cardano

Sustainable investing:
It’s the right thing to do

Stewardship Report

Reporting period, 2021.
Submitted, April 2022.

Cardano Risk Management Limited

April 2022

Stewardship Report

Our submission

This document has been prepared by Cardano Risk Management Limited (hereafter, "Cardano") to comply with the UK Stewardship Code 2021.

Cardano is a UK Stewardship Code signatory, successfully applying to the revised stewardship code in April 2021.

In our outcome letter, the FRC identified areas where our response meets expectations and areas where our response needs improvement. We have taken steps to address the FRC's feedback and we resubmit our response.

Cardano 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 noted last year, 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.

In January 2022, Cardano acquired sustainability specialist, ACTIAM. While it is our intention to integrate our stewardship activities, following discussion with the FRC, this submission relates to Cardano's investment activities.

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Introduction

Introductory statement

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.

We consider stewardship, and in particular, collaborative stewardship central to our objective to maximise real-world sustainability impact, as we set out below, in our model of influence.

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 investment 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 greenhouse gas emissions by 2050 in-line with the Paris Climate Agreement, with 50% greenhouse gas emissions reduction by 2030 based on 2019 emissions
- Promoting a fairer society, in particular, in the UK and Netherlands
- 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."

1 http://www.un-documents.net/our-common-future.pdf, accessed, April 2022
2 https://www.frc.org.uk/getattachment/975354b4-6056-43e7-aa1f-c76693e1c686/The-UK-Stewardship-Cod-Review-of-Early-Reporting.pdf, accessed, April 2022

As a fundamental part of our investment process, we consider two investment lenses, we call this 'double materiality':

1. Risk and return, including sustainability-related risks and opportunities
2. Influence and impact, including real-world sustainability impact

While 'risk and return' can be readily understood, there is less clarity about what is meant by 'influence', real-world sustainability impact, and how to measure it.

Consequently, we have developed our own 'model of influence'. We speak to our model of influence in the submission that follows.

Our model comprises of three key areas of influence, based upon how directly impactful our actions could potentially be.

Tier one – interactions that we believe are most impactful

- Collaborative company engagement on sustainability-related topics, for example through the Climate Action 100+ initiative
- Engaging with public policymaking to create a more sustainable economy, for example to decarbonise the electricity grid or rollout electric vehicles
- Supplying new capital, debt or equity to a company or government, where this has an environmental or social objective
- Enabling activities or markets that may be new to investors, such as water and sanitation, through new thematic impact strategies. This helps develop an evidence-base that can enable further capital flows into sustainability outcomes

Tier two

- Engaging with companies as an individual investor on sustainability-related topics – less impactful than collaborative engagement, but this nevertheless has an important impact

Tier three

- Incorporating environmental and social-related objectives into client investment mandates, as part of a scheme's overall investment approach. This directs capital flow towards more sustainable businesses and away from less sustainable businesses, indirectly influencing their cost of capital and hence their competitive positioning
- The integration of ESG factors into the buying and selling of securities

Having a thorough framework for our thinking about real-world sustainability impact helps us to engage effectively and efficiently: it helps us be better stewards.

A great example of how this framework works in practice can be shown in how we have refined due diligence questionnaires and RFP documentation for the third-party managers that we employ. Through 2021, we have reinforced our expectations of our third-party managers, clearly setting out our influence model and directing them as to how they can participate in improving stewardship standards[3].

3 https://www.cardano.co.uk/wp-content/uploads/sites/3/2022/02/2201_Letter_Cardanos-Latest-Thinking-on-Sustainable-Investing.pdf

Since last year's submission, Cardano has published a number of sustainability-related publications relevant to our submission, including:

- We invest sustainably, here's how
- Our plan to address the climate crisis
- Net zero asset managers initiative disclosure
- Pensions Expert ESG series (example article)
- End of year sustainability report
- Our annual letter to our third-party managers on sustainability. Our 2022 focus theme is stewardship

We have also responded to a range of public policy consultations in the UK, EU and US.

In Q3, 2021, we issued a Request for Proposal for an engagement provider. In November 2021, we selected Sustainalytics' Engagement 360 solution, which we apply to our fiduciary and DC investments. Engagement 360 is an integrated stewardship solution that addresses multiple sustainability issues impacting companies' overall risk management strategy and performance.

Where we have not updated our processes, we mirror responses in last year's submission, updating examples. Where we have updated our processes, we have sought to address the FRC's feedback. We encourage readership of the report as a whole.

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.

Our Purpose

Founded in 2000, Cardano is a privately-owned, purpose-built pensions advisory and investment specialist with a leading-edge sustainability offering. We are widely recognised as a market leader in the provision of specialised services to private-sector and collective pension schemes in the United Kingdom and the Netherlands. Our c. 500 professionals strive to deliver better and more secure financial outcomes.

- **Advisory:** A pensions covenant, investment, sustainability, corporate finance and risk advisory business serving approximately 400 scheme and corporate clients. Our scheme clients have aggregated assets of over £370bn

- **Investment Management:** A purpose-built asset and fiduciary management provider, with a leading-edge sustainability offering, serving pension schemes (and non-pension scheme clients with similar risk management requirements) with £50bn of assets under management

- **DC:** We manage over £15bn in DC assets across the UK and the Netherlands. In the UK, we operate NOW: Pensions, an award-winning UK workplace pension provider, serving 2m members and tens of thousands of employers from a wide range of industry sectors

Our world deserves better financial solutions – that are more resilient and sustainable. At Cardano, we bring a distinct approach to advisory and investment management that challenges the status quo. Rather than repeat the same outdated models, we think bigger about the world around us. By bringing together cognitively diverse teams with a mix of perspectives and skill sets, we reduce blind spots and open up new possibilities, delivering tailored solutions for our clients.

Investment Beliefs

We believe that steady and predictable returns are in our clients' interests, and that these can be achieved through strong risk management.

Our approach to risk management involves:

- 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

We invest in high-quality corporate bonds which are subject to direct analysis of their ESG credentials[4].

No single name equities are invested on a direct basis by 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, all of which are subject to ESG integration and stewardship requirements, and real-world sustainability impact, as set out in our response to the Stewardship Code.

4 Starting 2022, we have used ACTIAM's proprietary sustainable investment framework, including ACTIAM's fundamental investment principles, materiality drivers, and ESG scores, see: https://www.actiam.com/491aac/siteassets/4_verantwoord/document-en/en/a-actiam-sustainable-investment-policy.pdf.

Sustainable Investment Strategy and Culture

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.

As we set out in our introductory statement, in our model of influence, we consider stewardship, and in particular, collaborative stewardship central to our objective to maximise real-world sustainability impact.

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].

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

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

   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].

Impact on stewardship, investment strategy and effectiveness

Our investment beliefs and process have served our clients extremely well during 2021. Cardano exceeded its objectives across the board in 2021, recording growth, outperforming on client targets and taking innovative approaches to sustainable investment.

Cardano secured excellent returns on portfolios, comfortably growing assets over liabilities and over-delivering on client targets, closing funding gaps and improving solvency positions for pension funds.

