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PUTTING PRINCIPLES — INTO PRACTICE

2019 RESPONSIBLE INVESTMENT REPORT



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Part of  BNY MELLON

FOREWORD



Abdallah Nauphal
Chief Executive Officer

Investing responsibly is an essential part of managing risk.

We can all name companies that have suffered due to environmental, social and governance (ESG) issues. For us at Insight, looking at such factors is part of considering all the relevant risks when making investment decisions.

This is not about putting specific ethical considerations ahead of other criteria when creating portfolios. Understanding all the underlying material risks helps us decide whether an investment is overpriced or underpriced, or fair value. For all our client portfolios we systematically consider ESG issues within our research process: this has helped us identify significant risks, as the evidence in this report demonstrates.

Doing this well means taking a proactive approach. When we identify material ESG risks in a company, we will engage with management in order to better understand the issues and exert influence on behalf of our clients to encourage improvements to its practices. In doing so, we can reduce risks and increase the potential value created over the long term. We have also worked to develop our tools where publicly available data is lacking. Our climate change and sovereign sustainability indices, and our ESG questionnaires, are examples of such tools to help our analysts better understand the most relevant risks.

Some issues are too big to tackle alone. Where it makes sense, we collaborate with other stakeholders to engage on major topics, such as climate change. We can do more together than we can apart.

Ultimately, I believe investing responsibly means considering the long-term impact on our clients, rather than simply focusing on the short term for our business. I hope this report demonstrates how we go about this in practice, and it builds confidence that your best interests lie at the heart of our approach.

INSIGHT AND RESPONSIBLE INVESTMENT

- Insight was a founding signatory to the UN-supported Principles for Responsible Investment (PRI) in 2006, the world's leading proponent of responsible investment. Signatories to the PRI include investment managers and asset owners with trillions of dollars of assets under management.
- We have been supporters of the Institutional Investors Group on Climate Change (IIGCC) and CDP (formerly known as the Carbon Disclosure Project) initiatives since our founding in 2002.
- Insight has integrated ESG considerations into our decision-making processes for over a decade.
- In 2018, Insight was awarded an A+ rating by the PRI for our responsible investment approach to corporate debt, and an A rating for strategy and governance, and our approaches to sovereign and securitised debt.
- In 2016, Insight was given Tier 1 status by the UK Financial Reporting Council, recognising that we provide "a good quality and transparent description of [our] approach to stewardship and explanations of an alternative approach where necessary".
- Insight manages ESG strategies including those with best-in-class, climate, positive impact and exclusion objectives and criteria. As at December 31 2018 we managed more than £12bn in ESG overlay strategies.¹

¹ Assets under management (AUM) are represented by the value of cash securities and other economic exposure managed for clients.

INTRODUCTION

RESPONSIBLE INVESTMENT IS A WIDELY ACCEPTED APPROACH TO INVESTING FOR INSTITUTIONAL INVESTORS. CONSIDERING ESG FACTORS IN YOUR INVESTMENT ANALYSIS AND COMPANY ENGAGEMENT SUPPORTS THE PURSUIT OF LONG-TERM FINANCIAL AND NON-FINANCIAL OBJECTIVES.

In this report, we outline how we aim to help investors at every stage of their investment journey.



For investors considering a responsible investment policy, we clarify what a responsible investment approach means in practice and offer steps to follow when developing a formal policy. We also ask a leading institutional investor about their approach.

from page **08**



For investors seeking to understand the practical implications of a responsible investment approach, we offer examples of how an investment manager's approach actually makes a difference in practice. We ask our portfolio managers for clear examples of how our approach has driven investment decisions.

from page **18**



For investors looking to have a positive long-term impact through fixed income investment, we offer our take on the impact bond market today, and explain how we consider sustainability and impact targets in fixed income.

from page **40**

We hope this report helps you move forward in understanding and implementing a responsible investment approach that supports your objectives.



HIGHLIGHTS



A leading institutional investor explains the difference a responsible investment approach makes – and the challenges it can raise

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Our credit analysts' pay is linked to ESG analysis, with 10% of their current objectives tied to ESG research

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Longer-dated tobacco bonds now bear significant investment risks, so we have divested from our portfolios

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Gaps in ESG data for emerging market debt mean active engagement and analysis are crucial

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Our proprietary tools help us fill the void in available data on climate change and sovereign risk analysis

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Over 50% (709 out of 1,311) of our direct engagements in 2018 included discussions of ESG issues

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Impact bond issuance slowed in 2018 – meaning opportunities for dedicated impact strategies in fixed income remain limited

page 42



Most impact bonds analysed in 2018 did not fully meet our minimum sustainability standards: 3% received a red score, 56% an amber score and 41% a green score

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ADOPTING A RESPONSIBLE APPROACH



IN THIS SECTION, WE SET OUT STEPS TO HELP INVESTORS SET OUT A TAILORED RESPONSIBLE INVESTMENT POLICY THAT SUPPORTS THEIR LONG-TERM OBJECTIVES.

THREE STEPS TO ESTABLISHING AN EFFECTIVE RESPONSIBLE INVESTMENT POLICY

STEP 1

Clarify



CLARIFY BELIEFS
ABOUT RESPONSIBLE
INVESTMENT

Define responsible investment and how it relates to your objectives

STEP 2

Establish



ESTABLISH YOUR
RESPONSIBLE
INVESTMENT POLICY

Based on your beliefs, write a policy that clarifies any practical implications for your investment decisions and guidelines

STEP 3

Implement



IMPLEMENT YOUR
RESPONSIBLE
INVESTMENT APPROACH

Align investments and asset allocations with policy and establish metrics to confirm effective implementation

“The most significant development since we established our responsible investment approach was probably to establish an ESG steering group of Trustees to ensure we spent enough time considering the issues.”

[READ THE INTERVIEW ON PAGE 14](#)



Mark Thompson, Chief Investment Officer, HSBC UK Pension Scheme



DEVELOPING A RESPONSIBLE INVESTMENT APPROACH THAT HELPS YOU ACHIEVE YOUR GOALS

INVESTORS ARE INCREASINGLY IMPLEMENTING RESPONSIBLE INVESTMENT APPROACHES:

- **Allocations to responsible investment strategies are substantial:** Signatories to the PRI account for tens of trillions of dollars of assets under management, reflecting material growth over recent years.²
- **Interest from regulators and governments has risen materially:** Over half of all responsible investment-related policies date from 2013 to 2018.³
- **Many investors are seeking to develop a responsible investment policy:** Research suggests that many institutional investors have policies in place, and more are explicitly considering applying a responsible investment policy.⁴

These trends are confirmed by our interactions with our clients, our work on collaborative initiatives with other institutional investors, and in our engagement with policymakers.

In this section we set out some broad principles to help investors develop a tailored responsible investment policy that reflects their beliefs and effectively supports their long-term objectives.



RESPONSIBLE INVESTMENT CONSIDERED FOR TRILLIONS OF ASSETS

In the UK, after several years of discussions around fiduciary duty and how it applies to investment, the government has finalised regulations that require larger pension schemes to state how they consider ESG risks and to report on what this means in practice.

This marks a significant development in how institutional investors consider responsible investment approaches. The UK pensions industry plays an influential role in markets and the wider global pensions industry, accounting for trillions of pounds of assets under management⁵.

From 1 October 2019, trustees of UK pension schemes with over 100 members will be required in their Statement of Investment Principles to disclose how they take account of financially material considerations, including climate change and other ESG risks. They will also be required to set out policies with regard to stewardship of investments, including how they exercise voting rights and engage with the companies in which they invest.

From 1 October 2020, the trustees of such schemes are required to publish a report stating how they have implemented the principles they set out.

² As at end April 2018. See <https://www.unpri.org/pri>

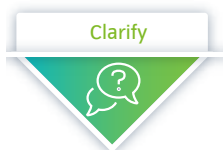
³ See <https://www.unpri.org/sustainable-markets/regulation-map>

⁴ See <https://retirementandinvestmentblog.aon.com/BlogHome/Blog/June-2018/Responsible-Investing-Survey.aspx>

⁵ Source: WillisTowersWatson, Global Pension Assets Study 2019.

STEP 1

Clarify



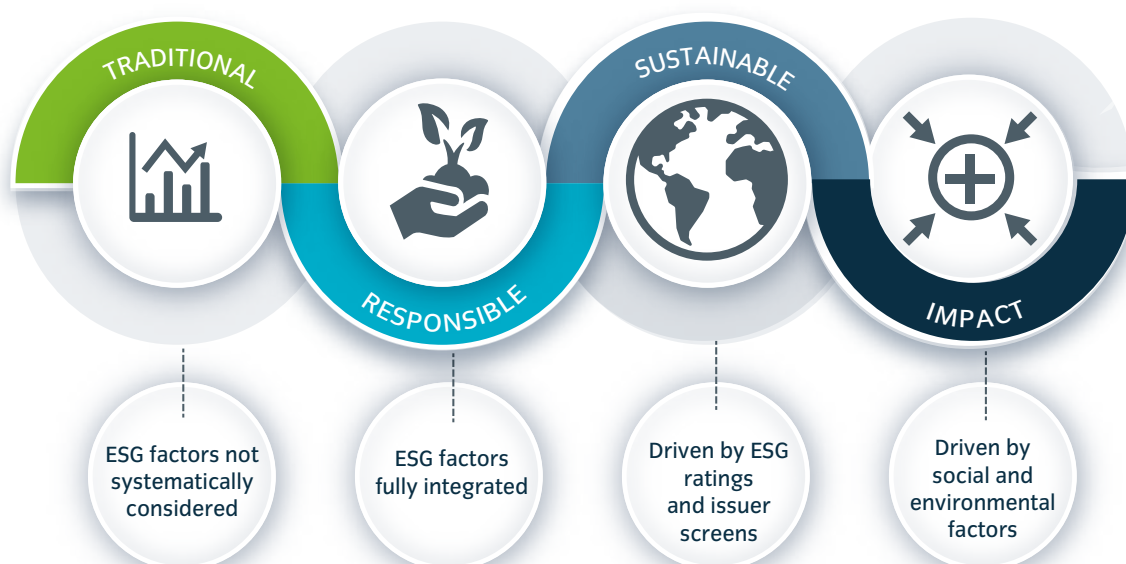
Clarify your beliefs about responsible investment

Clear beliefs about responsible investment will provide a solid foundation on which to establish a responsible investment policy that supports your long-term objectives.

Investors will have a range of beliefs that inform and guide how they seek to achieve their long-term financial objectives. In our experience, there are misunderstandings around what responsible investment means. We believe differentiating between responsible, sustainable and impact approaches is helpful (see Figure 1).

Responsible investment is defined by the PRI as an approach to investing that aims to incorporate ESG factors into investment decisions, to better manage risk and generate sustainable, long-term returns.⁶ This sets it apart from approaches like sustainable or impact investment, which aim for non-financial, as well as financial, objectives.

Figure 1: Differentiating responsible, sustainable and impact investing



To clarify your beliefs about responsible investment, questions to ask might include:

- ✓ What are our ultimate financial and non-financial objectives? How might we prioritise them?
- ✓ How might a responsible investment approach help us achieve our objectives?
- ✓ What relevance do environmental, social and governance risks have to investment management?
- ✓ How might climate change affect how we invest and how we pursue our objectives?
- ✓ Are there specific or systemic risks, like climate change, that we should take into account in our investment decisions?
- ✓ Should we seek to have a positive impact on society or the environment through our investment portfolio? If so, what impact are we seeking?
- ✓ Are there any minimum standards we should expect the companies in which we invest to meet?
- ✓ Are there any industry initiatives that reflect our priorities and that can be used to influence internal discussions?
- ✓ Should short-term, medium-term and long-term issues be identified more explicitly?

⁶ See <https://www.unpri.org/pri/what-is-responsible-investment>

STEP 2

Establish



Establish your responsible investment policy

Translating investment beliefs into a policy is necessary to provide a clear guide for investment decision-makers.

It may be appropriate to incorporate your beliefs about responsible investment into your overarching investment policy, rather than a separate responsible investment policy.

Points within a responsible investment policy may include:

- ✓ A definition of the investor's responsible investment approach and how it reflects the investor's beliefs (as established in Step 1)
- ✓ How the responsible investment policy relates to other policies set out by the investor or the corporate sponsor
- ✓ Guidelines on investments – this may include:
 - Procedures for different asset classes
 - Minimum standards for investee companies
 - Metrics for performance and implementation
 - Attitudes to responsible investment strategies such as portfolio screening (positive or negative), norms-based investment, and impact approaches
- ✓ Expectations around engagement with investee companies, including shareholder voting
- ✓ The role of third-party investment managers
- ✓ Risks associated with the chosen approach
- ✓ Non-financial targets

Insight can advise clients further on developing and establishing an integrated policy that meets industry best practice.

QUESTIONS TO ASK YOUR INVESTMENT MANAGER ABOUT RESPONSIBLE INVESTMENT

Responsible investment capabilities and experience

- What is the investment manager's responsible investment policy?
- How long has the investment manager followed a responsible investment approach? For example, when did the manager sign the PRI?
- How long has the investment manager managed money for clients with responsible investment objectives?
- What evidence can the manager provide that senior management is engaged in developing the company's responsible investment capabilities?
- What is the evidence that the manager's responsible investment approach makes a difference in practice?
- What are the PRI ratings for the manager's relevant capabilities?
- What evidence can the manager provide of experience and expertise in responsible investment?
- How are investment teams incentivised to follow a responsible investment approach?

STEP 3

Implement



Implementing your responsible investment approach

A clear policy sets out an approach in principle, but depending on the detail of the policy for your existing portfolio, applying this in practice may require a different approach.

For investors who manage their own portfolios, third-party data providers and advisers can help you adapt your portfolio to reflect your responsible investment policy.

For investors using third-party investment managers, your policy can establish clear guidelines for investments. Pooled funds' objectives and investment guidelines can be tested against your policy to ensure the minimum expectations are met. For segregated mandates, an asset manager with long experience and demonstrable expertise in responsible investment may be able to partner with you to reflect your objectives and concerns in a tailored approach.

A key consideration is how to gain confidence that an investment manager has the capabilities to implement a responsible investment approach in practice. We offer some key questions to ask investment managers below.

