UN GLOBAL COMPACT COMMUNICATION ON PROGRESS

1. **Introduction**: Global Evolution is a signatory of the United Nations Global Compact, a strategic policy initiative for businesses committed to aligning their operations and strategies with ten principles in the areas of Human Rights, Labor, Environment and Anti-Corruption. The sections below substantiate our:

   continued support over several years now to the UN Global Compact;
   - *the practical actions to implement the Global Compact principles;*
   - *our measurements of outcomes;*
   - *as well as how we are communicating and engaging with stakeholders on progress.*

   Global Evolution has a strategic commitment to impact investment and ESG sustainability as an integrated part of our approach to investment. In terms of our ESG integration approach, we have incorporated ESG dynamics across our investment process through various proprietary quantitative econometric models.

   For the full universe of emerging and frontier market countries, we construct proprietary ESG ratings, ESG-adjusted credit ratings, as well as statistical valuation signals for sovereign credit spreads and currencies based on ESG dynamics.

   In all modesty, we consider ourselves as being at the forefront of ESG sovereign research and ESG sovereign investment integration. We continue to play an active role in the public domain through our ESG research agenda and our close collaboration with the World Bank, the UN, and other relevant stakeholders.

2. **Continued support to UN Global Compact**: Global Evolution is pleased to reaffirm our continued support for the UN Global Compact, and we hereby renew our ongoing commitment to the initiative and its ten principles in the areas of Human Rights, Labor, Environment, and Anti-Corruption.

3. **ESG rationale**
   Financing the debt that provides macroeconomic sustainability and is spent promoting productivity and raising infrastructure, such as electricity production, health, water, security, transport, and school systems, has a significant impact on reducing poverty levels.

   A strong, integrated, and active ESG approach has become a prerequisite for investment managers to operate in today's market, but certainly also an important selection criteria for many institutional investors. At Global Evolution, we have conducted extensive and ground-breaking research into the relationship between sovereign debt investing and Environmental, Social, and Governance (ESG) indicators.

There is a clear correlation between the sovereign funding costs and ESG dynamics, with governance and human capital accumulation (under the "S" in ESG), unsurprisingly, the most prevalent. Consequently, by not integrating ESG dynamics into investment decisions, investors would sacrifice essential information. At Global Evolution we therefore recognize the importance of Environmental, Social and Governance (ESG) considerations for investors and advisors globally and continue to help our investors achieve their individual ESG goals.

Global Evolution is an active signatory of UN Principles for Responsible Investment and UN Global Compact and continuously publishes research on the relevant subjects of ESG dynamics and investment process integration. In 2018, Global Evolution chaired the UNPRI Advisory Committee on Credit Ratings (ACCR) which actively takes ESG factors into account.

4. **Practical Actions to Implement the UN Global Compact Principles**: Global Evolution has a strategic commitment to SRI and ESG Sustainability as an integrated part of our approach to investment. Practical actions and concrete processes over the last year to address ESG sustainability in our investment management approach include the following:

   a. **Top ESG Rating assigned to our firm**: In 2018, in their annual rating of asset managers for how well they integrate ESG, UNPRI awarded Global Evolution a score of 30 out of 30 points, and consequently the highest of their ratings. Despite this positive feedback, we continue to consistently look for ways to improve our ESG integration into the investment process. We were awarded an A+ by the UNPRI. Global Evolution earned the highest possible rating with a score of 30 out of 30 points across 10 indicators for the firm's ESG integration strategy and governance. Signatories are scored for each UN PRI principle and the scores are measured against those of other investment managers that have signed the UN PRI.

   b. **Influencing**
   Through the engagement in the EM Investor's Alliance (https://www.eminvestorsalliance.org) we aim to influence the integration ESG in emerging market debt investing. Emerging Markets Investors Alliance is a 501(c)(3) not-for-profit organization that enables institutional emerging market investors to support good governance, promote sustainable development, and improve investment performance in the governments and companies in which they invest. The Alliance seeks to raise awareness and advocate for these issues through collaboration among investors, companies or governments, and public policy experts.

   Beginning in 2010, the groundwork was laid for the Alliance through the organization of several informal educational events for investors on emerging market governance issues. The Alliance was formally incorporated in 2015 and holds educational events for investors on topics relating to transparency and anti-corruption, the environment, and corporate governance. The Alliance also produces educational materials on these issues and empowers investors to become effective advocates for good governance.

