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2020 Stewardship Report

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Stewardship Report

Our submission

This document has been prepared by Cardano Risk Management Limited (CRML) to comply with the UK Stewardship Code 2020.

Cardano Risk Management Limited is a *fiduciary manager* and *investment adviser* to UK pension schemes. We therefore adhere to both:

- Principles for Asset Owners and Asset Managers (because we are an asset manager), and
- Principles for Service Providers (because we are an investment adviser)

In the rest of this document, we set out our compliance with these principles, one by one. As there is significant overlap between four of the five *Principles for Service Providers* with the more comprehensive *Principles for Asset Owners and Asset Managers*, we have set out our compliance following the 12 *Principles for Asset Owners and Asset Managers* and incorporated the additional scope (Principle 5 for Service Providers) within our response to Principle 6.

Across our response we have sought to limit repetition, and we encourage readership of the report as a whole.

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INTRODUCTION

Introductory statement

Sustainability – including stewardship – has always been at the core of our culture and how we run our business. We approach sustainability from first principles. We are sustainable investors because it is the right thing to do.

Cardano's clients are overwhelmingly pension schemes. Their members and beneficiaries represent a broad spectrum of society in the UK and Europe across industries, income levels, age groups and cultural and ethnic backgrounds.

The youngest members of these schemes may be over 50 years away from retirement. Many of them will have families who will live into the next century. We believe that our clients' members and their dependents should enjoy a quality of life similar to or better than that possible at present. This should be in a sustainable and less polluted environment within a fairer society where they can enjoy financial security.

We believe we can contribute to achieving this in the way we invest and manage their assets. Sustainable investment is core to our corporate values and is right for our business, our society and our world. We believe there are additional compelling reasons to invest sustainably, including:

- Better risk-adjusted returns
- Identifying new investment opportunities
- Anticipating and preparing for sustainability-related policy and regulation

We believe that sustainable investing can contribute to more sustainable capital markets – and a more sustainable world. We focus our resources where we are passionate, knowledgeable and can have an impact. The real-world impacts we have prioritised are:

- The climate crisis, including net zero carbon emissions by 2050 in-line with the Paris Climate Agreement
- Promoting a fairer society
- Sustainable emerging market development

We use the following definitions of sustainability and stewardship taken from the United Nations Bruntland Commission and the UK Financial Reporting Council to inform our approach.

- Sustainability is meeting the needs of the present without compromising the ability of future generations to meet their own needs[1]
- Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and stakeholders, leading to sustainable benefits for the economy, the environment and society[2]

When we think of sustainability impact through the lens of investment, we think both of our generation's needs, and those of future generations. As such, we define sustainable investment as follows:

- Sustainable investment generates positive real-world impact and / or reduces negative real-world impact, while seeking to maximise risk-adjusted returns over the long-term, leading to sustainable benefits for the economy, the environment and society. We define real-world impact as meeting the needs of the present without compromising, and indeed seeking to support, the ability of future generations to meet their own needs

Our Sustainable Investment Policy sets out our approach[3].

[1] United Nations Bruntland Commission
[2] https://www.frc.org.uk/getattachment/975354b4-6056-43e7-aa1f-c76693e1c686/The-UK-Stewardship-Cod-Review-of-Early-Reporting.pdf

[3] https://www.cardano.co.uk/wp-content/uploads/sites/3/2021/03/Cardano-Sustainable-Investment-Policy-0321_final.pdf

PURPOSE AND GOVERNANCE

Principle 1: Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society

About Cardano

Founded in 2000, Cardano is a privately-owned, purpose-built risk and investment specialist.

Cardano comprises:

- **Cardano Risk Management Limited**: Cardano Risk Management Limited is a specialist fiduciary manager and investment adviser focusing on improving UK pension schemes' funding ratio and risk management
- **Cardano Risk Management BV**: Cardano Risk Management BV provides specialist risk management services to some of the largest institutional pension funds in the Netherlands, to protect the funds from unnecessary and unwanted financial risks
- **Lincoln Pensions**: Lincoln Pensions is the UK's leading independent covenant advisor with expertise in areas including covenant reviews, affordability analysis, scheme funding advice, corporate transactions, regulatory issues and counterparty assessments
- **NOW: Pensions**: NOW: Pensions is a leading UK multi-employer master trust. Started in 2012, NOW: Pensions serve tens of thousands of employers and 1.7 million members from a wide range of sectors. NOW: Pensions' mission is to help all members save for a better, more financially secure future

Whilst this Stewardship Report relates to the activities of Cardano Risk Management Limited, sustainability is managed centrally within Cardano, and therefore a consistent approach is taken throughout the group. For example, we refer to NOW: Pensions' *Underpensioned Report* in our response to Principle 4.

Our Purpose

We provide specialised services to private-sector and collective pension schemes in the United Kingdom and the Netherlands.

We strive to deliver better and more secure financial outcomes: **stability in an uncertain world**. We do so as a sustainable investor. We incorporate environmental, social and governance (ESG) risks and opportunities into all our investment analysis, decisions and advice, and our interaction and engagement with our clients, wider stakeholders and counterparties that our clients are exposed to. In addition to risk and return, we also consider both the positive and negative real-world impact of our investment activities.

The real-world impacts we have prioritised are:

- The climate crisis, including net zero carbon emissions by 2050 in-line with the Paris climate agreement
- Promoting a fairer society, and
- Sustainable emerging market development.

We support the aims of UK and EU policymakers in financing sustainable growth. We engage actively as long-term stewards for and on behalf of our clients.

Services Offered

Cardano Risk Management Limited provides fiduciary management and investment management services to UK institutional investors with combined assets of c. £16bn[4]. We also provide investment advice to UK pension funds with combined assets of c. £46bn.

A brief description of the services follows:

- **Fiduciary management**: combines investment advice (on journey planning, strategy, sustainability and compliance) with investment management of the entire pension fund. Under our fiduciary management services, we typically have a mandate to manage the assets against a scheme specific liability benchmark, with broad flexibility of asset allocation and manager selection
- **Investment management**: discretionary investment management services relating to one or several asset classes. Our asset management services include the management of LDI portfolios and broad, diversified growth portfolios
- **Investment advisory**: involves the provision of all aspects of advice concerning the investment of the fund (including journey planning, strategy, sustainability, selection and monitoring of 3rd party managers)

For all services provided, we charge our clients directly, and receive no financial remuneration from third parties. Our fees are bespoke to clients, but can include one or several of the following components:

- **Fixed fee retainer**: an annual fixed fee for an agreed package of services
- **Project fees**: specific fees charged for a specific project. This usually relates to irregular activity
- **Performance fees**: fees charged for achieving performance targets. These are structured using objective and quantifiable metrics

Investment Beliefs

We believe that steady and predictable returns are in our clients' interests, and that these can be achieved by a thoughtful, risk managed approach. Our approach to risk management involves:

[4] Based on net value of the assets under Cardano discretionary mandates as at 31 December 2020 on a mark to market or fair value basis

- Hedging low rewarded risks (e.g. LDI risks for DB pension funds)
- Diversified asset allocation (balancing outcomes across economic scenarios)
- Deliberate use of “protective” assets, such as options
- Actively managing the asset allocation to protect the downside and capture the upside
- Access to diversified manager skill (“alpha”)

We invest in high-quality corporate bonds which are subject to direct analysis of their ESG credentials. No single name equities are invested on a direct basis. We build diversified return seeking and hedging portfolios on behalf of clients through the use of derivatives, bonds and funds managed by third parties, all of which are subject to ESG and stewardship requirements, as set out in this stewardship report.

Sustainable Investment Approach

Sustainability has always been at the core of our culture and how we run our business. We approach sustainability from first principles. We are sustainable investors because it is the right thing to do.

