Shropshire County Council

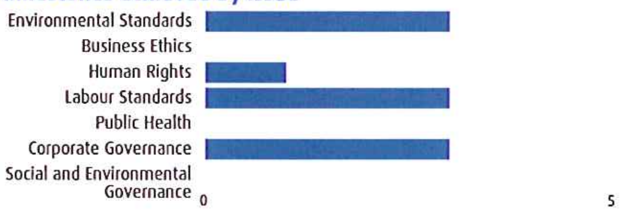
Q4 2015

The purpose of the ***reo***® (responsible engagement overlay)* service is to engage with companies held in portfolios with a view to promoting the adoption of better environmental, social and governance (ESG) practices. The ***reo***® approach focuses on enhancing long-term investment performance by making companies more commercially successful through safer, cleaner, and more accountable operations that are better positioned to deal with ESG risks and opportunities. Through a combination of constructive dialogue and active share voting, ***reo***® works to drive behavioural change with companies, and records successful outcomes as 'milestones' – changes in corporate policies or behaviour following intervention.

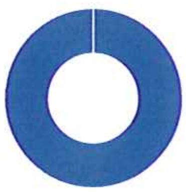
Companies engaged this quarter

Companies engaged	79
Milestones achieved	10
Countries covered	2

Milestones achieved by issue

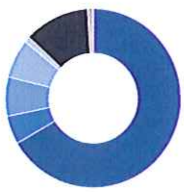


Companies engaged by country



United Kingdom	79

Companies engaged by issue **



Environmental Standards	66
Business Ethics	5
Human Rights	7
Labour Standards	7
Public Health	1
Corporate Governance	12
Social and Environmental Governance	1

BMO Global Asset Management

* ***reo***® is currently applied to £66.4bn ($100.8billion / €90.2billion) of assets as at 30th September 2015. ** Companies may have been engaged on more than one issue. *** This report has been compiled using data supplied by a third-party electronic voting platform provider. The statistics exclude ballots with zero shares and re-registration meetings. Meetings/ballots/proposals are not considered voted if: ballots have been rejected by voting intermediaries (e.g. where necessary documentation (such as Powers of Attorney, beneficial owner confirmation, etc.) was not in place); instructed as "Do not vote" (e.g. in share-blocking markets); or left uninstructed. This document is for professional advisors only and should not be circulated to other investors. Past performance should not be seen as an indication of future performance. Stock market and currency movements mean the value of, and income from, investments in the Fund are not guaranteed. They can go down as well as up and you may not get back the amount you invest. BMO Global Asset Management is a trading name of F&C Management Limited, which is authorised and regulated by the Financial Conduct Authority.

Company Engagement and Your Fund

Name	Country	Priority Company	Engagement	Milestone	In this report	Environmental Standards	Business Ethics	Human Rights	Labour Standards	Public Health	Corporate Governance	Social and Environmental Governance
Afren Plc	United Kingdom		✓			✓						
Alent Plc	United Kingdom		✓			✓						
Amec Foster Wheeler	United Kingdom		✓			✓						
Anglian Water Group Ltd	United Kingdom		✓			✓						
Anglo American	United Kingdom	✓	✓		✓	✓		✓				
Antofagasta	United Kingdom		✓			✓		✓				
Aquarius Platinum	United Kingdom		✓			✓						
Arrow Global Group plc	United Kingdom		✓								✓	
Associated British Foods	United Kingdom	✓	✓	✓	✓				✓			
Berendsen plc	United Kingdom		✓		✓						✓	
BG Group	United Kingdom	✓	✓	✓	✓	✓						
BP	United Kingdom	✓	✓	✓	✓	✓		✓	✓			
Cairn Energy	United Kingdom		✓			✓						
Carclo PLC	United Kingdom		✓			✓						
Centamin Plc	United Kingdom		✓			✓						
Centrica Plc	United Kingdom		✓			✓						
COPEL - Companhia Paranaense de Energia	United Kingdom		✓			✓						
Croda International plc	United Kingdom		✓			✓						
Drax Group	United Kingdom		✓			✓						
DS Smith Plc	United Kingdom		✓			✓						
Ecofin Water & Power Opportunities	United Kingdom		✓			✓						
Elementis PLC	United Kingdom		✓			✓						
Enquest Plc	United Kingdom		✓			✓						
Essentra PLC	United Kingdom		✓			✓						
Eversholt Funding PLC	United Kingdom		✓			✓						
Evraz Plc	United Kingdom		✓			✓						
Gas Natural	United Kingdom		✓			✓						
Gem Diamonds	United Kingdom		✓			✓						
GlaxoSmithKline	United Kingdom		✓							✓	✓	
Great Rolling Stock Co Ltd/The	United Kingdom		✓			✓						
Hanson Ltd	United Kingdom		✓			✓						
Hardy Oil & Gas PLC	United Kingdom		✓			✓						
High Speed Rail Finance 1 PL	United Kingdom		✓			✓						
Hochschild Mining	United Kingdom		✓			✓						
HSBC	United Kingdom	✓	✓		✓						✓	
Hunting plc	United Kingdom		✓		✓	✓	✓				✓	
Iluka Resources Ltd	United Kingdom		✓			✓						
John Wood Group	United Kingdom		✓			✓						
Johnson Matthey	United Kingdom		✓			✓						

