

RESPONSIBLE INVESTMENT QUARTERLY

Q2 2020



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01 Foreword



Iain Richards

Head of Global Responsible Investment Policy

Although the second quarter of every year is dominated to some extent by company annual general meetings (AGMs) and the proxy voting season, this year has been particularly notable. Details of our voting focus over the period are summarised later in this report, but the story of this year has been more involved than usual.

The coronavirus pandemic, social distancing and lockdowns have made for an unusual season, with the need for remote AGMs and responses to other challenges facing our companies. This has had a significant impact on the focus of our collaborative work

in particular. As the crisis developed, considerable time was dedicated to consulting with other capital markets stakeholders.

Examples of this work include:

- Collaborating with other market participants in the UK's Pre-emption Group to help put in place special arrangements to enable affected companies to raise significant amounts of capital quickly and effectively in response to the crisis.
- Working with counterparts at the Investment Association (the UK's trade association for the Investment Management industry) to provide companies with guidance and comfort on the approach investors could take across a range of issues, including financial reporting, AGMs and dividends.
- Providing input and feedback to regulators and the UK Government via HM Treasury on the above issues, as well as debt covenants, working capital statements and other market dynamics.
- In the equity markets, helping to provide the capital that businesses have needed in the face of the crisis.

- In the debt markets, helping to provide the capital needed to fund Covid-19 responses and initiatives. The developments in the social, sustainability and green bond market have been particularly interesting and are discussed later in this report.

Compared to the global financial crisis, the Covid-19 crisis has already had a significantly more direct and widespread impact on businesses and society. As economies look to reopen, a tendency towards a return to pre-crisis norms will be a possibility, although given the breadth and scale of the impact it is reasonable to expect that behaviours – both individual and corporate – may change, perhaps permanently. The seeds of this are certainly evident from our research and engagement.

Through the crisis we have maintained particular research intensity on the situation playing out. The ongoing collaborations between equity, responsible investment and credit analysts, as well as portfolio managers, have helped to identify some fundamental shifts and changes that are either accelerating or starting.

Now the focus of that work has turned to how, from both a top-down and bottom-up perspective, the world will change over a three- to five-year time horizon, to ensure our investment perspective continues to benefit from that research intensity.

Going into the crisis, the responsible investment world was already facing a tsunami of regulatory initiatives, which is likely to continue. In looking at how policymakers respond to the crisis two themes will be important in shaping the required stimulus:

- Firstly, there has already been a recognition that current policy measures do not adequately address the asymmetric effects of the crisis on the most vulnerable households, which need the most immediate support. It has also highlighted concerns about the medium- to longer-term impact on inequality and sustainability. This provides policymakers an opportunity to build on existing policy work to systematise and prioritise initiatives that support “inclusive growth”.
- Secondly, and unsurprisingly, there are clear signs of apprehension about the potential to lose focus on the “climate crisis”. However, the risk should not be as great as some fear. Many climate-positive policies are seen to have high

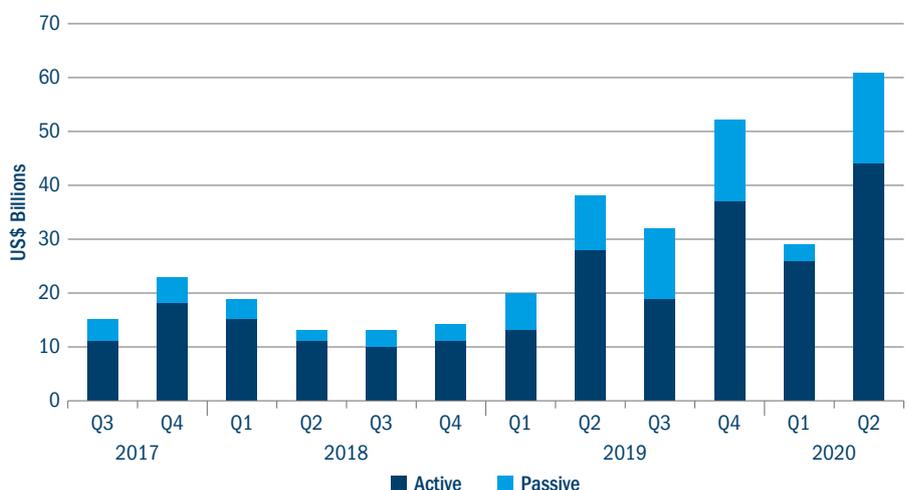
overall desirability for policymakers crafting their response to the crisis. The logic is simple: they can have significant benefits as measures of economic stimulus, with high long-run multiplier effects offering a strong return on investment for government.

While responses will not be uniform around the world, we are seeing continued emphasis on sustainability, not least in Europe – both at EU level as well as among local regulators – in continuing to pursue the climate and sustainability reform agenda that pre-dated the crisis. In addition, it appears there is growing investor interest in, and demand for, solutions

that incorporate responsible investment approaches.

Supported by the stock market recovery and this heightened interest in environmental, social, and governance issues, a recent report by Morningstar remarks that global inflows into sustainable funds were \$71.1 billion for the second quarter of 2020, up 72% on the first quarter. Europe continued to dominate this trend, accounting for 86% of this. Over Q2, flows into European sustainable funds more than doubled to \$61.3 billion (Figure 1). It is notable that these flows outpaced the mainstream flows: over the quarter, investors poured €35.1 billion into

Figure 1: Quarterly European Sustainable Fund Flows (US\$ billions)



Source: Morningstar Direct, as at June 2020.

sustainable equity funds, 63% more than in their mainstream equivalents. Although flows into sustainable fixed income funds were also positive, they did lag their mainstream peers. This will, in part, be down to the more limited choice in sustainable bond strategies.

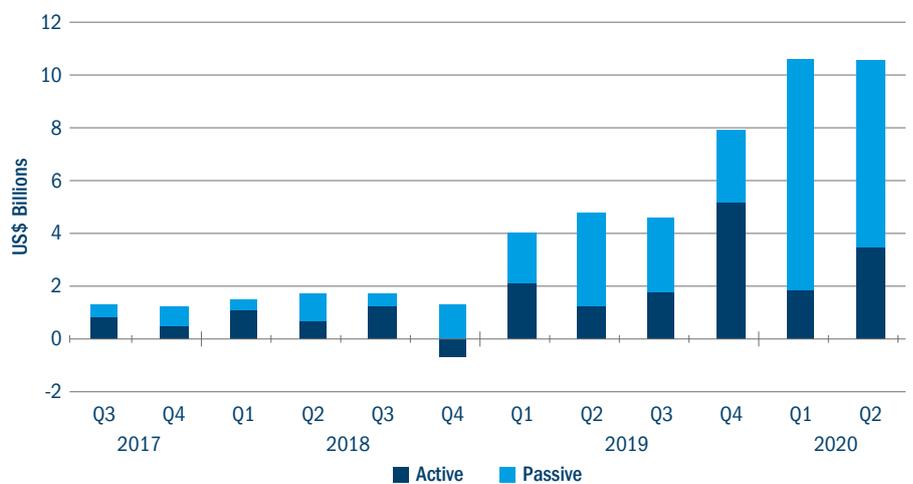
The US, meanwhile, accounted for 14.6% of global inflows. Over Q2 US sustainable fund flows continued to grow at a record pace, with estimated net flows of around \$10.4 billion (Figure 2). Of that, investors pumped \$5.8 billion into sustainable funds in April, almost all of it to equity funds – the largest monthly flow ever for US sustainable funds.¹ These flows were similar to those in Q1, bringing the total for the first half of the year to \$20.9 billion, just shy of the total for the whole of 2019 (US\$21.4 billion).