Cardano’s clients are overwhelmingly pension schemes. Their members and beneficiaries represent a broad spectrum of society in the UK and Europe across industries, income levels, age groups and cultural and ethnic backgrounds.

The youngest members of these schemes may be over 50 years away from retirement. Many of them will have families who will live into the next century. We believe that our clients’ members and their dependents should enjoy a quality of life similar to or better than that possible at present. This should be in a sustainable and less polluted environment within a fairer society where they can enjoy financial security.

We believe we can contribute to achieving this in the way we invest and manage their assets. Sustainable investment is core to our corporate values and is right for our business, our society and our world.

We believe there are additional compelling reasons to invest sustainably, including:

- Better risk-adjusted returns
- Identifying new investment opportunities
- Anticipating and preparing for sustainability-related policy and regulation

We believe that sustainable investing can contribute to more sustainable capital markets – and a more sustainable world. We focus our resources where we are passionate, knowledgeable and can have an impact. Our Sustainable Investment Policy sets out our approach[5].

[5] https://www.cardano.co.uk/sustainability-policies/

Sustainable Investment Beliefs

We have adopted the following Sustainable Investment Beliefs:

1. The assessment of both Environmental, Social and Governance risk and return factors (ESG factors), and real-world impact is essential to all investment decisions
2. We will invest in sustainable investments. We will be active owners and stewards of all our assets. We will prioritise real-world impact in our engagement activities
3. The transition to a more sustainable world economy is a journey that will evolve. The real-world impact of our portfolios should be measured. We will set ambitious sustainability targets. Our real-world impact agenda will be focused where we can be most effective
4. The United Nations Sustainable Development Goals (SDGs) form a good basis for defining real world impact. For Cardano, areas of particular focus where we can be most effective and which contribute to the UN SDGs are:
    a. We support the Paris Climate Agreement of aiming to limit global warming to +1.5C versus preindustrial levels. We do this by committing our investment portfolios to net zero carbon emissions by 2050, with ambitious interim targets
    b. Fairer Society: We support the ideals of western liberal democracies. We respect and support human rights globally and seek to fight against human rights abuses. We will look for ways to improve societal outcomes in the UK and the Netherlands, promoting diversity and inclusion and enhancing the wellbeing and financial security of our clients' beneficiaries and their families
    c. Sustainable Development of Emerging Markets: We support the sustainable development of nations in the emerging world, who are most vulnerable to the effects of climate change transition and where impactful change can be most meaningful, in close alignment with the objectives of Cardano Development
5. The transition to a more sustainable global economy will create many attractive investment opportunities. As such, sustainable investment is consistent with, and core to, maximising risk-adjusted returns.
6. Careful portfolio construction and employing an economically balanced risk allocation complements our sustainable investment beliefs and mitigates some of the factor risks that may arise when investing sustainably.

In our Sustainable Investment Beliefs we provide further explanation of and rationale for our beliefs[6].

[6] https://www.cardano.co.uk/sustainability-policies/

Impact on Stewardship, Investment Strategy and Effectiveness

Our investment beliefs and process have served our clients extremely well during 2020. Our risk managed approach meant that our portfolios experienced modest drawdowns during Q1, and we were able to recover, such that all fiduciary clients have experienced outperformance versus their benchmarks during 2020.

In addition, we were able to raise the topic of sustainability with *all of our clients* during 2020, and achieved several improvements to their governance and approach, including:

- Updating of Statement of Investment Principles (to incorporate new regulations)
- Agreeing new policies and approaches to sustainability
- Divesting from fossil fuel-related direct commodity investments
- Delivering Implementation Statements for several clients

Principle 2: Signatories' governance, workforce, resources and incentives support stewardship

What Does Stewardship Entail at Cardano?

We build diversified return seeking and hedging portfolios on behalf of clients through the use of derivatives, bonds and funds managed by third parties. We invest in high-quality corporate bonds which are subject to direct analysis of their ESG credentials. No single name equities are invested on a direct basis.

Stewardship at Cardano therefore focusses on:

- Engagement with the fund managers we select (in respect of the equities, bonds and other asset classes they invest in within their funds)
- Engagement with the issuers of bonds that we hold directly (this is principally governments and debt management offices of UK and core European countries)
- Engagement with derivative counterparties (investment banks and derivate exchanges)
- Engagement with policymakers (covered later in our response)

All of our engagements include ESG and stewardship requirements, as set out in this Stewardship Report.

Governance and Oversight Framework

All stewardship activities are fully integrated into the day-to-day roles of team members on our specialist investment and trading teams. This encourages accountability and fully integrates sustainability-thinking into our processes:

- ESG engagement, including stewardship, is part of each team member's role and ESG related goals form part of each team's vision and objectives
- Throughout Cardano, we have over 30 sustainability champions, who are responsible for integrating ESG issues, including stewardship, into their investment processes. Sustainability champions typically spend 10% to 50% of their time on sustainability related workstreams

Day-to-day team responsibilities are overseen through a robust governance structure:

- Tier 1 | team members in the manager research, LDI and derivatives trading teams are responsible for the day-to-day interaction with all managers and derivative counterparties within client portfolios (ESG ratings, selection, appointment, monitoring and engagement)
- Tier 2.a | Manager Research Committee, chaired by the Head of Manager Research (14 years in Manager Research) and includes Senior Investment Managers and the Deputy CIO (22 years in financial services), meets weekly and has overall responsibility for rating third-party fund managers (including ESG assessment and stewardship assessment and setting the engagement agenda with them). Manager Research coverage teams will escalate ESG issues to this Committee for discussion
- Tier 2.b | Dealer Committee, chaired by Director of Financing Markets and including a senior member from our Dutch Solutions Team, UK Head of Liability Driven Investment and Dutch Chief Risk Manager. This committee meets on a monthly basis and has overall responsibility for rating banking derivative counterparties (including ESG assessment and setting the engagement agenda with them). ESG assessment may from time to time be supported by other specialists in the business, as and when required.
- Tier 3 | Sustainability Steering Committee meets weekly and has overall responsibility for the Cardano Group's Sustainability agenda and policies. The committee has five participants:
  - Cardano Risk Management's CEO, Kerrin Rosenberg: Kerrin founded and leads Cardano's UK team and has overall responsibility for the UK business
  - Deputy CIO, Keith Guthrie: Keith is an experienced multi-asset investor and has responsibility for portfolio construction methodology
  - Cardano Partner and Head of Sustainability Netherlands, Karin Pasha: Karin is a Trader and Partner at Cardano, based in the Rotterdam office and was previously Head of Risk Analysis and Advice
  - Managing Director, Michael Bushnell: Michael is a client lead in the Cardano Group's covenant advisory business
  - Group Head of Sustainability, Will Martindale: Will heads sustainability activities at Cardano and joins from the UN PRI where he was director of policy and research.

- Tier 4 | Group Management Board. Kerrin Rosenberg is the named individual with responsibility for Sustainability on the board; Sustainability forming a key element of his objectives.

Resourcing Stewardship Activities

Our fees are agreed on a bespoke client-by-client basis, and typically comprise of a fixed retainer component (sometimes supplemented by project fee and/or performance fees). Our fixed retainers typically include an allowance for Stewardship activity, as we see that as an intrinsic part of our investment service.

In 2020, we subscribed to MSCI's ESG and Climate Scenario analytics and are working on a project to integrate this data into our investment processes and reporting.

Our Approach to Stewardship

In addition to our signatory to the UK Stewardship Code, we are a member and supporter of Climate Action 100+. While we do not invest in single name equities, we do invest in high quality single name credits, including sovereigns, and we do have high expectations of our managers' ESG and stewardship activities[7].