Company Engagement and Your Fund

Name	Country	Priority Company	Engagement	Milestone	In this report	Environmental Standards	Business Ethics	Human Rights	Labour Standards	Public Health	Corporate Governance	Social and Environmental Governance
Jupiter European Opportunities Trust	United Kingdom		✓	✓	✓						✓	
Lamprell Plc	United Kingdom		✓			✓						
London Stock Exchange	United Kingdom		✓									✓
Lonmin	United Kingdom		✓			✓						
Marks & Spencer	United Kingdom		✓		✓				✓			
Marshalls	United Kingdom		✓			✓						
Mondi Plc	United Kingdom		✓			✓						
National Grid	United Kingdom		✓			✓						
Next plc	United Kingdom			✓	✓				✓			
Ophir Energy PLC	United Kingdom		✓			✓						
Pennon Group	United Kingdom		✓			✓						
Petra Diamonds Ltd	United Kingdom		✓			✓						
Petrofac Ltd	United Kingdom		✓			✓						
Polyus Gold International Ltd	United Kingdom		✓			✓						
Porterbrook Rail Finance Ltd	Jersey		✓			✓						
Randgold Resources Ltd	United Kingdom		✓			✓						
Rank Group plc	United Kingdom			✓	✓						✓	
Reckitt Benckiser Group PLC	United Kingdom	✓	✓		✓						✓	
Regenersis Plc	United Kingdom		✓		✓						✓	
Reliance Infrastructure	United Kingdom		✓			✓						
Rexam	United Kingdom		✓			✓						
Rio Tinto Plc	United Kingdom		✓			✓						
Royal Dutch Shell	United Kingdom	✓	✓	✓	✓	✓						
RPC Group	United Kingdom		✓			✓						
Ruffer Investment Company	Guernsey			✓	✓						✓	
Safestore Holdings	United Kingdom		✓		✓						✓	
Salamander Energy Plc	United Kingdom		✓			✓						
Scottish Oriental Small Cos	United Kingdom		✓		✓						✓	
Serco Group	United Kingdom		✓		✓			✓				
Severn Trent Water Ltd	United Kingdom		✓			✓						
Shire Plc	United Kingdom	✓	✓		✓		✓					
SOCO International	United Kingdom		✓			✓						
SSE Plc	United Kingdom		✓			✓						
SThree Plc	United Kingdom		✓								✓	
Synthomer plc	United Kingdom		✓			✓						
Tesco Plc	United Kingdom		✓	✓	✓				✓			
United Utilities Group PLC	United Kingdom		✓			✓						
Vedanta Resources	United Kingdom		✓			✓		✓				
Vodafone Group Plc	United Kingdom		✓		✓				✓			