In addition, we were able to raise a range of topics related to sustainability with our clients during 2021, and achieved several improvements to their governance and approach, including:

- Updating Statement of Investment Principles (to incorporate new regulations and sustainability principles)
- Agreeing new policies and approaches to sustainability, including discussing new sustainability themes, for example, living wage, gender inequality and biodiversity (see our response on the V1.0 Beta Release of the TNFD disclosure framework)[7]
- Divesting from fossil fuel-related direct commodity investments
- Allocating to ESG-screened low carbon physical equity with stewardship
- Delivering Implementation Statements
- Building up sustainable bond exposures

Many of our clients are subject to TCFD reporting requirements, some have taken steps to undertake TCFD reporting requirements ahead of their regulatory obligation. This includes:

- Preparing a climate change-related risks and opportunities Trustee governance policy
- Selecting metrics and target setting. We have used (and contributed to) the IIGCC's Paris Aligned Investment Initiative's approach to metrics[8]
- Target setting. Our default approach in our fiduciary portfolios and in our advice is to net zero greenhouse gas emissions by 2050, with 50% emissions reduction by 2030 based on 2019 levels

Cardano secured excellent returns on portfolios, comfortably growing assets over liabilities and over-delivering on client targets, closing funding gaps, improving solvency positions for pension funds and improving stewardship across our third-party managers with a focus on influence and real-economy sustainability impact.

7 https://www.cardano.co.uk/wp-content/uploads/sites/3/2022/04/TNFD-letter.pdf
8 https://www.parisalignedinvestment.org/

Principle 2:

Signatories' governance, workforce, resources and incentives support stewardship.

What does stewardship entail at Cardano?

Figure 1:

We build diversified return seeking and hedging portfolios on behalf of clients through the use of derivatives, bonds and funds managed by third parties. Figure 1 sets out how we think about stewardship at Cardano.

Stewardship at Cardano focuses on:

- **Company policies** – Our company policies reflect our commitment to sustainability, for example, we measured (and offset) our company's greenhouse gas emissions in 2021, and will do so in 2022. We also measure, and have set targets, to improve workforce diversity, we participate in the Diversity Project and the 10,000 Black Interns programme
- **Market stewardship** – Engagement with policymakers, standard setters and stakeholders (covered later in this report)

- **Corporate engagement** – 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 counterparties that we trade with, and support and participation in collaborative engagement initiatives, such as Climate Action 100+

- **Direct investments** – In 2021 and early 2022, we increased our allocations to green, social and sustainable bonds, invested in two bespoke climate change baskets, allocated to ESG-screened, low carbon equity (with stewardship), applied ACTIAM's proprietary sustainability scoring to our bond investments, and partnered with Big Society Capital to invest up to £195 million in UK social and affordable housing

- **Manager research** – Engagement with the fund managers we select (in respect of the equities, bonds and other asset classes they invest in within their funds). We did engage managers on individual companies, which we felt were particularly important to our sustainability objectives (also covered later in this report)

In Q3, 2021, we issued a Request for Proposal for an engagement provider. In November 2021, we selected Sustainalytics' Engagement 360 solution, which we apply to our fiduciary and DC investments. Engagement 360 is an integrated stewardship solution that addresses multiple sustainability issues impacting companies' overall risk management strategy and performance.

Our governance

Cardano's Sustainability Steering Committee oversees the continual development and implementation of our Sustainability policies, both for our firm and client portfolios. The Sustainability Steering Committee comprises of:

- **Kerrin Rosenberg** (Chair, CEO of Cardano in the UK and member of Cardano Group Management Board)
- **Keith Guthrie** (Deputy Chief Investment Officer)
- **Karin Pasha** (Partner, Head of Sustainability of the Netherlands)
- **Michael Bushnell** (MD, Employer Covenant)
- **Will Martindale** (Group Head of Sustainability)
- **Dennis van der Putten** (Director of Sustainability and Strategy, ACTIAM)
- **Ruben Middel** (Project Manager)

In 2021, we set up, what we call, Investment Committee – Sustainability (IC-S). The IC-S includes the heads of each of our investment teams (multi-asset, manager research, and LDI), and our sustainability heads. The IC-S is co-chaired by Keith Guthrie and Hilde Veelaert (CIO, ACTIAM). The IC-S focused on investment implementation.

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'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 multi-asset 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 and includes Senior Investment Managers and the Deputy CIO, 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** | Investment Committee Sustainability meets monthly and has overall responsibility for the implementation of sustainability in our investment processes

- **Tier 4** | Sustainability Steering Committee meets weekly and has overall responsibility for the Cardano Group's Sustainability agenda and policies. The committee has six participants (listed above)

- **Tier 5** | 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

Starting in 2020, we subscribed to MSCI's ESG and Climate Scenario analytics and have integrated this data into our investment processes and reporting. This allows us to focus our stewardship activities on investments we consider are particularly exposed to ESG-related risks and opportunities, as well as help us identify priorities for collaborative engagement.

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.

Sustainability projects are being carried out by a network of around 30 sustainability champions distributed throughout the wider firm including Cardano Advisory and NOW: Pensions. Sustainability projects are included in individual and team objectives and form part of year-end assessments and appraisals.

Our investment team and sustainability heads are part of the IC-S and all have clear sustainability-related deliverables over the year which form part of their year-end assessments.

The challenges we face in sustainability are shared by peers and competitors and we believe that collaboration is important to achieve industry wide improvement. We therefore work collaboratively with peers through our membership of several industry wide organisations.

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[9].

9 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

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
- **Transparency:** Some engagement, perhaps even most engagement, will be unsuccessful. We're realistic, and we'd prefer transparency 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
- **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.

In 2021, we invited and heard from the following external sustainability experts:

Celebration of Black History Month
by **Mike Wariebi**, Lazard Asset Management

Climate Metrics and Targets
by **Daisy Streatfeild**, IIGCC

COP26
by **Meryam Omi**, COP Champions,
and **Nathan Fabian**, PRI

Human Rights
by **Alison Biscoe**, Centre for Sport and Human Rights

Impact measurement and BIX Capital
by **Jeroen Blüm**, Cardano Development

Overview of Social Issues
by **Simon Rawson**, ShareAction

Sustainable Energy Transition Investing
by **Sebastiaan Masselink**, ACTIAM

The Climate Crisis
by **Dr Robin Lamboll**, Grantham Institute

The Importance of Pride, Role Models and Allies
by **Matt Cameron**, LGBT Great

The Truth About Modern Slavery
by **Emily Kenway**

The Value of Nature
by **Gemma James**, PRI

UN Guiding Principles on Business and Human Rights
by **Nikolaj Halkjaer Pedersen**, PRI

Why Diversity Matters
by **Dr. Funke Abimbola**

Collaboration

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 benefit from external expertise as well as sharing our own expertise too.

