



qic

GLOBAL  
LIQUID STRATEGIES  
ESG UPDATE  
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## QIC RESPONSIBLE INVESTMENT

We believe environmental, social and corporate 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 seeing 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. Since our last [update](#) we have achieved further exciting progress on ESG integration. The most prominent among these are listed below and are discussed further in this ESG Report.

- Ongoing ESG issuer engagement programme
- Selective investment in Green / Social Bonds
- Ongoing integration of our ESG research, views and strategies into GLS portfolios
- Strong collaboration with MSCI to enhance their coverage of Australian fixed income bonds
- Attendance at several Responsible Investment conferences and events, as either speakers or panel members or participants

## 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.

### ESG is embedded in our investment process & values

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

### We tailor ESG solutions for clients

- Ability to screen countries, industries or companies
- Experienced in the Green Bond market
- At forefront of ESG research and developments (e.g. tobacco & cluster munitions exclusions)

### 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

## ESG ENGAGEMENT PROGRAMME

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

We seek to understand and influence positive ESG practices from corporate bond issuers in order 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.

Since our last report, we have undertaken ESG engagement meetings with senior management of six corporate issuers across five 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
- 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.

# INSIGHTS FROM RECENT COMPANY ENGAGEMENTS

INDUSTRY	DISCUSSION HIGHLIGHTS
<b>Automotive</b> Clean tech opportunities Labour relations Governance	<ul style="list-style-type: none"> <li>Fleet emission reduction targets and associated clean tech product development (e.g. bio fuel and hybrid vehicles)</li> <li>Sensitivities in labour / management relations and strategies to improve relationships</li> <li>Structures to achieve optimal balance across key stakeholders</li> </ul>
<b>Materials / Chemicals</b> Emissions reduction Human rights Board composition	<ul style="list-style-type: none"> <li>Targets and progress on NOx and GHG emissions</li> <li>Context and materiality regarding inputs sourced from a human rights sensitive region</li> <li>Strategies and peer-benchmarking to ensure non-executive Directors are not over-boarded</li> </ul>
<b>Financial</b> Climate change risks Environmental impact financing Social Bonds	<ul style="list-style-type: none"> <li>View climate change through both an opportunity and a risk lens; risks governed by overarching Environment &amp; Social Risk Management policy and asset class specific policy</li> <li>Targets and progress in environmental financing of activities that reduce climate change impacts and create environmental solutions</li> <li>Use of proceeds raised by proposed Gender Equality Social Bond</li> </ul>
<b>Energy &amp; Utilities</b> Green Bonds	<ul style="list-style-type: none"> <li>The companies are both on decarbonising paths and have active plans to switch from coal-fired generation to renewable energy sources</li> <li>Gas, wind and solar are key elements of their strategies to decarbonise</li> <li>Engagement the companies are having with regulators and stakeholders in keeping abreast of climate change policy changes impacting their business</li> </ul>

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. Here are a few conclusions we have found useful:

- 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

with four new issues printing in a pleasing display of increasing investor appetite for these assets.

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.

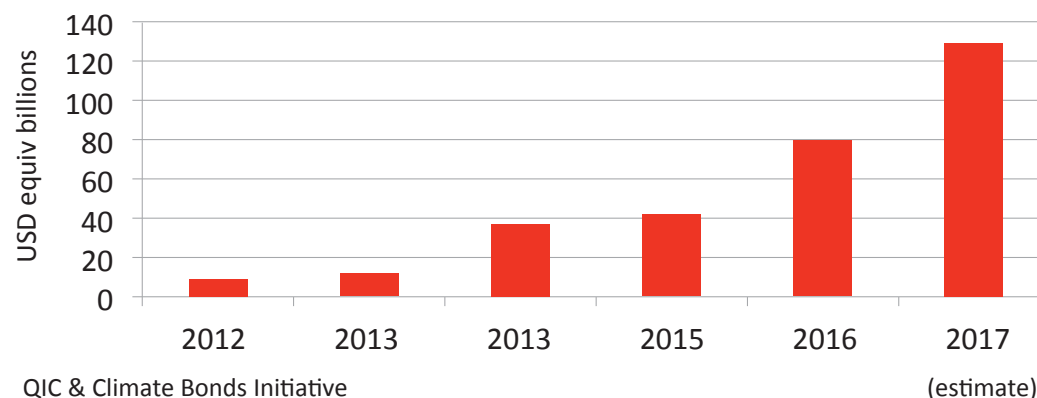
Our Australian Fixed Income fund now has a 5% weight to certified ESG bonds\*. To date, GLS' Green Bond investments have either contributed to outperformance or not detracted from performance of our portfolios (relative to holding the traditional bonds of the same issuers).

## 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.

### CBI compliant global green bond issuance



\*Including both green and socially responsible bonds.

We know from academic research that ESG consideration is important to fixed interest returns but there are other drivers for the necessity of taking ESG considerations seriously.

We believe these have increased considerably in Australia in the last 12 months with commentary from several important regulatory bodies as detailed in the table right.