Company Engagement and Your Fund

Name	Country	Priority Company	Engagement	Milestone	In this report	Environmental Standards	Business Ethics	Human Rights	Labour Standards	Public Health	Corporate Governance	Social and Environmental Governance
Wessex Water Services Finance	United Kingdom		✓			✓						
Western Power Distribution East Midlands Plc	United Kingdom		✓			✓						
William Hill PLC	United Kingdom		✓		✓		✓					
WPP Group Plc	United Kingdom		✓		✓						✓	

reo® Viewpoint – Public

October 2015

Anna-Sterre Nette, Associate Director, Governance and Sustainable Investment

Bangladesh revisited: progress slowly but surely

- Two years on from the collapse of Rana Plaza, we revisited Bangladesh for the second year running to check in on safety and labour reforms in the country's garment industry.
- Progress has been made around minimum wage, laws on worker unionisation, and building fire and safety inspections. Implementation of reforms by factories is lagging behind and international companies are being accused of failing to ensure safer factories.
- There is emerging recognition by brands and retailers that sustainable supply chain practices are not just costs but do make genuine business sense.

In April 2013, the Rana Plaza clothing manufacturing factory collapsed in the Bangladeshi capital of Dhaka. The incident resulted in more than 1,100 fatalities and was a result of poor building structure. Many international apparel brands were supplied directly and indirectly from the factory. It brought worldwide attention to the working conditions in Bangladesh as well as the practices of the global multi-national corporations sourcing from the country.

Last year, we went to the world's second-largest exporter of clothing on a fact-finding mission to engage local stakeholders on the pace and impact of the safety and worker rights' reform[1]. We found that international brands had improved their programmes to ensure supply chain policies are adhered to, but there continued to be underlying incentives for supplier non-compliance.

In June of this year, we went back to see for ourselves whether these programmes are working and forcing suppliers to alter their practices. One key finding emerged from our meetings: fire and building safety alone cannot truly improve working conditions without it going hand-in-hand with better protection.

[1] Details of the 2014 trip can be found in: reo Viewpoint 'Atonement: Bangladesh' garment industry seeks to build bright future" July 2014.

Multi-stakeholder delegation to Dhaka

We were invited to Bangladesh as part of a multi-stakeholder delegation together with Lilianne Ploumen, the Dutch minister for Foreign Trade and Development Cooperation, to promote sustainable supply chains in the Dutch textile sector. The Dutch government is funding, together with the United Kingdom and Canada, a programme by the International Labour Organisation (ILO) to: improve working conditions (Better Work Bangladesh); support the work of the National Tripartite Plan of Action (NTPA) on fire safety; and enhance relationships between the government of Bangladesh, factory owners, and employee representatives. The ILO program impacts policies and practices of our investee companies. After the official three-day program, we stayed on for another few days to visit factories that supply to the international brands together with the supply chain consultancy Impactt. This is an organisation founded by Rosey Hurst, who is a member of BMO Global Asset Management's Responsible Investment Advisory Council. Throughout the week we engaged industry representatives, trade unions, government officials, international brands and retailers, local factory employers and workers.

Engagement hurdles

Global apparel companies have generally been open to dialogue and engagement on the management of their supply chain risks in Bangladesh. We have held numerous discussions over the past two years with a broad number of companies. Despite this track record of responding to shareholder engagement positively, many of these companies were reluctant to meet us in the field in Bangladesh and schedule any factory visits for investors. The only company which invited us locally was **Associated British Foods** which sources products for its low-price clothing retail chain Primark.

We welcome Primark for showing leadership in its approach to investor dialogue on sustainability issues by taking an open and transparent approach. They discussed the achievements and challenges for increasing factory compliance with labour standards. This was another case of a learning we have developed through our engagement over the past few years: companies which sell clothes at low prices (and high volumes) do not necessarily have the weakest supply chain standards and source from the worst factories. In fact, western brands which offer products at different price points often are sourcing from the same factory.