As always, I hope you find the topics and insights in this quarterly report to be informative and helpful. It has been a busy quarter in the responsible investment field, and that is something

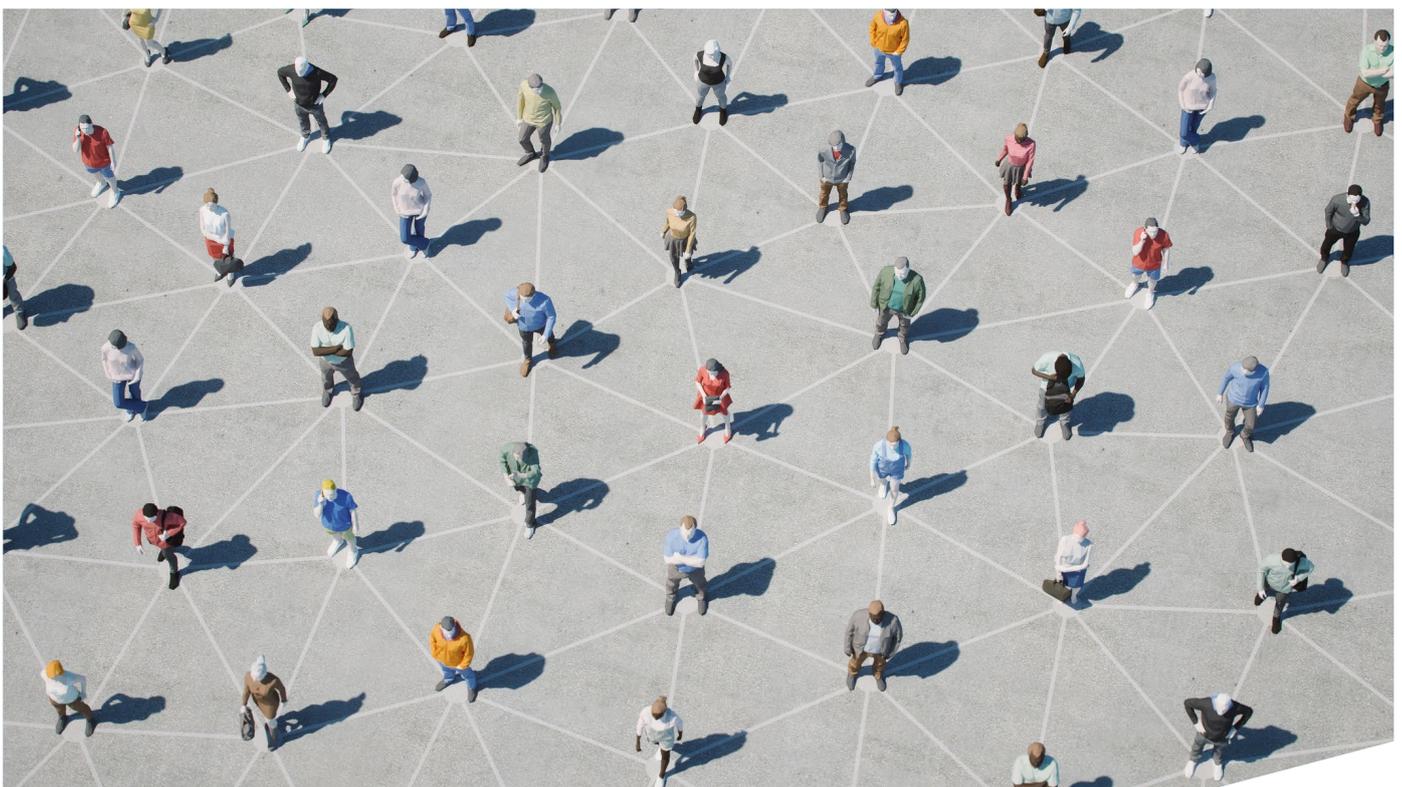
I don't expect to change given the policy environment and growing levels of investor interest.

Source:
1 Morningstar Direct, June 2020.

Figure 2: Quarterly US Sustainable Fund Flows (US\$ Billion)



Source: Morningstar Direct, as at June 2020.





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アコム

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アイフル

一軒酒場
190円
一軒酒場一番店
左の路地を右へ

ブランド高値買取

All-you-can-eat buffet for 2 hours
120分
しゃぶしゃぶ
Shabu-Shabu
食べ放題!
2,480yen
1,480yen
1,980yen
SAGIYA 5F

コスパ
キャンパスコース

とらとぼ
TORA TORI
立ちそば

OKONOMI Y
All-You-Can-Eat dinner with Free Drinks for 2 hours

2,700円
2,300円

パチンコ エスパス 日拓

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金沢

02 Portfolio Manager Viewpoint



Daisuke Nomoto

Portfolio Manager, Japanese equities

Japan's environment, social and governance (ESG) story truly began in 2006 when the country's institutions signed up to the United Nations Principles for Responsible Investment (PRI),² but it only started to gain momentum in 2011 when the country established the Principles for Financial Action towards a Sustainable Society.³ This momentum was carried over to the Japan Revitalisation Strategy set out in 2013 under Prime Minister Shinzo Abe's administration. As a backbone for the strategy, Japan's Stewardship Code⁴ and Corporate Governance Code⁵ were established in 2014 and 2015 respectively.

Both of these have played a significant role in the quest for better corporate governance and increased awareness of environmental and social issues.

The Stewardship Code states that investors should be in dialogue with companies and work to solve problems through constructive engagement to enhance medium- to long-term investment returns,⁶ while the Corporate Governance Code looks to facilitate transparent, fair, and timely decision-making by companies. The Government Pension Investment Fund (GPIF) in Japan, one of the world's largest asset owners, announced its intention to comply with the Stewardship Code in 2014 and signed up to the UN PRI in 2015. Due to its size and influence, the GPIF's commitment helped raise the sensitivity to ESG issues both from companies and institutional investors.

The Stewardship Code was revised in 2017,⁷ to mandate full disclosure of voting results, and it was revised once again in October 2019 to incorporate long-term sustainability in the investment process.⁸ The Corporate Governance Code was itself revised in 2018⁹ with several new guidelines added, such as minimum board independence requirements, mandating an objective CEO succession plan, and the

unwinding of cross-shareholdings¹⁰ to further enhance transparency. Another revision is planned in 2021 to further enhance the standard of corporate governance.

Key ESG focus areas

ESG covers a wide range of issues, but the key topics of discussion between corporate management and institutional investors in Japan include:

Board of directors structure

The amended corporate governance code requires that at least a third of board of directors be from outside the company, instead of just two. This is intended to encourage accountability around decision-making processes. Currently, around 70% of listed companies haven't met this requirement.¹¹ With regards to board diversity, the number of female directors as a percentage of the total has risen but was still only 5.2% as of 2019.¹² The government mandate is for corporates to increase this ratio to 10% in 2020.¹³

A related topic is executive compensation, which has been an area of scrutiny given the lack of transparency in decision-making processes determining executive compensation. Since the governance code also requires a

transparent process for the removal of management and succession, more companies are establishing nomination committees to achieve the desired accountability.

Parent-subsiary dual listings

One of the major issues arising as a result of parent-subsiary dual listings is the creation of conflicts of interest, potentially putting minority shareholders in a disadvantaged position. The number of listed subsidiaries in Japan is still quite high: 238 compared to 28 in the US, and none in the UK (as at 2018¹⁴), and we view parent-subsiary listings as running counter to the objectives of the governance code. That being said, we have observed some positive developments recently such as the dissolution of the dual-listing structure in some leading companies, including Hitachi, which sold Hitachi Kasei to Showa Denko, and also sold Hitachi Transport, Hitachi Capital, Hitachi Koki and Hitachi Kokusai; Toshiba, which sold Toshiba Plant, NuFlare Technology and Nishishiba Electric; and Mitsubishi Chemical, which sold Tanabe Mitsubishi Pharma.