We set out our stewardship preferences in our sustainable investment policy as follows:

- Quality over quantity: We're interested in meaningful quality engagements, with strong reporting (rather than, being interested in the quantity of votes). We want managers to prioritise the highest sustainability impacts in their portfolios
- Long-term: We encourage managers to form long-term relationships with companies. Successful stewardship can take many months, maybe even years
- Real world impact: We're interested in engagement on topics that contribute to positive real-world sustainability impact (such as, reduction in absolute carbon emissions)
- Honesty: Some engagement, perhaps even most engagement, will be unsuccessful. We're realistic, and we'd prefer honesty from managers
- Collaboration: Engagement is more efficient when managers collaborate – not just for the managers, but for the companies too (who will field fewer, but higher conviction, engagements from their investors). We encourage managers to participate in collaborative initiatives, such as Climate Action 100+
- Innovation: We welcome innovation, for example, third-party tools to independently assess a company's conviction on sustainability topics

[7] Among other resources, our approach to stewardship is informed by PRI's Active Ownership 2.0 programme: https://www.unpri.org/download?ac=9721&adredir=1

- Integrated: We're interested in how stewardship contributes to the investment thesis and whether managers link their stewardship to other engagement activity (for example, policy engagement)

Training

All employees of Cardano are provided with regular updates and information on sustainability. This is formally set out in a sustainable investment bulletin which is circulated to the business on behalf of the Sustainability Steering Committee on a monthly basis throughout the year.

ESG information, education and know-how is regularly circulated on a dedicated sustainability distribution list, accessible by the investment team. ESG factors are also regularly discussed at quarterly investment committee meetings.

Cardano has actively encouraged several employees to undertake formal training in sustainable investing through the CFA.

Diversity

Across the Cardano Group, we employ a diverse workforce. Women comprise 37% of our staff. We aim for gender parity, with a minimum of 30% women in senior management by 2025. We have increased female representation for our annual graduate intake to exceed 50%. We are a member of the Diversity Project[8].

We have established a Diversity and Inclusion Steering Group, chaired by our Group CEO, as well as a BAME network, Gender Inclusion network and a Parent and Carer network, and we will set up a LGBTQ network. A near-term priority objective of the Diversity and Inclusion Steering Group is to measure our BAME representation across our workforce.

Improvement

Cardano recognises the importance of sustainability – but also the challenges involved in 'doing it well'. We continue to develop and evolve our policies to reflect sustainability challenges. This reflects the evolution of our thinking on sustainability and the changes underway in the financial services sector, and society more broadly.

We are always seeking areas where we can improve our approach and processes around sustainability.

- Individual process improvements are carried out on the team level:
  - Example: this year the ESG rating process has iterated to include a formal devil's advocate appointment on all ratings, to improve consistency
- Formal improvements and change are overseen by the Sustainability Steering Committee:
  - Example: this year the Committee is overseeing a move to offering services to clients that include attention to real-world sustainability impact

[8] https://diversityproject.com/

- Formal polices aligned with our sustainability objectives:
  - Example: we're reviewing our remuneration policy in order to align with our corporate sustainability policy and will update the policy in 2021
- Industry collaboration:
  - Example: this year, we joined and participated in a number of sustainable investment initiatives. We are members of the UN Principles for Responsible Investment (PRI) and the Institutional Investors Group on Climate Change (IIGCC)

Principle 3: Signatories identify and manage conflicts of interest to put the best interests of clients and beneficiaries first

Managing Conflicts of Interest

Cardano Risk Management Limited has a detailed Conflicts of Interest Policy which is reviewed and updated annually by the Compliance Officer. The policy is supported by a Conflicts of Interest Register and a Conflicts of Interest Inventory which are updated with details of conflicts of interest when they arise and the mitigation activity undertaken. A summary of our Conflicts of Interest Policy can be accessed here (link).

The key points are as follows, however we recommend reviewing the policy summary in full:

- The conflicts of interest policy identifies actual and potential conflicts arising within Cardano and the procedures for managing those conflicts. Everyone in Cardano (including contractors and any other person directly or indirectly linked to us by control) involved in the provision of investment services to Cardano's clients must adhere to the policy
- Cardano has established and implemented the Conflicts of Interest Policy (CIP) which is appropriate to the investment services that Cardano provides and takes into account its client base. The CIP takes into account any circumstances, of which Cardano is or should be aware, which may give rise to a conflict of interest, including as a result of the structure and business activities of the other members of the Cardano Group
- Cardano is required to take all appropriate steps to identify actual and potential conflicts of interest that may cause a material risk of damage to the interests of a client. Each person in Cardano involved in providing investment services to clients must be aware of potential conflicts of interests
- Conflicts of interest, once identified, must be managed in a way which ensures that clients' interests are not adversely affected. This means that the conflict should be managed in such a way that all clients are treated fairly and Cardano conducts its business with integrity and according to proper business standards

As well as the Conflicts of Interest Policy, other policies, including the Personal Account Dealing Policy, Market Abuse Policy, Anti-Bribery Policy and Inducements Policy and Best Execution Policy ensure that certain conflicts of interest are avoided.

All colleagues receive induction and periodic training on their obligations in respect of conflicts of interest under Cardano policies and also the regulatory system. This includes:

- The obligation to take all appropriate steps to identify conflicts of interests that arise, prevent conflicts of interest from adversely affecting the interests of our clients and where we are not able to ensure this, Cardano must clearly disclose the nature of conflicts of interest to the client before undertaking business on its behalf; and
- As it is not possible to ensure that colleagues are not made party to inside information by managers and other third parties, colleagues are trained on what constitutes inside information and their obligations in respect of insider lists, not disclosing inside information and trading activity

This approach is designed to ensure that conflicts of interest between clients of Cardano and between Cardano and one or more clients are managed appropriately.

We encourage an active stewardship strategy by managers and we retrospectively monitor the extent of stewardship activity and stewardship results. We will not ordinarily request that a manager undertakes specific stewardship activity or give a view on a stewardship decision to be taken. Therefore, conflicts of interest will not ordinarily arise as a result of us voting or influencing voting on matters affecting a client or parent company.

In the unlikely event that a conflict does arise due to Cardano giving a view to a manager on a stewardship decision in respect of an investee company that is either connected to a client of Cardano or a Director of a Cardano Company, as required by the Cardano Conflicts of Interest Policy, the issue will be escalated to our Compliance Officer to oversee that the conflict is managed appropriately. This will involve consultation with our Legal function, Chief Investment Officer and Chief Executive Officer as appropriate. As it is likely that more than one client will have exposure to the investment in question, in order not to favour one client over another and to stay within our mandate, we will ordinarily push for the course of action that maximises the likely return under the stated strategy of the manager. We will aim to be transparent with the client that it is in the conflicted position with, however, this may not be possible depending on the extent to which we are an insider or subject to non-disclosure obligations.

There is no conflict of interest between our offering of advisory or delegated solutions to clients in respect of our stewardship approach, as the same assessment and reporting of ESG activity by managers is applied to both advisory and delegated services.

Principle 4: Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system

Managing Market-Wide and Systemic Risks

Our clients are exposed to several market-wide and systemic risks, including:

1. Interest rate risks
2. Inflation risks
3. Equity market risks
4. Credit market risks
5. Currency risks
6. Geopolitical risks
7. Longevity risks
8. Climate risks
9. Other environmental, social and governance risks

Our investment approach seeks to consciously manage the first six of these risks through diversification, the use of "protective" assets and active asset allocation. We regularly use scenario analysis to understand the potential impact of market-wide and systemic risks.

We have investigated longevity risk for several of our clients, and many of them use specific tools, including longevity swaps and buy-ins to manage those risks.

We are currently working on producing climate change scenarios as well as GHG emissions metrics and broader ESG analysis and will integrate those into our investment process.

We favour green, social or sustainable assets where the proceeds are invested in green or social objectives, which are independently verified, and where we can source at acceptable yields in both new issuances and secondary markets. We have ended our direct commodity exposure to oil and gas.