Fire and building safety improvements

Companies signing on to the programmes of the *Accord on Fire and Building Safety in Bangladesh* (known as the Accord) and the *Alliance for Bangladesh Worker Safety* (the Alliance) agree upon a five-year commitment to invest in a safe ready-made garments (RMG) industry. The first phase of inspections was concluded in spring 2015. We were informed that under the two agreements a total of approximately 1,800 factories were surveyed for fire, electrical and structural safety. These were issues that before Rana Plaza had not routinely been part of company audits of factories. In addition, through the National Tripartite Action Plan (NTAP) the Bangladesh government is estimated to have inspected a further 700 factories. In total, the inspections account for around 80% of export-orientated factories. Examples of safety hazards that were identified in the inspection reports include blocked fire exits, poor quality fire doors and the absence of fire sprinklers. We were able to confirm these nature of problems during our own factory visits in Bangladesh. In a number of cases, we were told that temporary or permanent closure of factories were recommended. Workers affected by these closures were either relocated to other plants or received pay-outs of a few months' pay.

In Dhaka, we met with a number of buyers representing companies that signed the Accord or the Alliance. They told us that all of their supplier partners completed the sanctioned inspections and are now working on the corrective action plans. The main industry organisations, namely the Bangladesh Garment Manufacturers & Exporters Association and the Bangladesh Knitwear Manufacturers & Exporters Association, which hold considerable influence and sway over the Ministry of Commerce policies, said that the development and implementation of the corrective action plans is the real challenge. This is because of the investments needed in resources such as skills, time and finances. Indeed, concerns about the delays in remediation were confirmed in our discussions with member factories. Repairs and renovations require specific skillsets. Resources that are difficult to source locally in Bangladesh, such as expert engineers and fire doors, are being imported from India and China. It is reported that unions may consider initiating formal complaints against the main exporting brands signed up to the Accord and Alliance to make them account for the delays in improvements in the supplier factories.

Progress needed on workers' rights

Significant efforts are underway to make factories safer but we believe that more could be done to encourage factories to abide by international labour standards to protect workers' rights, including improving workers' productivity levels and the right to form unions and advocate for better working conditions. The local trade union leaders highlighted the importance of not losing the momentum for reform after Rana Plaza, especially for labour rights. Amendments to the Labour Act in 2013 now allow workers to unionise without requiring approval from factory owners. But after an initial spurt in union registrations, requests lately have slowed down and appear to be facing resistance from employers and others. Overall, it is estimated that only 350 out of approximately 5000 factories hold a trade union government registration. We question the effectiveness of these unions as some were launched by factory management instead of employees.

In our talks with the local trade unions, it was stressed that workers trying to organise face continuous intimidation and harassment. As a result most workers feel hesitant to unionise as the direct benefits are unclear. Effective dissemination of best practice examples of successful cooperation between factory management and trade unions highlighting efficiency and improved working conditions are needed. Most international companies prefer to support capacity development around a substitute for trade unions — the government mandated elected workers participation committees for all factories. These are made up equally of elected management and workers and if registered, union representatives. We question the use and influence of these bodies as debated topics generally hardly cover sensitive issues such as health and safety concerns, overtime restrictions and wage levels. These committees fail to rebalance the weak bargaining power of workers.

We want to stipulate to the international brands and retailers that forming trade unions on local factory levels remains the best available instrument to enhance labour rights. This encourages a balanced social dialogue between workers, factory owners and government bodies. We acknowledge that this is not an easy process. Reports of corrupt trade unions reiterate the need for capacity development and carve a clear coaching role for the multi-nationals in cooperation with non-governmental organisations.

Continued

Child labour concerns

Despite great strides made by multi-national corporations to establish strong standards within their supply chains, child labour continues to be a reality in Bangladesh. There are estimated to be 5000 garment factories in the country. This means that half of these factories, which are often the smaller ones, fall outside the scope of the current remediation programmes of the Accord and the Alliance. These factories do not directly supply exporting brands in Europe and North America but supply companies from other lower income countries which have no supply-chain standards to speak of.

We saw children working in small workshops first hand when we visited the district of Keraniganj which is in the old part of Dhaka. Some were as young as five years old. We call on the exporting brands and retailers not to remain indifferent to these types of excesses. Child labour remains a major challenge to overcome in Bangladesh and companies are vulnerable to reputational damage by sourcing from here without sufficient controls in place.

