from the APAC region, in the UNPRI's bondholder engagement working group. The working group meets approximately every six weeks and its objective is to provide fixed income signatories with guidance on implementing Principle 2, which states "We will be active owners and incorporate ESG issues into our ownership policies and practices".

The following conferences and events were attended since July 2016:

CONFERENCES AND EVENTS ATTENDED	
PRI Bondholder Engagement Working Group Established in 2016 with a two-year work program Global working group with 13 members	Marayka Ward, Senior Credit Manager, is a member of the UNPRI's Bondholder Engagement Working Group. QIC's ongoing contribution since we last reported includes a PRI published case study on GLS' engagement process and the Working Group's seminal Guidance Note published in April 2018: https://www.unpri.org/fixed-income/esg-engagement-for-fixed-income-investors-managing-risks-enhancing-returns-/2922.article
KangaNews Sustainable Debt Summit March 2018 >150 delegates	Marayka Ward attended the Summit and was as a panel member in the session on "Practicalities and considerations of issuing sustainably in 2018". Phil Miall, Head of Credit Research & Strategy also attended. This was the first time KangaNews hosted its Summit as a full day event reflecting the exponential growth in interest to integrate ESG in the fixed interest universe.
Principles of Responsible Investment – Annual PRI-In-Person Conference, Berlin September 2017 >1000 delegates	Marayka Ward and Liesel Moorehead, Partner Global Infrastructure attended as speakers. Kate Bromley, Head of Responsible Investment, also attended as a delegate. The PRI is the largest investor collaborative network of its kind globally. The PRI in person conference in September provided a platform for PRI signatories and other investment professionals to learn, network and collaborate in person on ESG issues impacting investments. The Berlin conference focused on PRI's Blueprint for responsible investment.
Investor Group on Climate Change Summit October 2017 >100 delegates	Kate Bromley, Head of Responsible Investment, attended as a speaker and Andrew Saunders, Responsible Investment Strategist, attended as a delegate. The Group represents institutional investors with the summit focusing on climate change impacts against a backdrop of ever-evolving climate policy. Two reports were launched: Coal, Carbon & the Community: Investing in a Just transition; Commodities, Climate Investors & the Land: A Toolkit for Institutional Investors.

CONFERENCES AND EVENTS ATTENDED	
Responsible Investment Association Australasia – Annual RI Conference November 2017 >200 delegates	Andrew Saunders attended as a delegate. The Responsible Investment Association of Australasia (RIAA), which QIC is a member, had its annual RI conference in Melbourne. The key focus was on knowledge and expertise investors need in a world where clients demand a RI approach.
Centre for Investor Education – ESG Roundtable March 2018 >50 delegates	Andrew Saunders attended as a delegate. CIE's inaugural ESG Investing & Integration Roundtable looked into the issues associated with effective ESG implementation and ensuring it drives better investment outcomes. Following an interactive workshop structure, practitioners participated in an exchange of ideas between industry peers that focused on overcoming practical challenges.
Australian Council of Superannuation Investors (ACSI) Annual Conference May 2018 < 300 delegates	Kate Bromley and Andrew Saunders attended as delegates. ACSI is a member-based, superannuation industry body. The conference provided a view on the key environmental, social and corporate governance issues and risks of 2017 and discussed fiduciary duty, global trends in ESG and corporate culture.
Australian Securitisation Forum Evening Series June 2018 >80 delegates	Marayka Ward attended the Green Securitisation session as a panel member to provide insights from an investor perspective. The session focused on new and innovative green initiatives predominantly in the domestic securitisation and bond markets.
BBSW Advisory Committee	Scott Rissman, Director GLS is a member of the ASX BBSW Advisory Committee, which is the industry consultative committee reforming the BBSW benchmark, comprised of the RBA, ASIC, APRA and around 10 market participants.
Australian Foreign Exchange Committee	Stuart Simmons, Senior Portfolio Manager GLS, is a member of the Australian Foreign Exchange Committee (AFXC), a representative forum of the Australian foreign exchange market operating under the sponsorship of the Reserve Bank of Australia (RBA).
Global Foreign Exchange Committee	Stuart Simmons is a member of the Global Foreign Exchange Committee's (GFXC) buy-side liaison group, serving as lead representative to deepen the GFXC's engagement with the buy-side segment of the global FX market.

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