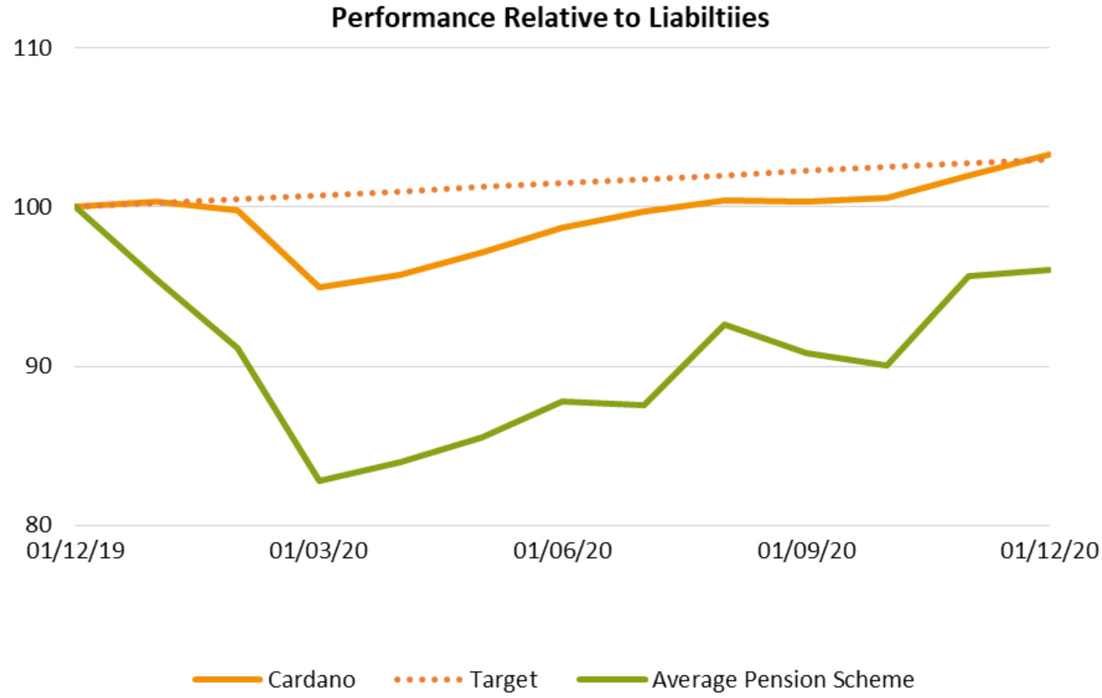
Effectiveness in Identifying and Responding to Market-Wide and Systemic Risks

2020 presented an unprecedented case study in market-wide and systemic risk management. Whilst we didn't predict the scale or impact of the Covid-19 outbreak, we were well prepared for the crisis in two important ways:

- Our fiduciary portfolios contained significant exposure to safe assets (such as government bonds) and assets specifically intended to protect against market stresses (e.g. equity put options and gold)

- Our technology infrastructure (including our use of cloud storage) facilitated a quick and seamless transition to working from home

As an illustration of the robustness of our fiduciary management portfolios, the following chart shows the 2020 performance of one of our performance composites versus our liability benchmark, compared with an estimate of the average UK pension fund.



<u>*Notes:*</u>

Cardano performance shows fiduciary management clients with return target of between liabilities + 2.5% < to ≤ 3.5% (net of fees), with full discretion - no asset restriction and no constraints on their hedge ratio. The benchmark is calculated as a combination of the liability benchmark and cash, using swaps- and/or gilts-based discounting as the benchmark. Due to the lack of published information, average pension scheme performance is estimated based on information contained in the Purple Book published by The Pensions Regulator and the Pensions Protected Fund using market index returns and implied hedge ratios based on the bond asset allocation only. No allowance for deficit repair contributions have been made. Past investment performance is not a reliable indicator of future results; no guarantees of future performance are provided

Through our use of scenario thinking and our approach to risk management, we were able to control losses during the sharp market downturn in Q1 2020, but still capture upside, after April, once markets started to recover.

Participation in Policy Consultations and Industry Initiatives

We actively engage with key policy makers and stakeholders in the pensions market and have an ongoing and regular dialogue with them regarding pensions issues. During 2020, we responded to and engaged on the following industry consultations:

- Defined benefit funding code (TPR)
- Climate change disclosures for UK pension funds (DWP)
- Charge cap review for DC AE sector (DWP)
- Changes to RPI (HMT)

We strongly believe in collaboration. Collaboration is efficient and effective. It allows us to benefit from external expertise, and we of course contribute our expertise where appropriate to do so.

We see collaboration as part of the way we can contribute to a more sustainable financial system. By coalescing around common themes and methodologies, we send clear messages to the companies we own – and to our regulators. Collaboration allows for a faster, smoother transition.

In 2020, we also participated in a number of industry initiatives (see also, Principle 10), including:

- PRI - UN Principles for Responsible Investment
- ICMA - International Capital Market Association
- IIGCC - The Institutional Investors Group on Climate Change
- PCAF - Partnership for Carbon Accounting Financials
- ICSWG - Investment Consultants Sustainability Working Group
- The Diversity Project

Joining these organisations is a first step. We participate in working groups, contribute our expertise where appropriate, and listen to and learn from others. For example, we are members of the PCAF Sovereign Bonds Working Group. We do this across the business so that our sustainability expertise is widely embedded across our investment, manager research, LDI and client teams. In addition, we encourage and assess our third-party managers on their participation in relevant sustainable investment organisations.

Example: NOW: Pensions Underpensioned Report

Over the past year, NOW: Pensions has developed, researched and engaged initiatives to create a fairer UK pension system. Every year, millions of people in the UK are retiring into pensioner poverty. The difference between pension savings for some groups is huge – with seven groups who we have identified as "underpensioned" reaching retirement age with 15% of the pension wealth of the UK average. The *Underpensioned Report* is part of NOW: Pensions' ongoing thought-leadership work to highlight the inequalities that exist in the UK pensions system[9].

[9] https://www.nowpensions.com/press-release/now-pensions-reveal-most-under-pensioned-groups/

Principle 5: Signatories review their policies, assure their processes and assess the effectiveness of their activities

Review of Policies

During 2020, we have embarked on a major firm-wide initiative to fully embed sustainability throughout our investment decision-making processes. Consequently, several of our internal policies[10] were reviewed and several changes and additions made:

- Engagement Policy (reviewed and updated)
- Stewardship Report (reviewed and updated to comply with the new 2020 principles)
- Corporate Sustainable Policy (new policy)
- Sustainable Investment Beliefs (new beliefs)
- Sustainable Investment Policy (new policy)[11]

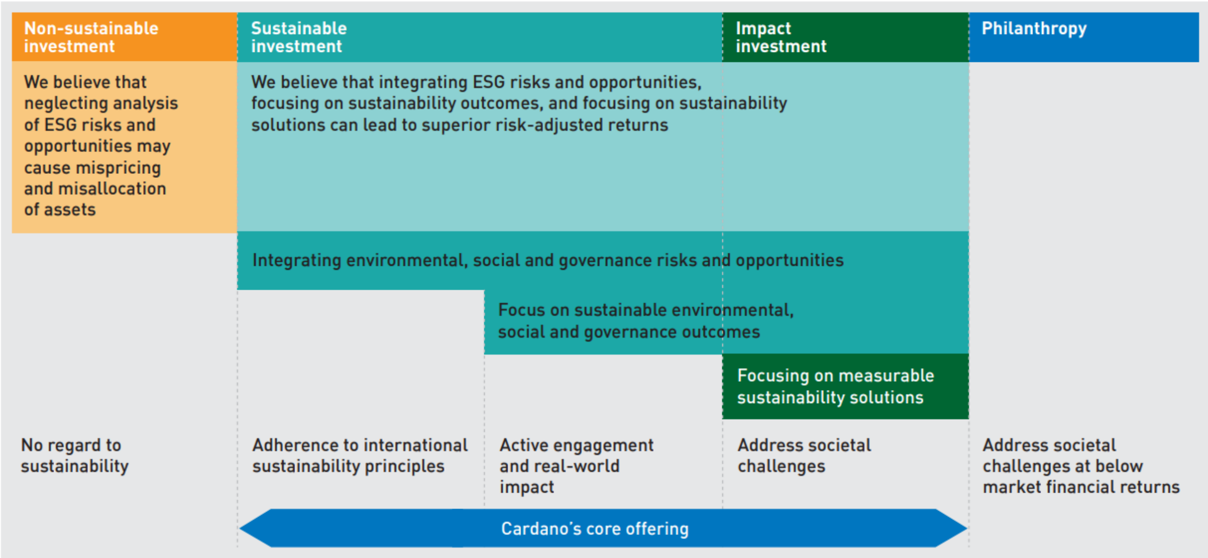
The purpose of these reviews has been to develop the firm's approach to sustainability and stewardship. In particular, we have increased our level of engagement with fund managers in which we invest, raising requirements regarding their reporting to us on voting and engagement activity.