Conclusion and next steps

Low production costs and high product volumes have always been the main considerations for companies sourcing from Bangladesh. But several brands told us that failures in the rule of law, government corruption and poor working standards fuel social unrest. This in turn severely impacts quality, productivity and security of supply. These are costs that cannot be offset against the savings made from cheap labour for much longer. International apparel companies are willing to bear higher costs in return for better factory standards in Bangladesh to reduce these risks.

The garment employers' associations told us that some factories have reported higher order numbers following inspections. This exhibits that when brands, trade unions and governments work together in a legally binding framework, suppliers can profit despite the higher costs of implementing corrective action plans. We will continue to press companies to think beyond traditional strategies of business-led codes of conduct and monitoring schemes, which possibly have failed to work as well as hoped in the past. Overall, there is a clear need for brands and factories to work in partnership and build sustainable supply chain practices that link better working conditions with productivity improvements. We will continue to engage investee companies sourcing from Bangladesh on the topics above until the end of the 5-year Alliance and Accord commitments in 2018.

BMO Global Asset Management

ESG Viewpoint

November 2015

Yo Takatsuki, Associate Director, Governance and Sustainable Investment

Green bonds: financing the transition to a new economy

- Green bonds have grown rapidly in recent years and emerged as an effective investment tool to finance the transition to a low-carbon economy.
- The Green Bond Principles have played a critical role in establishing an industry-wide definition for green bonds; BMO Global Asset Management became members in 2015.
- Key challenge remains on how to harmonise the measuring and reporting of environmental impact.

Green bonds are a type of fixed income instrument where the proceeds raised are used to finance clearly defined projects which have environmental benefits. Projects financed include renewable energy, water conservation, energy efficiency, green buildings, clean transport and sustainable land use.

The potential for green bonds to raise billions, and even trillions, in capital to tackle climate change by funding the transition to a low-carbon economy is generating excitement. The International Energy Agency estimates that $53 trillion of energy investments are needed between now and 2035, or nearly $1 trillion of additional investments a year, to avoid climate change and limit global average temperature rises to within two degrees Celsius. Bank loans and government funding alone will not be sufficient in providing all the necessary financing and the expectation is for the capital markets – including green bonds – to fill much of this shortfall.

The green bonds market has grown rapidly in recent years as major issuers and leading institutional investors have acknowledged the opportunities from participating in this space. At BMO Global Asset Management, we consider that green bonds could develop into a critical transition financing instrument and we are playing a part in supporting the successful growth of the market. We are starting to see the signs of the market maturing and we now believe that green bonds can become an increasingly attractive asset for investors seeking to incorporate climate change considerations into their investment strategies.

Green bond characteristics

- Standard fixed income instruments but where the proceeds are exclusively for environmentally focused projects.
- Projects include renewable energy, energy efficiency, and green buildings.
- Green bonds offer the same credit risk as the issuer as most bonds are standard recourse to the issuer debt obligations.
- Green bonds trade in line with non-green bonds in the issuer's yield curve.
- Supranational agencies started the market in 2007.
- The market is investment grade dominated.
- US dollar and euro are the main currencies.
- The labelled green bond market stands at $85 billion (as of 31 Oct 2015)[1].

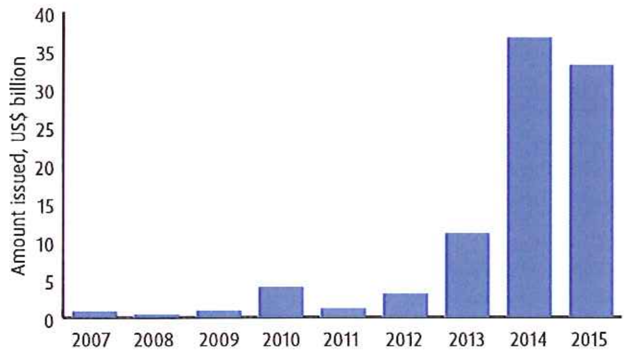
[1] Bank of America Merrill Lynch and Climate Bonds Initiative data

Continued

The history of green bonds is short. The first issuance was as recently as 2007 when supranational agencies pioneered green bonds as a way to assist governments in meeting their climate change related policy goals. AAA-investment grade issuances from **European Investment Bank** and the **World Bank** started the market. A major turning point was in 2013 when the first sizeable corporate green bonds were issued by **Électricité De France (EDF)** and **Bank of America**. 2014 was a landmark year with $36.6 billion of issuance – more than tripling the year before.