Prime Minister Abe recently initiated a debate on the governance reform guidelines at the Council on Investments for the Future.¹⁵ The proposals would require accountability of parent

companies to minority shareholders, while encouraging subsidiary companies to increase the proportion of external directors who are independent from its parent company. We expect this will help accelerate the unwinding of the dual-listing structure, which would better align the interests of management and shareholders. We also expect this to result in the more effective allocation of underutilised capital, be it through investment in higher capital-returning projects or via the return of excess capital to shareholders.

Strategic shareholdings¹⁶

While cross-shareholding, whereby listed companies sit on large portfolios of one another's shares, has declined over time, we still observe that many companies do not comply with the Corporate Governance Code and provide no rationale for employing a strategic shareholding structure. The latest revision to required disclosures forced companies to provide details about strategic shareholdings.¹⁷ Since this revised governance code states business transactions should not be based on strategic shareholding relationships, we expect further engagement to help unwind the cross-shareholdings, resulting in a more efficient use of capital.

Disclosures

Environmental considerations are an aspect of ESG engagement that have been gaining interest globally in recent years. Japan has been ahead of this trend in terms of disclosure on environmental activities, proactively disclosing non-financial information through the Integrated Report. The Rio Earth Summit in 1992 was a catalyst for Keidanren, the Japanese business federation, to request that its member companies publish environmental impact reports. According to the GPIF, 72.4% of companies make voluntary disclosures of relevant ESG information,¹⁸ either referring to the Global Reporting Initiative guidelines¹⁹ (40.7% of companies); the International Integrated Reporting Framework²⁰ (33.3%); or the remainder referring to the Ministry of Environment's Environmental Reporting Guidelines,²¹ the "Guidance for Collaborative Value Creation" published by the Ministry of Economy, Trade and Industry; or the "Guidelines for Investor and Company Engagement" published by the Financial Services Agency.²²

Meanwhile, the Task Force on Climate-related Financial Disclosures (TCFD)²³ has been receiving attention by offering a framework for disclosing information related to climate change. TCFD was formulated in 2017 to help

institutional investors and financial institutions better understand how climate-related risks and opportunities will impact future income statements and balance sheets.

Japan is the world's biggest TCFD-supporting country.²⁴ As of June this year 285 Japanese public and private entities have expressed support for the task force, a total of 1,293 signatories and many are already making disclosures in accordance with the framework. We expect further disclosure efforts under the TCFD to drive better-quality engagement with stakeholders regarding companies' sustainability practices.

Sustainable investment assets are growing in Japan

ESG investing has significantly increased globally, and Japan is no exception. The amount of global sustainable investment reached \$30.7 trillion in 2018 in the five major markets of Europe, the US, Canada, Japan, Australia and New Zealand, up 34% relative to 2016. Japan was the main contributor to this growth with sustainably managed assets growing more than 300%²⁵ during the period. Not surprisingly, in tandem with this shift Japanese corporate management is increasingly willing

to address corporate governance issues, capital efficiency and returns on capital. The GPIF, which manages roughly ¥160 trillion²⁶ (\$1.5 trillion), is integrating ESG factors into its investment principles. The rule of thumb is that when GPIF establishes a new policy, others will follow. Hence, we expect the influence of sustainable investment in Japan to gain further traction in areas such as ESG integration,²⁷ ESG screening, engagement and shareholder proposals.^{28 29}

As a related topic, activism has risen in Japan, too. We are witnessing the trend of public engagement increasing

Figure 3: Growth of sustainable investing assets by region in local currency (asset values are expressed in billions), 2014-2018

	2014	2016	2018	Growth per period		Compound annual growth rate (CAGR) 2014-18
				Growth 2014-2016	Growth 2016-2018	
Europe	€9,885	€11,045	€12,306	12%	11%	6%
US	\$6,572	\$8,723	\$11,995	33%	38%	16%
Canada (in CAD)	\$1,011	\$1,505	\$2,132	49%	42%	21%
Australia/New Zealand (in AUD)	\$203	\$707	\$1,033	248%	46%	50%
Japan	¥840	¥57,056	¥231,952	6,692%	307%	308%

Source: Global Sustainable Investment Alliance, 2018 Review.

via shareholder proposals at AGMs. Although Japan’s activism has been primarily concentrated on governance issues as opposed to environmental, activists are showing an increased desire for board representation and are also willing to engage in proxy battles to achieve their objectives.

Our approach

The series of revisions to the codes has motivated Japanese corporate management to be more focused on profitability and capital efficiency than it has in the past. Consequently, the return on equity (ROE) of Japanese companies increased from the low single digit level in the 90s and 2000s to around the 8% level in 2019 (9.8% in 2018), narrowing the gap with European companies (9.8% in 2019).³⁰ Along with corporate governance reform, the agenda in our meetings with

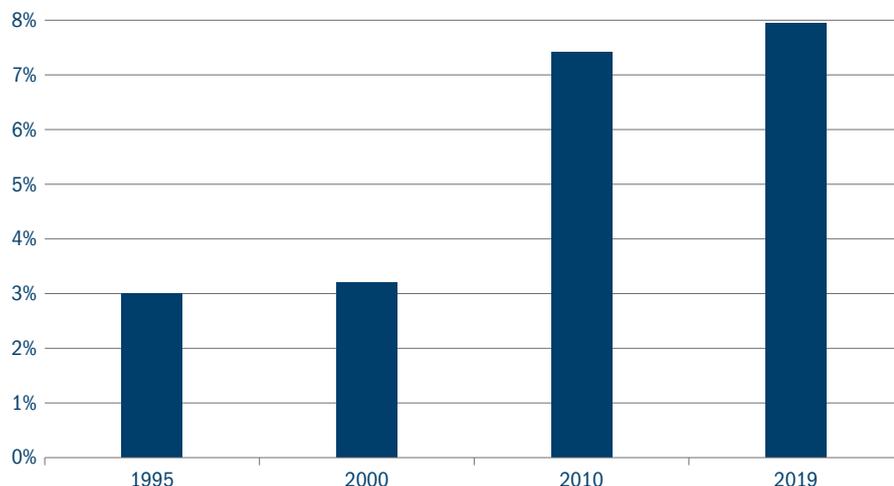
many Japanese senior management teams has changed noticeably, with a greater focus on long-term strategy including capital management policy, board structure and quantitative goals to demonstrate their commitment to environmental issues and outcomes.

Coupled with Columbia Threadneedle’s integration of ESG issues into our investment process, through the use of our proprietary RI tools, and through our research intensity, we think Japan is a market which increasingly has much to offer.

Source:

- 2 <https://www.unpri.org/pri/an-introduction-to-responsible-investment/what-are-the-principles-for-responsible-investment>
- 3 https://www.env.go.jp/policy/keiei_portal/kinyu/gensoku-en.html
- 4 280 institutional investors signed up as of March 2020. *The stewardship code was revised in March 2020, with the addition of items such as taking into account sustainability.*

Figure 4: Return on equity in the Japanese equity market



Source: Bloomberg as at 31 July 2020. Past performance is not a guarantee of future results.

