



# Cardano Risk Management

## Responsible Investment Policy

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# Cardano's Approach to Responsible Investment

## **Cardano is an investment adviser and manager to institutional clients and has offices in the UK and the Netherlands**

Cardano builds return seeking and hedging portfolios with a diverse set of exposures through the use of a range of derivatives, bonds and funds. Therefore we do not undertake direct investment in equities or corporate credit. Assessment of ESG risks is incorporated into investment decisions with a focus on the exposures with the highest potential impact. As such, our ESG activity is focused on and embedded into our manager research, broad market exposure portfolio construction and LDI implementation

- ESG factors have varying relevance to the investments that we employ in our portfolios. Therefore, we have determined whether each investment is high or low focus depending on the potential financial materiality of ESG risk factors. Whilst all investments in the portfolio are scrutinised from an ESG perspective, this framework enables us to concentrate our ESG monitoring on the areas of the portfolio that are most exposed and therefore our Responsible Investment approach has the greatest impact

## **Cardano believes that incorporating Environmental, Social and Governance factors into the assessment of the sustainability of business models produces better investment outcomes and is necessary to effectively manage risk in investment portfolios**

While we consider ESG factors when evaluating investment opportunities, we view Responsible Investment as a continuously evolving journey, requiring long term commitment and engagement

## **We promote awareness of ESG factors amongst clients, investment managers, trading counterparties and issuers**

We feel that a commitment to engagement and education will help to improve the quality of the approach to ESG across the investment industry

- We also continuously monitor industry updates and review how we can incorporate the best practices in our Responsible Investment framework

**Cardano is a signatory of the Principles of Responsible Investment. Cardano has published its UK Stewardship Code Compliance Statement on its website and is considered a tier 1 signatory by the FRC as a firm that has demonstrated commitment to stewardship**