Despite vastly optimistic projections of $100 billion of issuance, 2015 hasn't been able to maintain that level of growth momentum, and is likely to end with issuances similar in size to the previous year. The smaller than expected issuance levels for the year is driven in part by lower supply from the supranational agencies. Nevertheless, we have seen the market develop through the year with a diversification of issuers. There have been issuers coming from the emerging markets, most notably China, as well as sub-investment grade (high-yield/junk), municipalities and regional governments. The green asset-backed securities also picked up steam. The market has also seen longer maturity of issuances with the 10-year+ section growing. Our expectation is for the market to grow steadily and to diversify further in the coming years. Also, corporates will continue the trend from 2015 by overtaking supranational agencies to become the established main issuer of green bonds.

Green bond issuances



Source: Bank of America Merrill Lynch, Climate Bonds Initiative. 2015 data as of 11 November 2015.

Green Bond Principles

A key development in the history of the green bonds market was the establishment of the Green Bond Principles in early 2014. As the market grew, it became important for an industry-wide framework to be set up to define exactly what constitutes a green bond. The Green Bond Principles were drafted by a group of the leading investment banks in this area and provides voluntary guidelines for issuers and underwriters to follow.

There are four components to the Principles[2]:

1. **Use of proceeds:** the most fundamental aspect of green bonds. How the proceeds from the bonds will be spent needs to be clearly described in the bond's legal documentations. The proceeds must be used for financing projects/initiatives with environmental benefits.
2. **Process for project evaluation and selection:** the issuer should clearly outline the decision making process it follows to determine the eligibility of projects using proceeds.
3. **Management of proceeds:** net proceeds of green bonds should be sufficiently separated from other funds. The management system should be sufficiently transparent to allow third-parties, such as auditors, to verify the internal tracking method and allocation of funds.
4. **Reporting:** issuers should provide, at least annually, a list and descriptions of projects to which green bonds proceeds have been allocated.

In addition, the Principles recommend that issuers use independent third-parties to conduct external assurance to confirm that the issuance is aligned with the four components of the Principles. A micro-industry of service providers has developed providing second party reviews, such as Vigeo and Cicero. Major accountancy firms with global scale such as KPMG have started to provide audit and assurance services.

Issuers, investors and underwriters which have participated in the market can become members of the Green Bond Principles. BMO Global Asset Management became investor members in 2015. BMO Capital Markets the investment and corporate banking division of our parent company **Bank of Montreal (or BMO Financial Group)** – is also an underwriter member. Other organisations which are involved in green finance (such as service providers, NGOs and academic institutions) can become observers. Currently there are around 150 members and observers of the Green Bond Principles.

There is no doubt that the Principles have played a significant role in the professionalisation of the market and provided the platform for a broad range of participants to discuss the evolution of the market, and to enter it with greater confidence. A process for revising and updating the guidelines by consulting its members and observers is in place. This ensures that the Principles can stay relevant over time as the market develops across sectors and geographies.

At this stage of the market's maturity, we accept it is important to ensure some flexibility in the Principles to encourage a broad range of issuers from a variety of sectors and countries to make issuances. One of the current weaknesses of the market is that it remains narrow in scope despite diversification of issuers seen in the past year. In the corporate space, utilities and financials dominate. The narrowness in variety also extends to the underlying projects being financed by the bonds. Approximately 40% of proceeds go to renewables and 30% to buildings and industry[3]. These will need to broaden out to ensure that the composition of the green bond market can start to closer resemble the broader bond market.