This year, we are members of, and have contributed to, a number of sustainability initiatives including:

- Climate Action 100+
- Institutional Investors Group on Climate Change (IIGCC). We participate in the Derivatives and Hedge Funds Working Group (co-chaired by Cardano) and Policy Working Group (co-chaired by Cardano)
- Investment Consultants Sustainability Working Group (ICSWG). We participate in the Steering Committee, Stewardship Working Group, Policy Working Group
- Net Zero Asset Managers Initiative
- Partnership for Carbon Accounting Financials (PCAF). We participate in the Sovereign Bonds Working Group
- Pensions for Purpose. We joined in November 2021
- Principles for Responsible Investment (UN PRI). We participate in the SDGs Advisory Group, the Legal Framework for Impact Reference Group and the Global Policy Reference Group
- The Diversity Project
- The Green Bond Principles
- UN Global Compact
- Workforce Disclosure Initiative (ShareAction). We joined in November 2021

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. Examples from 2021:
  - Development of our engagement pathways, which help to focus our engagement with managers on Cardano's top sustainability priorities
  - Update and modification of our ESG rating methodology, which helps us raise the bar for what achieves a 'Strong' ESG rating
  - Aligning our ESG questionnaire with the PLSA template[10] and ICSWG template[11] around stewardship and engagement

- Formal improvements and change are overseen by the Sustainability Steering Committee:
  - Example: this year the Committee is overseeing the investment teams' objectives to maximise real-world sustainability impact. This is part of our sustainability project plan and includes monthly updates with our sustainability project manager, as well as quarterly reporting back to the Steering Committee

- Formal polices aligned with our sustainability objectives:
  - Example: In 2021, we measured and offset our firm's own greenhouse gas emissions. We have repeated in 2022

- Industry collaboration:
  - Example: this year, we joined and participated in a number of sustainable investment initiatives, including co-chairing the IIGCC derivatives and hedge funds working group, the IIGCC policy steering group, and joining Pensions for Purpose

10 https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2021/PLSA-Stewardship-and-Voting-Guidelines-2021.pdf
11 https://www.icswg-uk.org/resources

Examples

Example 1 – Global Macro Manager | High Focus, Good ESG Rating

Engagement Outcomes:

- ESG issues formally incorporated into the investment decision making process
- Created reporting on their portfolio's ESG rating with help of a third-party data provider
- Introduced a new role responsible for ESG issues at the firm level

Examples 2 – Global Equity Long/Short Manager | High Focus, Standard ESG Rating

Engagement Outcomes:

- Published a responsible investment policy and statement on climate change on their website, including stewardship
- Notable improvement in voting participation
- Produced a comprehensive annual ESG report

Example 3 – Global Credit Long/Short Manager | High Focus, Standard ESG Rating

Engagement Outcomes:

- Introduced a firm-wide ESG policy
- Launched a semi-annual ESG review committee with founders of the firm

Example 4 – US Equity Long/Short Manager | High Focus, Poor ESG Rating

Engagement Outcomes:

- Introduced a formal ESG policy, including stewardship
- Established an internal ESG taskforce, including firm CIO
- ESG considerations formally incorporated into investment memos

Example 5 – Global Long Only Equity Manager | High Focus, Standard Rating

Engagement Outcomes:

- Introduced a firm-wide, comprehensive, ESG policy
- Signed up to the UN PRI and UK Stewardship Code
- Provided detailed evidence of ESG considerations in investment decision-making
- Began publicly disclosing shareholder voting activity on website
- Evidence of incorporating active ESG views on voting decisions

Example 6 – Public & Private Credit Manager | High Focus, Good ESG Rating

Engagement Outcomes:

- Brought on-board a third-party data provider; feeding ESG data into risk systems and investment write-ups
- Producing annual ESG report with specific focus on greenhouse gas emissions reporting

Example 7 – Property Manager | High Focus, Standard ESG Rating

Engagement Outcomes:

- Provided input into the selection of an ESG consultant; attended calls with providers as well as key area for improvement
- Consultant has subsequently improved manager's overall approach

In each example, Cardano has actively engaged the manager on the specific objective listed in the bullet points above. In most cases, our third-party managers welcome our engagement, and have set out clear sustainability objectives of their own. We recognise most managers will be responding to the sustainability views of their clients.

As an enhancement to our 2021 submission, we believe that the robustness of our sustainability governance, and the clarity of our asks of our third-party managers, has improved the effectiveness of our stewardship activities.

Principle 3:

Signatories identify and manage conflicts of interest to put the best interests of clients and beneficiaries first.

Managing Conflicts of Interest

Cardano has a detailed Conflicts of Interest Policy which is reviewed and updated annually. 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.

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

- The conflicts of interest policy identifies actual and potential conflicts arising within Cardano and 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 which is appropriate to the investment services that Cardano provides and takes into account its client base. The Conflicts of Interest Policy 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 and to prevent or manage conflicts of interest that may adversely affect 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, 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

- 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 its 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 change 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 have set out our approach to climate change risks as part of our plan to address the climate crisis[12].

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, and replaced with base metals.

Focus on climate change

In 2021, we published our climate crisis action plan, including decarbonisation target-setting.

The climate crisis is the most fundamental challenge the global economy faces. The climate crisis refers to global warming and the resulting increase in weather events driven by the emissions of greenhouse gases.

Despite recent momentum, government action to tackle the climate crisis has so far been highly insufficient. Climate change is now a widely established and socialised concept within financial markets – both as a financial risk, due to transition and climate-related risks, and an investment imperative, because the way in which we direct capital will support (or hinder) climate targets.

We commit

We support the Paris Climate Agreement of limiting global warming to +1.5°C versus preindustrial levels. We do this by committing our investment portfolios to net zero carbon emissions by 2050.

We support global emissions reduction of 50% by 2030, with baseline year 2019. This informs our asset-class decarbonisation targets.

12 https://www.cardano.co.uk/our-approach-to-sustainability/our-plan-to-address-the-climate-crisis/

We support the concept of 'fair share' decarbonisation targets. In other words, countries with historically higher emissions (which tend to be developed markets) should decarbonise more rapidly than countries with historically lower emissions (which tend to be emerging markets).

This is our default position – in our fiduciary management, our advice and our liability driven investments.

We measure

We are measuring our investments' carbon footprint, its current greenhouse gas emissions, and its contribution to climate change. We use MSCI data.

We do this to measure:

- Our financial risks, including transition risks, physical risks and environmental opportunities
- Our real-world impact, to align our capital allocation and engagement with our commitment of limiting global warming to 1.5°C

We measure our portfolio financed emissions per pound invested, based on enterprise value including cash (EVIC). This is the primary measure that we will use to set targets and decarbonise our portfolios' carbon footprint over time.

Climate justice is critical to the success of the Paris Climate Agreement. For government bonds, we favour CO2e per capita for carbon foot-printing. In addition, we look at historical emissions, 'fair share' carbon budgets, and how emissions will evolve over time.

We believe scenario analysis helps inform our investment decisions.