- 5 As of July 2019, 21.3% of TSE1 constituents (457) were complying with all 78 principles in the code, 65.4% (1,404) were complying with at least 90%, and 13.4% (287) were complying with fewer than 90%.
- 6 <https://www.fsa.go.jp/en/refer/councils/stewardship/minutes/20170131.pdf>
- 7 <https://www.fsa.go.jp/en/refer/councils/stewardship/20170529.html>
- 8 <https://www.fsa.go.jp/en/refer/councils/stewardship/20200324.html>
- 9 <https://www.fsa.go.jp/en/news/2018/follow-up/20180330-1.html>
- 10 The structure that a publicly traded company owns stock in another publicly traded company to interlock business relationships and to protect itself from takeover actions.
- 11 <https://www.jpx.co.jp/english/equities/listing/cg/tvdivq0000008jb0-att/b5b4pj000002xyj7.pdf>
- 12 <http://www.gender.go.jp/policy/mieruka/company/yakuin.html>
- 13 http://www.gender.go.jp/english_contents/index.html
- 14 <https://www.jpx.co.jp/equities/improvements/study-group/nlsgeu000004acah-att/nlsgeu000004hgca.pdf>
- 15 https://japan.kantei.go.jp/98_abe/actions/201903/_00012.html
- 16 Shareholdings for the purpose of maintaining business relationships or take-over defense including cross-shareholdings.
- 17 https://www.jpx.co.jp/english/news/1020/b5b4pj000000jvxx-att/20180602_en.pdf
- 18 https://www.gpif.go.jp/en/investment/summary_report_of_the_4th_survey.pdf
- 19 <https://www.globalreporting.org/Pages/default.aspx>
- 20 <https://integratedreporting.org/resource/international-ir-framework/>
- 21 https://www.env.go.jp/policy/j-hiroba/kigyo/2018Guidelines_E20190412.pdf
- 22 https://www.gpif.go.jp/en/investment/summary_report_of_the_4th_survey.pdf
- 23 <https://www.fsb-tcfd.org/>
- 24 <https://www.fsb-tcfd.org/tcfd-supporters/>
- 25 http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf
- 26 https://www.gpif.go.jp/en/investment/190905_Esg_Report.pdf
- 27 The investment that systematically incorporates ESG (environmental, social, and corporate governance) factors into regular management processes (e.g., ESG evaluation, screening, and due diligence prior to investment, and monitoring and engagement after investment).
- 28 Communicating with corporations as a shareholder based on engagement policies. Or, exercising shareholder rights other than voting rights.
- 29 <http://japansif.com/2019survey-en.pdf>
- 30 MSCI Japan and MSCI Europe, data from Bloomberg, June 2020.



03 Country Head Focus – France



Eleonard Buono
Country Head

France: Responsible Investment spotlight

As governments introduce Covid-19 related economic recovery packages, they are subtly revealing their commitments to environmental, social and governance (ESG) initiatives. Nowhere is this truer than France, which is seeking to stimulate a green recovery. Along with Germany it has spearheaded the EU's agreed €750 billion recovery fund, of which a significant chunk has been reserved for climate-friendly measures.³¹

And in France specifically, support for sectors such as the car industry include money for electrification.³²

These initiatives crown an ambitious legislative agenda, designed to foster green growth and encourage investment in climate-friendly projects through the transformation of Paris into a leading global centre for sustainable finance.

At the One Planet Summit in France in 2017, French president, Emmanuel Macron, confirmed sustainable finance as a priority.³³ Further, in 2019 Robert Ophèle, chairman of the Autorité des Marchés Financiers, France's top financial regulator, urged Europe to speed up the introduction of common European standards on ESG to prevent so-called "greenwashing", whereby funds give a misleading impression of their green credentials.³⁴

Five years of encouraging responsible investment

France's emphasis on a green recovery builds on five years of supporting green growth, partly through pioneering responsible investment. Characteristically, the state has been actively encouraging the sector through a series of measures.

In 2015, for instance, it became the first country in the world to introduce mandatory climate change-related reporting for institutional investors.³⁵ This energy transition law, which came into effect at the beginning of 2016, required a wide range of investors, including fund managers, insurance companies and pension funds, to disclose how they integrate ESG factors into investment portfolios. They also had to measure the carbon footprint of their portfolios, a move which has been credited with diverting capital from carbon-intensive companies.³⁶

Also in 2016, two public fund labels were introduced: the first, a Socially Responsible Investment (SRI) label, is designed to promote investor awareness of sustainable funds; the second is called TEEC (Energy and Ecology Transition for the Climate) and is for green funds. In 2018 the TEEC was extended to real estate funds, while 2020 saw the French government unveil an SRI label for real estate funds. Both fund labels are awarded for three years and must be audited by a third party. At the end of September 2018, the SRI label had been awarded to 166 funds from 36 asset management firms with the TEEC label awarded to 22 funds from 15 asset managers.³⁷

Innovation in green finance

In the area of green finance, France has also made significant strides, becoming the first major global economy to launch a sovereign green bond in 2017. Since then, leading French companies including energy group Engie and state-owned public transport operator RATP have followed suit.

In 2019, France achieved another first with the issuance of the world's longest duration green bond to date, tapping into growing demand for longer duration bonds from pension funds and insurers. The money raised from the 100-year bond issued by railway operator SNCF was used to fund green projects.³⁸ That year France was the world's third biggest issuer of green bonds, behind the US and Germany, with issuance of just over \$16.1 billion.³⁹

Beyond the bond market, France was at the forefront of the then infant green loan market in 2017 when green electricity producer Quadran was granted the country's first green loan. That year also saw the launch of France's first green asset-backed security.⁴⁰

Signs of sustainability

France's long history in responsible investment and green finance is paying dividends in terms of greening the economy. Money raised from green bonds in France has been used to finance clean energy projects as well as transport and building projects. Nearly two-thirds of proceeds from green bonds were used to finance clean energy in 2016. The following year building projects became the most popular investment destination for money raised from green bonds.⁴¹

What's more, French companies rank as world leaders on ESG criteria, according to a study published in June 2020 by the Sustainable Finance Programme at the University of Oxford.⁴² French companies ranked first among 30 for their ESG scores.

The study also found that high ESG standards correlated with improved economic performance. According to the report, if Indonesia, which had the lowest ESG score of the countries surveyed, matched France's rating its per capita gross domestic product would be 15% higher.⁴³ This suggests France's green recovery package could foster a recovery that is sustainable in all senses of the word.

Source:

- 31 Will Covid-19 serve as a stimulus for the energy transition in France? *Crédit Agricole* <https://etudes-economiques.credit-agricole.com/en/Publication-EN/2020-juin/Will-Covid-19-serve-as-a-stimulus-for-the-energy-transition-in-France>
- 32 France and Germany lead EU countries in delivering green stimulus packages, *Green Car Congress*.
- 33 European SRI study, 2018, *Deloitte* <https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/sustainable-dev/lu-european-sri-study-2018.pdf>
- 34 EU 'urgently' needs common ESG rules, says French watchdog, *Financial Times* <https://www.ft.com/content/63e5a2d3-8ee2-40be-899b-5509b776a0c8>
- 35 ESG integration in Europe, the Middle East, and Africa: Markets, practices and data, *CFA Institute* <https://www.unpri.org/download?ac=6036>
- 36 Impact of ESG disclosures, *KPMG* <https://assets.kpmg/content/dam/kpmg/xx/pdf/2019/09/impact-of-esg-disclosures.pdf>
- 37 European SRI study, 2018, *Deloitte* <https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/sustainable-dev/lu-european-sri-study-2018.pdf>
- 38 SNCF Network launches 100-year Green bond, *International Railway Journal* <https://www.railjournal.com/financial/sncf-network-launches-100-year-green-bond/>
- 39 Green bonds set to gain strength in 2020 following bumper year, *Linklaters* <https://www.linklaters.com/en/about-us/news-and-deals/news/2020/january/green-bonds-set-to-gain-strength-in-2020-following-record-year>
- 40 France country briefing, *Climate Bonds* https://www.climatebonds.net/files/files/France_report_final_20_04_18.pdf
- 41 France country briefing, *Climate Bonds* https://www.climatebonds.net/files/files/France_report_final_20_04_18.pdf
- 42 The Effect of Firm-level ESG Practices on Macroeconomic Performance Xiaoyan Zhou, Ben Caldecott, Elizabeth Harnett, & Kim Schumacher, 3rd June 2020.
- 43 The Effect of Firm-level ESG Practices on Macroeconomic Performance, *University of Oxford* <https://www.smithschool.ox.ac.uk/publications/wpapers/workingpaper20-03.pdf>