All policies are overseen by the Sustainability Steering Committee.

We position our approach within the sustainability landscape as follows:

[10] https://www.cardano.co.uk/sustainability-policies/

[11] https://www.cardano.co.uk/wp-content/uploads/sites/3/2021/03/Cardano-Sustainable-Investment-Policy-0321_final-1.pdf


Non-sustainable investment
Sustainable investment
Impact investment
Philanthropy
We believe that neglecting analysis of ESG risks and opportunities may cause mispricing and misallocation of assets
We believe that integrating ESG risks and opportunities, focusing on sustainability outcomes, and focusing on sustainability solutions can lead to superior risk-adjusted returns
Integrating environmental, social and governance risks and opportunities
Focus on sustainable environmental, social and governance outcomes
Focusing on measurable sustainability solutions
No regard to sustainability
Adherence to international sustainability principles
Active engagement and real-world impact
Address societal challenges
Address societal challenges at below market financial returns
Cardano's core offering

INVESTMENT APPROACH

Principle 6: Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them

Here we disclose against Principle 6 and include Principle 5 of the Principles for Service Providers: Signatories support clients' integration of stewardship and investment, taking into account, material environmental, social and governance issues, and communicating what activities they have undertaken.

Client Base and Objectives

All of our clients are UK institutional investors, with the vast majority being the trustees of defined benefit pension schemes serving the corporate sector.

Our client base summarised as follows:

Number of clients	Fiduciary Management	Advisory
>£1bn	3	5
£500m-£1bn	2	1
£250m-£500m	5	
<£250m	10	
Total	**21**	**6**

As at 31 December 2020

Typically, our investment objectives are to outperform a gilt or swap-based proxy for the scheme's liabilities by between 1.0% and 3.5% p.a. Most of our clients have long-term time horizons, typically 5 to 10 years.

Reflecting Clients' Needs

At the outset of a new appointment, we undertake significant fact-finding and initial analysis, to establish our clients' returns requirements, their appetite and tolerance for risk, their comfort with different types of investment and their investment beliefs, including their ESG beliefs and policy. This mandate specification will form the basis of our fiduciary management contract (or investment advisory agreement, in the case of an advisory client).

The mandate specification, including the risk/return requirements and ESG policy, is reviewed on a regular basis (usually in conjunction with triennial actuarial valuation cycle). We provide our clients with training and advice in updating their ESG policies and Statement of Investment Principles.

During 2020 we helped all of our clients review their ESG policies and update their Statement of Investment Principles.

It is the responsibility of the Client Director to ensure that client specific stewardship and investment policies are correctly reflected in our mandates.

We evaluate the effectiveness of our understanding of client needs by several means:

- Client customer care visit undertaken by a senior colleague who is not part of the client service team
- Survey feedback via independent third parties
- Formal annual review of our performance (in the broader sense)

All our portfolios are managed in alignment with our clients' stewardship and investment policies.

We take account of clients' views in several ways:

- Customising our advice (both style and content) to meet their requirements
- Customising our reporting to meet their requirements
- Engaging in client specific research projects (e.g. searching for a new manager to meet specific requirements, or evaluating an investment opportunity at the client's request)
- Providing training on a wide variety of investment topics, including sustainability and stewardship

Reporting to Clients

Our regular quarterly reports include ESG ratings for all fund managers. Voting activity and specific engagement examples are reported annually, to coincide with the Scheme Report and Accounts completion as part of the Implementation Report.

Many of our clients employ specialist and independent advisers to help them review us, and that review will include our activity and reporting on ESG issues.

Principle 7: Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities

Integrating ESG – our Sustainable Investing approach

ESG issues and real-world sustainability impact are integrated throughout our investment process across asset classes and investment types.

Within the LDI and Multi-Asset Teams, where exposure is primarily to government and agency bonds and derivatives, this involves:

- The assessment of ESG risks and opportunities as a component in the risk and reward assessment of individual positions
- For a number of clients, we have started integrating Green and Sustainable bonds into their bond exposures and have developed a Sustainable Bond investing framework. We favour green, social or sustainable assets where the proceeds are invested in green or social objectives, which are independently verified, and where we can source at acceptable yields in both new issuances and secondary markets
- In 2020, we integrated ESG issues into our Dealer Committee's (DC) approach to counterparty assessment for derivative and trade execution (set out below)
- For some clients, we have started to integrate ESG issues into the collateral management programs through the choice of cash funds they implement. For example, for one client we are allocating a portion of their collateral to environmentally aware cash funds

We do not invest in any single name equities directly, and only have a limited number of high-quality corporate bonds which are subject to direct analysis of their ESG credentials. The integration of ESG risk assessment, real-world impact and stewardship does apply in our third-party manager selection process.

Our approach encompasses all investment strategies. However, we recognise that ESG issues, real-world impact and stewardship have a greater impact on some investment 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 apply to all managers.

We believe that impactful engagement and, therefore, effective stewardship flows from high quality dialogue with our managers. We aim to achieve this through:

- Education

  - Our approach is to prefer engagement (working with our managers to improve standards) over automatic exclusion
  - We actively work with our managers to educate them on what ESG integration and real-world impact means to us and our clients, as well as the expectations we have of them
  - We do this through day-to-day monitoring and discussions with managers which have included bespoke education and know-how sharing sessions around ESG issues
- Granular Assessment and Measurement
  - At the outset of approving a manager, the manager's approach to stewardship is assessed and is part of the approval process
  - Each year we gather detailed information on fund managers' practices and approach to ESG through a strategy specific ESG questionnaire. We have aligned our ESG questionnaire with the UN PRI reporting and assessment framework. We believe this has two benefits: (i) it should allow current signatories to maximise efficiencies (i.e. the responses they use on annual UN PRI transparency reporting can simply be replicated here); and (ii) act as a steppingstone for those managers who are not UN PRI signatories today (i.e. answering our questions well should be a lead indicator that our managers are able to meet UN PRI signatory standards).
  - Through a detailed review of this information, combined with information gathered through-out the year monitoring, each position is given a granular ESG rating
  - The granular nature of this ESG rating process allows us to track managers' practices and processes around stewardship and engagement through time; enabling us to:
    - focus and set specific goals for managers around ESG; and
    - then track a manager's progress against those goals. (For detail on our ESG rating process, please see our published Engagement Policy[12])
  - We seek to quantify our engagement impact by registering the changes that managers have / are about to make to their policies or practices as a result of our education and engagement efforts
- Consistent Communication
  - A critical part of effective engagement is making clear our expectations around sustainability
  - We aim to provide this through:
    - Regular, active dialogue on relevant issues through the day-to-day monitoring that members of the manager research team carry out

[12] https://www.cardano.co.uk/sustainability-policies/

  - An annual communication to all invested managers, setting out our beliefs and expectations around sustainability
  - Each year, managers are also provided detailed information on how our rating process works, as well as how they were rated. A feedback process we see as a critical and powerful tool for bringing about change
- We use communication to engage with managers, by articulating clear milestones for specific sustainability initiatives to be in place and corresponding implications. We recognise change is a process, at times haste may be necessary, but change should not be overly rushed
- While we prefer to work with managers to bring about change, we are happy to redeem positions where a manager has consistently not delivered on sustainability-based milestones

- Reflection
  - We reflect on the process so that lessons are learned in order to improve future engagement activity

We have given a more detailed explanation of our manager selection process and integration below under Principles 8 and 9.