[2] International Capital Market Association Green Bond Principles 2015
[3] Climate Bonds Initiative

Continued

Defining green

There are some concerns that the non-prescriptive, flexible and voluntary nature of the Principles could mean that green bond issuances which fall far short of the desired quality and integrity will be placed to the market with insufficient controls in place. There are calls from stakeholders, including from investors, for mandatory minimum standards to be developed. This would require issuers to meet a pre-defined set of specifications around post-issuance reporting and verification of the quality of projects financed. This idea has been the focus of widespread discussions amongst market participants.

From the issuer's perspective, there are additional costs involved in issuing green bonds – such as establishing segregated treasury accounts, reporting and second party opinions. These costs are being borne by the issuer as there is currently little pricing advantage in issuing green bonds over standard bonds. As a result, new corporate issuers to the market are having to carefully weigh up whether the benefits of green bond issuance – namely diversifying their investor base and strengthening their sustainability credentials – outweigh the costs.

The most contentious area of debate is around evaluating the "green-ness" of the projects financed. While the Principles identify the type of projects which would qualify (e.g. renewable energy, energy efficiency), they do not provide defined criteria for the environmental impact and additional benefits of the projects.

In the vacuum of universally adopted approaches, a number of organisations are developing standards to define what is considered green. A leading player has been the Climate Bonds Initiative, a not-for-profit organisation, which has developed technical specifications for certain types of climate-related projects. There are other approaches including from the World Wide Fund for Nature (WWF) and research providers such as MSCI ESG.

Part of the answer to the question of defining "green-ness" may involve a more rigorous analysis of the ultimate impact of the projects being financed. The major supranational agencies have taken the lead in implementing best practice amongst the issuers. They have set up robust internal processes to evaluate projects from an environmental perspective and adopted a high standard of environmental impact reporting. For example, the European Investment Bank's 2015 green bonds reporting[4] provides details of the individual projects financed and the impact on greenhouse gas emissions. While this level of detail and transparency is not always possible nor appropriate for every issuer, it has highlighted the wide range in the quality of reporting provided to investors. Several of the multilateral development banks have made a proposal for a harmonising framework for impact reporting on renewables and energy efficiency projects. This is a positive development but implementation in the corporate space could be difficult. This is due to the reality that increasing impact reporting standards entails taking on further costs that borrowers aren't sure are justified by green bonds without preferential pricing. This situation may require regulatory intervention[5].

"A systematic and efficient green finance system can attract private investment and enable China to achieve growth in financial sector and economic and green development"

Wang Yao, Deputy Secretary General, China Green Finance Committee, 23 October 2015

The role of governments

Whatever the final outcome of the Paris global climate change negotiations in late November, government involvement in encouraging environmentally friendly technology will increase in the coming years as countries attempt to meet their carbon emission cutting goals. Whilst no national governments have issued green bonds yet, some may consider measures such as preferential tax treatments for investors/issuers and preferential regulatory capital treatment for investor banks[6].

China's government is set to take the lead by making sustainable and green finance growth a top priority. The Peoples' Bank of China has developed detailed proposals to green China's financial system, and the **Agricultural Bank of China** became the first Chinese bank to issue green bonds when selling $1 billion worth in London in October. Depending on how aggressively the government presses forward with its plans, China could foreseeably become one of the major players in green bond issuances in the coming years. Questions will undoubtedly be asked by investors of the transparency they could realistically expect from Chinese green bonds issuers – especially on the use of proceeds and reporting – bearing in mind how limited the meaningful disclosures currently are on ESG (Environmental, Social and Governance) issues from Chinese companies compared to Western companies.

Impact investing and engagement

Leveraging our position as an established responsible investor, we have been proactively engaging a wide range of market participants in 2015 on the issues facing the green bonds market. We have engaged in the past a number of green bond issuers including meetings with the European Investment Bank, World Bank, **Nordic Investment Bank, EDF** and **Societe Generale** amongst many others. Discussions have focused on the nature of projects financed, assessment of projects, quality of reporting and standards in the market. We have found these meetings to be a valuable opportunity to access bond-only issuers, allowing us to assess not only their green bond strategies but also their broader approach to managing ESG risks and opportunities. We have also held discussions with the investment banks who have played an important role in developing the market and the service providers.