04 Sovereign social bonds in a post-Covid-19 world



Benjamin Kelly

Senior Analyst,
Global Research



Simon Bond

Director of Responsible Investment,
Portfolio Management

The Covid-19 pandemic has brought about a multitude of changes to our lives. The disruption it has had on societies across the world is unparalleled in recent times, affecting everything from employment to our health, wellbeing and daily routines. But capital markets are responding to this crisis, and it is a comparatively unsung part that is taking centre stage.

When considering environmental, social and governance (ESG) investments, social attributes are often overlooked for the more salient environmental and

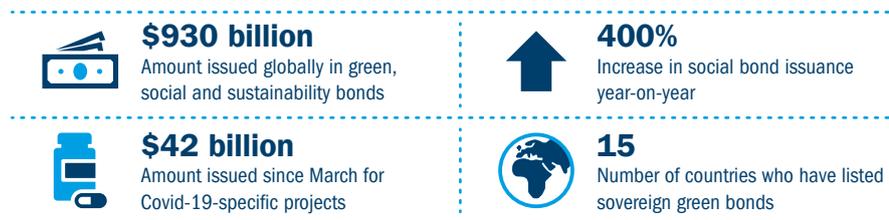
governance characteristics. Perhaps this is because assessing the “E” and the “G” aspects of a company is easier: we can measure carbon emissions from aircraft or board diversity relatively easily.

The “S” is a bit more challenging in that regard. So while coronavirus has reinforced the importance of ESG overall, it is social that is currently the fastest-growing part of sustainable finance, with the outbreak proving a catalyst for increased interest in social bond issuance.

Boom time for bonds

Bond markets have traditionally been a great barometer of investor interest in ESG-related activities through the issuance of green, social and sustainability bonds. These are defined as “specific use-of-proceeds” bonds, which means the financing is exclusively channelled to pre-identified projects where the outcome will be green, social or sustainable (a mixture of green and social).

Figure 5: Global bonds in numbers



Source: Bloomberg and Columbia Threadneedle Investments, 2 June 2020.

This area has grown rapidly in recent years, with the total amount of issuance exceeding \$900 billion.⁴⁴ So far in 2020 alone there has been \$141 billion issued, versus \$107 billion issued at the same time 12 months ago.⁴⁵ Within that, however, the Covid-19 outbreak has invigorated social bonds in particular as they allow borrowers to raise financing for projects aimed at alleviating the pandemic, such as health care and job preservation.

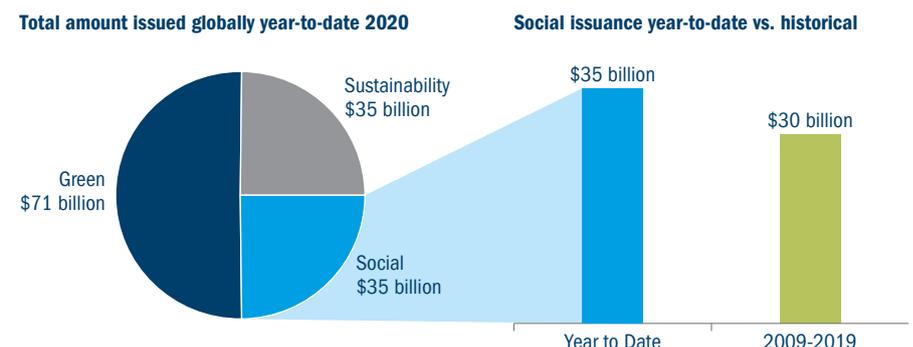
Since the International Capital Markets Association introduced the social bond principles back in 2017, social bonds have steadily gained traction – prior to the pandemic there had been more than \$50 billion issued. However, they were outweighed by green bonds and represented only about 7% of “specific use-of-proceeds” issuance.⁴⁶ What the coronavirus crisis has done is push people to widen their scope to also include social and sustainability bonds.

So while we have seen a 13% decrease in green bond issuance versus the same time last year – \$82 billion in 2019 versus \$71 billion in 2020 year-to-date – we have seen a 400% increase in labelled social bonds versus the same time last year – \$7 billion in 2019 versus \$35 billion in 2020 year-to-date (Figure 6). In addition, there has been \$42 billion in dedicated Covid-19-related issues using social or sustainability bonds.⁴⁷

During this increased period of activity there have been some standout examples: from 2017-2019 International Finance Corporation (IFC) raised \$1.46 billion across 28 social bonds, but in March this year sold \$1 billion in a single issue.⁴⁸ In May, meanwhile, France’s National Professional Union for Employment in Industry and Trade, Unédic, issued its inaugural social bond worth €4 billion, which was the largest social bond ever issued worldwide for any type of issuer. Then in June the agency issued a second social bond, attaining another €4 billion.

There has also been Covid-19-specific issuance from the financial community: Banco Bilbao Vizcaya Argentaria (BBVA), Bank of America, and Kookmin Bank in South Korea have all issued social

Figure 6: Global social bond issuance



Source: Columbia Threadneedle Investments and Bloomberg, as at 2 June 2020.

bonds whereby the use of proceeds have been directed towards social projects which aim to mitigate the impacts of the virus.

So, we've seen unprecedented numbers over the year-to-date. Will this trend persist? We think it is likely, even as we move through and out of the pandemic. On the question of whether social will ultimately eclipse green bonds, however, we are less sure.

Post-virus prospects

Psychologically, investors are typically monothematic – we can only concentrate on one big idea at a time. As social has temporarily stolen the limelight as investors focus on the Covid-19 crisis, we expect social bond issuance to blossom in the short run.

But the coronavirus has also exposed the fragility of the ecosystem and the urgency to reduce emissions. As crises traditionally increase the absorption of trends which were present beforehand, we believe climate change will be a great example of this, and recent policy signals from governments around the