ESG Counterparty Monitoring

The Cardano Dealer Committee (DC) has developed a framework, using data sourced from MSCI and Bloomberg, which screens counterparties for material ESG issues.

If the ESG rating is a pass, the credit rating remains, and we continue to trade with the counterparty.

If the ESG rating is a fail, we will engage the counterparty on the material ESG issue (or issues). If not resolved, we will not trade with the counterparty. Governance related aspects are considered more stringently due to the potential for Governance aspects to have significant near-term implications.

Voting on Fund Resolutions and Representation on Fund Advisory Boards

We will vote on behalf of clients on any issues that arise in respect of the funds which invest on behalf of clients seeking to maintain or enhance the value of our client's assets.

In respect of *private market funds*, where possible we aim to secure a position on the fund's advisory board. This allows us to raise issues, monitor the manager more closely and engage and influence fund manager behaviour.

Over 2020, in respect of our private market funds, we dealt with numerous fund extensions, asset sales and with one case where a material restructuring of the fund manager was required.

Our Focus Areas

During 2020, Cardano has adopted a Corporate Sustainability Policy that entails focussing on several environmental and social goals:

- **Climate Crisis:** We support the Paris Climate Agreement of aiming to limit global warming to +1.5C versus preindustrial levels. We do this by committing our investment portfolios to net zero carbon emissions by 2050, with ambitious interim targets
- **Fairer Society:** We support the ideals of western liberal democracies. We respect and support human rights globally and seek to fight against human rights abuses. We will look for ways to improve societal outcomes in the UK and the Netherlands, promoting diversity and inclusion and enhancing the wellbeing and financial security of our clients' beneficiaries and their families
- **Sustainable Development of Emerging Markets:** We support the sustainable development of nations in the emerging world, who are most vulnerable to the effects of climate change transition and where impactful change can be most meaningful, in close alignment with the objectives of Cardano Development

Our preference is to engage (and change behaviour) rather than divest. That said, 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.

We have communicated our areas of focus to all our managers and expect our managers to incorporate in their investment decision-making processes. We expect to have set specific metrics for each of these goals in 2021.

Principle 8: Signatories monitor and hold to account managers and/or service providers

ESG Rating Framework

All fund managers that we invested in are monitored through our ESG rating framework. Part of this framework focuses specifically on managers' stewardship and engagement and assists our investment team and Manager Research Committee (MRC) in ensuring that investments are being managed in accordance with our expectations around ESG.

Timing of when strategies are rated:

1. Prior to investment: investment proposals for all new investments tabled at the MRC must contain a dedicated section setting out (i) the ESG rating; and (ii) a summary of the rationale used to get to that rating
2. Post-Investment: (i) all strategies' ESG ratings are formally reviewed on an annual basis by the relevant coverage team; and (ii) ESG ratings are updated on an ad-hoc basis: coverage teams speak to all

invested managers regularly as part of the overall monitoring process - this will include discussing ESG issues

Each ESG Rating consists of three parts:

Part 1 | High or Low Focus

- Strategies are designated either (i) High Focus (strategies where ESG factors are deemed to potentially materially impact financial risk return and real-world impact); and (ii) Low Focus (strategies where ESG factors are deemed to have less potential to materially impact financial risk return and real-world impact)
- This is based on an internal methodology in order to seek to ensure consistency of approach

Part 2 | Overall Rating (Strong, Good, Standard or Weak)

Strategies are assigned an overall rating.

- The rating is calculated by aggregating scores from four specifically assessed categories: (i) People and policy; (ii) Process integration; (iii) Monitoring, Stewardship & Engagement; and (iv) Reporting
- Each category score carries with it certain weightings, to reflect areas we deem to be most appropriate in the assessment of ESG within the particular type of strategy

Part 3 | Momentum Score (Up, Down, No Change)

- Each strategy is assigned a momentum score to reflect whether coverage teams are seeing the manager make (or are implementing) changes to enhance their approach to ESG integration

Data Capture

Information to assist in this rating process is gathered from managers as follows:

- **Annual Questionnaire** | a detailed questionnaire is sent to all invested managers annually; the questionnaires are tailored to reflect the differences in our core manager strategies (e.g. equity, fixed income, multi-asset, private equity etc.)
- **Quarterly voting information** | we ask all High Focus managers to provide details of their voting records on a semi-annual basis. This includes details on voting against and for management, as well as asking managers to explain their most significant vote in the reporting period
- **Additional information** | added information is gathered by the investment team as part of the formal day-to-day investment monitoring is stored in our databases, throughout the year

Manager Selection

For High Focus managers specifically, an assessment of their Stewardship approach will be an important component of the initial stages of the manager selection process.

For example, in a project focused on selecting passive equity managers in 2020, the managers' stewardship approach became the most important defining feature of the managers approved for use in client portfolios, with several managers eliminated on stewardship grounds and three managers finally approved for use with client portfolios because of the quality and resourcing of their approach to stewardship.

Failure to Comply

New Investments

ESG is specifically addressed in investment proposals and extensively discussed at MRC. Managers that have not met expectations have not progressed through MRC. An example from 2020 includes a healthcare equity focused manager, where work was discontinued due to poor ESG integration despite strong performance results.

Invested Managers

Where specific milestones have been set for managers (see the engagement section under Principle 9), we expect to see progress against milestones over time.

These milestones, together with ESG ratings of invested managers are periodically reviewed and discussed by the MRC. Where a manager fails to meet the required standards or milestones, such that it would affect the overall risk-return of the strategy, we would consider redeeming the manager.

ESG Data

Our primary data source is MSCI ESG and Climate Scenario analytics, which we use to assess the sustainability of our own investments and those of our managers. Among other issues, we have engaged MSCI on coverage.

ENGAGEMENT

Principle 9: Signatories engage with issuers to maintain or enhance the value of assets.

Engagement with Fund Managers

We do not invest in any single name equities directly. Therefore, we do not engage directly with issuers ourselves. Engagement with underlying issuers is undertaken by the fund managers that we select for our clients.