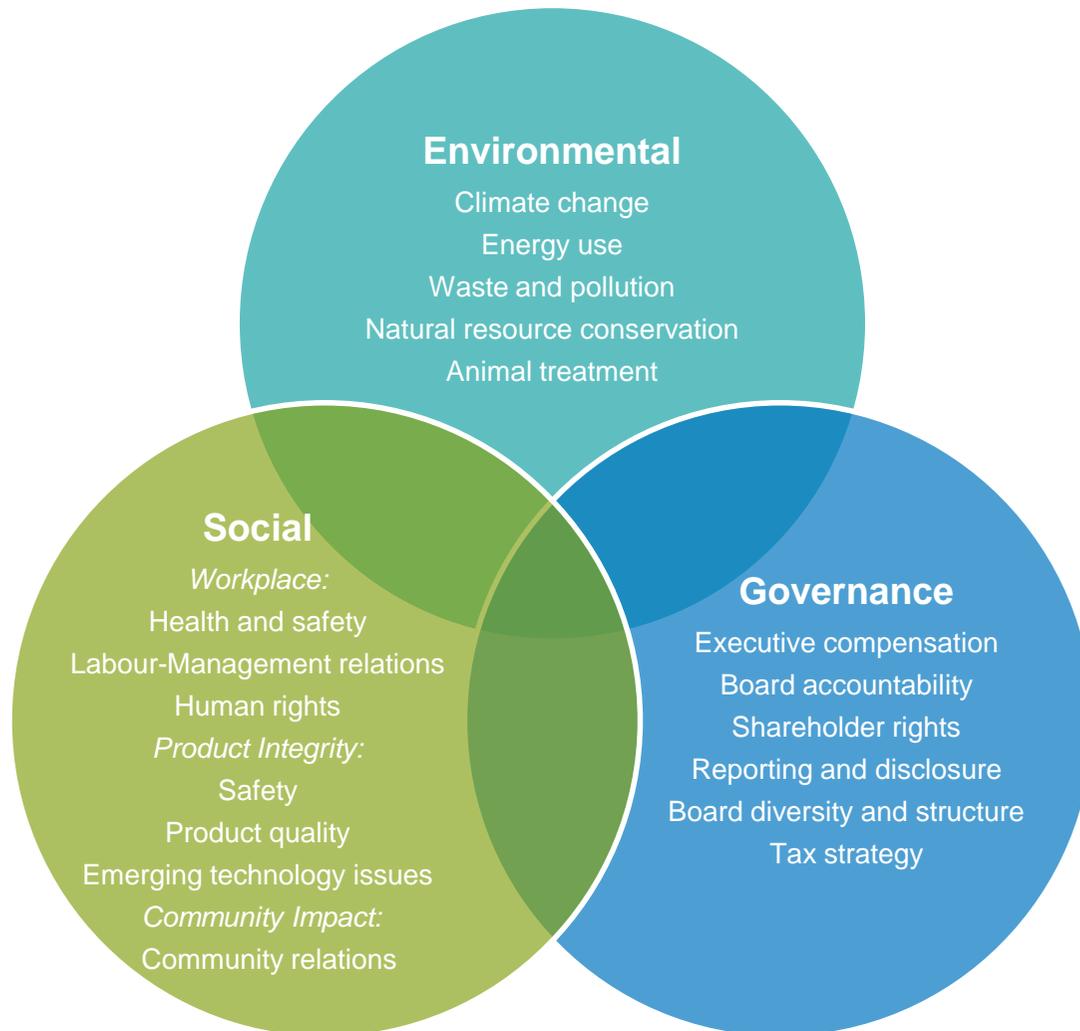


# Introduction to Responsible Investing



# What is ESG?

## Common ESG factors considered in investment analysis:



**Environmental, social and corporate governance (ESG) is a framework for considering non-financial factors that can have a financially material impact as part of the investment decision-making process**

Different factors are taken into consideration to the extent that they are material to the company's future financial performance

**It is important to consider these factors explicitly as they can influence risk and return of underlying investments**

i.e. non-financial risk can become a financial risk and therefore could be material to performance

**It is especially important for long-term investors to consider these effects**

It takes time for ESG risks to financially materialise

The long-term time horizon of our clients means that these risks could affect future returns



# ESG is the foundation of Responsible Investing

## What is Responsible Investing...

“**Responsible investing** is an approach to investing that aims to incorporate **environmental, social and governance factors** into investment decisions, to better **manage risk and generate sustainable, long-term returns**”

*United Nations Principles for Responsible Investment*

- + **Integrating** ESG factors into qualitative and quantitative analysis
- + **Engaging** with investee companies/entities on relevant ESG factors
- + **Stewardship** – using voting rights to influence company behaviour
- + **Monitoring** ESG risk and reporting exposures

## What it isn't...

**Responsible investing** is about creating and maintaining sustainable value, it **is not purely about overlaying one's moral values**

- X **Screening & exclusion** – Responsible investing (RI) does not mean excluding certain assets or managers from your portfolio provided that you have adequately accounted for the risks to which you are exposed
- X **Investing only in specialist products** – RI does not just mean targeting allocations in tailored products, for example, with an environmental theme
- X **Socially Responsible Investing (SRI)** - is a sub-set of Responsible Investing. However to be a Responsible Investor does not require you to invest in line with certain moral values