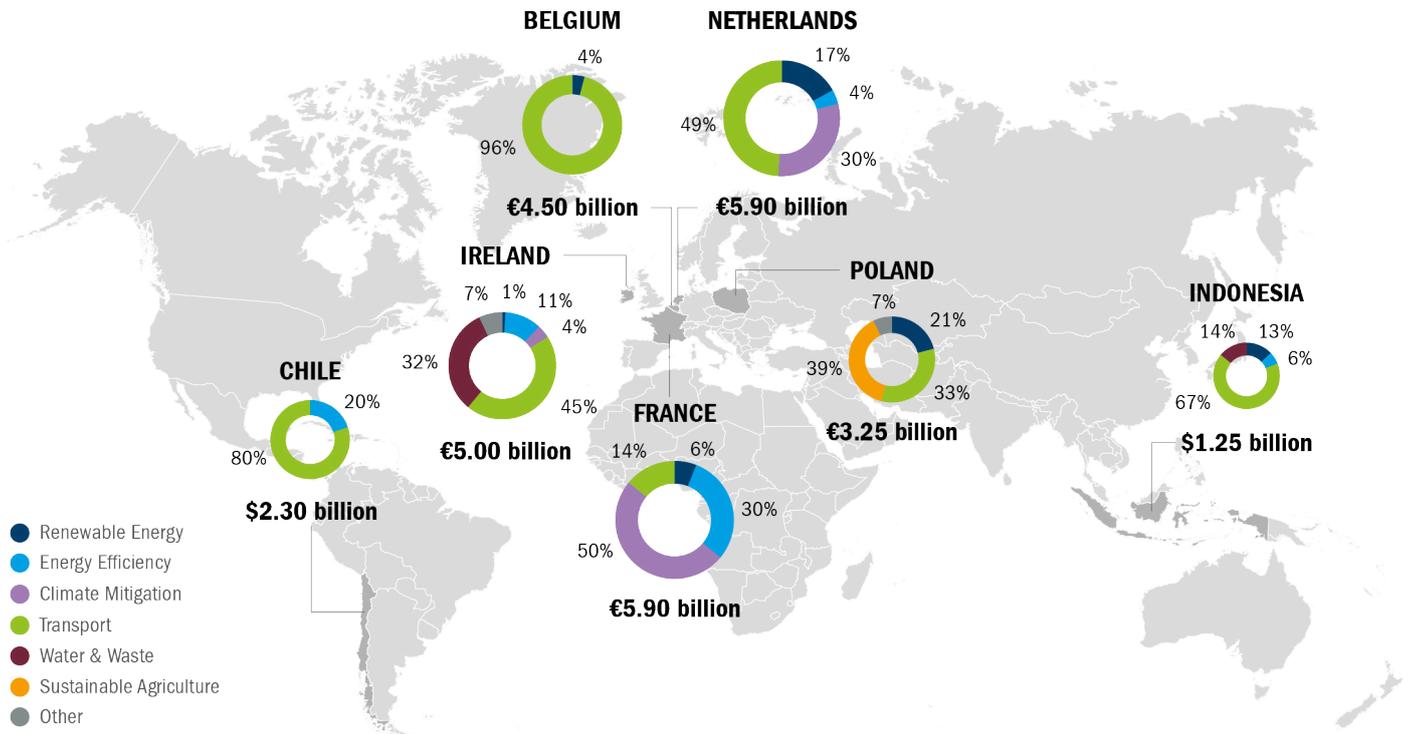
world suggest as much. With the EU already having increased its emissions reduction target for 2030 from a fall of 40% (versus 1990 levels) to 50%, it has put tackling climate change at the heart of its economic recovery. Its announcement of a €1.85 trillion European Recovery Plan to aid a post-Covid world includes at least €200 million for specific climate investment. Elsewhere around the globe a long-term structural shift towards climate change alleviation remains. So, although social will remain prominent in people's minds in a post-Covid-19 world, climate change is likely to resume its role as the key ESG theme.

The Covid-19 pandemic is also expected to further reinforce the importance of ESG considerations in corporate behaviour and investment decisions, and the sector has "passed a test" through the crisis: ESG-focused strategies scored positively on flows and investment performance through the crisis, with ESG fund flows year-to-date up 3% versus broadly flat flows for non-ESG funds.

This demand is certainly an opportunity for governments to follow supranationals and issue sovereign bonds in response to this crisis. This is not a new idea: a number of countries have done so in the past three years, including the Netherlands, France, Ireland and Belgium, all of which were green bonds focusing on renewable energy, energy efficiency and green transport (see Figure 7), and over the next six months it is expected that Sweden, Germany and Spain will follow suit. Mexico, meanwhile, is poised to release a United Nations Sustainable Development Goal (SDG) a bond aligned to the UN Sustainable Development Goals.

Despite UK investors consistently being one of the largest purchasers of such bonds – for example, with the recent Council of Europe Social Bond they represented 14% of purchasers, behind only France and Asia⁴⁹ – the UK government has yet to issue a gilt of this nature. We continue to campaign for this.

Figure 7: Global new sovereign social issues



Source: Dutch State treasury Agency, May 2020/Ministry of Economy and Finance (France), 2017/Irish Sovereign Green Bond Allocation Report, 2018/Federal Public Service Health, Food Chain Safety and Environment, Belgium, 2018/Ministry of Finance Poland, 2017/Republic of Indonesia Ministry of Finance, 2019/International Finance Corporation, 2017.

So Covid-19 has heralded unprecedented times, which should ultimately be a positive for “specific use-of-proceeds” issuance across the board, and in the future we expect greater interest from governments, corporates and investors around social, with 2020 likely being a record year for issuance. Although this will not

supersede green bond issuance in the long term, from here-on “S” will likely be viewed as equal to “E” and “G” over the coming years.

- Source:**
- 44 Bloomberg and Columbia Threadneedle Investments, June 2020.
 - 45 Columbia Threadneedle Investments, as at 2 June 2020.
 - 46 Bloomberg, June 2020.
 - 47 Columbia Threadneedle Investments, as at 2 June 2020.
 - 48 https://www.ifc.org/wps/wcm/connect/2be3dc0e-ec8e-40ce-8f71-3d8cafe25a59/2_IFC_Factsheet_SocialBond_02122019.pdf?MOD=AJPERES&CVID=mXsodH5
 - 49 CEB, CEB issues social inclusion bond in response to Covid-19 Pandemic, 8 April 2020.



05 Responsible investment adds to research intensity



Roger Wilkinson

Head of Equity and RI Research, EMEA

At Columbia Threadneedle Investments we believe in Research Intensity, combining views from all parts of the firm to increase our research insights. We achieve this through close collaboration between our equities, credit and data science teams, as well as regional fund managers and our Responsible Investment (RI) team. Greater research insight means we are better informed and helps us deliver better investment outcomes for our clients (Figure 8).

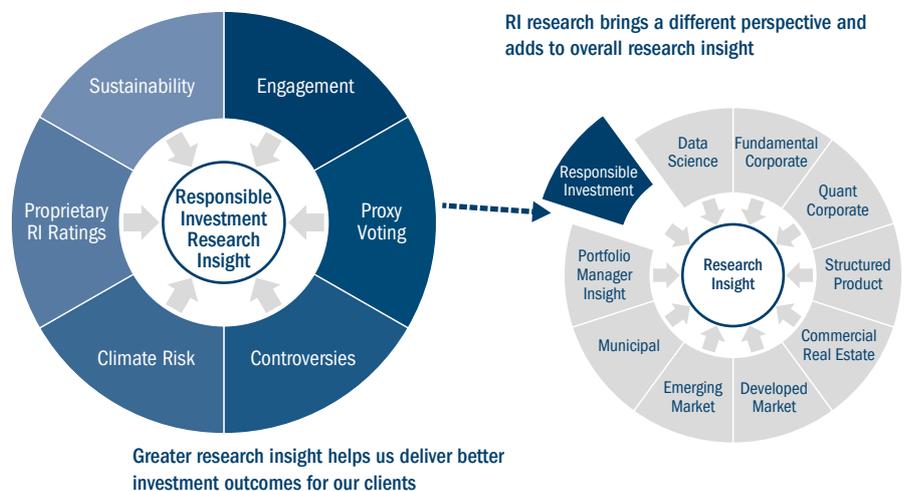
We believe RI research brings a different perspective and is therefore an important addition to the overall research insight for all our strategies, not just specialist RI strategies.