Only a few international institutions have the power to influence public sector governance in emerging markets. These include international financial institutions such as the World Bank, select non-governmental organizations such as Transparency International, and other governments. The Alliance empowers investors to stand alongside these institutions as leading advocates for good governance.

c. Engagement on the ground

Furthermore, through 25-30 country missions annually, we conduct extensive on-the-ground dialogue with policy makers discussing strategies to optimize their funding strategies to promote swift and sustainable economic development. This is partly related to our "direct engagement" with policy makers in the countries in which we invest. We furthermore participated in the World Bank/IMF Spring Meetings in April 2018 with several members of our investment team. This is partly related to our "indirect engagement" with policy makers in the countries in which we invest.

d. **ESG dissemination and conference participation**: Ole Jorgensen, Research Director, speaks at a number of conferences regarding integrating ESG into the investment process. Notably, in Hong Kong Ole spoke at the Financial Times conference on sustainability, and he spoke at several other international conferences (internal and external) with institutional clients mainly in Europe.

e. UNPRI Advisory Committee on Credit Ratings Report: Global Evolution co-authored a report by the UNPRI ACCR in 2018. As Chairman of the Board at the UNPRI ACCR committee, Ole Jorgensen, Global Evolution Research Director, coauthored the report *ESG, CREDIT RISK AND RATINGS (PART 2: EXPLORING THE DISCONNECTS).* The PRI ESG in Credit Ratings Initiative is facilitating system-level change. The first of its kind at this scale, credit practitioners from investors and credit rating agencies (CRAs) are uniting to discuss environmental, social and governance (ESG) topics.

Following the 2017 publication of Shifting perceptions: ESG, credit risk and ratings – part 1: the state of play, the PRI organized a series of roundtables, the findings of which form the basis of this report. Although ESG factors are not new to credit risk analysis, the extent to which they are explicitly and systematically considered by fixed income (FI) investors is. They are also of increasing interest to policy makers amid growing realization that ESG issues, such as climate change, can represent systemic risks to financial markets.

Ongoing dialogue is beginning to address misconceptions, including the difference between assessing the impact of ESG factors on credit risk and evaluating a bond issuer's ESG exposure, or versus rules-based investing (such as exclusion). It is also highlighting the progress that CRAs – particularly the bigger players – are making through research and organizational changes, as well as transparency-related efforts and more explicit reference to ESG factors when these contribute to rating actions.

Finally, it is drawing attention to new CRAs – some of which are not regulated yet – that provide dedicated ESG risk assessments or augmented analyses of creditworthiness.

Roundtable attendees generally agreed that, although considering ESG factors in FI assets is primarily a tool to manage downside risks, it is also becoming more valuable to enhance returns or for relative value investment strategies, as well as to highlight the importance of bondholder engagement. Commercial pressures from rising client demand are also mounting.

The roundtables were structured around the four investor-CRA disconnects identified in part one of the report series; but the discussions revealed that, more than just disconnects, these are common challenges that credit practitioners on both sides are encountering as they try to make ESG consideration more prominent or rigorous. Below are some highlights:

Materiality of ESG factors to credit risk

While an assessment of governance factors has traditionally featured in credit risk analysis, both sides concur that they are in the early phase of formalizing a systematic approach to considering environmental and social factors. Assessing where these are relevant and how they can impact balance sheets and cash flow projections needs more work. Participants discussed the value of using them as early indicators such as through exposing inadequate management oversight and potentially anticipating deteriorating credit conditions – even before traditional financial metrics worsen.

The materiality of ESG issues from a credit risk perspective depends on many factors, such as the financial profile of an entity, its sector and geographical location, as well as the type and characteristics of a bond. Moreover, on the environmental front, the importance of differentiating between physical and transition risks (including policy developments) was highlighted.

Relevant time horizons to consider

There is no silver bullet to identify the right time horizon over which to assess ESG factors in credit risk analysis. However, participants considered the benefits of gathering insight about future environmental and social policies to better evaluate the quality of governance, as well as the sustainability of business models.