Our three favoured scenarios are:

- A 1.5°C degrees Paris-aligned transition – this is our goal, how we direct our capital and how we engage. This assumes measures are taken that will keep the rise in temperature limited to 1.5 degrees
- A 2°C degrees late transition (or, 'inevitable policy response') – this is our forecast of what we think will happen
- A 3°C slow transition – this is our "hot house" scenario

We engage

While we do not invest in single equities, we do invest in single credits, including sovereigns, and we do have high expectations of our managers' stewardship activities, including engagement and voting consistent with the Paris Climate Agreement. For example, we engaged a manager to understand their voting rationale with respect to Duke Energy, a high emitting US-based electric and gas company.

We are signatories to Climate Action 100+.

In November 2021, we selected Sustainalytics' Engagement 360 solution, which we apply to our fiduciary and DC investments. Engagement 360 is an integrated stewardship solution that addresses multiple sustainability issues impacting companies' overall risk management strategy and performance. Several Sustainalytics engagements seek to address climate change risks.

We see policy engagement as a natural extension of our net zero commitment. We recognise the need to improve the sustainability of the market as-a-whole and that there are clear benefits to us and our clients through well-designed and implemented sustainable investment policy reform.

In particular, we will respond to policy consultations relevant to sustainable investment in the UK, Netherlands and Europe, and we will offer our expertise and experience where it is appropriate to do so.

Effectiveness in identifying and responding to market-wide and systemic risks

In June 2021, we invested in two climate change baskets. We wanted an investment that would help protect our portfolios from the transition risks necessary to decarbonise the economy as part of the EU's Fit for 55 strategy and the UK's Ten Point Plan for a Green Industrial Revolution. We also believe that, as these companies decarbonise, the companies may result in relative outperformance.

As part of our investment toolkit we can invest in thematic equity baskets through our counterparties. Based on our research, the view was that broadening out our approach to climate change from direct renewables exposure to a wider sectoral exposure provided the best risk-adjusted opportunity.

The baskets capture the broad thematic opportunities that will arise from the green deal and the energy transition including: clean energy, sustainable transport, green infrastructure and circular economy. We screened the baskets through our internal ESG tools, which highlighted the higher weights to companies which will capture climate opportunities.

Over time, the percentage of revenues that these companies generate that will come from renewables will increase, with the subsidies supporting the substantial capex requirements that this will require – ultimately with the expectation that this will lead to higher returns for investors through earnings upgrades.

To date the baskets have performed to our expectations and have weathered different macro environments. Avoiding too much concentration in renewables has been an effective strategy in a year where traditional energy has outperformed. We think the medium-term thesis of policy support remains intact.

Participation in policy consultations

This year, we have responded to eight public policy consultations, in the UK, EU and US, covering a range of sustainability topics including social risks and opportunities, climate change and stewardship.

We see policy engagement as a natural extension of our sustainability commitments. We recognise the need to improve the sustainability of the market as-a-whole and that there are clear benefits to us and our clients through well-designed and implemented sustainable investment policy reform.

In general, we welcome the direction of policy makers on sustainability topics. Highlights include:

The Department for Work and Pensions (DWP) call for evidence on the consideration of social risks and opportunities.

In our experience, it is not common practice for pension schemes to have a standalone policy on social issues. This is, perhaps in part, because social risks and opportunities are more difficult to quantify, there is less political urgency; nor is there the same consensus on the problems we're trying to solve.

This, however, doesn't lessen their importance. We believe the DWP should clarify governance requirements on social risks and opportunities, set out key metrics on social issues, base regulatory requirements on international frameworks, such as the UN Guiding Principles, and for Trustees of DB pension schemes, understand the potential impact of social risks on the employer covenant.

The Financial Conduct Authority (FCA) consultation on enhancing climate-related disclosures by asset managers.

We believe that the largest asset managers should publish their TCFD report by mid-2022 – as is the case for the largest UK pension funds; there should be a degree of standardisation in metrics and scenarios, to allow for comparability; metrics should be accompanied by narrative-based disclosures (to, for example, provide context to allocations to high carbon assets, where the asset manager is engaging in support of transition plans).

We also responded to industry consultations, for example, PCAF's consultation on how to measure the carbon footprint of sovereigns. We favour weighted average emissions per capita rather than issued debt. Debt levels vary between countries, whereas a ton of carbon dioxide (or other greenhouse gases) affects everyone on the globe, regardless of its origin.

We will continue to respond to public policy consultations relevant to sustainable investment in the UK, Netherlands and Europe, and we will offer our expertise and experience where it is appropriate to do so.

Participation in industry initiatives

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 2021, we also participated in a number of industry initiatives, including:

- **Climate Action 100+**
- **Institutional Investors Group on Climate Change (IIGCC). We participate in the Derivatives and Hedge Funds Working Group (co-chaired by Cardano) and Policy Working Group (co-chaired by Cardano)**
- **Investment Consultants Sustainability Working Group (ICSWG). We participate in the Steering Committee, Stewardship Working Group, Policy Working Group**
- **Net Zero Asset Managers Initiative**
- **Partnership for Carbon Accounting Financials (PCAF). We participate in the Sovereign Bonds Working Group**
- **Pensions for Purpose. We joined in November 2021**
- **Principles for Responsible Investment (UN PRI). We participate in the SDGs Advisory Group, the Legal Framework for Impact Reference Group and the Global Policy Reference Group**
- **The Diversity Project**
- **The Green Bond Principles**
- **UN Global Compact**
- **Workforce Disclosure Initiative (ShareAction). We joined in November 2021**

Joining these organisations is a first step. We participated in working groups, contribute our expertise where appropriate, and listen to and learn from others. For example, we co-chaired the IIGCC derivaitives and hedge funds working group. The group has published a consultation paper on how to consider real-world sustainability impact, including net zero, in hedge funds and derivatives, asset classes where sustainability implementation often lags.

We participate in sustainability working groups across our 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.

Principle 5:

Signatories review their policies, assure their processes and assess the effectiveness of their activities.

Here we respond to Principle 5 for Asset Owners and Asset Managers. We respond to Principle 5 for Service Providers alongside Principle 6 for Asset Owners and Asset Managers.

Review of policies

We are on a sustainability journey – our approach will evolve as our understanding of science, technology and corporate and investment practice evolves. As such, we have updated our policies periodically to ensure we're at the forefront of thinking on sustainability issues.

As such, during 2020 and 2021, we reviewed a number of internal policies[13] were reviewed and several changes and additions made:

- Engagement Policy (reviewed and updated) (2020, updated 2022)
- Stewardship Report (reviewed and updated to comply with the new 2020 principles)
- Corporate Sustainable Policy (2021)
- Sustainable Investment Beliefs (2020)
- Sustainable Investment Policy (2021)
- Our Plan to Address the Climate Crisis (2021)
- We Invest Sustainably Here's How (2021)
- Our Year End Sustainability Report (2021)

We have also:

- Written to all our third-party managers setting out our sustainability expectations. In January 2022, our letter focused on stewardship[14]
- Written to all our counterparties setting out our sustainability expectations

In 2021, we also participated in a UN PRI case-study[15].