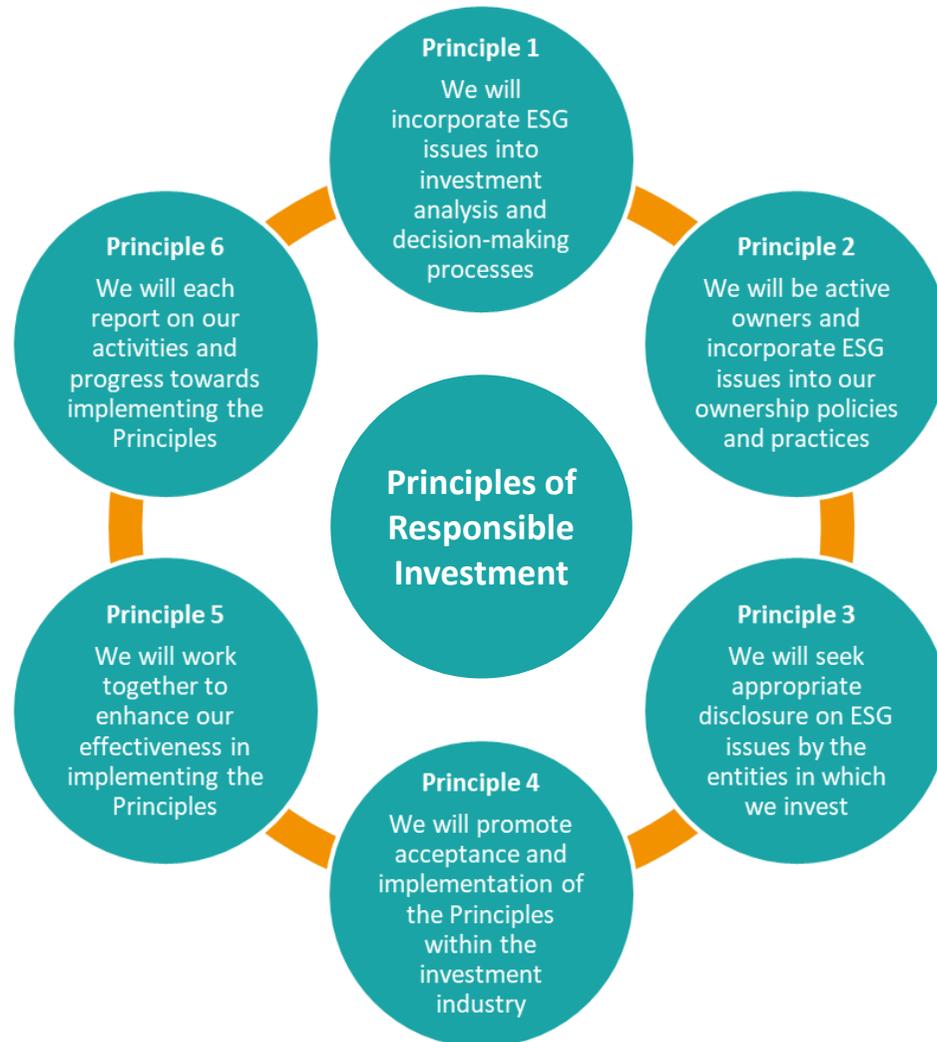


## Overarching principles

Cardano's approach to Responsible Investment



# Cardano's commitment to Responsible Investing



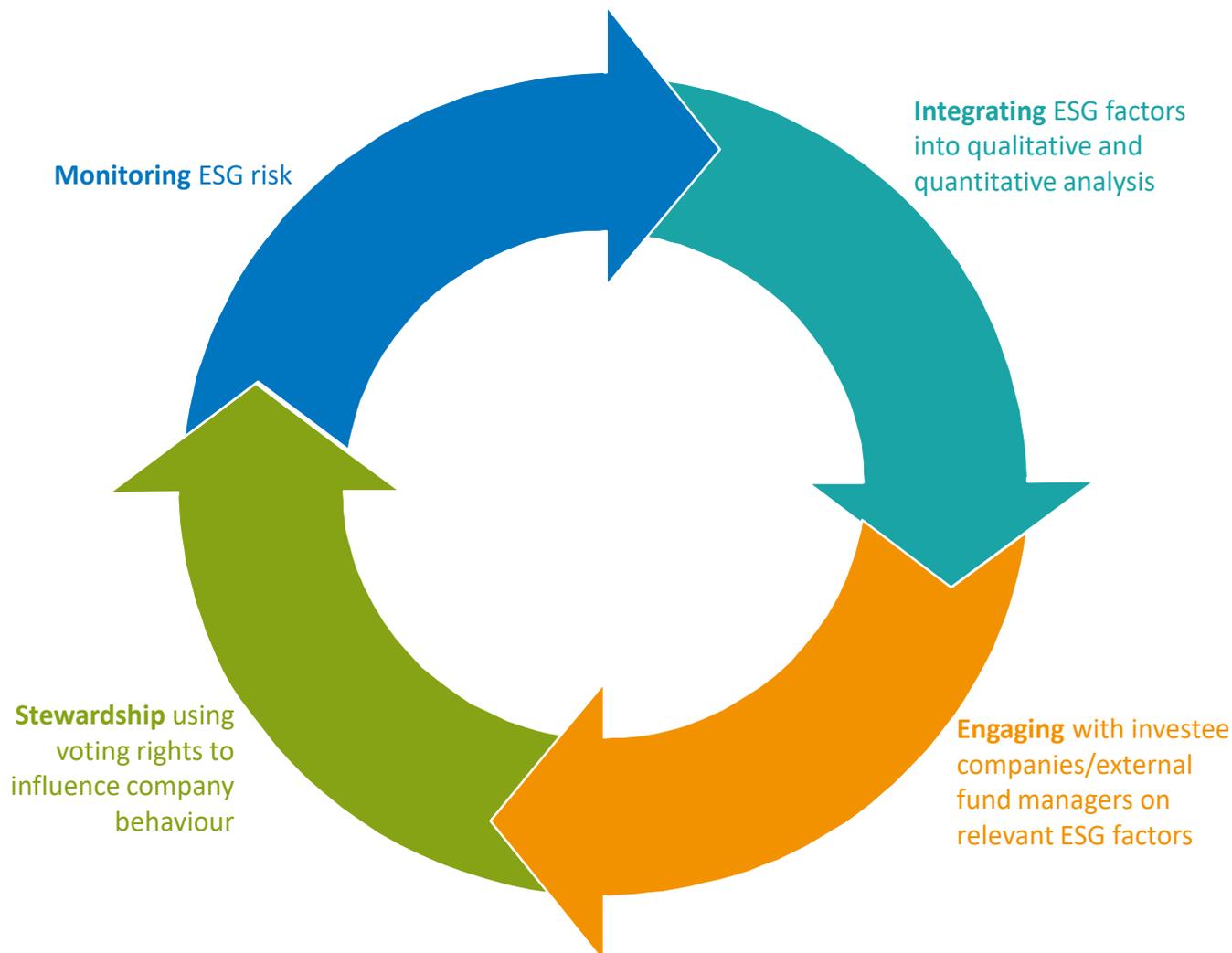
## Cardano is a signatory to the Principles of Responsible Investment (PRI) and the UK Stewardship Code

