12 January 2021

Dear Manager,

Over the course of 2020, we have observed a rapid rise in industry and client focus on Environmental, Social and Governance (ESG) factors. These factors have been impossible to ignore with issues ranging from transitioning to a lower carbon world, sustainable emerging market development and creating a fairer society. We are writing to you to share our latest thinking on sustainability and highlight how we have taken steps to bring ESG considerations and sustainable investment practices to the forefront of our investment solutions.

The Past

For many years Cardano has adopted a Responsible Investment approach and expected managers to incorporate ESG factors into investment decisions where those factors had the potential to materially affect the risk and / or return of an investment.

The Present

We have recently embarked on a major firm-wide initiative to take this significantly further. Going forward we will work towards pursuing a Sustainable Investment approach, where we will seek to maximise risk-adjusted returns across portfolios, with the added objective of generating positive real-world impact and/or reducing negative real-world impact through the investments we make. Not only do we think this is the right thing to do but we also believe it makes financial sense too. Cardano has committed to –

- Net zero carbon emissions by 2050, consistent with Paris Climate Agreement, with mid-term targets, (we will use the UK government’s commitment of 68% reduction in carbon emissions by 2030 from 1990 levels as a guideline).
- Respect and support for human rights and avoiding human rights abuses as set out in UN Global Compact Principles 1 and 2

We believe the transition to a low carbon economy in particular will create significant risks for a wide range of existing businesses that are still underappreciated by both companies and markets at present. Given the scale of transformation required, we think the transition to a more sustainable global economy will create attractive long-term investment opportunities that need not come at the cost of financial reward.
Under our framework we will view all investments through three lenses; risk, return and real-world impact. We will permit portfolios to hold some investments that detract from our objectives on one of these dimensions, whilst potentially adding in another, provided that our portfolio, as a whole, is on the right path. In the same manner that some investments are judged to be too risky irrespective of returns, some investments will be judged to have too negative a real-world impact, in particular, with regard to systemic issues, such as climate change or respect for human rights.

As a firm, we are committing substantial resources to this initiative; we have established a steering committee consisting of Will Martindale (Head of Sustainability), Keith Guthrie (Deputy CIO), Kerrin Rosenberg (UK CEO) and Karin Pasha (Partner on our trading desk in the Netherlands) and supported by 30+ Sustainability Champions integrated into all parts of our business. Will joined us on 4 January 2021, in a newly created role, Head of Sustainability. He brings a wealth of industry experience having recently been Director of Policy and Research at UN Principles for Responsible Investment.

**Implications**

Our move towards being a Sustainable Investor will have the following implications for you –

- Our expectations and level of engagement around ESG policies, process incorporation, corporate engagement and reporting will rise.

- We will be expanding our focus from the investment process to incorporate the sustainable footprint of your firm e.g. corporate sustainability policies and initiatives (see appendix for more detail). We want our managers to be investing in sustainable businesses and in turn we want to be investing with firms who run their businesses in a sustainable way.

- Our approach will continue to encompass all managers/strategies and be centred around a materiality-based framework, recognising that ESG factors have a greater impact on some managers/strategies than others and that some managers are able to exert a higher degree of influence and engagement than others. For example, managers investing directly in single name equities and credit will have greater focus than managers investing synthetically through derivative instruments. That said, minimum standards will apply to all managers.

- We will continue to rate your approach based on our interactions with you and our ESG questionnaire. Real life examples of ESG integration in action, supported by data and research, remain the best way to demonstrate your approach and we encourage you to share as many of these with us as possible.

- We will begin to develop and adopt methodologies to measure the real-world impact of our investments at a portfolio level and expect our managers to start moving in this direction as well.

- A requirement of the evolving UK Stewardship code and pension fund disclosure legislation is that we demonstrate how managers we have selected on behalf of our clients are actively engaging with businesses and issuers, including voting activity. This will be disclosed in Cardano’s annual Stewardship statement and in our clients’ Implementation Statements. Thus we will need to be supported by greater transparency from our managers in relation to this activity.
Please see the appendix for a more detailed description of what we are looking for in the four key areas that we assess your approach: policies, process incorporation, engagement with issuers and reporting.

Our journey towards being a Sustainable Investor is sure to evolve as our thinking on the subject and the market itself develops. What we do now is important but we recognise this is a multi-year journey for us and potentially for you.

As we move forward, we are here to help. We will continue to provide you with feedback and transparency around how we are evaluating your approach as well as how it compares to best practice we see elsewhere. For those wanting to make refinements and enhancements to their process, we offer ourselves up as a sounding board. Will has a significant amount of expertise in this area that we can make available, should that be helpful.

Finally, whilst we do not expect change to occur overnight, we will need to see material signs of progress over the next 6 to 18 months for those that currently fall short of our standards. Our aim is to work with you to meet our portfolio’s and client’s objectives in this area, together. Ultimately, we want your help in transitioning our global economy to one that is fairer, more stable and more sustainable.