The purpose of these reviews has been to develop the firm's approach to sustainability and stewardship. All policies are overseen by the Sustainability Steering Committee.

Improvements to our Third-Party Manager ESG Questionnaire

- Raising our sustainability and stewardship expectations
  - Standards raised irrespective of high / low focus designation
  - Introduction of a 4-tier scoring system for each of our assessment areas: Policy, ESG Integration, Engagement and Reporting
  - 'Strong' rating reserved for best-in-class funds and asset managers

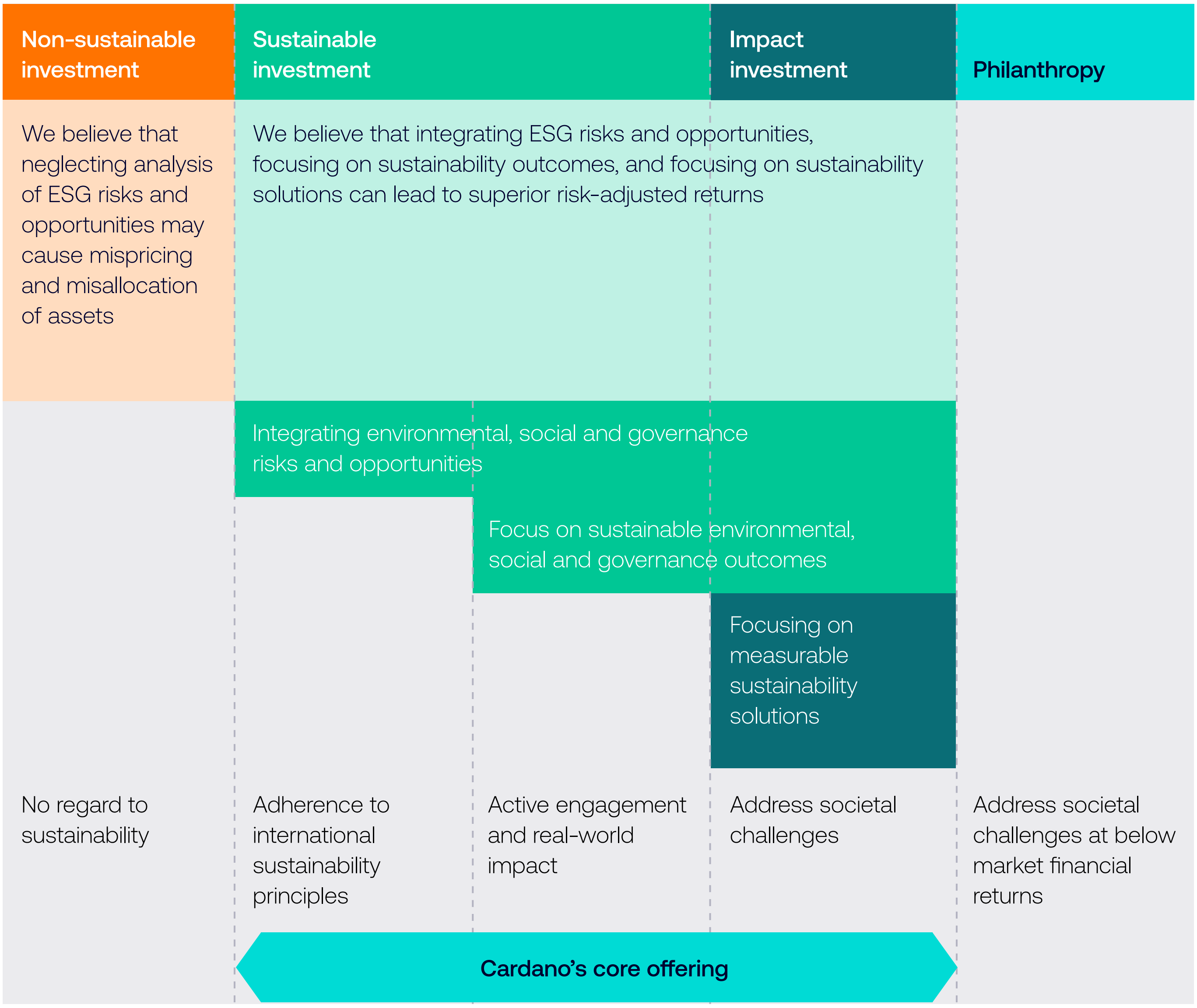
- Alignment with industry initiatives, including: PRI, PLSA and ICSWG
  - Demonstrates our support for industry collaboration on sustainability and stewardship topics
  - Alignment is designed to encourage managers to become signatories (where appropriate)
  - Responds to manager feedback around consistency

13 https://www.cardano.co.uk/sustainability-policies/
14 https://www.cardano.co.uk/our-approach-to-sustainability/selecting-managers-based-on-sustainability/
15 https://www.unpri.org/asset-owner-resources/engaging-external-managers-on-sustainable-investment/7721.article

- Expanded scope
  - Granularity and quantity of questions increased
  - Introduced 25 organisationally-focused questions (previously more investments focused)
  - More focus on engagement examples

Sustainability Landscape:

We position our approach within the sustainability landscape as follows:



Model of Influence for Real-World Sustainability Impact

As a fundamental part of our investment process, we consider two investment lenses, we call this 'double materiality':

1. Risk and return, including sustainability-related risks and opportunities
2. Influence and impact, including real-world sustainability impact

While 'risk and return' can be readily understood, there is less clarity about what is meant by 'influence', i.e. real-world sustainability impact, and how to measure it.

Consequently, we have developed our own 'model of influence'. This comprises of three key areas of influence, based upon how directly impactful our actions could potentially be.

Tier one – interactions that are most impactful

- Collaborative company engagement on sustainability-related topics, for example through the Climate Action 100+ initiative

- Engaging with public policymaking to create a more sustainable economy, for example to decarbonise the electricity grid or rollout electric vehicles

- Supplying new capital, debt or equity to a company or government, where this has an environmental or social objective

- Enabling activities or markets that may be new to investors, such as water and sanitation, through new thematic impact strategies. This helps develop an evidence-base that can enable further capital flows into sustainability outcomes

Tier two

- Engaging with companies as an individual investor on sustainability-related topics – less impactful than collaborative engagement, but this nevertheless has an important impact

Tier three

- Incorporating environmental and social-related objectives into client investment mandates, as part of a scheme's overall investment approach. This directs capital flow towards more sustainable businesses and away from less sustainable businesses, indirectly influencing their cost of capital and hence their competitive positioning

- The integration of ESG factors into the buying and selling of securities

Having a thorough framework for our thinking about impact boosts our credibility and enables us to engage effectively and efficiently.

A great example of how this framework works in practice can be shown in how we have refined due diligence questionnaires and RFP documentation for the third-party managers that we employ. Furthermore, we have reinforced our expectations of third-party managers, clearly setting out our influence model and directing them as to how they can participate in improving stewardship standards[16].

Example

Cardano and Big Society Capital, UK social impact investor, are partnering with the intention to direct up to £195 million of new investment towards real estate fund strategies addressing the UK housing crisis. This will be a combination of Big Society Capital's own investment and client capital from Cardano.