Research and engagement

- How does the investment manager assess the quality and relevance of ESG research provided by independent or third-party data providers?
- To what extent does the investment manager conduct its own proprietary ESG research rather than depend on third-party research and data?
- What value-added work is provided by the fund manager to supplement third-party data and research?
- How do the manager's ESG specialists work alongside analysts and portfolio managers?
- What examples can the investment manager provide of decisions driven by a responsible investment approach (that are not a result of pure rules-based exclusions)?
- Can the investment manager provide examples of both investments avoided and held as a result of ESG research?
- Can the investment manager provide examples of direct engagement with companies on ESG issues that have resulted in either a greater understanding of the relevant ESG risks, or in an improvement on the part of the company?
- What are the differences and similarities between the manager's responsible investment approaches across asset classes?

Sustainability and impact

- What experience can the investment manager demonstrate of investing in line with sustainability or impact objectives?
- How does the manager measure performance relative to sustainability and impact objectives?
- In portfolios with sustainability and impact targets, how do the holdings differ to equivalent strategies run by the manager without those targets? Can the manager clearly explain how the investment process led to those differences?

INTERVIEW: MARK THOMPSON, CHIEF INVESTMENT OFFICER HSBC UK PENSION SCHEME

(Conducted in January 2019)



MARK THOMPSON, CHIEF INVESTMENT OFFICER AT THE HSBC UK PENSION SCHEME, HELPS TO OVERSEE OVER £30BN OF ASSETS UNDER MANAGEMENT IN BOTH DEFINED-BENEFIT AND DEFINED-CONTRIBUTION PENSION SCHEMES. AN EARLY PROPONENT OF A RESPONSIBLE INVESTMENT APPROACH, MARK EXPLAINED TO INSIGHT THE RATIONALE BEHIND THE APPROACH ADOPTED BY THE HSBC UK SCHEMES AND WHAT THIS HAS MEANT IN PRACTICE.

Q

How would you describe your approach to responsible investment?

The term responsible investment can be misunderstood. I like to describe our approach as being about the management of ESG risks – it's about value, not values. This means it is all about the effect ESG risks could have on the value of our members' investments.

Q

How did you establish your approach?

Eight years ago, I worked with the pension scheme's trustees to decide on our investment beliefs. These were not very long, and one of them states that ESG risks, including climate change, are a material factor in investment decision-making.

Having settled on our beliefs, we developed our policy, and this included a statement on corporate governance and socially responsible investing. This says the trustees expect investment managers to ensure ESG factors are incorporated within investment processes.

Q

Your approach has been in place for a long time. How have you refined it?

When we began discussing this with investment managers, most fund managers were not taking these risks explicitly into account. A big part of our efforts over the years has been pushing our fund managers to consider these risks more, and to communicate how they are doing that.

The most significant development since we established our responsible investment approach was probably to establish an ESG steering group of Trustees to ensure we spent enough time considering the issues. This committee was set up to answer three questions: how to get better evidence from our fund managers that they were in fact acting on their promises; whether we should adopt a climate change policy; and how we might incorporate ESG risk management into our investments more.

Q

How does climate change feature in your thinking?

On climate change, our approach has changed somewhat over time. We did analysis on our portfolios to assess how we might alter our asset allocations in response to different climate scenarios. This highlighted just how bad things could get – not least for our members. This led the trustees to decide that lobbying on broader climate change policy was consistent with their fiduciary duty.

We also decided to establish our own climate change policy, which we adopted in 2015. We then wrote to each of our fund managers and asked them what they were doing. When the TCFD (Task Force on Climate-related Financial Disclosures) issued its recommendations in 2017, we again wrote to our fund managers to understand how they are incorporating the TCFD framework.



Our approach is about the
management of ESG risks – it's about
value, not values

MARK THOMPSON





It is all about the effect ESG risks
could have on the value of our
members' investments

MARK THOMPSON



FURTHER READING ON RESPONSIBLE INVESTMENT AND THE HSBC UK PENSION SCHEME

- **Stewardship report 2018:** <https://futurefocus.staff.hsbc.co.uk/-/media/project/futurefocus/information-centre/active-hybrid/newsletters/stewardship-report-2018.pdf>
- **TCFD statement 2018:** <https://futurefocus.staff.hsbc.co.uk/-/media/project/futurefocus/information-centre/active-hybrid/newsletters/com01511-hsbc-tcf-statement-2018-v60lr.pdf>

Q Can you explain some of the practical results of your approach?

We worked with an investment manager to create an equity fund based on a customised index that has tilts away from companies with higher carbon emissions and reserves, and towards companies with greener revenues. The manager committed to a proactive engagement policy on ESG issues including climate change.

This included writing to 84 companies across the six sectors most susceptible to climate change and asking what they were doing about it. If there was no progress after a year, the manager would vote against the re-election of the chairmen at the next annual general meeting and divest the stock from our fund. In June last year, we divested from eight companies as a result of this – and all eight are putting the work in to improve their processes as a result.

Q How about for fixed income strategies?

In fixed income markets, the credit rating is a big factor. The big credit ratings agencies are getting better at incorporating ESG factors into their research. As in equity markets, engagement is relevant, but the approach is necessarily different. Equity investors can vote and have a direct say in matters that affect long-term performance. That said, companies need finance, which means they will listen to bond investors.

Q What challenges have you faced in adopting and implementing a responsible approach?

It helped that the trustees were in the right mindset from the beginning. I think the biggest problem around responsible investing can be a lack of clarity, so we have always been clear it's about risk management.

It is necessary to actively question and challenge how the approach is implemented. When appointing new managers, we ask a lot of questions around what they do in this area. We expect them to be able to articulate their approach and to show how they're responding to major new initiatives like the TCFD. I've questioned why our investment managers voted on their shareholdings in a particular way. My questions led the managers to change their voting policy.

Q What role does ESG data play?

I believe a company that governs itself well and manages ESG risks effectively will do well over time. But judging this purely on ESG data is questionable. You can't be sure how accurate or up-to-date the data is.

A lot of companies can improve their ESG ratings simply through better communication of what they are doing. One of our smaller equity managers invested in an Asian online gambling company, for which an ESG data provider had two red flags over labour and energy. The flags were driven by assumptions about labour rights in the company's home country and typical energy usage by the online gambling sector. It turned out the company's workforce was mostly well-paid accountants and the company had taken extensive measures to minimise the impact of its energy use, so the ESG red flags were simply a result of lack of communication with the ESG data provider.

This shows why transparency is crucial: more disclosures can only result in more accurate analysis. I asked an index provider to analyse the carbon emissions of our equity portfolio relative to the index, and the provider was only able to find real data for about half of the companies: the remainder had to be modelled. This is why we support the broader push, in line with the TCFD, to get more companies to disclose information like this.

Q What progress would you like to see in how investors and investment managers approach responsible investment?

Ultimately, there needs to be more engagement at both the policy level and through investment managers. Asset owners can be more assertive and ask their managers exactly what they have done, and how. I want to see that our investment managers do more than incorporate ESG ratings – I want to see that they have the right mindset when it comes to investment.

RESPONSIBLE INVESTMENT IN PRACTICE



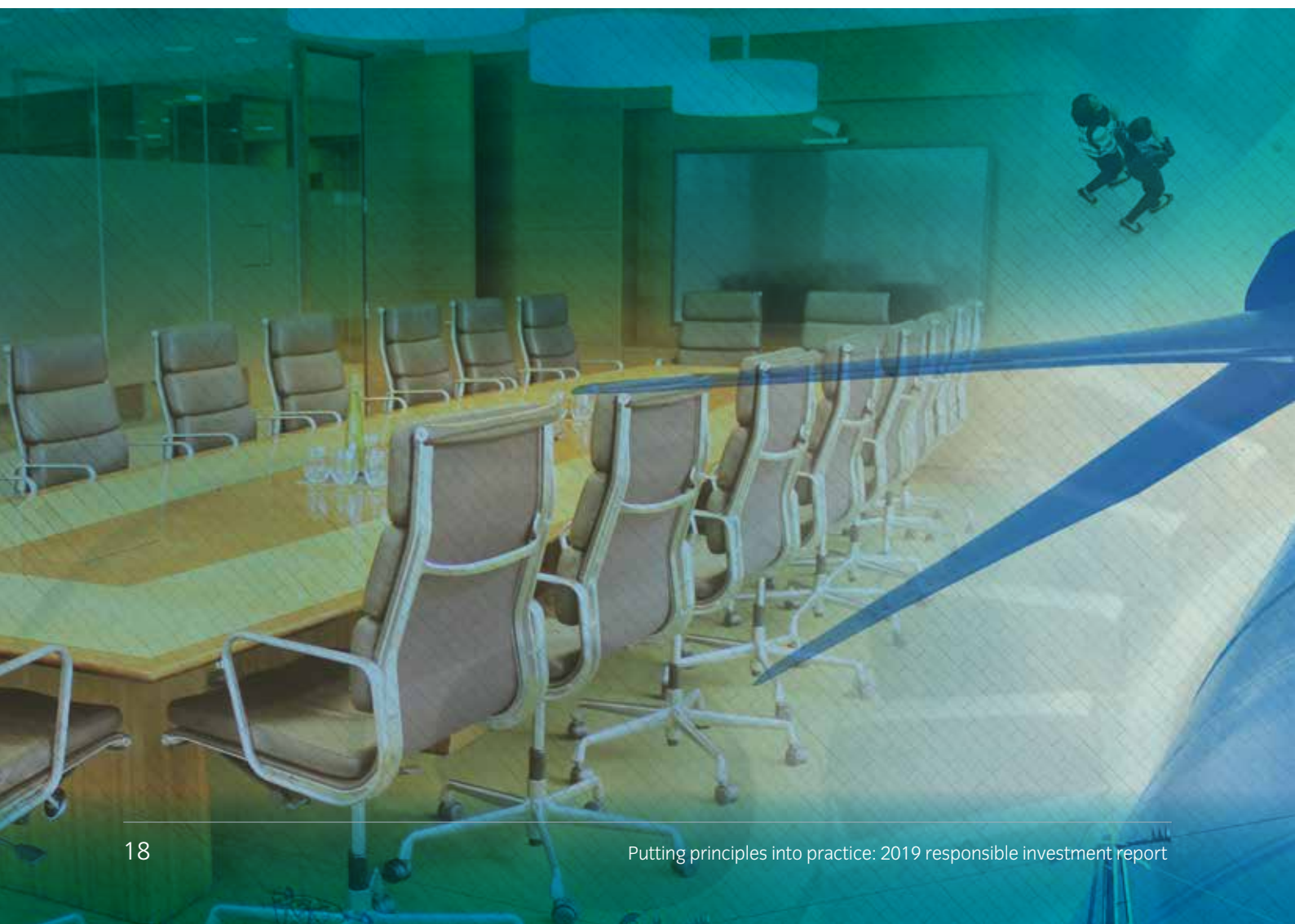
A RESPONSIBLE INVESTMENT POLICY WILL HELP TO SET GUIDELINES FOR INVESTMENTS, BUT DEMONSTRATING THE IMPACT OF THAT POLICY IS CRUCIAL. GAUGING THE DIFFERENCE A RESPONSIBLE INVESTMENT APPROACH MAKES TO INVESTMENT DECISION-MAKING, RETURN POTENTIAL AND RISK MANAGEMENT CAN BE COMPLEX.

In this section we offer practical examples of ESG analysis in action.
Examples include:

Divestment from longer-dated tobacco bonds due to long-term risks // 22

Proprietary ESG research to complete our risk analysis in a Middle Eastern bank, leading us to invest // 25

Cautious approach to cement producers, partly due to their environmental impact // 30



We demonstrate how stewardship and engagement can support long-term objectives.
Examples include:

Engagement with an Indonesian telecoms company to help it better communicate its approach to ESG risks // 25

Dialogue with a Danish utility provider to better understand their new green bond linked to biomass energy // 35

Collaborative engagements on climate change and cyber risks // 36



KEY POINTS ON INSIGHT'S ENGAGEMENTS IN 2018

- ▶ Over half our direct company engagements included discussions of ESG issues
- ▶ Climate change and cyber risks were key areas for our collaborative engagements
- ▶ We continued to engage with policymakers on new regulations and responsible investment initiatives



INSIGHT'S RESPONSIBLE INVESTMENT POLICY

WE BELIEVE STRONG GOVERNANCE PRACTICES AND MANAGEMENT OF ENVIRONMENTAL AND SOCIAL RISKS ARE IMPORTANT DRIVERS OF INVESTMENT VALUE OVER THE SHORT AND THE LONG TERM. WE ALSO BELIEVE THAT DELIVERING SUSTAINABLE INVESTMENT RETURNS IS DEPENDENT ON EFFICIENT AND WELL-MANAGED FINANCIAL MARKETS, AND STABLE AND TRANSPARENT SOCIAL, ENVIRONMENTAL AND ECONOMIC SYSTEMS.

Our objective is to achieve superior investment returns over clients' expected time horizons. We consider responsible investment to contribute towards this goal through providing investment solutions that deliver quality and excellence; managing financial and non-financial risks for our clients; and operating to high ethical and professional standards.

We consider responsible investment as central to our investment activities, to our culture, to our relationship with clients and to our interaction with stakeholders.

To deliver on our objectives, we:

- 1** **Take account of financially material short and long-term risk factors in our investment research and decision-making processes.** These risk factors may include ESG issues.
- 2** **Exercise our stewardship role in the companies and other entities in which we invest.** We believe that good stewardship can create investment opportunities and reduce investment risk. We therefore engage with management to discuss issues such as strategy, deployment of capital, performance, remuneration, risk management and ESG factors. We also vote our shareholdings.
- 3** **Support efforts that seek to improve the operation, resilience and stability of financial markets.** This includes sustainable economic development and health of the natural environment.

PRACTICAL EXAMPLES OF ESG ANALYSIS IN ACTION

OUR APPROACH TO RESPONSIBLE INVESTMENT IS UNDERPINNED BY THE BELIEF THAT ESG ISSUES ARE IMPORTANT DRIVERS OF INVESTMENT VALUE. THIS MEANS WE INCORPORATE ESG ANALYSIS ACROSS OUR INVESTMENT STRATEGIES AND PORTFOLIOS, AND ENGAGE ON ESG ISSUES TO BETTER UNDERSTAND THE ESG RISKS COMPANIES FACE AND HOW THEY INTEND TO MANAGE THEM.