We believe impactful engagement and effective stewardship flows from high quality dialogue with these managers. We aim to achieve this through:

- Education
  - Our approach as Sustainable Investors is to prefer engagement (working with our managers to improve standards) over automatic exclusion

- We actively work with our managers to educate them on what ESG integration and real-world sustainability impact means to us and our clients, as well as the expectations we have of them
- We do this through day-to-day monitoring and discussions with managers which have included bespoke education and know-how sharing sessions around ESG issues

- Granular Measurement
  - Each year we gather detailed information on invested funds' practices and approach to ESG (as set out under Principle 7, above)
  - Through a detailed review of this information (including the voting track record of the manager) combined with information gathered throughout the year, each fund is assigned an ESG rating and all ratings are debated and agreed by the Manager Research Committee
  - The granular nature of this ESG rating process allows us to track managers' practices and processes around engagement through time; enabling us to:
    - focus and set specific goals for managers around ESG issues; and
    - track a manager's progress against those goals. (For detail on our ESG rating process, please see our published policies[13])
  - We seek to quantify our engagement impact by registering the changes that managers have / are about to make to their policies or practices, as a result of our education and engagement efforts
- Consistent Communication
  - A critical part of effective engagement is making clear our expectations around ESG issues and real-world impact
  - We provide this through:
    - Regular, active dialogue on relevant issues through the day-to-day monitoring that members of the Manager Research Team carry out
    - An annual communication to all invested managers, setting out our beliefs and expectations around ESG issues
    - Every year we provide each manager with detailed information on how our rating process works, as well as how they were rated. This transparency is a critical and powerful tool for bringing about change
  - We use communication to engage with managers, by articulating clear milestones for specific ESG initiatives to be in place and corresponding implications

[13] https://www.cardano.co.uk/sustainability-policies/

  - While we prefer to work with managers to bring about change, we are prepared to sell or advise our clients to sell where a manager has consistently not delivered on ESG based milestones

- Reflection
  - We reflect on the process so that lessons are learned in order to improve future engagement activity

Our framework is specifically designed to focus engagement resource and time on the exposures where ESG factors have the highest potential impact to our clients' risk-adjusted returns. This focus is achieved through classifying (using our proprietary methodology) all invested strategies as either:

- **High Focus** | ESG factors could materially impact the risk and return profile of the strategy (e.g. listed or private equities, corporate credit etc.)
- **Low Focus** | ESG factors are likely to have limited impact on the risk and return profile of a strategy (e.g. macro orientated derivative-based strategies, highly diversified trend following strategies)

Where we select a high focus manager, we set out our expectations regarding the level of engagement we expect the manager to have in relation to the issuers. Specifically, we expect high focus managers to:

- Take account of Environmental, Social and Governance risks and real-world sustainability impact inherent in each investment
- Engage directly with management of the underlying companies to effect change
- Vote at AGMs
- Work together with industry wide collaborations to effect change

We see considerable variation in approaches to Stewardship across geographies and across manager life-stages. Engagement therefore needs to be customised and prioritised. We do this by developing custom engagement plans for managers.

- In 2020 this specifically focused on two high focus, equity managers which were rated as Weak in our ESG scoring methodology. In 2021 this approach will be rolled out to a broader set of High Focus managers rated as Standard

An example of underlying manager engagement is as follows:

- Manager type: listed equity
- Issue identified: Not a UNPRI signatory. Tier 2 Stewardship status. No written ESG policy
- Process: the team flagged these items as specific milestones for the manager to improve against in certain time periods, with the risk of material redemptions over the medium term should standards not improve
- Outcome: As a direct result of our engagement -

- Internal processes were improved upon to allow the Stewardship Rating to increase to Tier 1 Status
- The manager published a formal written ESG policy
- The manager is actively considering UNPRI signatory status

Characteristics of Good Stewardship

Good stewardship can be subjective. We have communicated our preferences as follows:

- Quality over quantity – we're interested in a few meaningful quality engagements, with strong reporting (rather than, being interested in the quantity of votes). We want managers to prioritise the highest sustainability impacts in their portfolios
- Long-term – we encourage managers to form long-term relationships with companies. Successful stewardship can take many months, maybe even years
- Real world impact – we're interested in engagement on topics that contribute to positive real-world sustainability impact (such as, reduction in absolute carbon emissions)
- Honesty – some engagement, perhaps even most engagement, will be unsuccessful. We're realistic, and we'd prefer honesty from managers
- Collaboration – engagement is more efficient when managers collaborate – not just for the managers, but for the companies too (who will field fewer, but higher conviction, engagements from their investors). We encourage managers to participate in collaborative initiatives, such as Climate Action 100+
- Innovation – we welcome innovation, for example, third-party tools to assess a company's conviction on sustainability topics
- Integrated – we're interested in how stewardship contributes to the investment thesis and whether managers link their stewardship to other engagement activity (for example, policy engagement)

Engagement and Stewardship Regarding Private Assets

Where we invest in private market strategies (e.g. private equity, property or private credit) we often have greater ability to engage because:

- Items often require a vote by Limited Partners, which we do on behalf of our clients
- We aim, where possible to gain a set on the Advisory Board of the manager

We are active in engaging with these managers through Advisory Board seats and will raise any topic we think necessary in respect of protecting and enhancing the value of the investments, including raising questions around their ESG approach, risk assessment and integration.

In one example, we worked actively with a group of other investors in a working party sub-committee of the Advisory Board to implement a restructuring of the fund manager when this became necessary to protect the value of client assets.

Engagement on Non-Corporate Assets

See below under Principle 10 for details of engagement on Government and Agency bond exposures.

Further Development

During 2020, Cardano has adopted a Corporate Sustainability Policy that entails focussing on several environmental and social goals:

- Climate Crisis: We support the Paris Climate Agreement of aiming to limit global warming to +1.5C versus preindustrial levels. We do this by committing our investment portfolios to net zero carbon emissions by 2050, with ambitious interim targets
- Fairer Society: We support the ideals of western liberal democracies. We respect and support human rights globally and seek to fight against human rights abuses. We will look for ways to improve societal outcomes in the UK and the Netherlands, promoting diversity and inclusion and enhancing the wellbeing and financial security of our clients' beneficiaries and their families
- Sustainable Development of Emerging Markets: We support the sustainable development of nations in the emerging world, who are most vulnerable to the effects of climate change transition and where impactful change can be most meaningful, in close alignment with the objectives of Cardano Development

We have communicated these goals to our managers and will be raising our expectations of them where relevant to their investment strategies.

Example Engagements on Climate and Fairer Society

Example 1 | Climate Change

- The manager had a holding in Charter Communications, Inc. The Fund voted in favour of a Shareholder Proposal at the company's AGM to provide a Report on Sustainability. This vote was against management's recommendation, however a vote for was warranted, as investors would benefit from additional information on the company's sustainability policies and practices as well as its management of related risks and opportunities

Example 2 | Climate Change and Fairer Society

- The manager engaged with Rio Tinto ahead and recommended their divestment from coal businesses, given the long-term commercial and regulatory outlook was in the interests of shareholders.
- The manager also engaged on board composition, recommending further diversity

Example 3 | Fairer Society

- The manager engaged Lufthansa on board composition, recommending further diversity

Principle 10: Signatories, where necessary, participate in collaborative engagement to influence issuers.

Collaborative Engagement

We strongly believe in collaboration. Collaboration is efficient and effective. It allows us to benefit from external expertise, and we of course contribute our expertise where appropriate to do so.

We see collaboration as part of the way we can contribute to a more sustainable financial system. By coalescing around common themes and methodologies, we send clear messages to the companies we own – and to our regulators. Collaboration allows for a faster, smoother transition.

As such, we are members of a range of sustainable investment organisations, including:

- PRI - UN Principles for Responsible Investment
- ICMA - International Capital Market Association
- IIGCC - The Institutional Investors Group on Climate Change
- PCAF - Partnership for Carbon Accounting Financials
- ICSWG - Investment Consultants Sustainability Working Group
- The Diversity Project

Joining these organisations is a first step. We participate in working groups, contribute our expertise where appropriate, and listen to and learn from others. We do this across the business so that our sustainability expertise is widely embedded across our investment, manager research, LDI and client teams. In addition, we encourage and assess our third-party managers on their participation in relevant sustainable investment organisations.

We participate in a number of working groups, for example, PCAF's sovereign bonds workstream and the ICSWG's asset management and stewardship workstreams.

We support the aims of the UK's green finance strategy and the EU's sustainable finance action plan. We welcome policy intervention on sustainable investment topics, and we will contribute to policy development where we have expertise.

We will review our membership of sustainability organisations on an at least six-monthly basis to consider how and where we can best contribute and whether we should consider additional organisations as our sustainable investment activities evolve.

Policy Engagement

As an investor in European Green Bonds, we worked together with banks as they engaged with the UK Debt Management Office on the potential to issue Green Bonds. We provided input on investor appetite, desired maturity, liquidity and usage of Green Bonds in portfolios. In November 2020, the UK Government announced its intention to issue its first sovereign Green Bond in 2021.