Cardano and Big Society Capital are calling on real estate fund managers to participate in a joint Request for Proposals (RfP) focused on fund strategies that increase the supply of good quality, affordable housing in the UK – alongside generating a market rate financial return. We aim to expand the market through Big Society Capital's own investments combined with Cardano's client investments, as well as facilitating additional institutional investment alongside them.

Further details are available on our website[17].

16 https://www.cardano.co.uk/wp-content/uploads/sites/3/2022/02/2201_Letter_Cardanos-Latest-Thinking-on-Sustainable-Investing.pdf

17 https://www.cardano.co.uk/industry-insights/cardano-and-big-society-capital-launch-joint-rfp/

Investment Approach

Principle 6 of the Principles for Asset Owners and Asset Managers:

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

Principle 5 of the Principles for Service Providers:

Signatories support clients' integration of stewardship and investment, taking into account, material environment, social and governance issues, and communicating what activities they have undertaken.

Client base and objectives

All of our UK clients are 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	Advisory	Endowment
>£1bn	5	6	1
£500m - £1bn	2	1	0
£250m - £500m	9	0	0
<£250m	8	1	0
Total	**24**	**8**	**1**

As at 31 December 2021

Typically, our investment objectives are to outperform a gilt or swap-based proxy for the scheme's liabilities by between 1% and 3.5% p.a. Most of our clients have long-term time horizons, typically 5 to 10 years.

Note that the fiduciary and advisory columns includes DB and DC clients.

All clients are UK-based.

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 includes the risk / return requirements and approach to sustainability, including stewardship. The approach is reviewed on a regular basis (usually in conjunction with triennial actuarial valuation cycle) and is supplemented with ongoing sustainability reporting and, where necessary, training. We provide our clients with training and advice in updating their ESG policies and Statement of Investment Principles.

We organised a series of specialist briefings, for example, a briefing on inequality in June 2021 and a briefing on COP 26 in October 2021. A summary of our research on inequality is available on our website[18]. The COP briefing included two external speakers from the COP26 High-Level Climate Champions and UN PRI.

It is the responsibility of the Cardano 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. Our questionnaire invites trustees to set out their views on a range of sustainability topics, which we synthesise, present and discuss.
- 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.

We make use of the PLSA voting template, as well as the ICSWG engagement reporting guide[19] (discussed below).

18 https://www.cardano.co.uk/perspectives/the-risks-of-inequality-must-not-be-forgotten-in-the-shift-to-sustainability/
19 https://www.icswg-uk.org/resources

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, social 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 October 2021, we were pleased to successfully participate in the UK green gilt issuance
- Starting in 2020, we integrated ESG issues into our Dealer Committee's approach to counterparty assessment for derivative and trade execution. In 2021, we engaged all our counterparties on sustainability topics, writing to counterparties setting out our sustainability expectations[20]
- For some clients, we have started to integrate ESG issues into the collateral management programmes 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

Dialogue with our managers

We help our clients invest in more than 160 managers across most major markets, asset classes (public and private) and geographies. Our approach, therefore, is flexible – to account for different strategies – without compromising on focus, which we believe drives the best outcomes.

We comprehensively assess and integrate ESG issues at every investment stage. And through granular data and regular dialogue with our partners we learn and adapt; striving to constantly improve.

We expect our managers to:

1. Be aware of financially material ESG issues associated with an investment
2. Take ESG issues into account where they have the potential to materially affect the financial risk and / or return
3. Engage strategically on ESG issues, where possible within the portfolio and externally. We expect all managers to exercise voting rights where possible
4. Weight substance over form – we look for genuine integration of ESG issues

20 https://www.cardano.co.uk/our-approach-to-sustainability/how-we-work-with-counterparties/

Stewardship approach of third-party managers

Our approach to stewardship starts with data. Granular data drives higher quality discussions. Our ESG questionnaire and manager framework is deliberately detailed and assesses fund managers across four areas: People and policies, ESG integration, stewardship and engagement, and reporting. Where possible, we have aligned our framework with key industry initiatives (see Principle 5).

Engagement

We are passionate about active engagement. We treat managers as partners, feeding back ESG ratings and using these to set specific, time-based milestones for managers to make progress.

From there, we are able to engage with managers further to ensure ESG issues remain at the forefront of their investment decision-making. We regularly discuss ESG related topics as part of our ongoing monitoring throughout the year.

Example

We conducted research into passive managed ESG funds, reviewing:

- all the leading ESG data providers used in ESG index construction
- the spectrum of ESG index solutions available; with a preference for approaches that were broad (addressed E, S, and G issues), and that had strong climate credentials
- passive index managers' ESG capabilities – conducting multiple deep dives into managers' stewardship abilities paying particular attention to voting behaviours

The completion of this research led to us replacing non-ESG equity index exposure with equity exposure that is now ESG-integrated, and has a 50% lower carbon footprint than before and with higher levels of stewardship and engagement.

Current Engagement Examples

Example 1 – Global Macro Manager | High Focus, Good ESG Rating

Key Engagement Areas

- Encourage the manager to become signatory to UN PRI and to become more involved in the initiatives mentioned in their ESG policy (i.e., CDP on Climate Change, ICGN on corporate governance and United Nations Global Compact) plus others such as Climate Action 100+ and the Net Zero Asset Managers Initiative
- Guide the manager to publicly support TCFD and the Paris Climate Agreement, including decarbonisation target-setting
- Push the manager to start tracking the proportion of the portfolio exposed to E, S and G risks and opportunities
- Encourage the manager to develop a scenario analysis framework to identify climate change-related risks and opportunities
- Ask the manager to publicly report voting decisions

Example 2 – Systematic Manager | Low Focus, Good ESG Rating
Key Engagement Areas

- Encourage the manager to become a signatory to a regulatory-led stewardship code (relevant to their jurisdiction)
- Ask the manager to provide more examples of ESG issues being integrated into their investment processes
- Ask the manager to consider partnering with an external advisor to assist with their engagement efforts
- Improve transparency and reporting of greenhouse gas emissions-related metrics necessary for TCFD reporting

Example 3 – US Equity Long/Short Manager | High Focus, Poor ESG Rating
Key Engagement Areas

- Guide them towards 1) developing a formal stewardship policy and 2) signing up to a Stewardship Code or joining an industry wide initiative that looks to collaborate and advance sustainability goals
- Continue to push the manager to reconsider becoming a UN PRI signatory and publicly support Paris Climate Agreement and TCFD reporting
- Encourage manager to publicly disclose proxy voting details and highlight most significant votes
- Discuss developing an exclusion / screening policy
- Encourage the manager to introduce oversight of their sustainability objectives by investment staff (rather than COO)

Aligning to industry best practice

Principles for Responsible Investment (UN PRI)
We believe that a critical part of improving sustainability and stewardship practices requires improved clarity and standardisation (around terminology but also metrics and reporting).