We asked our portfolio managers two questions:

Q1 How have you applied our responsible investment approach in your portfolios?

Q2 What specific examples can you provide of decisions made in light of your ESG analysis?

CREDIT



Lucy Speake
Head of European Credit and Deputy Head of Fixed Income
Insight Investment



KEY INSIGHT

Our credit analysts are expected to consider ESG research in their analysis across every issuer in our investment universe. Our research contributed to our decision to divest from longer-dated tobacco bonds across our credit portfolios on investment grounds.

Q

How have you applied a responsible investment approach in your portfolios?

For credit, alongside financial metrics, we pay particular attention to key business risks using a checklist that identifies important sources of risk that can lead to a sudden deterioration in credit quality. ESG risks are a key element of this checklist, and this means our credit analyst notes include an assessment of each issuer's ESG risks and whether they may be material for performance. In 2018, over 50% of meetings with corporate debt issuers (709 out of 1,311 meetings) included discussions of ESG factors.

We make sure our credit analysts have clear incentives to maintain their focus on ESG, and for several years we have linked their annual performance appraisals to analysis of relevant ESG risks in their research. A specific ESG objective accounted for 10% of credit analysts' total objectives in 2018, up from the previous 5%. The outcome of the performance appraisal is linked closely to any discretionary compensation element.



What specific examples from 2018 can you provide of decisions made in light of your ESG analysis?

I would highlight two examples of our responsible investment approach having a demonstrable impact.

We divested from a high-risk mining company. ESG risks are often material in our buy-and-maintain portfolios, which are long-term in nature. In 2018, a client's buy-and-maintain portfolio transitioned to us from another investment manager. It included an issue from a mining company. Our analysts' review of the company's fundamentals looked reasonable, but it scored badly on ESG risks, even within the mining sector – which is more exposed than others to some material ESG risks. The company did not respond to requests to engage on these issues. Given historical examples of mines failing due to environmental issues, and their owners struggling to repay their debt, we decided to sell the holding.

We excluded longer-dated tobacco bonds from our active and buy-and-maintain portfolios due to long-term risks. The large tobacco companies are generally investment grade issuers, with strong near-term cash flow profiles and stable ratings. However, in 2018, we changed our position towards tobacco issuers.

We believe **regulatory risks** have increased in developed markets as a result of more healthcare focused legislation, such as marketing restrictions. These actions are likely to have led to reduced demand, which is evident across developed markets.

Regulations in emerging markets also appear to be catching up with developed markets faster than expected. Also, **alternative technologies** such as vaping are attracting a greater customer base and are replacing demand from traditional cigarettes.

Meanwhile, more investors are excluding tobacco investments from their portfolios, **pushing up funding costs**. These weaker long-term fundamentals are not reflected in market valuations, with spreads moving in line with broader credit markets.

As a result of these trends, we decided to rotate out of longer-dated tobacco exposures into attractive alternative sectors in both our active and buy-and-maintain funds. Some individual positions within the sector may still be appropriate in some situations, dependent upon an individual issuer's credit quality, pricing and maturity factors. We continue to monitor the impact for client portfolios but do not expect the move to have negative investment impacts.



For more information on Insight's credit investment process, see page 52.

APPLYING ESG OVERLAYS TO CREDIT PORTFOLIOS

Insight can apply a wide variety of ESG overlays to corporate bond portfolios. Typical overlays include:

1. **Exclusion screens:** Using criteria provided by clients to prevent investments in certain business activities, such as tobacco, weapons and alcohol.
2. **Norms screens:** Managing (reducing or eliminating) exposure to companies with past high-profile events that suggest they do not meet globally respected standards such as the UN Global Compact and those set out by the International Labour Organisation.
3. **'Best in class':** Using ESG ratings to rank companies on their ESG performance, which can be used to identify leaders and tilt portfolios away from companies with the worst ESG performance and/or the highest ESG risks, and towards companies with the best ESG performance/the lowest ESG risks.
4. **Low carbon:** Identifying companies with poor carbon emissions performance or those demonstrating greater environmental risk, and using this information to reduce the carbon footprint of portfolios.
5. **Positive impact:** Tilting portfolios in favour of either individual bonds or corporate issuers that have a sustainability element. This includes impact bonds and the UN Sustainable Development Goals. See page 43 for more information on our investments in impact bonds.

HIGH-YIELD DEBT



Ulrich Gerhard
Senior Portfolio Manager, High Yield
Insight Investment



KEY INSIGHT

High yield debt issuers generally have worse ESG risks and ratings, meaning constant ESG analysis and engagement are a high priority for our high-yield managers.



Q How have you applied our responsible investment approach in your portfolios?

In high-yield debt markets, ESG risks can be more significant than for investment grade debt due to the prevalence of some sectors – such as energy – which have higher short and long-term ESG risks. ESG scores from independent data providers generally assign worse ESG ratings to high-yield debt issuers.

The acceptable margin for error in making bad high-yield bond investments is less than for investment grade credit. We therefore **demand more legal restrictions** on what a high-yield borrower can do, and **we require greater disclosure** as a starting point. We use our research tools and regular meetings with borrowers to constantly assess their exposure to and management of ESG risks. As creditors, our interests are very closely aligned with the management of ESG factors.

For example, for a car-seat manufacturer we would regularly and repeatedly ask management if they are investing in the manufacturing plant. Adequate investment would mean the car seats are made to a high standard required, without product concerns, and the customer would come back to buy more; and the plant is more likely to be safe for employees. A plant supported by adequate investment is more likely to operate without disruption, generating cashflows for the bond investor. We would also examine the bond documentation, ensuring the relevant cash would not be paid to shareholders as a dividend and that any potential conflicts of interest are mitigated through legal documentation.



Q What specific examples from 2018 can you provide of decisions made in light of your ESG analysis?

In 2018, we avoided issues from Astaldi and CMC Ravenna, partly due to ESG concerns. These are companies with joint ventures operating in numerous jurisdictions. We could not understand the companies' cashflows or whether cash would be given away as dividends to the shareholders and away from the business.

Since deciding against these companies' issues, the price of the relevant bonds has fallen materially. We believe these decisions are clear examples of the benefits of integrated risk analysis and reflect clearly how the analysis of ESG risks is aligned with our clients' interests as creditors.

EMERGING MARKET DEBT



Colm McDonagh
Head of Emerging Market Fixed Income
Insight Investment



KEY INSIGHT

Gaps in ESG data for emerging market debt issuers mean active engagement and proprietary analysis are crucial. Information from our proprietary ESG questionnaire covers 20% of our emerging market corporate debt portfolio.



Q How have you applied a responsible investment approach in your portfolios?

Industry awareness of ESG factors, and how they relate to emerging market debt investing, has increased significantly. This is particularly true for corporate debt. The creation of dedicated emerging market debt ESG indices in 2018 has helped drive the increased awareness, and reflects the growing support among investors for data-led ESG investing in the asset class.

In our view, investors should now move beyond relying on third-party data alone for ESG analysis. We believe the real benefit comes when you engage with issuers and perform your own work as part of the overall credit process.

Of particular relevance at present are the gaps in ESG data provided by third parties. Roughly 80% of emerging market corporate indices on a weighted basis are covered by the major data providers. Concerningly, this coverage deteriorates as credit risk increases: 90% of investment grade issuers are covered, compared to 50% to 60% of single-B and unrated issuers.⁷

Yet as credit risk increases, ESG can have a much more material impact on bond performance. Since 2015 there have been 12 emerging market corporate defaults in excess of \$1bn. Seven of them suffered from significant ESG issues, but only one was covered by the major ESG data providers.⁸ Where ESG factors are most significant, coverage by the data providers is weakest.

Investors need to work hard to fill the gaps, and over the past year we have worked with issuers to complete several Insight-designed ESG questionnaires. Coverage from our proprietary questionnaire now exceeds 20% of our emerging market corporate debt portfolio.

This is just the start. Our credit analysts actively assess and engage with issuers where appropriate to understand how they manage ESG risks in practice. As seen below, overlaying our own analysis on the initial data provided by ESG or Insight's proprietary questionnaire has been key to extracting the full benefit from ESG analysis.



Q What specific examples from 2018 can you provide of decisions made in light of your ESG analysis?

There are several ways in which our responsible investment approach has had a clear impact on our investment decisions. Examples include the following.

We avoided an issue due to ESG concerns. We avoided issues from EA Partners, a special purpose vehicle (SPV) linked to Etihad Airways that provided financing to airlines in which Etihad held stakes. The issues were structured as a collateralised debt obligation with Etihad responsible for only 35% of the debt, and the remainder covered by five other, much weaker, airlines. In 2017, Alitalia and Air Berlin defaulted; in 2018, Jet Airways encountered significant financial difficulties. Attempts to auction claims on the defaulted debt failed, forcing EA Partners to begin restructuring talks.

⁷ Source: JP Morgan, MSCI and Insight. As at 31 December 2018.

⁸ Source: JP Morgan, Bloomberg and Insight. As at 31 December 2018.

Notably, the SPV is not covered by the ESG data providers. We avoided the issues throughout. There were no investor contacts available at EA Partners or Etihad, with extremely limited and poor quality financial disclosure. The deal was complex and poorly structured, portrayed as an Etihad bond, yet without recourse to Etihad. The lead bookrunner on the deal had filed for bankruptcy twice and its owner had been sued repeatedly for fraud. While the bonds only fell in price significantly in 2017 and 2018, the ESG warning signals were there from the start.

We engaged with an issuer to help it demonstrate better ESG performance. Indonesian company Tower Bersama develops and maintains telecom towers. It has annuity-like long-term contracts with major mobile network operators, with all its debt fully hedged back to the Indonesian rupee. ESG data provider MSCI ESG Research lowered its governance score to the worst possible as the company had not signed up to the UN Global Compact nor publicly disclosed key policies and procedures.

We disagreed with this assessment and informed management so they could counter the low ratings. Our research confirmed that Tower Bersama has adopted ISO 26000, which incorporates all UN Global Compact Principles; all standard operating procedures are in place; and following our engagement, the one shortcoming identified – the lack of a whistle-blower policy – is being addressed. We believe the company remains one of the most defensive Indonesian corporates with strong ESG risk management. We bought an issue in July 2018.

We used proprietary ESG analysis to drive a positive decision. Abu Dhabi Islamic Bank is not covered by any major third-party ESG research provider and we engaged with the bank to complete our proprietary ESG risk assessment. It scored strongly across the board. We purchased the perpetual bond at new issue, given our positive view of fundamentals and ESG risk management which we felt were not reflected in pricing. The bonds' price rose as the market recognised the strength of the bank.

SECURED FINANCE



Shaheer Guirguis
Head of Secured Finance
Insight Investment



KEY INSIGHT

Loans are a key source of ESG risks. We reject any loan application that does not provide sufficient information on these risks.



Q How have you applied a responsible investment approach in your portfolios?

Long-term investors are increasingly filling the space left by banks who continue to rebuild their balance sheets and scale-back their lending activities. We believe attractive returns are available to investors that can access private direct lending and related opportunities. These typically involve lending that is secured against a portfolio of physical assets providing investors with tangible security.

These 'secured finance' assets encompass a wide range of opportunities, including public and private debt, focused on residential and consumer borrowing; commercial real estate; and secured corporate assets.

For any direct lending, we ask borrowers to provide information on ESG risks to which they are exposed, and how they manage them. If a borrower does not provide this information we decline the loan. Credit analysts and portfolio managers therefore have clear incentives to ensure that borrowers provide the necessary information on ESG factors.

Another example of a secured finance asset is CLOs. As with our broader credit analysis, we incorporate ESG research within our CLO analysis. CLOs are typically managed portfolios of 100 or more obligors, but our analysts and portfolio managers review CLO portfolios line-by-line. Corporate governance is a fundamental part of the review: if the CLO manager scores badly on governance it would be unlikely to be recommended for investment or with such recommendation being restrictive, our due diligence checklist and scoring will discriminate against such managers.



Q What specific examples from 2018 can you provide of decisions made in light of your ESG analysis?

In 2018, we rejected an opportunity to lend to a company that provides finance to borrowers who have had credit events in the past, such as missed mortgage payments or lower credit scores due to past indebtedness.

Our decision was driven by a range of factors, such as concerns over data quality, but ESG concerns played a significant role. Notably, while the business had good processes in place for lending, we believed it needed to refine its policies to comply with Treating Customers Fairly principles and to deal appropriately with vulnerable customers. The company's policies for both were out of date and not up to industry best standards. While this could be rectified, we believe it demonstrated a lack of focus on compliance – a must for this sector.



SOVEREIGN DEBT



Isobel Lee
Head of Global Fixed Income Bonds
Insight Investment



KEY INSIGHT

Gaps in ESG data for sovereign issuers led us to develop a proprietary model which provides a snapshot of ESG performance and progress for 186 countries.



Q How have you applied a responsible investment approach in your portfolios?

We include ESG factors in our long-term risk assessment for sovereign debt. For clients that request it, we bias allocations towards better performers, or can exclude sovereign issuers from the relevant benchmark.

Traditionally, sovereign debt investors will look at the economic and political picture. ESG factors sit alongside these, and will typically reflect longer-term risks. We would acknowledge that the relevance of ESG factors for sovereign issuers is still at a developmental phase compared to other asset classes. Unlike corporates, there is very limited scope for engagement with sovereign issuers, but **one area in which there may be scope for dialogue is green bonds where sovereign issuance is increasing**. For example, we added Belgium's inaugural green bond to some of our investment portfolios (see page 45).

Better frameworks for evaluating ESG risks and engaging with sovereigns on such issues are helping capital markets to price in such risks. Sovereigns are becoming increasingly aware of this and in some cases are reacting to these developments. To support our own analysis and engagement, **we have developed a country sustainability risk model** that generates two scores for each country: an overall ESG score, and an ESG momentum score that reflects whether its ESG performance has improved or deteriorated over the last six years.