These require us to report on our ESG and stewardship related activities

- The key principles of the PRI are shown opposite
- As signatories, we report annually to the PRI on how we adopt the principles shown
- The UK Stewardship Code aims to improve long-term risk-adjusted returns to shareholders by improving the level of engagement and transparency between investors and companies



# Cardano's approach to Responsible Investing



## Cardano's approach, integrating the PRI, includes the following:

- Focusing on ensuring ESG is fully integrated into portfolio analysis and decision making
- A differentiated approach is adopted where greater emphasis is given to investments where ESG factors are most material and impactful
- Engage with and educate investment managers and trading counterparties with a view to improving awareness and quality of approach across the industry
- Ensure voting rights are used and investee companies are engaged with to influence and improve company behaviour
- Monitor ESG risk within the portfolio and report to clients

**Our approach aims to incorporate environmental, social and governance factors into investment decisions, to better manage risk and generate sustainable, long-term returns**

Our approach does not dictate any moral values-based investing on clients



Externally managed assets

Cardano's Responsible Investment  
Approach



# Cardano's approach to manager interaction

Cardano have developed four key “pillars” that we expect managers to implement as part of their Responsible Investment approach

## Responsible Investment



Managers can publicly demonstrate their commitment to Responsible Investment by becoming a signatory to a Responsible Investment body e.g. PRI

Not all managers who apply ESG within their investment and ownership decisions are signatories

- This doesn't necessarily mean that they are less responsible
- On the contrary, it is possible for those who do not formally express their ESG considerations to be more responsible investors than those that do

**The broad direction of travel of the industry is asset owners are requiring these formal and/or visible aspects of Responsible Investment from managers**

- However, investors should be wary of managers “greenwashing” i.e. not fully embracing Responsible Investment but saying that they do



# Integration of ESG in manager selection

## Manager selection decisions follow the following process:

1. The Manager Research Team is required to review RI / ESG policies, documentation and online materials for each manager, prior to investment
2. The Manager Research Team must send Cardano's bespoke, specific ESG questionnaire to each manager prior to approval for completion and their responses are reviewed by team responsible for the investment
3. The Manager Research Team ensures that all managers have a form of on-site (physical, video conference or telephone) to discuss various risk-return drivers (including ESG). This will include identifying specific examples of where and how ESG factors can or have been incorporated into investment decision making around risk or potential returns
4. Each manager is assigned an ESG rating based on an evaluation of each of the above sources of information. The rating is structured to seek constancy across portfolios. The lead analyst on the Manager Research Team for the manager is responsible for integrating our view of a manager's ESG credentials when a proposal is made. This culminates in a dedicated ESG section in the investment proposal, itemising the ESG rating and the rationale for that rating

## ESG information is considered and weighted as a core part of our manager selection process

Critically, we do not silo out this assessment to a segregated team but ensure it is carried out by the team responsible for the investment

This ensures:

- Robust, consistent and centralised oversight from our various investment committees across strategies
- Full integration - we view ESG risk as potentially having material financial impact on risk / return - as such, Environment, Social and Governance factors should be considered by the investment team as part of their overall risk-return assessment, alongside any other source of risk or return (outside of ESG)

**Encouraging open challenge to views before investment is made in a manager, helps strengthen our robust ESG rating methodology**



# Cardano's ESG manager monitoring framework

## Classification

Investment Managers are classified into two tiers:

1. **High Focus** | higher focus on ESG monitoring regime
2. **Low Focus** | lower focus on ESG monitoring regime

Classifications are based on our assessment of material impact to risk / return in a particular investment strategy

## Rating

All managers (High and Low Focus) are evaluated across a range of categories:

1. **Policy**
2. **Process**
3. **Portfolio**
4. **Reporting**

An overall score is then calculated based on the results allocating managers to performance bands:

**Weak | Behind | Good | Strong**

## Monitoring and engagement

All manager's ratings monitored on an on-going basis as part of our standard monitoring process