GOVERNING BODY	RECOMMENDATION/REQUIREMENT
<b>APRA</b> Speech by Geoff Summerhayes (Executive Board Member) 17 February 2017	It is no longer the case that climate risks are a future problem or a non-financial problem. “Some climate risks are distinctly financial in nature. Many of these risks are foreseeable, material and actionable now.” “it’s unsafe for entities or regulators to ignore risks just because there is uncertainty, or even controversy, about the policy outlook” “Scenario analysis as the new normal” <a href="http://www.apra.gov.au/Speeches/Pages/Australias-new-horizon.aspx">http://www.apra.gov.au/Speeches/Pages/Australias-new-horizon.aspx</a>
<b>Financial Stability Board</b> November 2016	Taskforce on Climate-related Financial Disclosures a business-led report recommending a voluntary, practical, global framework for improving a wide spectrum of climate-related disclosures <a href="https://www.fsb-tcfd.org/publications/recommendations-report">https://www.fsb-tcfd.org/publications/recommendations-report</a>
<b>Centre for Policy Development and the Future Business Council</b> November 2016	Legal opinion on directors’ duties Company directors who fail to properly consider and disclose foreseeable climate-related risks to their business could be held personally liable for breaching their statutory duty of due care and diligence under the Corporations Act <a href="http://cpd.org.au/wp-content/uploads/2016/10/Legal-Opinion-on-Climate-Change-and-Directors-Duties.pdf">http://cpd.org.au/wp-content/uploads/2016/10/Legal-Opinion-on-Climate-Change-and-Directors-Duties.pdf</a>
<b>ASX Corporate Governance Principles and Recommendations (Third Ed)</b> 27 March 2014	Recommendation 7.4 A listed entity should disclose whether it has any material exposure <sup>38</sup> to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks. <a href="http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf">http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf</a>

## 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	
<b>UNPRI Bondholder Engagement Working Group</b> 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. The objectives of the bondholder engagement working group are to: <ul style="list-style-type: none"> <li>Clarify and define bondholder engagement and explore possible approaches</li> <li>Highlight current examples and case studies of bondholder engagement</li> <li>Identify broad investor trends of bondholder engagement</li> <li>Support collaborative bondholder engagements through PRI's collaboration platform</li> <li>Publish guidance which helps investors implement a bondholder engagement strategy where required</li> </ul>
<b>KangaNews Socially Responsible Investment Seminar</b> March 2017 >100 delegates	Phil Miall, Head of Credit Research & Strategy, attended as a panel member in the session on "Responsible investment principles and ESG". The seminar had approximately 115 delegates and focussed on the role of sustainable investing, the domestic Green Bond market and the future of Australia's SRI fixed income market. The KangaNews SRI Seminar is an annual event held in Sydney in conjunction with KangaNews' DCM Summit.
<b>Principles of Responsible Investment – Annual In Person Conference, Singapore</b> September 2016 >700 delegates	Arti Prasad-Naidu, former Head of Responsible Investment, attended as a delegate. QIC is a signatory to the UN-Backed Principles of Responsible Investment (PRI). 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 Singapore conference was focused on governance and the ESG risks and opportunities within Asia.

## CONFERENCES AND EVENTS ATTENDED

<b>The QLD Govt Climate change Summit</b> October 2016 >100 delegates	Arti Prasad-Naidu, former Head of Responsible Investment, attended as a delegate. The QLD Govt held the first ever climate change summit inviting key stakeholders within the region to discuss and promote the need to address climate change. It was an intimate workshop event where organisations, consultants and policy makers were able to openly and honestly discuss the key areas requiring focus and attention. Resilience studies and building awareness of climate change risks impacting infrastructure was one of the key topics of the discussion.
<b>Responsible Investment Association Australasia – Annual RI Conference</b> November 2016 > 300 delegates	Arti Prasad-Naidu, former Head of Responsible Investment, attended as a delegate and Kate Bromley, Responsible Investment Analysts attended as delegates. The Responsible Investment Association of Australasia (RIAA), which QIC is a member, had its annual RI conference in Melbourne. The key theme this year was the rise in consumer awareness and demand for RI related investment products.
<b>Centre for Investor Education – ESG Investing and Integration Roundtable</b> March 2017 >50 delegates	Kate Bromley, Head of Responsible Investment, 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.
<b>Carbon Market Institute, 4th Australasian Emissions Reduction Summit, 2017</b> May 2017 >500 delegates	Kate Bromley, Head of Responsible Investment, attended as a delegate. The 2017 Summit Program included a wide variety of keynote presentations, plenary sessions, panel discussions and workshops run by industry experts from Australia and around the world. The theme of the summit was the key developments and trends that are shaping the policy, technology, economic and environmental landscapes towards a low emissions world.
<b>Australian Council of Superannuation Investors (ACSI) Annual Conference</b> May 2017 < 300 delegates	Kate Bromley, Head of Responsible Investment, attended as a delegate. 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.



## IMPORTANT INFORMATION

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