The results show few surprises in terms of which countries perform well or badly overall, but there are some unexpected results among the momentum scores. For example, the model indicates that Ivory Coast has the highest ESG momentum score in the world. We believe that highlighting how a country's ESG performance has changed over time can help to highlight potential opportunities or problems that could become material for debt investors.



Q What specific examples from 2018 can you provide of decisions made in light of your ESG analysis?

In 2018, our country sustainability risk model gave Turkey the worst possible governance rating, and showed its governance had deteriorated materially over recent years. Policymaking appeared to have become constrained and the quality of policymakers reduced as President Erdogan had sought to consolidate powers for some time. In 2017, Turkish citizens voted in favour of constitutional amendments that would shift the existing parliamentary system of government towards a presidential system, and after the 2018 election, which the president's coalition won comfortably, he moved to further consolidate power. These developments had a clear impact on investor sentiment and contributed in part to our becoming more negative on Turkey over 2018. Since 2017 our risk assessment has classed Turkey as 'deteriorating'.

We note that our model showed Turkey's environmental score was in line with other emerging markets, though there was some negative momentum as renewable energy consumption was declining and carbon emissions were increasing. Social performance was surprisingly strong and showed meaningful positive momentum over recent years, with education and housing metrics on a par with developed nations.



For information on Insight's country sustainability risk model, see page 32.

MULTI-ASSET



Matthew Merritt
Head of Multi-Asset Strategy Team, Multi-Asset Group
Insight Investment



KEY INSIGHT

Governance is a key consideration for real-asset exposures, and the team actively engages on relevant issues.



Q How have you applied a responsible investment approach in your portfolios?

Our flagship multi-asset approach, Insight's broad opportunities strategy, dynamically invests across a wide range of asset classes including equities, fixed income and real assets.

We make extensive use of derivatives and index instruments to gain market exposures. Where appropriate, we take ESG risks into account when making investment decisions. For direct investments we have an engagement programme: we raise ESG issues and actively encourage management to improve practices, and we exercise our stewardship responsibilities by actively voting on our shareholdings.

Insight's broad opportunities strategy invests in listed closed-end investment companies within real assets. The structure of closed-end investment companies typically comprises of an independent board and an investment manager/adviser. The board is responsible for defining overall company strategy and ensuring that the underlying investments, on behalf of shareholders, are managed appropriately. In comparison to broader listed equities, the governance structure embedded in listed closed-end investment companies changes the scope of ESG considerations in investment decision making. As outlined above, we exercise our stewardship responsibilities by actively voting on our shareholdings, which generally includes voting on routine matters including reports and accounts, distributions, equity issuance and board member remuneration.

Where the strategy invests in Insight-managed pooled funds to access certain credit exposures, ESG issues are a fundamental part of the research process.



Q What specific examples from 2018 can you provide of decisions made in light of your ESG analysis?

At the end of 2017, a UK-based construction contractor and facilities management service provider to some of the infrastructure holdings held in the broad opportunities strategy had issued a profit warning. This was duly noted as concerns regarding this counterparty's financial strength in the relevant portfolio holding reports. The company was subsequently placed in compulsory liquidation in early 2018.

During this time, we engaged extensively with the affected portfolio companies' boards and/or investment advisers to discuss contingency plans that provided for continuity of service. We continued to review progress on the appointment of replacement service providers and associated costs over 2018. We also encouraged portfolio companies to identify and implement lessons learnt from this experience so that shareholder interests could be better protected in the event of similar situations in the future.



For details on our multi-asset team's shareholder voting in 2018, please see page 37.

EQUITIES



Andy Cawker
Head of Specialist Equities, Specialist Equity Group
Insight Investment



KEY INSIGHT

To help highlight relevant risk factors for our holdings, we have introduced a quarterly ESG analysis of our absolute return equity portfolio.



Q How have you applied a responsible investment approach in your portfolios?

As the economic cycle matures, this can typically lead to poor financial practice and disclosure as companies and investors lose sight of the lessons of the past. These practices can lead to capital raisings, which are not always easy, to restore financial stability. In 2018 we saw this in Kier Group, Patisserie Valerie and Conviviality.

We have introduced a quarterly ESG analysis of our portfolio to highlight relevant risk factors, investigate their substance and whether they are indeed risks that we have not already considered or covered.

We would note environmental risks as an increasing factor to consider in the long-run growth prospects of a company. For example, we have invested in Neste Oil for some time – we believe it benefits from its leading position in renewable energy products. We have also held paper company Mondi, which we believe benefits from a vertically integrated model through the recycling of waste paper and ownership of virgin pulp. As China has increasingly stepped back from processing international waste, this has become a key risk for paper companies and introduced volatility into underlying pulp prices. On the negative side, we have been cautious for some time on construction companies with material exposure to cement production. The increasing environmental impact of cement production, and emergence of more sustainable and environmentally friendly materials, are long-term risk factors for this industry.



Q What specific examples from 2018 can you provide of decisions made in light of your ESG analysis?

On a day-to-day basis our analysis and interaction with companies is a dialogue around many of these ESG risks and issues. Examples in 2018 include the following:

RPC: We closed our position as public concern over the use of plastics in packaging rose and sell-side analysts pointed to accounting issues at the company. The company's share price subsequently fell further on weaker-than-expected trading and concerns on the mid-term outlook.

Taylor Wimpey and peer: We held a long position in Taylor Wimpey against a short position in another housebuilding company. There has been controversy over whether the owners of leasehold properties have been properly informed as to their rights and the terms of their lease, and while both companies have sold leasehold properties, they have taken very different approaches to managing them: Taylor Wimpey announced its exposure and provided a provision to buy back in leaseholds, while its peer did not comment. We believe this is indicative of the companies adopting very different approaches to customer care and ESG issues in general. We also believe these differing attitudes are reflected in margins. Ultimately, we feel Taylor Wimpey is being run with longer-term objectives and all stakeholders in mind, and this drove our decision to hold a long position in the company relative to its counterpart.

Essentra: We met with management in June and considered the stock interesting, but noted its preferred solution in tobacco filters looked less healthy than alternative delivery systems and so decided not to invest. The regulatory environment in the US has since worsened and company's share price has suffered.



For details on our specialist equity team's shareholder voting in 2018, please see page 37.

LIABILITY-DRIVEN INVESTMENT (LDI)



Jos Vermeulen
Head of Solution Design, Client Solutions Group
Insight Investment



KEY INSIGHT

A key focus is our proactive engagement with regulators over proposals to reform derivatives markets.



Q How have you applied a responsible investment approach in your portfolios?

Pension schemes' liabilities typically stretch over many decades and their present value is directly linked to inflation, interest rates and the longevity of their members. An LDI solution invests some of a scheme's assets to help manage these liability risks.

An LDI approach will typically make use of government bonds or high-quality credit. Partially-funded instruments, such as repo and swaps, are used to provide investment exposures without a substantial commitment of initial capital.

Our responsible investment approach applies to LDI strategies in several ways given the different strategies and assets employed.

- **For fixed income assets**, our analysis of their suitability as liability hedging instruments will reflect material ESG risks, in line with our investment processes for credit and sovereign debt analysis.
- **For derivatives**, we seek to manage the risks associated with swaps and repo through counterparty selection and daily collateralisation, among other processes. Our assessment of counterparties will be a result of our credit research process, which includes ESG risk analysis.



Q What specific examples from 2018 can you provide of decisions made in light of your ESG analysis?

Engagement with counterparties, regulators and stakeholders on relevant issues is key. We have proactively engaged with regulators over proposals to reform derivatives markets, and have sought to educate our clients on the relevant market and industry issues to help them make informed decisions.



For more information on our efforts in this area, and other areas relevant to LDI, please see our section focusing on supporting sustainable financial markets (see pages 38 and 39).

CRITICAL FACTORS FOR RESPONSIBLE MANAGEMENT OF LIABILITY HEDGES

Counterparty risk mitigation

- Approval and monitoring of counterparty panel by Insight's Counterparty Credit Committee, chaired by Insight's Chief Risk Officer
- Creditworthiness of counterparties assessed by Insight's credit research team
- Assessment of ESG risk factors incorporated into credit research view
- Long-standing approach has been to collateralise daily using high quality assets

Regulatory engagement

- Pension fund exemption from central clearing (EMIR)
- Better clearing solutions (EMIR)
- Non-cleared margin rules (EMIR)
- Transition from LIBOR to other risk-free rates
- Indirect impact of bank capital rules
- Development of new sources of repo

Meeting client objectives of reducing risk

- Education
- Controlling volatility of funding positions
- Meeting cashflow commitments

FILLING THE GAP: INSIGHT'S PROPRIETARY ESG TOOLS FOR FIXED INCOME

INFORMATION ON ESG FACTORS AND RELATED RISKS IS OFFERED BY A WIDE RANGE OF INSTITUTIONS AND PROVIDERS BUT THERE ARE SIGNIFICANT GAPS. WE SEEK TO DEEPEN OUR UNDERSTANDING OF SUCH ISSUES THROUGH OUR OWN ANALYSIS, ENGAGEMENT AND USING PROPRIETARY ESG TOOLS.

1 INSIGHT'S INTERNAL ESG RATINGS

For many smaller issuers, particularly emerging market or high-yield companies, the availability of relevant non-financial data lags behind information from larger issuers.

Since 2016 we have generated internal ESG ratings for such issuers by sending tailored ESG questionnaires to management. These inform our credit analysts' assessment and help them identify issues to address through further engagement.

In 2019, we aim to develop an internal database of ESG ratings across our investment universe for corporate issuers. Our ratings will be based on independent data and proprietary research.

2 INSIGHT'S COUNTRY SUSTAINABILITY RISK MODEL

In 2018, we introduced a proprietary country sustainability risk index, which generates ESG ratings for 186 countries. This aims to help us better understand the ESG risks at the country level across our portfolios.

Fixed income investors are sharpening their focus on the sustainability risks of individual countries. We believe investing effectively in sovereign debt requires analysis of ESG matters. We complement our research with a proprietary index to help us better understand country ESG risks across our bond portfolios.

The Insight country sustainability risk index generates two sustainability ratings for each country: an overall ESG rating and an ESG momentum score. It is used in four principal ways:

- **To expand the scope of our existing risk models:** When making investment decisions regarding sovereign debt, and other related debt such as issues from state-owned enterprises where the sovereign is effectively the backing entity, identifying changes in economic conditions and the risk profile of the relevant country are key. ESG indicators can provide another angle on economic and other matters.
- **To guide the management of client-specific portfolios with ESG guidelines:** We manage strategies for clients specifying that the overall ESG rating of portfolio holdings must exceed (be better than) that of the relevant benchmark. The index enables us to exclude or focus on issuers according to their ESG performance.
- **To support reporting to clients on ESG-specific factors:** The index ratings enable us to demonstrate how sovereign debt portfolios perform from an ESG perspective, either on an absolute basis or relative to a benchmark.
- **To indicate issues for dialogue:** Dialogue with sovereign issuers can be challenging and politically sensitive, but there can be opportunities to open discussions with officials from relevant agencies. Our index presents a tool by which we might identify and prioritise matters to address with sovereign issuers. This is particularly relevant for emerging/developing markets.



Please see our white paper⁹ on the index for more details, including:

- how metrics are generated,
- initial results and insights, and
- details of underlying ESG datasets.

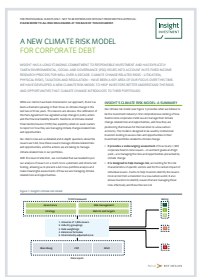
3 INSIGHT'S CLIMATE RISK INDEX

In 2017, we introduced the investment industry's first climate risk index for corporate debt. It ranks c.1,900 issuers according to how they manage climate change-related risks, and is aligned with the framework developed by the TCFD.

Our climate risk index is what we believe to be the investment industry's first comprehensive ranking of how fixed income corporate credit issuers manage their climate change-related risks and opportunities, and how they are positioning themselves for the transition to a low-carbon economy. The index is designed to be used to assess risks and opportunities related to climate change.

- **It provides a wide-ranging assessment** of how nearly 1,900 corporate fixed income issuers – investment grade and high yield – are managing the risks and opportunities presented by climate change
- **It aims to help manage risk**, accounting for the risk characteristics of specific sectors and for the carbon impact of individual issuers. It aims to help investors identify the issuers most at risk from a transition to a low-carbon world. It also allows investors to identify issuers that are managing these risks effectively and those that are not
- **It helps users monitor risks in line with TCFD guidelines.** The index framework and methodology are aligned with the requirements of the TCFD, with companies assessed against objectively assessable indicators across the four TCFD themes: governance, strategy, risk management, and metrics and targets
- **It is based on independent data** sourced from the CDP, MSCI ESG Research and Bloomberg

In 2018, we further developed the index to incorporate new metrics.



For more details about the index, including:

- how Insight uses the index,
- the methodology underlying it, and
- details of key findings,

please see our paper¹⁰ on the index.

⁹ <https://www.insightinvestment.com/globalassets/documents/recent-thinking/uk-sovereigns-and-sustainability.pdf>

¹⁰ https://www.insightinvestment.com/globalassets/documents/recent-thinking/uk_climate_risk_model_intro.pdf

STEWARDSHIP AND ENGAGEMENT ACROSS OUR STRATEGIES

A KEY ELEMENT OF STEWARDSHIP IS PROACTIVE ENGAGEMENT WITH COMPANIES TO ENSURE ACCURATE ANALYSIS AND TO INFLUENCE THEM TO IMPROVE THEIR PRACTICES.



KEY POINTS ON INSIGHT'S ENGAGEMENTS IN 2018

- ▶ Over half our direct company engagements included discussions of ESG issues
- ▶ Climate change and cyber risks were key areas for our collaborative engagements
- ▶ We continued to engage with policymakers on new regulations and responsible investment initiatives

INSIGHT'S DIRECT ENGAGEMENTS WITH COMPANIES IN 2018

The total number of engagements undertaken by credit analysts reached 1,311 in 2018. **More than 50% of engagements included some reference to ESG issues.** This reflects the strength of ESG in the credit process and that ESG including engagement now makes up part of credit analyst remuneration.

In 2019 Insight will roll out a new engagement platform to enable a more efficient process for recording, monitoring and reporting engagement activity. This new system will provide credit and ESG analysts a central resource in which to examine historical engagement activity.