The importance of RI as a research input

Customer behaviour and buying habits are increasingly influenced by environmental, social and governance (ESG) factors and interest in mitigating the environmental impacts of the products and services consumed seems to have increased particularly through the coronavirus pandemic

which has served to highlight the fragility of the ecosystem in which we exist. We are also seeing a growing influence of the “S” in ESG, with social aspects gaining higher attention. Recent examples include top brands suspending social media advertising spending on Facebook in protest of its perceived poor controls over hate messaging; while media allegations of worker exploitation at suppliers to UK retailer Boohoo.com led to customer boycotts and suspensions of the brand by other retail platforms such as Next, Zalando and Asos, highlighting that social aspects can have very real financial implications for companies in terms of loss of sales.⁵⁰

Figure 8: Research insight process



Source: Columbia Threadneedle Investments, August 2020.

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Additionally we are seeing significant flows towards RI-aware investment processes, clearly demonstrating the increasing importance of related factors in investment decision making and a reflection of the evolving desires of asset owners. ESG-focused strategies have come through the stress tests posed by Covid-19, scoring positively on flows and investment performance, with ESG fund flows year-to-date up 3% versus broadly flat flows for non-ESG funds.⁵¹

Businesses, too, are responding with more and more setting their own ESG targets. BP, Shell and Total announced in quick succession that they intend to be net zero businesses by 2050. While important caveats remain, this has arguably created competition within the industry on future emissions reduction and energy transition plans. A growing number of companies are taking it one step further and incorporating ESG targets within their long-term incentive performance pay, with Vodafone one such example. However, even companies without their own targets are being impacted as many are part of a supply chain and so impact the targets of other companies. This will

be a bigger issue going forward with the impact they have on their customers' targets being a decision factor in whether or not they win a contract.

Government policy, regulation and tax are ever more linked to environmental goals. There was some question over whether a Covid-induced recession would mute policy focus on environmental goals, but we have actually seen an acceleration of existing trends, albeit divergence in efforts across regions still persists. In the EU tackling climate change is at the heart of the economic recovery, while in China the response is mixed and in the US it is more divergent between state and federal level. However, if we were to see a new US president voted in later this year then things could change dramatically, as Joe Biden's policies are much more environmentally focused. Whatever happens at the polls though, going forward we believe, that taxes related to greenhouse gas emissions are only going to increase, as this both raises money and is popular with voters. Again this highlights a real and increasing cost to companies that we must try to forecast.

RI integration and the importance of specialisms within the research team

While many investment houses are trying to integrate RI into their investment process, few if any have fully succeeded due to the challenges this poses. At the core of the problem is that, historically, RI specialists were generally not trained as investors, while investors themselves do not typically have an RI background. We believe asset managers need to focus prominently on collaboration, making sure RI research is investment focused.

Collaboration has always been one of the core values at Columbia Threadneedle so we start from a strong foundation. Additionally, we identified three core specialisms: RI research, RI policy and RI stewardship. The entire team sits within our Research division with RI researchers embedded in the central research team (their focus being on conventional investment analysis). This ensures the RI research output is investment focused and further promotes collaboration and integration.

Finally, we organised our specialism by cross-sector themes based on the UN Sustainable Development Goals (SDGs). These goals are well established and have become the benchmarks used for setting and

measuring policy in many countries, and have also been widely adopted by corporates for reporting and goal setting. It therefore made sense for us to align our research focus where possible with them. However, the

SDGs were originally set with the purpose of addressing global challenges, not with an investible outcome in mind. We therefore investigated the 17 goals and identified eight of these as underpins for broader but closely related sustainable themes that could have an investible outcome (Figure 9). These then became the basis for our sustainable thematic research proposition and the specialisms our researchers have adopted. In this way our thematic research is by definition investment relevant for all strategies and, through alignment to the UN SDGs, provides solutions for our specialised RI strategies that align with sustainability themes which we believe will shape the future economy.

We believe this approach, and our established culture of collaboration and focus on research intensity, will in turn lead to better investment outcomes for our clients.

Figure 9: Columbia Threadneedle sustainability themes



Source: Columbia Threadneedle Investments, August 2020.

Source:

- 50 Metro newspaper, July 2020. <https://metro.co.uk/2020/07/07/asos-next-zalando-drop-boohoo-amid-modern-slavery-allegations-12958913/>
- 51 JP Morgan, "ESG adoption continues, with flows and performance resilient amid COVID-19", 30 June 2020.

STEWARDSHIP IN ACTION

Columbia Threadneedle Investments views an integrated, joined-up approach to stewardship as an integral part of its responsible approach to investment. We vote actively at company meetings, applying our principles on a pragmatic basis. We view this as one of the most effective ways of signalling approval (or otherwise) of a company's governance, management, board and strategy. We classify a dissenting vote as being where a vote is cast against (or where we abstain/withhold from voting) a management tabled proposal, or where we support a shareholder-tabled proposal not endorsed by management. While analysing meeting agendas and making voting decisions, we use a range of research sources and consider various ESG issues, including companies' risk management practices and evidence of any controversies.

Our final vote decisions take account of, but are not determinatively informed by, research issued by proxy advisory organisations such as ISS, IVIS and Glass Lewis as well as MSCI ESG Research. Proxy voting is effected via ISS. Although we subscribe to proxy advisors' research, votes are determined under our own custom voting policy which is regularly updated. The RI team assesses the application of the policy and makes final voting decisions in collaboration with the firm's portfolio managers and analysts. Votes are cast identically across all mandates for which we have voting authority. All our voting decisions are available for inspection on our website seven days after each company meeting.

In prioritising our engagement work, we focus our efforts on the more material or contentious issues and the issuers in which we have large holdings – based on either monetary value or the percentage of outstanding shares. There are

many companies with which we have ongoing engagements, as well as a number that we speak to on a more ad hoc basis, as concerns or issues arise. We actively participate in several investor networks, which complement our approach to engagement. Along with other investors, we raise market and issuer-specific environmental, social and governance issues, share insights and best practice. We do not make use of third party engagement services.

The significant impact of Covid-19 on companies' ability to operate continues to be a main topic of engagement. Our approach to active stewardship remains unchanged: we continue to engage with companies to better understand their management of financial and non-financial risks and how they generate sustainable long-term returns. Companies' response to and management of Covid-19 will be a core part of this analysis going forward.

06 Voting Q2

Between April and June 2020 we voted at 3,886 meetings across 57 global markets. This compares to 578 meetings across 45 global markets in the first quarter.

Of the 3,886 meetings, 3,554 were annual general meetings, 179 were combined annual/special, 142 were special, four were court, four were proxy contests, two were written consents and one a debenture meeting. We cast at least one dissenting vote in 1,913 meetings (50%).

Figure 10: Meetings voted by region

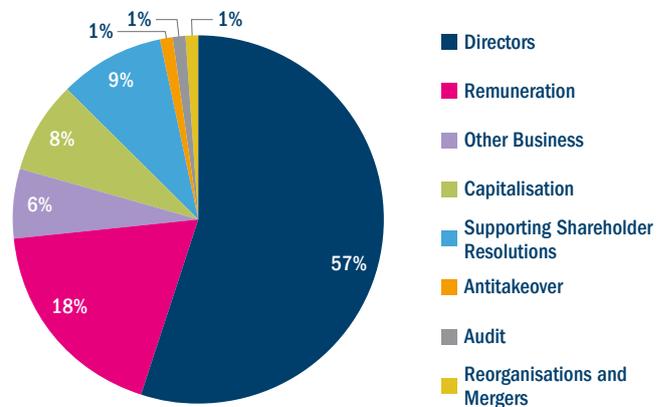


Source: Columbia Threadneedle Investments, ISS ProxyExchange, 30 June 2020.