Managers' ESG ratings are then formerly reviewed annually

Engagement is concentrated on managers where ESG is highly relevant but have a low score

## Reporting

The overall rating of the manager (Poor | Standard | Good | Strong) will be shown in the quarterly report, with a separate explanation provided for **any material manager changes** as and when they occur

We also provide a momentum rating ( = | ↑ | ↓ ) to show current evaluations relative to previous years

**The aim of our ESG manager framework is to improve the standard of ESG investing and stewardship across the managers in which we invest**

We tailor our approach to monitoring based on our assessment of the materiality of the risk

When material for the strategy, we will assess and monitor managers closely in the same way we do with any other material sources of risk-return:

- How risks are mitigated, and/or
- The opportunities captured

**Our primary means of creating ESG impact in High Focus areas is through the selection and influence of Investment Managers**

This is because we don't invest directly in the equity or debt of companies

**Where possible we favour managers with a strong ESG framework**

Our level of engagement is highest for High Focus managers that are rated "Weak"

- High Focus managers rated Weak will be reviewed and may be redeemed



Internally managed (return seeking) assets

Cardano's Responsible Investment Approach



# Cardano's ESG approach to beta investments

## Classification of Cardano's Beta Strategy

Following the same approach we use for managers, our beta strategy is Low Focus.

Low Focus managers are characterised by for example:

- Synthetic/derivatives exposure
- No voting rights attached to the underlying holdings
- Small exposure to individual companies
- No material control over individual companies

Specific to our beta strategy,

- We tend to invest in derivatives, often futures, which means we invest in the most liquid indices
- Given our high level of diversification, we have low idiosyncratic ESG risk
- We do not have any control over individual companies
  - The Prospectus of our beta-only product states that no shares carrying voting rights of an issuing body can be acquired

**Cardano manages part of our return seeking portfolios internally – our “beta” strategy i.e. without the use of external fund managers**

These assets are invested in a range of instruments, largely:

- Derivatives incl. futures, options, swaps and forwards
- Bonds
- Exchange traded funds
- Cash

We do not invest in any equity or corporate bond positions directly

In order to assess the ESG risks, we assess our beta strategy in the same way we assess the external managers we invest in

**Our beta strategy would qualify as Low Focus under our manager evaluation criteria**



# Cardano's ESG approach to beta investments

## ESG within the beta strategy

Despite the strategy being Low Focus, we actively consider ESG because

- There are parts of the strategy where ESG has more impact on expected returns, either positively or negatively
- We want to be comfortable that the overall strategy remains Low Focus

## Beta ESG methodology

- We determine for each investment thesis within the beta strategy whether ESG has a High or Low impact
- High impact investments are either a risk or opportunity. They need an ESG assessment prior to introducing or closing down the position and as part of our ongoing monitoring

## Monitoring

- Each investment is formally reviewed once every three months by the Strategy Team
- High impact ESG risks will also be monitored as part of the Strategy Team's normal process analysing potential risks and returns over the quarter and discussed if changes occur
- Investments in funds will follow our externally managed assets ESG rating methodology

## Reporting

We maintain a summary of ESG considerations for our investments that is updated once every three months

## Our approach to beta investments is similar to our methodology for rating ESG in third party managers

We tailor our approach to ESG monitoring based on the materiality of the risk for each investment

When material for an investment, we will assess and monitor investments closely on ESG criteria in the same way we do with any other material sources of risk-return:

- How risks are mitigated, and/or
- The opportunities captured



Internally managed (government  
bond and Liability Driven  
Investment) assets

Cardano's Responsible Investment  
Approach



# Liability Driven Investment

## Key considerations for Liability Driven Investment

- 1 Match liability risk using high-quality fixed income investments
- 2 Manage liquidity and trading costs in the portfolio
- 3 Consider the ESG rating when evaluating bond issuers
- 4 Consider alternative green bonds if available with equivalent quality, liquidity and yield or in line with client specific mandate design

## Cardano manages matching portfolios for clients

The objective of these portfolios is to closely match the financial characteristics of our client's specific liabilities

- Hence this is often referred to as "Liability Driven Investment"

## The aim is to do this as safely as possible with high-quality fixed income assets

In addition, this is done in house on a "passive unless" basis i.e. bonds are selected that most closely reflect the liability benchmark unless there is a reason to deviate, for example for liquidity or pricing purposes

A significant majority of these portfolios are held in Euro, UK and US government bonds, as well as other high quality fixed income and money market funds

## This is another Low Focus area of the portfolio for ESG impact



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