Figure 2: Proportion of company meetings in 2018 that featured discussion of ESG issues

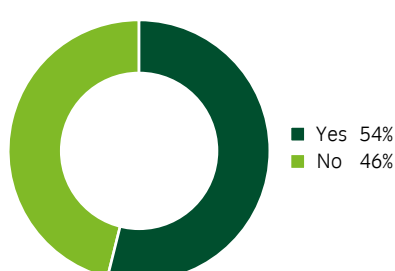


Figure 3: ESG issues raised at company meetings in 2018



CASE STUDIES – EXAMPLES OF DIRECT ENGAGEMENTS

Ørsted



KEY INSIGHT

Our engagement led to a change in our assessment of Ørsted's green bond linked to biomass energy

Insight engaged with Danish utility provider Ørsted as a result of its green bond issuance. We broadly support green bonds that have a positive environment impact, and aim to add bonds that are high quality and fit the risk profile of client mandates to clients' portfolios.

However, Ørsted's green bond led us to raise critical questions on the use of proceeds. The company's strategy was to convert coal plants into biomass renewable energy generation. During our research, we identified a number of initial problems with the green credentials of Ørsted's strategy. We were concerned that the carbon emissions from biomass would be comparable to coal due to a combination of factors, including: importing wood, deforestation, absolute carbon emissions, inefficient incineration, loss of heat and transport carbon impact. While an engagement call with management was organised, we did not receive clarity on the risks identified or any transparency on the carbon emissions from biomass plants.

We therefore avoided participating in the green bond.

Insight revisited the potential investment opportunities after further engagements when Ørsted provided disclosure on its biomass carbon emissions. After a meeting with management we became more confident that the biomass technology and the supply of wood for incineration are compatible with a reasonable definition of green energy: the wood is from cuttings mostly discarded by industry, the wood is sustainably sourced, and the emissions are significantly lower than coal overall.

As a result, our analysis suggested that Ørsted green bonds would be compatible with a sustainable bond portfolio and the impact was positive overall. We continue to add Ørsted green bonds to our portfolios and believe the company is well positioned to further decarbonise its asset portfolio.

RAC



KEY INSIGHT

Our engagement led to increased disclosures from RAC, enabling analysis of its bonds' suitability for our portfolios

RAC did not provide enough information for us to reach a confident assessment of its suitability for our fixed income portfolios. We explained to RAC that offering no public reports or a calendar for investors weakened governance and accountability, and that it could explain the wider spreads on RAC's debt relative to its peers.

As a result of our engagement, RAC announced it would add investor reports to its corporate website along with the dates for its half-year and full-year results, and the timing of its annual investor call. They also committed to providing disclosures quickly to the full market.

Insight took a positive view of the change and considered it would be a financial opportunity for select funds. RAC's year-end results were solid and revealed none of the high capital expenditure announced by its peers. It remained committed to steady deleverage by its private equity shareholders and is not subject to the same headline risk.

Our credit analyst issued a buy recommendation for RAC bonds, driven by the improved governance, and we added the bonds to clients' portfolios.

INSIGHT'S COLLABORATIVE ENGAGEMENTS IN 2018

Climate change

We believe climate change is a long-term systemic risk with significant implications for businesses and society as a whole. In light of this, we are a supporter of the Climate Action 100+ initiative, the TCFD, a signatory of the CDP, and a member of the IIGCC.

Insight's support for the Climate Action 100+ initiative involves working alongside other investors engaging the largest corporate issuers on their low-carbon strategies. As part of this initiative we have targeted issuers from the utilities, consumer discretionary and materials sectors.

Following our meetings there is evidence of company awareness and willingness to have open dialogue on the issues confronting the businesses. As the engagements are ongoing we continue to learn more about the strategic direction of businesses and how well placed they are to reorient their businesses in a more climate-resilient fashion.

We will continue to engage with these companies throughout 2019.

Insight's commitment to the TCFD initiative was most clearly demonstrated in the launch of our climate risk index, which seeks to evaluate corporate fixed income issuers and their climate change-related risks.



See page 33 for more information.

Going forward, we expect to undertake more research on our investments and the carbon risks in client portfolios. As part of that we are also rolling out carbon intensity disclosures for all credit portfolios. This information gives clients a footprint report on the carbon performance at an aggregate level.

Cyber risk

Cyber risk is one of the biggest challenges facing businesses. A number of high-profile data privacy events occurred in 2018, with victims including Facebook and British Airways.

For investors, the risks are many: financial risks from cost of corrective action, reputation impact and business disruption. While the average cost remains low from a data breach, preventative IT security is increasingly a large part of corporate strategy and risk management. We expect all companies to have an IT security plan in place.

As part of our work with the PRI collaborative cyber security group we engaged with a high-profile pharmaceutical company to understand its preparedness for IT security risks. Following the engagement we are confident the company has suitable governance in place but transparency is inadequate. The company outlined its commitment to improve and this is likely to be reflected in its upcoming annual report.

CYBER SECURITY – A GROWING CONCERN¹¹

- Cost of the average data breach to companies worldwide: \$3.86 million
- Cost of the average data breach to a U.S. company: \$7.91 million
- Average time it takes to identify a data breach: 196 days

¹¹ See <https://costofadatabreach.mybluemix.net/#us-company>

Involvement in lobbying for public policy focusing on responsible investment

A significant focus for Insight is supporting a sustainable financial system (see pages 38 and 39 for details). In practice, our efforts include direct engagement with policymakers and stakeholders where necessary, and we will also seek to engage with relevant consultations and collaborate with others in encouraging regulators to develop effective and appropriate policy.

A notable example is a consultation in early 2019 to explore potential improvements to the UK Stewardship Code. Launched in 2010, the Code was the first of its kind and has significant global influence. Many international stewardship codes have been launched since.

Insight asked for a more balanced code, reflecting the role of fixed income investors and their responsibility to act as stewards. This is particularly relevant as more private companies issue debt – such companies typically have weaker governance and accountability due to less stringent reporting requirements. We are encouraged by proposals to update the Code with a more effective oversight regime and revised principles for investors.

This comes after a consultation in 2018 exploring ways to improve the UK Corporate Governance Code. Insight responded to this consultation, emphasising our belief that it should better reflect the opportunities for fixed income investors to engage.

INSIGHT'S VOTING ACTIVITY IN 2018

Most of our equities exposure is through derivatives, which means we have less ability to direct and control companies through voting. We review a range of financial and non-financial factors as part of our investment strategy, and the equities team engages directly with companies where they deem it necessary.

With respect to our clients' rights as shareholders, we maintain a voting commitment that ensures we routinely vote on their behalf with regard to the UK companies in which they have a shareholding. We retain the services of a specialist proxy voting service to manage our voting activities. For more information on our commitment, please see the Appendix (page 55).

Equity income portfolios

In our equity income portfolios, we consider relevant ESG issues in our voting decisions. These portfolios focus on UK issuers, where we believe there to be comparable and typically strong governance standards with sufficient regulatory oversight.

Specialist equities portfolios

For our specialist equities funds, where we hold ownership positions, we meet with companies to discuss investment risks and opportunities. (Over 90% of our holdings are via derivatives rather than shares.) These meetings involve a review of all salient business investment issues, including strategy, financial performance, and ESG factors where relevant.

Our investment focus is UK and European-listed entities and meetings are organised directly with companies or via their advisers.



For details on our specialist equity team's shareholder voting in 2018, please see the Appendix (page 56).

Multi-asset portfolios

Our multi-asset team exercises its stewardship responsibilities by actively voting on shareholdings on matters typically covering adoption of reports and accounts, appointment of auditors, election of members of the board and changes to capital base.

In 2018, the team voted on 127 proposals in 10 listed closed-end investment companies within the strategy's real assets component. The team also engages with investee management and company boards to discuss governance, strategy and other relevant issues. As part of ongoing monitoring of investee companies, the team had 40 contacts with investee management and company boards over 2018.



For more details on our multi-asset team's shareholder voting in 2018, please see the Appendix (page 57).

SUPPORTING SUSTAINABLE FINANCIAL MARKETS

AS A RESPONSIBLE INVESTOR, WE BELIEVE WE MUST TAKE A PROACTIVE ROLE IN ENSURING THE LONG-TERM SUSTAINABILITY OF THE MARKETS. THIS IS IN OUR CLIENTS' LONG-TERM INTERESTS, AS WELL AS THAT OF WIDER SOCIETY. IN THIS SECTION WE OFFER HIGHLIGHTS OF OUR EFFORTS TO ENGAGE ON SIGNIFICANT REGULATORY AND MARKET ISSUES.

1

INSIGHT AND THE EUROPEAN MARKET INFRASTRUCTURE REGULATION (EMIR)

Insight has actively engaged with European policymakers on a range of issues as we seek the best outcome for our pension scheme clients.

Advocacy on European pension fund clearing exemption

Clearing could require pension funds to hold large amounts of cash in order to meet variation margin (VM) calls from central counterparties (CCPs) that can only be met in cash due to the CCPs' operating models. Pension funds are not natural holders of cash, and any rules that inadvertently force pension funds to hold large reserves of cash could limit a pension fund's ability to manage risk prudently and to invest appropriately for the long term.

Since 2010, Insight has made it a priority to represent pension funds' interest on this issue and has been instrumental in securing the initial and subsequent extensions to the pension fund clearing exemption.

Extension of pension fund exemption in EMIR Refit

Insight has been actively advocating for an extension to the pension fund clearing exemption which formally expired in August 2018. Insight, working in collaboration with Dutch and Danish pension fund asset managers, has been advocating to policymakers that further extensions to the pension fund exemption are necessary. We have written and published policy papers and have had many discussions with European policymakers.

Seeking a long-term clearing solution for pension funds

Insight is actively working with policymakers and the wider industry to develop a robust long-term clearing solution for pension funds. The clearing exemption provided to pension funds is only temporary as policymakers ultimately desire a solution to the cash variation margin issue so that pension funds can enter the mandatory clearing regime. We believe it is in our pension fund clients' interests that they are not mandated to clear before a robust clearing solution is found, alleviating the need for pension funds to hold substantial cash buffers.

To support this process, after discussions with Insight and our pension-fund collaborators, the European Commission set up private meetings with select pension funds, CCPs, clearing members and central banks. All invited pension funds were from our pension fund collaboration group and Insight was the sole representative of UK pension funds. We helped to coordinate and communicate the messages of the pension fund delegates to ensure a clear, collaborative approach to the key issues.

Working to protect UK pension funds post-Brexit

Insight is working with UK policymakers to ensure UK pension funds benefit from an exemption to clear after the UK withdraws from the EU. The pension fund exemption is expected to be on-shored to the UK and Her Majesty's Treasury (HMT) has shared initial drafts of how this may look. However, technical complications around the process exist which HMT is aiming to address.

Advocating for the timely implementation of the small financial counterparty regime

Insight supports the EMIR Refit proposal to exempt smaller clients permanently from the requirements to clear. It puts forward an exemption for small financial counterparties below certain clearing thresholds. We welcome this as we expect it would allow many of our clients to have the option of accessing either cleared or non-cleared liquidity.

However, we were concerned the rules as originally proposed would not deliver the exemption in practice for many reasons. Insight has successfully increased the profile of this issue and has received support from both industry trade associations and policymakers.

Driving the exemption for pension funds from the sovereign issuer concentration rule

Insight was instrumental in ensuring UK pension funds are allowed to collateralise their derivative positions fully using UK gilts, without being forced to diversify their collateral pool by investing in foreign government bonds, as proposed under 'sovereign issuer concentration' rules relating to non-cleared initial margin. This could have introduced unnecessary currency risk for UK pension funds.

2 HIGHLIGHTING THE UNINTENDED CONSEQUENCES OF BANK CAPITAL RULES

Bank capital rules, particularly the recently introduced leverage ratio and Net Stable Funding Ratio rules, play an important role in changing the behaviour of banks towards servicing their clients. As such, we believe it is important to understand these rules and where changes could potentially lead to a negative impact on the service and liquidity banks provide to our clients.

We have modelled certain elements of bank capital rules for our clients' portfolios and have become a key industry voice on this issue.

3 STRIKING A BALANCE ON GLOBAL RULES FOR NON-CLEARED MARGIN ON DERIVATIVES

Insight is supporting efforts to reduce the burden on clients of having to post and receive margin.

The final phase of the global rules on margin for non-cleared derivative transactions will require entities with gross notional amount of non-cleared derivatives in excess of £8bn/\$8bn/€8bn (or 8bn denominated in relevant jurisdictional currencies for other domiciles) to post and receive initial margin from September 2020, for new non-cleared trades. The purpose of these rules is to reduce systemic risk and to increase the transparency of the derivatives market.

Experiences across the wider industry from the implementation of earlier phases of these rules has resulted in wide industry advocacy, driven by the International Swaps and Derivatives Association (ISDA) and the Securities Industry and Financial Markets Association (SIFMA), aimed at striking the right balance between achieving the objectives behind the new rules while avoiding too high a burden on smaller clients. Insight supports this initiative and has represented buy-side interests on this issue to global rule-setting bodies BCBS and IOSCO.

4 MANAGING THE LIBOR TRANSITION

Insight is engaging with clients and policymakers on the impact of the transition away from LIBOR to ensure our clients' interests are fully represented.

ISDA issued a consultation on technical issues related to new benchmark fallbacks for derivative contracts that reference certain interbank offered rates (IBORs). The conclusion of the consultation corresponds with the recommendation made by Insight to ISDA and we were pleased to see a large number of UK pension funds participate. We believe the recommended approach will minimise uncertainty for clients.

Insight is also an active member of a range of working groups and committees focused on different aspects of the transition from LIBOR.

Our goal is to engage actively with a range of industry participants to ensure we fully understand all of the various ways in which the LIBOR transition could affect our clients' interests, enabling us to help both our clients and the consultant community to navigate through the transition process.

5 ENGAGING WITH POLICYMAKERS ON INCENTIVES TO CLEAR OTC DERIVATIVES

Insight has engaged with policymakers to suggest improvements to support clearing for buy-side clients. We engaged with the exercise undertaken by the Financial Stability Board (FSB) and other policymakers on incentives to centrally clear over-the-counter (OTC) derivatives for clients. We explained potential improvements to support clearing for buy-side clients.

