

# ESG Integration for Income and Fixed Interest

## Summary

We include material ESG factors into our analysis and investment decisions across our Income and Fixed Interest funds. We view ESG integration as a way of understanding other risks and opportunities outside of traditional credit research. ESG risks can highlight potential future credit concerns.

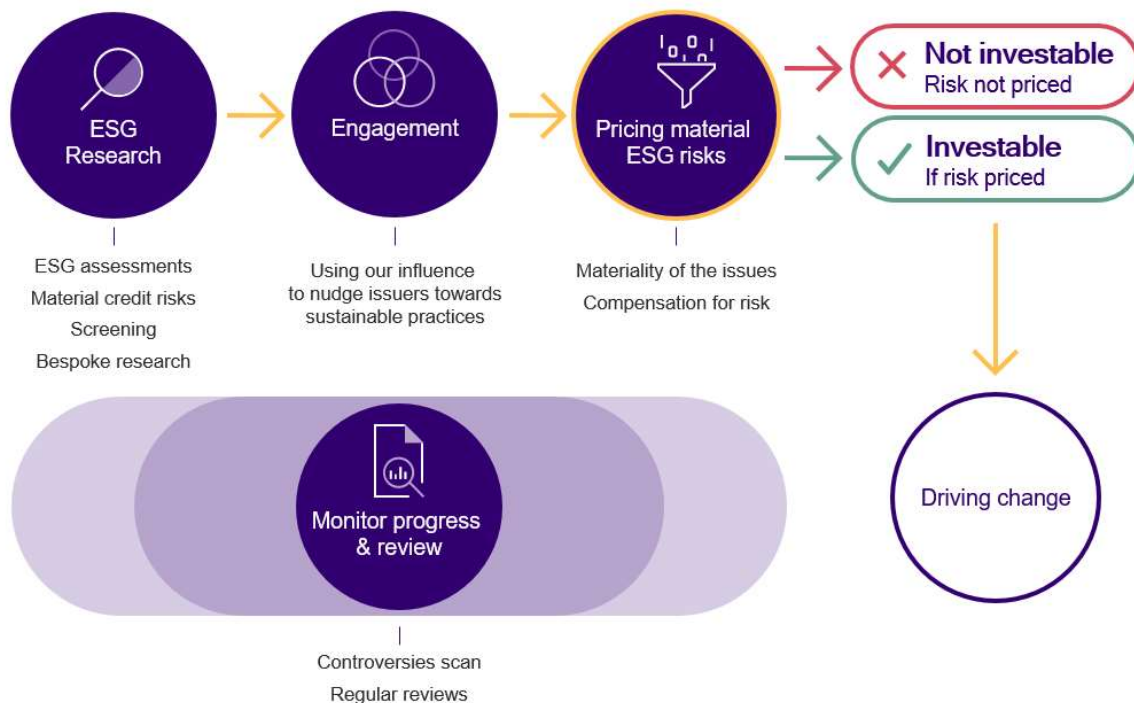
We use ESG integration in our vanilla funds to better understand risks and opportunities, probability of credit downgrades as well as any variations on liquidity and pricing particularly in the secondary market. ESG integration and engagement allows us to use our responsibility as active investors to influence the market by promoting sustainable issuers and nudging towards improved transparency.

Our ESG integration process includes:

- **ESG Research** - understanding ESG risks across different issuers
- **Engagement** - using our influence to nudge issuers towards sustainable practices
- **Pricing material ESG risks** - ensure we are compensated for ESG risks
- **Monitor and review** - monitor changes to issuers and broader risks.

We collaborate widely and leverage other areas of Pandal and Regnan, our in-house ESG research team. Our ESG integration process is iterative: monitoring progress and controversies feeds into our ESG research and directs our engagements.

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## ESG research

Accurate and timely research is essential to considering ESG concerns. Along with our macro inputs, credit research and portfolio construction, we look at different issuers across a range of ESG concerns to understand systemic and explicit risks and opportunities.

### ESG assessments

This process is supported by the specialist skills of internal research (including our dedicated ESG research and engagement team, Regnan) and third party research providers. Sustainability assessments includes an issuer's sustainability performance relative to peers. We identify leading and lagging companies/issuers. Some of the areas we look at include carbon emissions, response to the physical and transition risks of climate change, worker safety record, community engagement with new projects, adherence to regulation, reporting on modern slavery risks, diversity and governance.