This is why, we have aligned our strategy specific ESG questionnaires – detailed sets of questions we send to all our managers annually – with the UN PRI's reporting framework, the PLSA template and ICSWG resources.

We hope this will encourage managers to align to a single, standardised means of reporting, as well as to become UN PRI signatories themselves.

Investment Consultants Sustainability Working Group (ICSWG)
We are an active participant in the ICSWG – a body made up of 17 investment consultant firms to UK asset owners. The group published in November 2021 guidance designed to improve the engagement reporting by managers, which we have included in our manager ESG questionnaire:

- The ESG Metrics for Asset Managers[21]
- The ICSWG Engagement Reporting Guide[22]

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

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.

21 https://www.icswg-uk.org/_files/ugd/9624a9_12e6622be8e14cbd8f4b12b3b31caf80.pdf
22 https://www.icswg-uk.org/resources

Over 2021, in respect of our private market funds, we engaged and voted on numerous issues. These included –

- Fund extensions
- Third-party cost reimbursement
- Principal transactions with affiliates
- Asset sales
- Operating consultant consent

Our focus areas

We focus our resources where we are passionate, knowledgeable and can have an impact. The real-world impacts we have prioritised are:

- **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 50% emissions reduction target by 2030, based on 2019 emissions

- **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.

In January 2022, we wrote to our external managers to specifically focus on stewardship as we don't think the topic gets the attention it deserves. We highlighted climate action and tackling inequality[23]. We said:

"There is an opportunity to create value by improving lagging businesses' standards – thereby avoiding reputational and investment harm, and perhaps upgrading them into sustainable leaders, driving outperformance as they improve. Businesses focused on their impact and building a reputation for addressing inequality are likely to gain competitive advantage by attracting talent and human capital from a younger generation far more attuned to sustainability issues; and building a customer base who engage and consume based on their alignment of values, as much as on price value."

23 https://www.cardano.co.uk/wp-content/uploads/sites/3/2022/02/2201_Letter_Cardanos-Latest-Thinking-on-Sustainable-Investing.pdf

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. Managers also need to complete our ESG questionnaire prior to investment.

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. In 2021, we began using the MSCI ESG data sets to support our initial and ongoing rating of managers. MSCI ESG data provides a good sense for whether managers are implementing their sustainability beliefs.

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 Poor)
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 all managers, but in particular, high focus managers, 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 and 2021, 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. We made an allocation in 2021 to an ESG-screened, low carbon passive mandate, with strong stewardship, and expect to make a second allocation in 2022.

Failure to Comply

New Investments

ESG issues and real-world sustainability impact is specifically addressed in investment proposals and extensively discussed at weekly Manager Research Committee (MRC) meetings. Managers that have not met expectations will not progress through the MRC decision-making.

Example – Private Equity Manager | High Focus, Strong ESG Rating

- Decided not to re-invest in the manager's latest fund.
- The strategy's fossil fuel exposure conflicted with our sustainability agenda despite strong controls in place.

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.

Example 1 – Equity Long/Short Manager | High Focus, Poor ESG Rating

- Rating moved to sell in Q3 2021
- Manager had a 'poor' ESG rating, driven by limited integration of ESG issues into their process and a weak approach to stewardship
- Our downgrade was partially driven by the slow pace of improvement to their approach

Example 2 – Equity Long/Short Manager | High Focus, Poor ESG Rated

- Rating moved to sell in Q2 2021
- Our downgrade was driven by concerns related to internal governance practices and oversight. This led to question marks around the decision-making of investment professionals at the firm

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.

Case study

In June 2021, we contributed a case-study to UN PRI's asset owner resources on our process of engaging external managers on sustainable investment.

The case-study is available on UN PRI's website[24].

24 https://www.unpri.org/asset-owner-resources/engaging-external-managers-on-sustainable-investment/7721.article

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. 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
  - We 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, in particular, on our three priority sustainability themes

- Granular Measurement
  - Each year we gather detailed information on invested funds' practices and approach to ESG issues and real-world sustainability impact (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)

  - 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 and stewardship
    - 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

25 https://www.cardano.co.uk/sustainability-policies/

- 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 ESG issues 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, in particular, on our three priority sustainability topics

We see considerable variation in approaches to stewardship across geographies and across manager life-stages (see below). 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 was rolled out to a broader set of managers, prioritising our high focus managers.

An example of underlying manager engagement is as follows:

- Manager type: listed equity
- Issue identified: Not a UNPRI signatory. Tier 2 Stewardship status (not the latest stewardship code). 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 UN PRI 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)
- **Transparency** – some engagement, perhaps even most engagement, will be unsuccessful. We're realistic, and we'd prefer transparency 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, integration and diversity and inclusion.

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.

Example Engagements on Climate and Fairer Society

Example 1 – Global Macro Manager | High Focus, Good ESG Rating

Key Engagement Areas

- Encourage the manager to become signatory to UN PRI and to become more involved in the initiatives mentioned in their ESG policy (i.e., CDP on Climate Change, ICGN on corporate governance and United Nations Global Compact) plus others such as Climate Action 100+ and the Net Zero Asset Managers Initiative

- Guide the manager to publicly support TCFD and the Paris Climate Agreement, including decarbonisation target-setting

- Push the manager to start tracking the proportion of the portfolio exposed to E, S and G risks and opportunities

- Encourage the manager to develop a scenario analysis framework to identify climate change-related risks and opportunities

- Ask the manager to publicly report voting decisions

Principle 10:

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

Collaboration

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 2021, we also participated in a number of industry initiatives, including:

- **Climate Action 100+**
- **Institutional Investors Group on Climate Change (IIGCC). We participate in the Derivatives and Hedge Funds Working Group (co-chaired by Cardano) and Policy Working Group (co-chaired by Cardano)**
- **Investment Consultants Sustainability Working Group (ICSWG). We participate in the Steering Committee, Stewardship Working Group, Policy Working Group**
- **Net Zero Asset Managers Initiative**
- **Partnership for Carbon Accounting Financials (PCAF). We participate in the Sovereign Bonds Working Group**
- **Pensions for Purpose. We joined in November 2021**
- **Principles for Responsible Investment (UN PRI). We participate in the SDGs Advisory Group, the Legal Framework for Impact Reference Group and the Global Policy Reference Group**
- **The Diversity Project**
- **The Green Bond Principles**
- **UN Global Compact**
- **Workforce Disclosure Initiative (ShareAction). We joined in November 2021**

Joining these organisations is a first step. We participated in working groups, contribute our expertise where appropriate, and listen to and learn from others. For example, we co-chaired the IIGCC derivaitives and hedge funds working group. The group has published a consultation paper on how to consider real-world sustainability impact, including net zero, in hedge funds and derivatives, asset classes where sustainability implementation often lags.

We participate in sustainability working groups across our 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.

In June 2021, we contributed a case-study to UN PRI's asset owner resources on our process of engaging external managers on sustainable investment.

The case-study is available on UN PRI's website[26].