We take part in relevant industry consultations, like the RPI reform as well as consultations organized by the EC/ECB. In each consultation we aim to represent the interest of pension fund members in the financial markets. Amongst others:

- We responded to the DWP on their consultation on improving governance and reporting by pensions schemes on climate change risk. Outcome is awaited
- We responded to the DWP on their consultation on the RPI reform. The outcome was not the desired outcome for the pension fund members

We take place in a number of policy-related working groups:

- ECB Working Group Euro Risk Free Rates. The goal isto develop a new benchmark in line with generally accepted IOSCO Benchmark principles
- Euribor Steering Committee of the European Money Markets Institute: supervision of the fair development of the Euribor benchmark
- ISDA Working Groups, with the aim of "safe and efficient markets"

Principle 11: Signatories, where necessary, escalate stewardship activities to influence issuers.

Escalation via Fund Managers

We invest in high-quality corporate bonds which are subject to direct analysis of their ESG credentials. No single name equities are invested on a direct basis.. Therefore, we do not engage directly with issuers ourselves. Engagement and escalation with underlying issuers is undertaken by the fund managers that we select for our clients, subject to our selection, appointment, monitoring and engagement.

Having assessed the manager’s approach to stewardship in the initial selection process and as part of the ongoing monitoring process we will then monitor their approach to escalation. We will usually let each manager decide how best to steward investee companies in line with their investment strategy, stewardship policy, nature of any issue, upcoming opportunities to escalate and their sustainable investment policies.

We will encourage active engagement and escalation by managers directly with investee companies but will not ordinarily intervene on a decision by a manager as to the extent to which they will make their concerns about a company public.

Our stewardship discussions with managers focus on the size of underlying holdings, the manager's conviction in a company, opportunities to exercise stewardship and specific opportunities to challenge companies, including on ESG issues. We expect managers to be open about their stewardship activity and inform us about issues with particular holdings.

Where necessary, we are willing to open discussions about us potentially redeeming assets from a manager in order to force them to engage with us and in active stewardship of a particular company. We expect to see managers engaging with companies to escalate concerns (where relevant), and also proactively looking for opportunities to consult with other shareholders to establish the strength of concern.

As explained in our response to Principle 7, our preference is to engage (and change behaviour) rather than divest. That said, 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.

Below is an example of where an invested manager (Majedie UK - listed equity) has escalated issues with investee companies:

Example 1 | BP

- Escalation: The manager stressed to the management of BP that it needed a clearer picture of the group's plan for energy transition alongside return thresholds for the group's incremental capital investments.
- Outcome: The underlying manager exited its position in BP, given the uncertainty around its approach to the energy transition.

Example 2 | Orange

- Escalation: The manager met with the CEO of one of its positions, Orange, to discuss (i) share ownership and alignment within the management team; and (ii) accounting reporting and disclosure practices.
- Outcome: Orange guided the manager to expect improvements in disclosures. However, following a period of no improvement, the manager reduced its holding in the group and have since exited the position.

EXERCISING RIGHTS AND RESPONSIBILITIES

Principle 12: Signatories actively exercise their rights and responsibilities.

Engagement with Fund Managers

Cardano does not invest directly in companies in its portfolios or advise on direct investment. Therefore, we do not directly exercise our clients' rights and responsibilities with issuers ourselves. Rather this is undertaken by the fund managers that we select for our clients.

We will not ordinarily request that a manager undertakes specific stewardship activity or give a view on a stewardship decision to be taken. We believe impactful engagement and effective stewardship flows from high quality dialogue with these managers. We aim to achieve this through:

- Granular Measurement
  - Each year we gather detailed information on invested funds' practices and approach to ESG (as set out under Principle 7, above).
  - Through a detailed review of this information, combined with information gathered throughout the year, each fund is assigned an ESG rating and all ratings are debated and agreed by the Manager Research Committee
  - The granular nature of this ESG rating process allows us to track managers' practices and processes around engagement through time; enabling us to:
    - focus and set specific goals for managers around ESG; and
    - track a manager's progress against those goals. (For detail on our ESG rating process, please see our published policies[14]).
  - We seek to quantify our engagement impact by registering the changes that managers have / are about to make to their policies or practices, as a result of our education and engagement efforts
- Consistent Communication
  - A critical part of effective engagement is making clear our expectations around ESG issues
  - We provide this through:

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[14] https://www.cardano.co.uk/sustainability-policies/

  - Regular, active dialogue on relevant issues through the day-to-day monitoring that members of the Manager Research Team carry out
  - An annual communication to all invested managers, setting out our beliefs and expectations around ESG issues and real-world sustainability impact.
  - Every year we provide each manager with detailed information on how our rating process works, as well as how they were rated. This transparency is a critical and powerful tool for bringing about change
- We use communication to engage with managers, by articulating clear milestones for specific ESG initiatives to be in place and corresponding implications
- While we prefer to work with managers to bring about change, we are prepared to sell or advise our clients to sell where a manager has consistently not delivered on ESG based milestones

Our framework is also specifically designed to focus engagement resource and time on the exposures where ESG factors have the highest potential impact to our clients' risk-adjusted returns. This focus is achieved through classifying (using our proprietary methodology) all invested strategies as either:

- **High Focus** | ESG factors could materially impact the risk and return profile of the strategy (e.g. listed or private equities, corporate credit etc.)
- **Low Focus** | ESG factors are likely to have limited impact on the risk and return profile of a strategy (e.g. macro orientated derivative-based strategies, highly diversified trend following strategies)

Where we select a high focus manager, we set out our expectations regarding the level of engagement we expect the manager to have in relation to the issuers. Specifically, we expect high focus managers to:

- Take account of Environmental, Social and Governance risks inherent in each investment
- Engage directly with management of the underlying companies to effect change
- Vote at AGMs

We require managers to report back to us:

- How they have voted, and in particular where they have voted against management
- Whether voting is carried our directly or through a proxy service provider and, if through a service provider, the level of service in place
- The details of the "most significant" votes cast and their rationale for their inclusion as significant
- The commitments the manager makes to engagement
- Specific case studies of engagement with underlying issuers

We discuss these reports in our regular meetings with the underlying managers and will challenge them if we believe they are failing to adopt a sufficiently engaged stance.

Example 1 |

- Manager type: listed equity
- Issue identified: Not a UNPRI signatory. Tier 2 Stewardship status. No written ESG policy.
- Process: the team flagged these items as specific milestones for the manager to improve against in certain time periods, with the risk of material redemptions over the medium term should standards not improve.
- Outcome: As a direct result of our engagement -
  - Internal processes were improved upon to allow the Stewardship Rating to increase to Tier 1 Status
  - The manager published a formal written ESG policy
  - The manager is actively considering UNPRI signatory status

Further Development

During 2020, Cardano has adopted a sustainable investment beliefs and a corporate sustainability policy that entails focussing on several environmental and social goals:

- **Climate Crisis:** We support the Paris Climate Agreement of aiming to limit global warming to +1.5C versus preindustrial levels. We do this by committing our investment portfolios to net zero carbon emissions by 2050, with ambitious interim targets
- **Fairer Society:** We support the ideals of western liberal democracies. We respect and support human rights globally and seek to fight against human rights abuses. We will look for ways to improve societal outcomes in the UK and the Netherlands, promoting diversity and inclusion and enhancing the wellbeing and financial security of our clients' beneficiaries and their families
- **Sustainable Development of Emerging Markets:** We support the sustainable development of nations in the emerging world, who are most vulnerable to the effects of climate change transition and where impactful change can be most meaningful, in close alignment with the objectives of Cardano Development

We have communicated these goals to our managers and raised our expectations of them to help us achieve our goals where relevant to their investment strategy.

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