As well as ESG research for corporate issuers, we've also developed a Sustainable States ESG Index which provides ESG assessments of Australian States. We incorporate over 50 indicators across environmental and social concerns such as including carbon emissions, renewables energy policy, health and gender equality. Our investments in and engagements with semi-government issuers is heavily influenced by the findings from our Sustainable States ESG Index.

### Material credit risks

ESG concerns are included as part of our fundamental analysis of issuers by our credit team. Every credit assessment includes an assessment of material ESG risks that could impact the credit rating of an issuer in the short term. We also include longer-term ESG risks which might not immediately impact the credit rating, but could influence liquidity and pricing in the secondary market.

### Screening

There are no formal negative ethical screens for many of our vanilla funds. However, we tend to avoid entities that produce tobacco, controversial weapons, pornography and other contentious products. Where possible, we try and focus on renewables, recycling and waste management and efficient transport. We leverage off the processes developed for our sustainability funds to assess social, green and sustainability bonds to help prevent greenwashing.

### Bespoke research

Regnan undertakes research projects to complement our ESG research. Examples of recent research projects include sustainable agriculture, green hydrogen and diversity and inclusion.

## Engagement

Using our influence to nudge issuers towards sustainable practices

An important component of our ESG process is engaging with issuers. This includes strong ESG performers as well as laggards. We take our engagement responsibilities seriously and strives to use the influence we have. When an issuer deviates from expectation either by its behaviour or issuance, we consider it an opportunity to engage to nudge towards more sustainable behaviour. We have averaged more than one formal engagement every week over the last two years with over 100 engagements with 64 different issuers.

One of the unique opportunities in Fixed Income is the ability to influence the behaviour of non-listed entities. Some of the big changes needed to prevent the disastrous consequences of climate change will require action from utilities and infrastructure businesses. These are sectors which are often in private ownership.

Another area where we can have influence is in shaping the debt market. Engagements with arrangers often focus on encouraging them to use their influence on issuers in relation to specific instrument construction (especially the types of projects we would be looking to fund), market expectations for impact reporting and where we would like the market to be moving to. Approximately 20% of our engagements are with arrangers.

## Pricing material ESG risks

### Material issues

There are two main concerns that ESG risks have for our funds: a change in the fundamental credit outlook of an issuer, and a change in the demand for an issuer which impacts liquidity and pricing. We have mapped the ESG risks that may have material impact on credit and longer-term concerns across the sectors in our investable universe. This mapping assists us in better understanding the risks associated with investing in particular issuers over different timeframes.

### Compensation for risk

An important distinction between our sustainability and our vanilla funds is how we respond to issuers that have weaker ESG performance. Our sustainability funds cannot invest in any issuer that are considered lower than average or laggards. However, for our vanilla funds there is an avenue for investing in these lower rated ESG issuers if there is compensation for this increased ESG risk through an elevated credit spread/yield. Where a company or issuer has been identified as having material ESG risks that are either not sufficiently compensated or are of such an egregious nature, we will not invest in that issuer.

## Monitor progress and review

### Controversies scan

As active managers, we monitor changes to the risk profile of issuers, including broad and specific ESG risks. We have set up media monitoring across a large range of issues to ensure we pick up any emerging risks for issuers or their industry peers. We also use third party data providers that monitor different issuers to supplement our research. This includes monitoring fair work and Worksafe rulings, regulatory changes and compliance concerns. Where possible, we collaborate with Pandal equity analysts to understand ongoing ESG risks that they are focused on. Along with downside risks, we look for improvements across a range of ESG concerns. Our ESG integration process is iterative: monitoring progress and controversies feeds into our ESG research and directs our engagements.

### Fortnightly review

Our Income and Fixed Interest team has a fortnightly review of changes in ESG assessments to any names in our investable universe, developments in the Australian and international market and relevant ESG research that may impact investment decisions. This includes the entire Income and Fixed Interest team and ensures ESG concerns are mainstreamed across our different funds and portfolio managers.

## Driving change

The world of investing is constantly changing. Our sustainability funds are at the cutting edge of ESG, helping to shape the impact investing scene in Australia. The expertise we have gained from our many years in running sustainability funds is influencing our ESG integration processes for our vanilla funds. We will continue to ensure we have a robust ESG integration process across all the portfolios we manage.