26 https://www.unpri.org/asset-owner-resources/engaging-external-managers-on-sustainable-investment/7721.article

Policy Engagement

This year, we have responded to eight public policy consultations, in the UK, EU and US, covering a range of sustainability topics including social risks and opportunities, climate change and stewardship.

We see policy engagement as a natural extension of our sustainability commitments. We recognise the need to improve the sustainability of the market as-a-whole and that there are clear benefits to us and our clients through well-designed and implemented sustainable investment policy reform.

In general, we welcome the direction of policy makers on sustainability topics. Highlights include:

The Department for Work and Pensions (DWP) call for evidence on the consideration of social risks and opportunities.
In our experience, it is not common practice for pension schemes to have a standalone policy on social issues. This is, perhaps in part, because social risks and opportunities are more difficult to quantify, there is less political urgency; nor is there the same consensus on the problems we're trying to solve.

This, however, doesn't lessen their importance. We believe the DWP should clarify governance requirements on social risks and opportunities, set out key metrics on social issues, base regulatory requirements on international frameworks, such as the UN Guiding Principles, and for Trustees of DB pension schemes, understand the potential impact of social risks on the employer covenant.

The Financial Conduct Authority (FCA) consultation on enhancing climate-related disclosures by asset managers.
We believe that the largest asset managers should publish their TCFD report by mid-2022 – as is the case for the largest UK pension funds; there should be a degree of standardisation in metrics and scenarios, to allow for comparability; metrics should be accompanied by narrative-based disclosures (to, for example, provide context to allocations to high carbon assets, where the asset manager is engaging in support of transition plans).

We also responded to industry consultations, for example, PCAF's consultation on how to measure the carbon footprint of sovereigns. We favour weighted average emissions per capita rather than issued debt. Debt levels vary between countries, whereas a ton of carbon dioxide (or other greenhouse gases) affects everyone on the globe, regardless of its origin.

We will continue to respond to public policy consultations relevant to sustainable investment in the UK, Netherlands and Europe, and we will offer our expertise and experience where it is appropriate to do so.

IIGCC derivatives and hedge funds PAII working group
Our Deputy CIO, Keith Guthrie, co-chairs IIGCC's derivatives and hedge funds Paris-aligned investment initiative's working group. Derivatives and hedge funds are typically considered hard-to-reach asset classes, with the treatment characterised more by questions than answers, including:

- Can engagement be made effective without voting rights? We believe derivative counterparties should also actively engage with the entities that represent their underlying investments, with collective actions far more powerful than individual initiatives

- What is the value of stewardship rights? Can value be created by separating voting rights from ownership to form a new asset class that better matches the sustainability objectives of investors independent from the instruments that they choose to represent their investments?

A discussion paper, prepared by IIGCC, will be published in Q2 2022.

IIGCC policy advisory group

Our Group Head of Sustainability, Will Martindale, co-chairs IIGCC's policy advisory group. The group discusses topics ranging from financial regulation to real-economy policy making. For example, we supported IIGCC's engagement of the European Commission on the inclusion of nuclear and gas in the Taxonomy[27].

COP 26 engagement

In November, we participated in and contributed to a number of COP 26 events in Glasgow. We shared our key messages for Trustees from COP 26 in a video in partnership with Pensions Expert[28].

27 https://www.iigcc.org/news/iigcc-publishes-open-letter-calling-for-gas-to-be-excluded-from-the-eu-taxonomy/
28 https://www.pensions-expert.com/Special-Features/Videos-Podcasts/COP26-Key-messages-for-trustees

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.

In Q3, 2021, we issued a Request for Proposal for an engagement provider. In November 2021, we selected Sustainalytics' Engagement 360 solution, which we apply to our fiduciary and DC investments. Engagement 360 is an integrated stewardship solution that addresses multiple sustainability issues impacting companies' overall risk management strategy and performance.

For reporting year, 2021, we did 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.

Example 1 – Equity Long/Short Manager | High Focus, Poor ESG Rating
- Rating moved to sell in Q3 2021
- Manager had a 'poor' ESG rating, driven by limited integration of ESG issues into their process and a lite approach to stewardship
- Our downgrade was partially driven by the slow pace of improvement to their approach

Example 2 – Equity Long/Short Manager | High Focus, Poor ESG Rating
- Rating moved to sell in Q2 2021
- Our downgrade was driven by concerns related to internal governance practices and oversight. This led to question marks around the decision-making of investment professionals at the firm

Exercising Rights and Responsibilities

Principle 12:

Signatories actively exercise their rights and responsibilities.

Engagement with Fund Managers

No single name equities are invested on a direct basis by 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, all of which are subject to ESG and stewardship requirements, as set out in our response to the Stewardship Code.

We believe impactful engagement and effective stewardship flows from high quality dialogue with these managers.

We aim to achieve this through:

1. Granular Measurement

Each year we gather detailed information on invested funds' practices and approach to ESG issues and real-world sustainability impact (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 (MRC).

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 sustainability topics
- Track a manager's progress against those goals (For detail on our ESG rating process, please see our published policies)

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.

2. Consistent Communication

A critical part of effective engagement is making clear our expectations around ESG issues.
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 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 our sustainability 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 issues could materially impact the risk and return profile of the strategy (e.g. listed or private equities, corporate credit etc.)
- Low Focus | ESG issues 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 ESG risks and opportunities inherent in each investment, as well as real-world sustainability impact
- 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.

3. Engagement and voting

Example 1, Egerton Capital: Voted for climate assessment report
We voted with a shareholder proposal for a climate assessment report, against the recommendation of management.

Example 2, Sands Capital: Voted against election of all directors up for re-election
This was an engagement escalation. After many years of engaging the company on governance and board composition, we felt that voting against all directors up for re-election this year would send a strong signal to the company.

Example 3: 2022 Shareholder Resolution at Sainsbury's plc on Living Wages
In November 2021, Cardano was contacted by Share Action, a UK-based charity that promotes sustainable investment.

Share Action set out the rationale for engagement and a shareholder resolution on Living Wages.

The UK Living Wage Foundation defines the living wage as:

> "the wage rate that meets everyday needs – like the weekly shop or a trip to the dentist."

The Impact Institute defines the living wage as:

> "the amount a worker needs to make in order to afford a decent living for his/her entire family. This includes a decent and varied diet, decent housing, necessary non housing, non food necessities (such as clothing) and some additional value for savings and social security."

Both the International Labour Organisation (ILO) and OECD categorise living wage as a fundamental human right.

In the UK, Share Action explained that no major supermarket is an accredited Living Wage employer.

Cardano supported Share Action's proposal to engage Sainsbury's. We took the proposal to a third-party manager with a holding in Sainsbury's. The manager was receptive and our engagement is ongoing. The client invested in this manager had prioritised Living Wages as a priority sustainability theme.

Further Development

In Q3, 2021, we issued a Request for Proposal for an engagement provider. In November 2021, we selected Sustainalytics' Engagement 360 solution, which we apply to our fiduciary and DC investments. Engagement 360 is an integrated stewardship solution that addresses multiple sustainability issues impacting companies' overall risk management strategy and performance.

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