Working with ISDA, Pensions Europe, and pension funds, we drove a joint ISDA and Pensions Europe paper aiming to quantify certain industry constraints within clearing that could develop in the future once pension funds starting clearing in volume. The aim was to encourage regulators to support industry solutions around these issues.



For more information on these and other initiatives, please ask your Insight contact.

MAKING A LONGER-TERM IMPACT



MANY OF OUR CLIENTS SEEK TO ACHIEVE NON-FINANCIAL OBJECTIVES WITHIN THEIR PORTFOLIOS. THESE RANGE FROM BROAD SUSTAINABILITY OBJECTIVES, SUCH AS INVESTMENTS ALIGNED WITH THE UN SUSTAINABLE DEVELOPMENT GOALS, THROUGH TO TARGETS AIMING FOR A POSITIVE SOCIAL OR ENVIRONMENTAL IMPACT.



KEY POINTS FOR IMPACT BONDS IN 2018 // 42

- ▶ Growth in impact bonds slowed
- ▶ Governments, financials and utilities continued to dominate impact bond issuance
- ▶ Opportunities to invest in dedicated fixed income impact strategies remain limited
- ▶ Only a minority of sustainable issues fully met our minimum sustainability requirements





KEY INSIGHTS ON SUSTAINABLE AND IMPACT INVESTING IN FIXED INCOME // 46

- ▶ A sustainable approach to fixed income doesn't mean giving up on your performance targets
- ▶ Impact objectives are compatible with a conventional outperformance target



FOCUS ON IMPACT BONDS



KEY POINTS FOR 2018

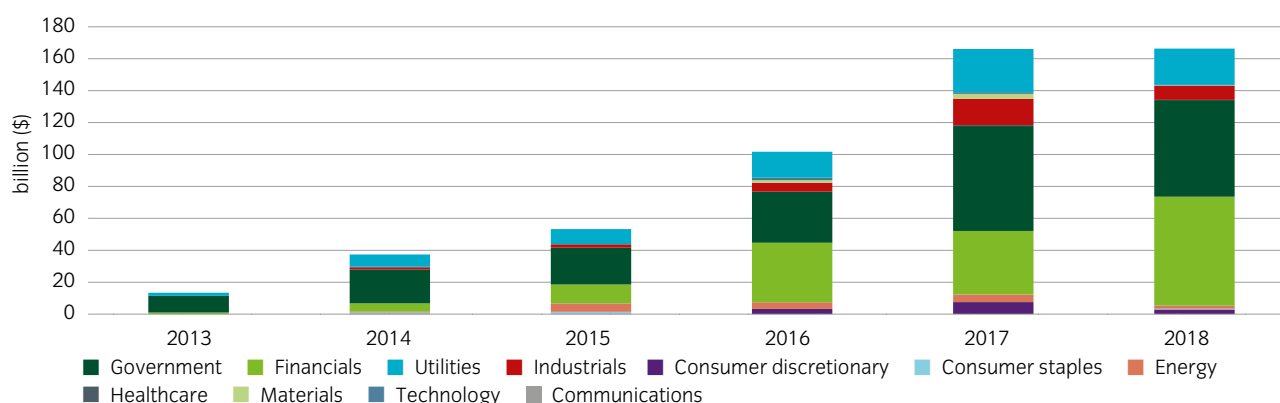
- ▶ **Growth in impact bonds slowed in 2018**, potentially due to weaker fixed income markets, uncertainty over the introduction of new European guidelines for sustainable finance, and a lack of new issuers coming to market
- ▶ **Governments, financials and utilities continued to dominate impact bond issuance in 2018** – with financials issuance increasing sharply as a proportion of total issuance
- ▶ **Opportunities to invest in dedicated fixed income impact strategies remain limited** due to the limited issuance of bonds at a size suitable for inclusion in benchmarks – meaning clear parameters and skilled analysis are even more essential for impact bond portfolios
- ▶ **Only a minority of sustainable issues we analysed in 2018 fully met our minimum sustainability requirements**, with weaknesses in a majority of bonds with regard to sustainability

Growth in the impact bond market slowed in 2018. US dollar issuance of all impact bonds over the year totalled \$166.3bn, only slightly up from issuance in 2017 of \$166.1bn.

There are several possible reasons for the slowdown. General market weakness and cautious investor sentiment may have limited the issuance of impact bonds, as they did for conventional bonds. Uncertainty over the implications of the European Commission's green taxonomy may have limited supply. Another factor is that many companies with leading sustainability programmes have already issued impact bonds and are now putting the bond proceeds to work, so the pool of potential issuers has shrunk.

Financials were again the biggest issuer of impact bonds, accounting for 41% of impact bond issuance, up from 24% in 2017 (see Figure 4). Utility issuance over the year fell for the first time, to 13.7% of all impact bonds.

Figure 4: Growth of the impact bond market¹²



Achieving the UN Sustainable Development Goals is expected to require \$5trn to \$7trn of total investment by 2030¹³. Impact bonds – where bond proceeds are used for positive environment or social themes – are a key way to contribute towards such sustainability objectives.

For fixed income investors, it is possible to incorporate sustainability targets within their portfolios, but the opportunities to invest in dedicated impact strategies remain limited.

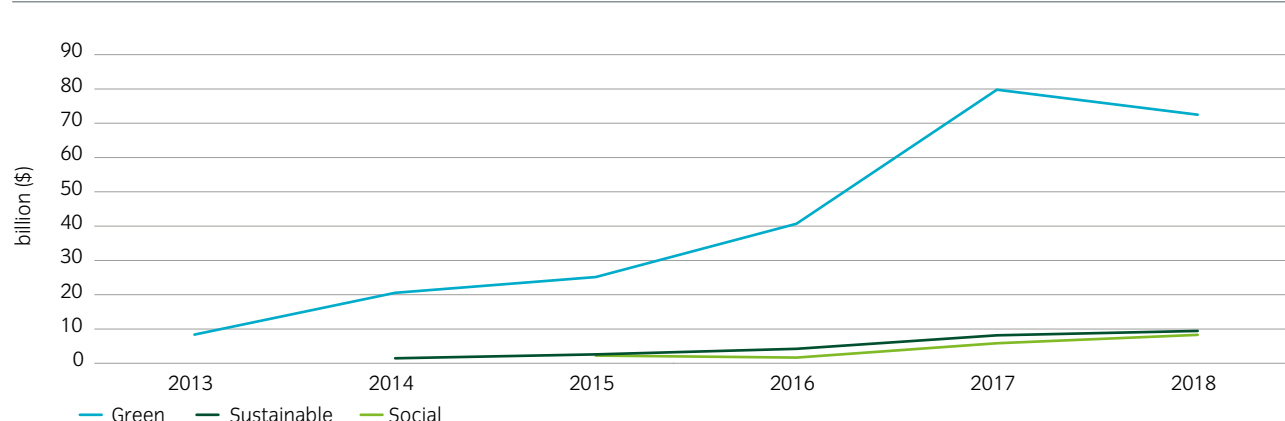
¹²Source: Bloomberg and Insight.

¹³See <http://www.undp.org/content/undp/en/home/blog/2017/7/13/What-kind-of-blender-do-we-need-to-finance-the-SDGs-.html>

This is best illustrated by Figure 5, which shows the dollar value of bond issuance large enough to be incorporated within broad benchmarks (above \$300m), denominated in euros, US dollars or pounds sterling. In total, 97 bonds of this size were issued in 2018, of which 89 were from issuers in the government or sovereign, financials or utilities sectors, accounting for \$90bn of issuance.

Green bond issuance appears to have slowed, but steady growth remains in social and sustainability-labelled bonds that can achieve more of the UN Sustainable Development Goals aside from climate action and climate mitigation.

Figure 5: Green bond issuance appears to have slowed – issuance of impact bonds above \$300m in size¹⁴



Insight's activity in the impact bond market

In 2018, Insight added 42 impact bonds to client portfolios. This included 37 green bonds, two social bonds and three sustainable bonds across a range of sectors (see Figure 6). Most of the bonds were issued by utilities and financials, and many have been repeat issuers of green bonds.



A full list of impact bonds added to client portfolios is available on page 54.

Figure 6: Impact bonds added to client portfolios (by sector)

Sector	Green	Social	Sustainable	Total
Banks	9	1	1	11
Communications Equipment	1			1
Diversified Banks	3		1	4
Educational Services	1			1
Food & Beverage			1	1
Government Development Banks		1		1
Government Local	1			1
Power Generation	3			3
Real Estate	2			2
Retail - Consumer Discretionary	1			1
Sovereigns	2			2
Supranationals	2			2
Utilities	12			12
Total	37	2	3	42

¹⁴ Source: Bloomberg and Insight.




INSIGHT'S SUSTAINABLE BOND ANALYSIS FRAMEWORK

Our framework to assess companies' sustainable bond issuance is used by our credit analysts when considering bonds for all Insight's investment portfolios.

Our credit and ESG analysts rate issuers on the following categories using our framework:

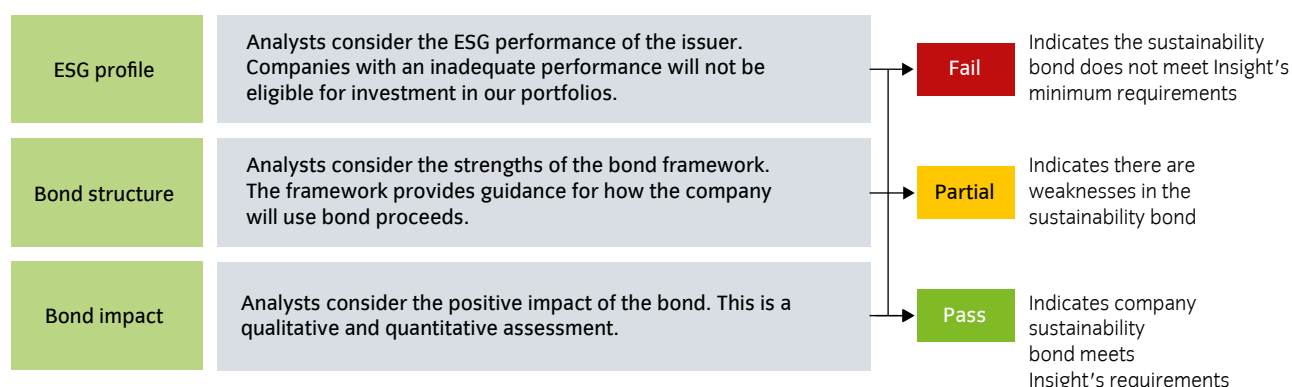
1. **ESG profile:** Analysts consider the ESG performance of the issuer, including corporate governance quality, its history of environmental and social activity and breaches of global norms.
2. **Structure of bond:** Analysts consider the strengths of the framework outlining the impact of the bond. The framework provides guidance for how the company will use bond proceeds.
3. **Bond impact:** Analysts focus on the tangible impact of the bond proceeds. This is a qualitative and quantitative assessment. Individual analysts have the flexibility to define the impact performance of the bond.

Analysts consider the three-point framework and allocate a yes/no score. Analysts will then use their judgement to allocate a traffic light score.

-  **Red** indicates the sustainability bond does not meet Insight's minimum sustainability requirements
-  **Amber** indicates there are weaknesses in the bond with regard to sustainability
-  **Green** indicates a company's sustainability bond meets Insight's minimum sustainability requirements

Analysts are expected to give a brief summary of the bond and their reasons for assigning the traffic light score. A red score does not automatically exclude the bond from Insight's portfolios. The rating will be used as an input into the overall fundamental review of a credit and its suitability for all credit portfolios.




Figure 7: Insight's framework for assessing sustainable bonds



In 2018, we analysed 39 issuers of impact bonds:

- 16 received a green score
- 22 received an amber score
- and one received a red score

Figure 8: Examples of sustainable bond assessments in 2018

Issuer	Bond type	ESG profile criteria met?	Bond structure criteria met?	Bond impact criteria met?	Framework score	Analyst assessment
Belgium	Green	Yes	Yes	Yes	Amber 	<p>In February Belgium issued its inaugural green bond, which was added to various client accounts. Belgium has aspirational targets for renewable energy generation and energy efficiency. The bond proceeds are used to meet these objectives.</p> <p>The green bond's framework outlines how tax credits will form a key role in allocating expenditure to related energy efficiency programmes. However, the impact will depend on how much consumer interest there is and there are no targets or details on the programmes that would qualify. Also, there are no defined targets or minimum standards from the use of green bond proceeds. These contributed to our amber score.</p>
HSBC	Sustainable	Yes	Yes	Yes	Green 	<p>HSBC issued a bond linked to the UN Sustainable Development Goals. The proceeds will be used for health and wellbeing, quality education, clean water and sanitation, affordable and clean energy, industry innovation and infrastructure, sustainable cities and communities and climate action. Eligible businesses or projects must derive 90% or more of revenues from these sectors.</p> <p>HSBC follows best practice, with a green bond committee and sustainability representatives having oversight of projects with the power to veto. The bank's 2018 report shows that 52% of proceeds went to new projects, while in terms of sectors 51% went to industry, innovation and infrastructure.</p> <p>These factors contributed to our green score for the bond.</p>
Danone	Social	Yes	Yes	Yes	Amber 	<p>The issue from Danone was a rare example of a consumer-focused impact bond. The proceeds cover a number of themes that serve a strong social purpose, such as responsible farming, natural farming methods, small and medium-sized enterprise financing and water access. The proceeds also include research and development and employee health benefits. We do not consider employee health benefits a good use of bond proceeds, but the commitment to health care nutrition products will drive business and consumer improvements.</p> <p>A commitment to spend the capital within two years and annual reporting on the proceeds with quantifiable metrics on the proceeds ensured that the social bond scored an amber rating in our sustainable bond analysis framework.</p>

INCORPORATING SUSTAINABILITY AND IMPACT OBJECTIVES – AN EXAMPLE



Robert Sawbridge
Portfolio Manager,
Fixed Income

WE BELIEVE OUR APPROACH TO SUSTAINABLE AND IMPACT INVESTING IN FIXED INCOME, EXEMPLIFIED BY OUR SUSTAINABLE EURO CORPORATE BOND STRATEGY, BALANCES THE REQUIREMENTS OF MANY OF OUR CLIENTS FOR AN APPROACH THAT INCORPORATES BOTH SUSTAINABILITY AND IMPACT TARGETS, WHILE MAINTAINING A PERFORMANCE TARGET RELATIVE TO A CONVENTIONAL FIXED INCOME INDEX.