Your usual contacts on the team are on hand to answer any questions you may have and we’d encourage you to be in touch.

Wishing you every thanks for your efforts in 2020 and all the very best for 2021.

Yours sincerely

Keith Guthrie
Deputy CIO

Ben Cooper
Team Head of Manager Research

Will Martindale
Head of Sustainability

Encl.
Appendix

Sustainability Assessment Criteria

Our assessment focuses on four key areas:

1) Policies - clear demonstration of intent

- What are we looking for?
  - Investment policies proving clear statements of how ESG considerations are integrated into decision making. Policies should cover all funds/strategies and cover topics such as risk and impact assessment, stewardship, securities lending activities and training of investment professionals. Your own corporate policies addressing issues such as climate change, carbon footprint, diversity/inclusion and governance.
  - Signing up to globally recognised standards e.g. PRI Details of other initiatives you are involved with that further sustainable goals e.g. Institutional Investors Group on Climate Change, the UN Global Compact and support for UN Sustainable Development Goals, Climate Action 100+. We encourage managers to commit to decarbonisation targets and support ESG regulatory initiatives, particularly in respect of human rights.

2) Incorporation – entrenched in the process, backed by evidence and examples

- What are we looking for?
  - Clear and structured integration of E, S and G factors into the investment due diligence and monitoring process.
  - Multiple examples of where ESG factors have been considered. For example, considering the social risks and opportunities, for example the risks of forced labour in supply chains, or the positive social impacts an investment may deliver.
  - Incorporation of ESG data into the investment process. E.g. Measuring climate transition risk, understanding a company’s carbon/GHG footprint and incorporating potential future cost of carbon into company valuation and balance sheet/credit analysis.
  - Supporting initiatives such as i) the Sustainability Accounting Standards Board (SASB), which seeks to develop sustainability accounting standards, ii) the Task Force on Climate-related Financial Disclosure (TCFD) which seeks to improve disclosures and emphasise transition plans around climate-related financial information and iii) policy-led initiatives such as the UK green finance strategy and the EU action plan on financing sustainable growth.

3) Engagement – focus on positive change

- What are we looking for (which may not relevant for all strategies)?
  - Using your position as a provider of capital both in the case of debt and equity, to engage with company management or issuers on material ESG issues. This may begin with raising material issues with management during meetings, tracking their progress against your
own milestones, through to exercising voting in the case of director appointments and shareholder resolutions at company AGMs, or your participation in discussions of terms and conditions around the issuance of new debt.

- Our focus will be on the stewardship outcomes that help achieve positive real-world impact rather than the number of engagements.
- We encourage focus on systemic issues, such as climate change.
- Working with third parties to assist you with voting and engagement where appropriate.
- Placing demands on management (individually or through collective actions) to provide plans and measurement of a range of relevant ESG metrics, including for example, Science Based Targets on their plans for the transition to a Low Carbon economy.
- Supporting collective initiatives e.g. Climate Action 100+ to engage with businesses and create change.
- Please note that we understand that different managers have very different approaches to engagement and public disclosure of all engagements may not be optimal in many situations. We will work with you to ensure appropriate disclosures to meet the requirements.

4) Reporting – don’t allow perfection prevent progress

- What are we looking for?
  - Communication around how policies are applied in practice.
  - Disclosing your voting and engagement records. Implementation Statements are now a regulatory requirement for UK pension funds. These statements include the need to report on the voting behaviour taken on behalf of the trustees during the year. With respect to Voting activity we will need more detailed records of how shares were voted on and why, and what the outcomes were.
  - Beyond your voting record what did other engagements look like: as an example can you track and explain how many times you raised material ESG issues with management, which issues were raised most often, how do you track what progress businesses are making with regards to managing and measuring ESG risk.
  - We will need to work with you to understand how we can appropriately disclose such engagement or voting without compromising any of your investment process, but in-line with the required standards being required by the UK stewardship code.
  - Measuring real world impact, for example using internal or third party (MSCI, Sustainalytics) data to provide portfolio level assessment. For example on portfolio aggregate Carbon Intensity and a comparison to standard market indices. What is its forward looking preparedness for the climate transition.
  - We encourage the use of ESG benchmarks and the disclosure of ESG incidents (or principal adverse impacts). Where applicable we also encourage commitment to disclose against the EU Taxonomy.
Links to Useful Resources

Getting started

- PRI | What is responsible investment | Link
- PRI | Private Equity ESG guide | Link (other asset class guides are available)
- EU | What is sustainable finance | Link
- OECD | Responsible business conduct for institutional investors | Link
- UN Global Compact | The ten principles | Link

More advanced

- PRI | Academic research on ESG topics | Link
- IIGCC / PRI | Net zero asset managers initiative | Link
- CISL | The sustainable investment framework | Link
- CFA | CFA UK level 4 certificate in ESG investing | Link
- PRI | Why and how investors should act on human rights | Link

UK policy frameworks

- UK | UK stewardship code | Link
- UK | Green finance strategy | Link