We voted in 57 separate markets in the second quarter. Most meetings were voted in the US (2,145), followed by Japan (408), the UK (165) and France (92).

The majority of the voting items that we did not support throughout the quarter related to directors, followed by remuneration and non-salary compensation-related proposals.

Figure 11: Proportion of dissenting votes per category



Source: Columbia Threadneedle Investments, ISS ProxyExchange, 30 June 2020.

07 Engagement Highlights

Between April and June, we engaged with the 58 issuers listed below, some on multiple occasions.

Environmental, social and governance discussions

Air Liquide, Amazon.com Inc., Argo Group International Holdings Ltd, AT&T Inc., Barco NV, Baxter International Inc., Bluebird Bio Inc., Chevron Corp., Dassault Systemes SA, Mack-Cali Realty Corporation, Mondelez International Inc., PepsiCo Inc., Takeaway.com NV, Total SA, Valero Energy

Specific social focus

Pernod Ricard, Moncler, Royal Mail plc, Teleperformance, Vale SA

Specific environmental focus

ArcelorMittal, Coca-Cola European Partners, DS Smith, Essity, Ferrari, Moncler, Pernod Ricard, Total SA, Vale SA

Specific governance focus

Advanced Micro Devices Inc., AIA Group Limited, Alexion Pharmaceuticals Inc., Alexion Pharmaceutical, Inc. (DISSIDENT), Amundi SA, Applus SA, AVEVA Group Plc, AXA SA, Belimo Holding AG, BT Group plc, Burberry plc, Collaborative – JDW, CompuGroup Medical SE, DiaSorin SpA, easyJet plc, EBAY, Inc., Exxon Mobil Corp, Fidelity National Information Services Inc., Huhtamaki Oyj, ITV plc, Kingspan, Knorr Bremse, M&G plc, Marks & Spencer plc, Morrison (WM.) Supermarkets plc, Qualcomm Inc, Rentokil Initial plc, Royal Mail plc, SAP SE, SSP Group plc, Stillfront Group AB, Ted Baker plc, Teleperformance, Tesco plc, Wetherspoon (J.D.) plc

Case studies

The following case studies describe ESG-focused engagement led by members of the RI team.

Amazon.com Inc, USA, Consumer

Employee welfare

- We met with Amazon.com management to assess the company's response to the Covid-19 pandemic, with a focus on employee welfare.
- With nearly a million employees in hundreds of locations around the globe Amazon's task to protect workers is significant, and it has been criticised. The company also serves as a critical cog in the global economy, a role made especially acute by pandemic-driven shifts to ecommerce. The bar is high given the CEO's recent shareholder letter setting sustainability as a business priority.
- During Q2 the company announced \$4 billion in investments for pandemic response, including personal protection equipment, thermal temperature scanners and 175,000 additional workers. Our engagement assessed warehouse and store practices and determined that they were better than prevailing media stories portrayed.
- Amazon was among the first employers to take on-premise temperature scans, provide mandatory masks and set protocols for managing infections. The company also employed its analytical focus to develop sophisticated contact tracing and employee communications tools. While infections still occurred, the company reported infection rates were consistent with their local communities and, in many cases, were lower. We encouraged the company to disclose aggregated infection figures, and agreed to follow up on engagement. While much work remains, the company demonstrated a solid approach and commitment to employee welfare and risk management.

Baxter International Inc, USA, Healthcare

Corporate governance

- We met with the Lead Independent Director and the Audit Committee Chair of Baxter International ahead of its AGM to assess risks presented by recent events. The company is in the early stages of rebounding from prior production and quality issues and is presently under an SEC accounting investigation related to the booking of income from foreign exchange gains.
- The company has concluded its own internal investigation and undertaken remediation steps, as well as clawed back CEO and CFO incentive compensation related to earnings restatements.
- We decided to cast dissenting votes against the directors in view of the accounting failures and also supported two shareholder proposals, one of which sought to separate the combined Chair/CEO dual role. The latter proposal, we believe, will help establish more independent board oversight during a critical time in the company's history. We note that the proposal received majority support from investors.

Valero Energy Corporation, USA, Energy

Sustainability disclosures

- The company operates in a sector maligned for its involvement in carbon, but is among the more progressive of the oil refiners in its approach to emissions reduction and energy transition. We engaged to better understand the current state of the company's sustainability efforts and to encourage enhanced disclosures to improve its profile. We believe the company and marketplace underestimates these strengths.
- The company is the largest renewable fuels producer in North America, and no other company exceeds its capital expenditures on renewable diesel.
- Its Port Arthur refinery has a large-scale carbon capture and storage (CCS) operation – 1 million tons of carbon dioxide per year – which is the only refinery with this well-developed technology. Its reclamation and recycling efforts enable it to be the lowest cost refiner.
- We encouraged the use of the disclosure frameworks advanced by TCFD and the Sustainability Accounting Standards Board, and encouraged a restart to reporting to CDP (formerly the Carbon Disclosure Project) which the company has shunned for several years. The company has committed to publishing a SASB-focused report in late 2020, and intends to enhance its TCFD reporting and to build the aforementioned strengths into investor calls so the market better understands where the company falls on the risk/opportunity spectrum.

Air Liquide, France, Materials

Environmental

- The company produces and distributes gases for industry and healthcare applications. We wanted to learn more about the company's plans around hydrogen, which can play a key role in a future net zero carbon economy, so we met the CEO and members of the sustainability team at separate meetings during the quarter.
- Hydrogen is a big focus, but currently a small proportion of sales. The company is positioning itself as an enabling player in energy transition via the production and distribution of hydrogen. The opportunities are significant. The Hydrogen Council estimates that by 2050 a hydrogen economy could be developed – saving 2.5 trillion tonnes of emissions. The potential addressable market is large.
- The company aligns with our theme of Energy and Climate Transition, and contributes to themes on Sustainable Resource Management & Transformation, and Regeneration, by enabling greener industrial production, transport and heating for buildings. There is ongoing internal research, and this will be discussed at our September Investment Themes meeting.

Kingspan, Ireland, Industrials

Governance

- Although a sector leader in terms of ESG and sustainability practices, over the past few years we have held regular meetings with board directors and management and have used voting action as a signal to emphasise our concerns relating to board composition.
- During the quarter, we were pleased to note that the focus on corporate governance continues and that succession planning remains robust. At the annual general meeting, we therefore voted in support of relevant items.

Teleperformance, France, Industrials

Employee welfare

- Teleperformance is a French outsourcing company, running call centres, back-office services and providing digital services for many multinational companies. There have been negative press articles on working conditions for employees affected by Covid-19. We held a teleconference with the CFO and General Counsel.
- The company has been providing support across all of its locations, with 92% of employees covered by sick pay. The firm has also purchased 6.3 million face masks.
- We gained comfort from our improved understanding of the firm's approach but see an increased reputational risk due to the scale of the company. We also encouraged the company to undertake a more proactive communications strategy while we continue to monitor our investment.

ITV, UK, Communication Services

Board remuneration

- We frequently engage with ITV on various topics, including ESG and corporate governance, and have been an active participant in the company's remuneration consultation. During the quarter, the company held its AGM.
- Our assessment of companies' executive pay practices focuses on quantum, strength of variable pay metrics, the link between pay and performance, and alignment with shareholders. We encouraged ITV to keep a total shareholder return element in its long-term variable pay to strengthen this alignment. The company did this, and we voted in support of all items at the general meeting.

To find out more visit
COLUMBIATHREADNEEDLE.COM

EMEA.Stewardship@columbiathreadneedle.com

US.Stewardship@columbiathreadneedle.com

RI.Thematic@columbiathreadneedle.com



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