This builds on our responsible investment approach, which we apply across all of our strategies and portfolios.



KEY INSIGHTS

- ▶ **A sustainable approach to fixed income doesn't mean giving up on your performance targets.** Our sustainable strategy's outperformance target is set against a conventional bond index. When we introduced ESG and sustainability objectives to the strategy, we did not materially alter its performance objective.
- ▶ **Impact objectives are compatible with a conventional outperformance target.** Our strategy's exposure to impact bonds over the year was well above the benchmark, even as it sought to outperform the benchmark.

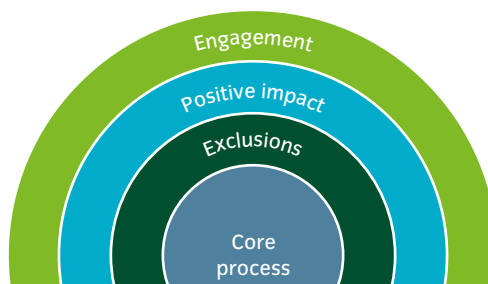
INSIGHT'S SUSTAINABLE EURO CORPORATE BOND STRATEGY

Our sustainable euro corporate bond strategy has three distinguishing features:

1. It only invests where minimum standards for ESG factors are met,
2. It seeks to make a positive impact by favouring issuers with superior sustainability profiles, and
3. We actively engage with companies held to encourage better management of social and environmental issues.

The strategy invests on the basis of our long-established investment philosophy and process, and incorporates quantitative and qualitative inputs. Our sustainable approach builds on this investment process to augment the ESG focus of the strategy.

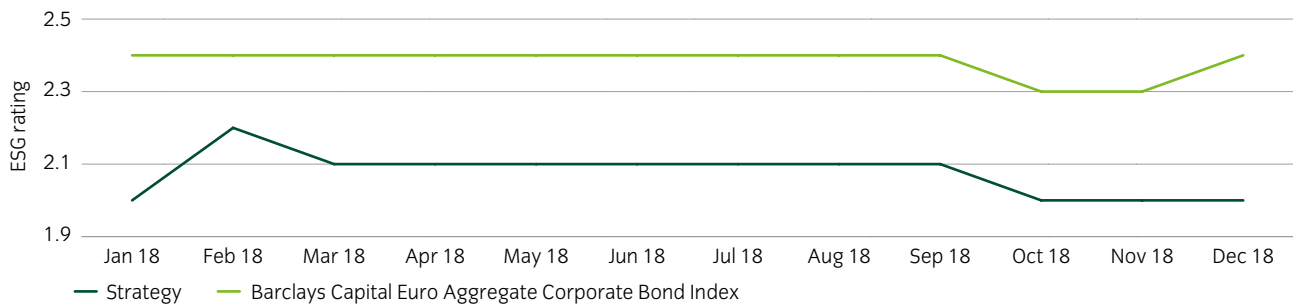
Figure 9: Insight's sustainable euro corporate bond strategy – a sustainable approach





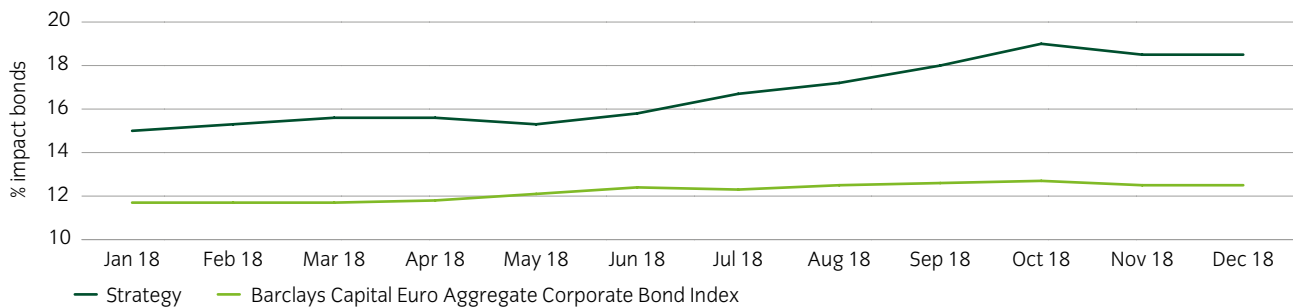
Better ESG performance than the benchmark¹⁵

The strategy's ESG score remained largely steady over 2018, with a better overall ESG rating than its benchmark. The portfolio reflects a best-in-class tilting strategy that aims to invest in better-performing ESG companies and avoid those with the lowest ESG ratings.



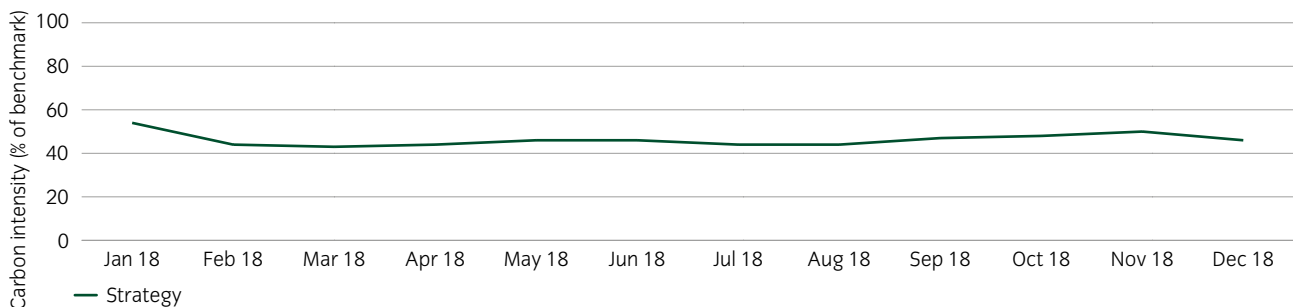
Substantial exposure to impact bonds¹⁵

The strategy's exposure to positive impact bonds grew over the year. Some of that growth was down to new issuance of green bonds. On average, 16.7% of the strategy had a strong link to positive impact opportunities over the year. The strategy aims to increase its allocation to positive impact opportunities and our aim is to see this grow over time.



Much lower carbon intensity than the benchmark¹⁵

The carbon intensity of the strategy was, on average, 46% lower than its benchmark over the year. This was achieved by removing the most carbon-intensive issuers from the portfolio.



¹⁵ Source: Insight and Bloomberg.

CASE STUDY

Bayer



KEY INSIGHT

We engaged with Bayer after the acquisition of Monsanto led its ESG rating to fall

In 2018, we engaged with Bayer after its acquisition of Monsanto was approved by regulators. Bayer entered the transaction despite ESG risks with Monsanto. The acquisition led Bayer's ESG rating to fall to the worst possible rating.

The Insight sustainable bond strategy requires that if an issuer deteriorates to 'worst in class' status we engage with the company with an aim to highlight and improve the issues that caused the deterioration. If a company is not compliant after a 12-month period, we would sell the bonds in the sustainable bond strategy.

We were concerned about the reputational risk to Bayer and our clients from exposure to Monsanto. For several decades, Monsanto has been subject to popular attention over its agricultural chemicals products, namely Roundup.

Insight's credit analyst and ESG analyst organised a meeting with Bayer management to focus on ESG issues. In August 2018, a US jury ordered Monsanto to pay \$289m compensation to an individual over health-related issues. Bayer's share price fell over 10% and bond spreads widened.

We discussed with senior management a range of critical issues surrounding the company including product concerns, class-action lawsuits, and its strategy to manage the ESG risks. As a result of this engagement, we were confident there is no current definitive scientific basis for the product concerns and that the litigation events and potential costs would be manageable for the company. We also concluded the headline risks will stay with the company for some time.

We recommended that due to the high-profile event, the company should consider developing an improved investor communication approach to respond to fast-moving issues. The company has provided further information in its 2018 annual report, published in 2019.

We determined that the company's ESG risks are being managed and that, over time, Bayer's culture and business practices – including sensitivity to sustainability issues – will be positive for the acquired Monsanto business. Ultimately, while we are confident Bayer is managing these risks and investors are suitably compensated for the elevated ESG risks at current spreads, we sold holdings in the sustainable corporate bond strategy due to the controversies that we did not see as being aligned with the non-financial objectives of the strategy.

Figure 10: Bayer's credit spreads widened materially in 2018, relative to its peer Merck¹⁶



¹⁶ Source: Bloomberg. As at 31 December 2018.



Insight's sustainable bond strategy requires that if an issuer deteriorates to 'worst in class' status we engage with the company. If it is not compliant after 12 months, the strategy sells the bonds



APPENDIX I. LEADING OUR RESPONSIBLE INVESTMENT PROGRAMME

IN 2019 WE INTRODUCED ENHANCEMENTS TO OUR OVERSIGHT AND STRUCTURE ON ESG INVESTMENT ISSUES.

We have replaced the ESG Working Group with an ESG Business Group, and introduced two formal meetings focusing on ESG in corporate and sovereign fixed income. All meetings are quarterly and contain key investment and business staff.

	ESG Fixed Income Group (Corporate)	ESG Fixed Income Group (Sovereign)	ESG Business Group (formerly ESG Working Group)
Mandate	<p>To effectively apply the responsible investment strategy across corporate fixed income, in particular:</p> <ul style="list-style-type: none"> • High ESG risk issuers • Significant ESG changes • Thematic issues • Research requirements • Engagement outcomes • Process enhancements 	<p>To effectively apply the responsible investment strategy across sovereign fixed income, in particular:</p> <ul style="list-style-type: none"> • High ESG risk issuers • Significant ESG changes • Thematic issues • Research requirements • Engagement outcomes • Process enhancements 	<p>To review business risks and opportunities from an ESG perspective:</p> <ul style="list-style-type: none"> • RFP and account developments • Communications and marketing • Product development • Industry and regulatory developments • Client and stakeholder investment communication
Meeting frequency	Quarterly	Quarterly	Quarterly
Chair	Rob Sawbridge, Portfolio Manager, Fixed Income	Colm McDonagh, Head of Emerging Market Fixed Income	Lucy Speake, Head of European Credit, Deputy Head of Fixed Income
Vice Chair	Joshua Kendall, Senior ESG Analyst	Joshua Kendall, Senior ESG Analyst	David Avere, Head of Credit Analysis

APPENDIX II. INSIGHT'S WEAPONS POLICY

INSIGHT DOES NOT INVEST IN COMPANIES INVOLVED WITH THE PRODUCTION, SALE OR MAINTENANCE OF CLUSTER MUNITIONS OR LANDMINES.

There are two major international conventions that address cluster munitions and landmines specifically:

- The Convention on Cluster Munitions (2008): This Convention restricts the manufacture, use, and stockpiling of cluster munitions and the components of these weapons
- The Convention on the Prohibition of the Use, Stockpiling, Production and Transfer of Anti-Personnel Mines and on Their Destruction (1997): This Convention, often referred to as the Anti-Personnel Landmines Convention, aims to eliminate anti-personnel landmines around the world

In line with these international conventions and following their ratification into domestic law by a number of countries, Insight has adopted a global policy which commits it to avoiding direct investments in companies that:

- Design, produce, sell or maintain cluster munitions and/or landmines
- Undertake research and development to develop cluster munitions and/or landmines
- Breach the requirements of the Convention on Cluster Munitions or the Anti-Personnel Landmines Convention

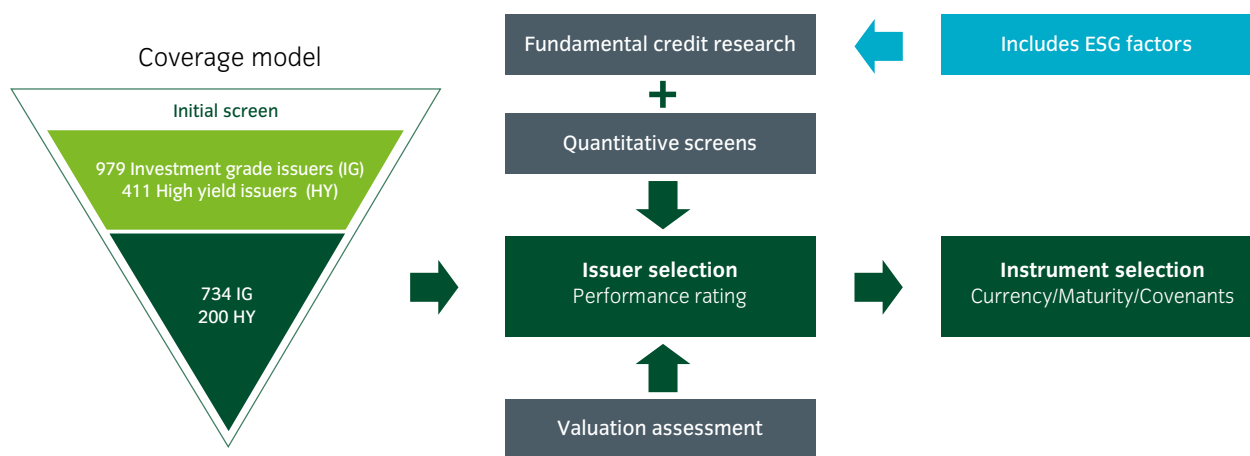
This policy:

- Applies across all asset classes
- Excludes affiliated companies: that is, companies with affiliations or commercial relationships with screened companies will not be excluded from investments
- Does not apply to passive holdings in index-tracking instruments