Due to the multi-dimensional nature of ESG factors, difficulties in modelling non-financial factors and capturing data interdependencies were cited among the biggest obstacles to ESG consideration in credit risk analysis. Specifically, the interplay between the following was flagged: 1) the long-term structural trends that tend to influence ESG risks; 2) the probability that ESG-related incidents will materialize and when; 3) the risk of these incidents reoccurring, and 4) their impact on an issuer's credit fundamentals and its ability to adjust its business model by buying or selling companies and introducing or reacting to disruptive technology.

Organizational approaches to ESG

Expertise and resources are improving among both investors and CRAs, particularly where there is senior management buy-in. The level of CRA participation and backing of the roundtables is a testament to this. However, building a formal framework to ensure that credit analysts systematically consider ESG factors is still a work in progress. Different approaches that could be taken were considered, including developing skills in-house, insourcing external expertise or outsourcing on an ad-hoc basis.

Overcoming internal inertia is another obstacle. While some investors and CRAs are making headway, for other market players breaking down barriers, addressing siloed work practices and securing internal buy-in is challenging. Another hurdle is how to incentivize and reward analysts that are the best at unlocking ESG value because it can take decades for corporate strategies to produce tangible results, or for blow-up events to materialize.

Communication and transparency

Communication and transparency specifically on ESG topics has been limited until recently, partly due to a lack of meaningful outreach or engagement, which is now improving. Gaps exist at different levels of the investment chain – not only between investors and CRAs but between asset owners (AOs) and asset managers (AMs) and, ultimately, bond issuers. Few participants were aware that some CRAs are making ESG factors more transparent in their methodologies and research, and of the rating changes which have occurred as a result.

Several options on how to improve CRA communication were discussed, including how they present ratings and signal long-term risks. Ideas ranged from a separate ESG section within credit opinions to sectoral and scenario analysis. The benefits and drawbacks of a built-in approach, which is integrated but more challenging to demonstrate, were considered versus an add-on approach. Attendees reflected on their role in enhancing issuer ESG data disclosure.

Observations from the roundtables are complemented by examples from CRA credit rating opinions or recent research and eight investor case studies demonstrating how ESG factors can affect the assessment of creditworthiness. A section of the report is on the automotive sector – the focus of the Frankfurt roundtable – as this industry lends itself as a good example of the interplay between ESG factors in corporate credit risk. Finally, the report is corroborated by the results of a survey that participants were asked to take before attending the roundtables.

The forums focused on ESG factors in corporate credit risks but began considering asset classes, touching on some of the differences between corporate and sovereign credit risk. Part three in the series will report on these as well as explore the solutions that started to emerge to address the challenges faced by credit practitioners. Following the release of the report, our Research Director, Ole

Jorgensen, stepped down after a number of years as Chairman of the ARRC Committee to focus on other initiatives.

5. **Measurement of Outcomes**: Our ambition includes the development and incorporation into our investment process of proprietary ESG models, as well as instigating a complementary ESG Research Program to inform the investment process and ensure that best practices from investment cases will be extracted for ongoing screening and research purposes. These qualitative targets have successfully been met within the timeframe we had defined in the context of our ESG Research Program which continuously incorporates lessons from market trends and developments. Our proprietary Valuation and Rating Framework (VRF) which incorporates ESG dynamics is interdependently linked to the ESG Research Program to continuously enhance the screening and investment process. The models and its output for investment decisions are proprietary in nature.

   Furthermore, in terms of our research on the causality between sovereign bond yields and ESG ratings, countries with higher ESG ratings perform dynamically better in terms of return on investment. This testifies to the important issue that funds incorporating ESG analysis in their investment decision making are likely to outperform traditional funds over time.

6. **Communicating and engaging with our stakeholders**: Our corporate communication is both internal to employees and board members as well as external to stakeholders such as clients and affiliated consultants as well as the media and other stakeholders. With our continued growth, we are increasingly aware of the role we play in the markets, economies and societies in which we practice. Our engagement with stakeholders on the ten principles and our proprietary approach to ESG modeling and country investment selection is consequently essential to our business operations. In client meetings, we consistently stress the significance of our dedication to the Global Compact principles reflected in our choice of ESG factors in our proprietary modeling. In addition, we experience that the interaction with our clients is also cross-directional since clients increasingly display this focus and seek discussions on these important issues. Consequently, our ESG deliberations and careful analysis as part of the investment processes will play a central role in our screening and portfolio allocations going forward.

Yours sincerely,

Ole Jorgensen
Research Director, Global Evolution

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