APPENDIX III. INSIGHT'S CREDIT INVESTMENT PROCESS

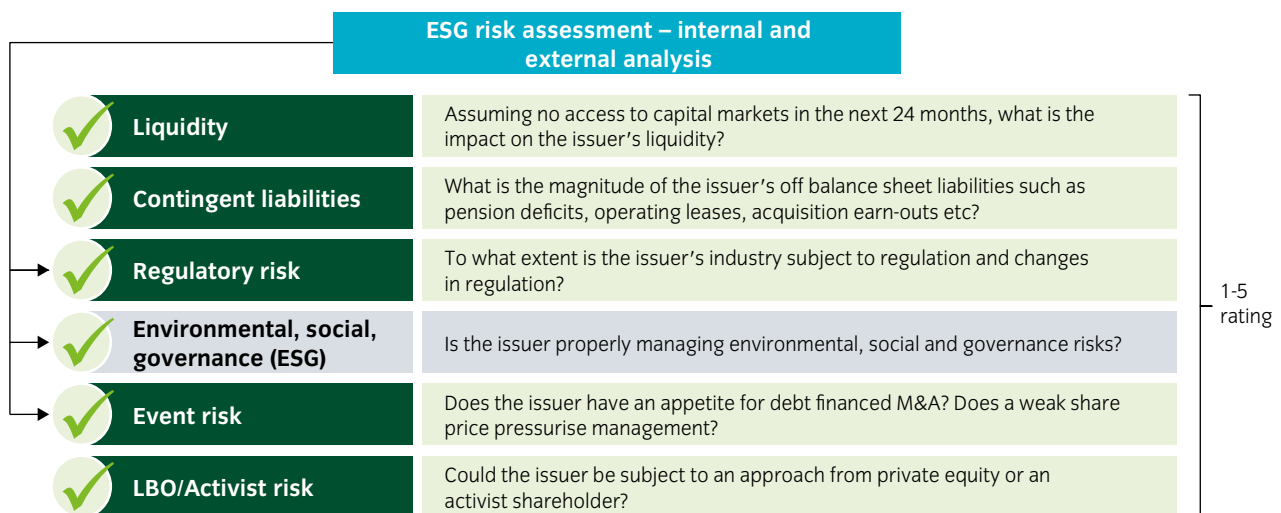
IN DISCUSSION WITH PORTFOLIO MANAGERS, WE APPLY FILTERS TO OUR CREDIT UNIVERSE TO ARRIVE AT A SMALLER GROUP OF INVESTABLE ISSUERS. THIS SHORTER LIST IS THEN SUBJECT TO RIGOROUS FUNDAMENTAL ANALYSIS BY OUR CREDIT ANALYSIS TEAMS IN LONDON AND NEW YORK. WE TEND TO SCREEN OUT INVESTMENTS IN ISSUERS THAT OFFER INSUFFICIENT ACCESS TO FINANCIAL DATA AND COMPANY MANAGEMENT, AND ISSUES WHICH ARE INSUFFICIENTLY LIQUID (SEE FIGURE 11).

Figure 11: ESG risks are integrated within Insight's credit analysis¹⁷



Our analysts conduct a fundamental review of a company's financial risk, in particular its cash flow, revenue and profitability. We pay particular attention to the scoring of key business risks using a checklist that identifies important sources of risk that can lead to a sudden deterioration in credit quality and that identifies sources of risk that may not be readily apparent from an examination of a company's financial performance (see Figure 12).

Figure 12: Insight's risk checklist



¹⁷ As at 31 December 2018. For illustrative purposes only.

Default risk is the prism through which our analysts consider every issue. A full investment analysis is required to inform an investment decision and ESG risk scores are a necessary element in assigning a credit rating that indicates the relative risk of default loss. Insight's Credit Analyst Team is charged with determining the materiality of issues on the checklist, defined as the contribution these make to the default likelihood of a potential investment.

It is through the combination of ESG risk screening and financial analysis that Insight's extended credit risk appraisal process brings together an assessment of the financial risks associated with a company's performance with a clearly defined set of key business risks, including ESG considerations, as a part of the mainstream investment process. Insight believes that its approach exemplifies Principle 1 of the PRI.

IDENTIFYING ESG RISKS

We transpose third-party ESG ratings into the five-point risk scale that we use to assess the significance of non-financial risk factors. Our ESG assessment focuses on the material risks in each sector or business. For example, we consider health and safety, and carbon emissions, as important risks for companies operating in the mining sector, but we see these as generally of lower importance for financial services companies. The exception is with corporate governance, where we consider the risks an important part of our evaluation for every type of issuer and credit quality. The range of ESG risk issues and the scores used are illustrated in the graphic below.

Figure 13: ESG ratings framework¹⁸

ESG Overall Score Normalised industry-adjusted score 1-5								Ratings used in Risk Checklist
Environment Pillar Absolute score 1-5			Social Pillar Absolute score 1-5			Governance Pillar Absolute score 1-5		
Carbon	Natural Capital	Pollution	People	Products	Place	Corporate Governance	Behaviour	ESG key issues
Carbon Emissions	Water Stress	Toxic Emissions	Labour Management	Product Safety and Quality	Controversial Sourcing	Board*	Business Ethics	
Carbon Vulnerability	Biodiversity and Land Use	Waste	Health & Safety	Chemical Safety		Pay*	Anti-Competitive Practices	
Product Footprint	Raw Material Sourcing		Human Capital Development	Financial Product Safety		Ownership*	Corruption and Instability	
Financing			Supply Chain	Privacy and Data Security		Accounting*	Financial System Instability	
			Health and Demographic Risk	Responsible Investment			Tax Transparency	

FILLING THE GAP

Data from third-party providers is important, but not enough. For many smaller issuers, especially emerging market and high yield companies, the availability of relevant non-financial data often lags behind that available for larger issuers. For issuers in our investment portfolios it is important that, wherever possible, we have data that enables us to make a robust assessment of companies' risk exposure and risk management. We are particularly aware that assuming that a lack of disclosure means that a company is not effectively managing an issue could lead to us significantly mispricing the risks associated with these issues.

Insight follows a process to generate ESG ratings if we cannot source independent ESG analysis from our market data providers:

1. Credit analysts identify companies with no ESG ratings but are, or may be, issuing bonds suitable for Insight's credit portfolios
2. Credit analysts work with the ESG Analyst to develop a custom ESG self-assessment tool that reflects the sector-specific risk issues relevant to the issuer
3. Company management is contacted to complete the self-assessment
4. Insight generates an ESG scorecard based on the self-assessment response
5. Insight credit analysts follow up with any risk issues identified

¹⁸ Source: Insight and MSCI. For illustrative purposes only. Based on MSCI ESG ratings framework. *Assessed for all issuers.

APPENDIX IV. IMPACT BONDS ADDED TO CLIENT PORTFOLIOS IN 2018

Figure 14: Impact bonds added to Insight's fixed income portfolios in 2018¹⁹

Issuer	Sector	Impact theme	Year Issued	Maturity
ALD SA	Retail - Consumer Discretionary	Green	2018	11/10/2022
ANGLIAN WATER SERV FIN	Utilities	Green	2017	10/08/2025
ANGLIAN WATER SERV FIN	Utilities	Green	2018	26/10/2029
APPLE INC	Communications Equipment	Green	2017	20/06/2027
AUST & NZ BANKING GROUP	Banks	Sustainable	2018	21/02/2023
BELGIUM KINGDOM	Sovereigns	Green	2018	22/04/2033
BNP PARIBAS	Diversified Banks	Green	2016	01/06/2022
BNP PARIBAS	Diversified Banks	Green	2018	17/04/2024
BPCE SA	Banks	Social	2018	26/09/2023
BPCE SA	Banks	Green	2015	14/12/2022
DANONE SA	Food & Beverage	Social	2018	26/03/2025
DEVELOPMENT BK OF JAPAN	Government Development Banks	Sustainable	2015	21/10/2019
DNB BOLIGKREDITT AS	Banks	Green	2018	19/06/2025
DTE ELECTRIC CO	Utilities	Green	2018	15/05/2048
DUKE ENERGY CAROLINAS	Utilities	Green	2018	15/05/2022
DUKE ENERGY CAROLINAS	Utilities	Green	2018	15/11/2028
ELECTRICITE DE FRANCE SA	Power Generation	Green	2013	27/04/2021
ELECTRICITE DE FRANCE SA	Power Generation	Green	2016	13/10/2026
EUROPEAN INVESTMENT BANK	Supranationals	Green	2015	15/11/2023
EUROPEAN INVESTMENT BANK	Supranationals	Green	2017	15/11/2047
FONCIERE DES REGIONS	Real Estate	Green	2016	20/05/2026
FRANCE (GOVT OF)	Sovereigns	Green	2017	25/06/2039
HSBC HOLDINGS PLC	Diversified Banks	Sustainable	2017	22/11/2023
IBERDROLA FINANZAS SAU	Utilities	Green	2016	07/03/2024
IBERDROLA FINANZAS SAU	Utilities	Green	2017	07/03/2025
IBERDROLA FINANZAS SAU	Utilities	Green	2018	28/10/2026
IBERDROLA INTL BV	Utilities	Green	2014	24/10/2022
ING BANK NV	Banks	Green	2015	24/11/2020
KOREA HYDRO & NUCLEAR PO	Power Generation	Green	2018	25/07/2023
MASS INSTITUTE OF TECH	Educational Services	Green	2014	01/07/2038
MIDAMERICAN ENERGY CO	Utilities	Green	2018	01/08/2048
MITSUBISHI UFJ FIN GRP	Diversified Banks	Green	2018	26/01/2023
NATIONAL AUSTRALIA BANK	Banks	Green	2017	07/09/2022
NATIONAL AUSTRALIA BANK	Banks	Green	2018	30/08/2023
NATIONAL AUSTRALIA BK/NY	Banks	Green	2018	20/06/2023
SKANDINAVISKA ENSKILDA	Banks	Green	2017	17/02/2022
SOUTHERN POWER CO	Utilities	Green	2016	20/06/2026
TENNET HOLDING BV	Utilities	Green	2018	05/06/2028
TORONTO-DOMINION BANK	Banks	Green	2017	11/09/2020
TRANSPORT FOR LONDON	Government Local	Green	2015	24/04/2025
UNIBAIL-RODAMCO SE	Real Estate	Green	2014	26/02/2024
WESTPAC BANKING CORP	Banks	Green	2017	22/11/2024

¹⁹ For illustrative purposes only. This is not a recommendation to buy or sell the securities mentioned.

APPENDIX V. VOTING COMMITMENT

WITH RESPECT TO SHARE OWNERSHIP, IN THE MAJORITY OF THE CURRENT EQUITY INVESTMENT STRATEGIES INSIGHT DOES NOT HAVE MATERIAL INVESTMENTS IN PHYSICAL HOLDINGS. WHERE INSIGHT DOES HOLD PHYSICAL EQUITY POSITIONS WE ROUTINELY VOTE ON BEHALF OF OUR CLIENTS WITH REGARD TO THE UK COMPANIES IN WHICH THEY HAVE A SHAREHOLDING.

Insight retains the services of a third party for proxy voting services and votes at all meetings where it is deemed appropriate and responsible to do so. The third party provider offers research expertise and voting tools through sophisticated proprietary IT systems allowing Insight to take and demonstrate responsibility for voting decisions. Independent governance analysis is drawn from thousands of market, national, and international legal and best practice provisions from jurisdictions around the world.

Independent and impartial research provides advance notice of voting events and rules based analysis to ensure contentious issues are identified. The third party provider analyses any resolution against Insight-specific voting policy templates which will determine the direction of the vote. Where contentious issues are identified these are escalated to Insight for further review and direction. Insight will undertake a review of the voting policy templates on an annual basis.

APPENDIX VI. SHAREHOLDER VOTES IN 2018

Figure 15: Specialist equities funds – voting on management resolutions in 2018

Category	Insight's vote		
	Abstain	For	Total
Appropriate Profits		1	1
Auditor – Election		75	75
Auditor – Remuneration		67	67
Authorised Share Capital		3	3
Board Committee		1	1
Bonds & Debt		2	2
Capital Structure		4	4
Directors – Discharge		3	3
Directors – Elect		634	634
Dividends		60	60
Environmental Practices		1	1
General Meeting Procedures		54	54
Issue of Shares & Pre-emption Rights		209	209
Meeting Formalities		2	2
Other A&R related		1	1
Other Articles of Association		16	16
Other Corporate Action		1	1
Political Activity		44	44
Remuneration – Non-executive		3	3
Remuneration – Policy (All-employee Share Plans)	1	5	6
Remuneration – Policy (Contracts)		1	1
Remuneration – Policy (Long-term Incentives)	7	5	12
Remuneration – Policy (Overall)	14	1	15
Remuneration – Report	63	6	69
Report & Accounts	1	72	73
Share Buybacks & Return of Capital		76	76
Takeover Governance		1	1
Transactions – Significant		18	18
Total	86	1366	1452

Figure 16: Multi-asset holdings – voting on management resolutions in 2018

Category	Insight's vote		
	Abstain	For	Total
Auditor – Election		11	11
Auditor – Remuneration		9	9
Board Size & Structure		1	1
Capital Structure		1	1
Directors – Discharge		1	1
Directors – Elect		47	47
Dividends		14	14
Issue of Shares & Pre-emption Rights		15	15
Meeting Formalities		2	2
Other Articles of Association		4	4
Other Corporate Action		2	2
Remuneration – Non-executive		3	3
Remuneration – Policy (Overall)		1	1
Remuneration – Report		7	7
Report & Accounts		13	13
Share Buybacks & Return of Capital		9	9
Transactions – Related Party		1	1
Transactions – Significant		2	2
Treasury Shares		1	1
Total	0	144	144

IMPORTANT INFORMATION

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

ASSOCIATED INVESTMENT RISKS

Fixed income, liability-driven investment and multi-asset

Where the portfolio holds over 35% of its net asset value in securities of one governmental issuer, the value of the portfolio may be profoundly affected if one or more of these issuers fails to meet its obligations or suffers a ratings downgrade.

A credit default swap (CDS) provides a measure of protection against defaults of debt issuers but there is no assurance their use will be effective or will have the desired result.

The issuer of a debt security may not pay income or repay capital to the bondholder when due.

Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.

Investments in emerging markets can be less liquid and riskier than more developed markets and difficulties in accounting, dealing, settlement and custody may arise.

Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.

Where high yield instruments are held, their low credit rating indicates a greater risk of default, which would affect the value of the portfolio.

The investment manager may invest in instruments which can be difficult to sell when markets are stressed.

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