[4] European Investment Bank Climate Awareness Bonds Newsletter, March 2015
[5] Green Bonds: Investors and issuers still not seeing eye to eye, BMO Capital Markets fixed income research, October 2015
[6] European Investment Bank Climate Awareness Bonds Newsletter, March 2015

"Green bonds leverage BMO Global Asset Management's strengths in fixed income markets, portfolio construction and responsible investment."

Michiel De Bruin, Head of Global Rates and Money Markets, BMO Global Asset Management

We have utilised many of our learnings from our experiences engaging on ESG issues to provide input into the development of the green bonds market. We encourage companies to protect their sustainability credentials and avoid accusations of greenwash by communicating with investors in a transparent manner, establishing robust management processes and controls, and developing methods to measure, track and report on environmental results. We are planning to collaborate with other members of the Green Bond Principles in the coming months. There will be working groups looking at issues such as assurance and reporting.

Away from green bonds, an area of interest in 2016 for issuers and investors is likely to be discussion and consideration around a development of a framework for social bonds (also known as social impact bonds). These are similar to green bonds but where the proceeds from the bonds are used for projects which have social benefits. These include tackling issues such as education, housing, criminal justice or employment. There is currently no market-wide approach to defining social bonds and there are important hurdles, once again, to be overcome about how social impact would be measured and reported. Should a framework like the Green Bond Principles be established, it could be the first steps for investors to eventually launch sustainability impact bond funds/mandates which would be invested in both green and social bonds.

Routes to green bond investment

As the market has developed, investors have become increasingly interested in holding green bonds within their own portfolios. Key appeal of green bonds for investors have included making investments with an environmental impact, being at the forefront of climate finance, sending a signal to stakeholders of their commitment to responsible investment and aligning their investing activities with their own principles.

In Europe, BMO Global Asset Management provides investors access to green bonds through the following fixed income strategies:

Standard bonds: green bonds are held as a part of a portfolio alongside regular bonds.

Responsible bonds: socially responsible investment strategy which holds green bonds alongside regular bonds of issuers which meet the sustainability-related screening criteria.

Green bonds: a portfolio focused solely on green bonds. Every issuer and issuance is evaluated and monitored within a dedicated process.

"At BMO Global Asset Management, it is important for us to evaluate carefully any green bond from an investment perspective and to not just blindly accept the environmental label"

Andrew Brown, Director, Credit, BMO Global Asset Management

ESG Viewpoint

November 2015

Vicki Bakhshi, Director, Head of Governance and Sustainable Investment; Kajetan Czyz, Analyst, Governance and Sustainable Investment.

The Paris climate negotiations: a world in transition

- In Paris, the stage is set for global leaders to secure a climate change deal which would aim to curb fossil fuel use.
- China, India and the US are signalling their willingness to keep global warming to within two degrees Celsius.
- We have worked intensively to engage policy makers and companies advocating for reforms which will result in a smooth transition path to a more sustainable economy.

A new hope

After 21 years of climate negotiations, the final stages may be just days away. Following the failure to secure a deal in Copenhagen in 2009, the negotiations which are to begin in Paris on the 30th of November stand a chance of securing commitments to adopt policies which would reduce emissions and keep climate change at 'safe' levels. This would definitively set the scene for a fundamental transition over the coming decades: an industrial revolution from a fossil-fuel based system, to a largely decarbonised economy.

In Cancun in 2010, governments had agreed to hold global warming to within two degrees Celsius (2°C). However, few concrete actions were agreed to make this happen. The aim of the Paris meeting will be to translate that goal to specific country level reduction commitments. Although there remain disagreements around climate finance and the status of the final document, substantial progress has already been made. Around 160 countries representing 92% of global emissions have submitted Intended Nationally Determined Contributions (INDCs). These self-imposed targets have already reduced projected 2030 emissions by 15% from their business as usual trajectory, translating into a reduced warming of 2.7°C compared to recent estimates of 4°C to 5°C under a business as usual scenario.

There is still much ground to cover to align INDCs with the agreed 2°C goal. However, with the apparent willingness of the large emitters, most notably China, India and the US, a deal seems within reach. Observers who are pessimistic on getting a deal in Paris seem to be basing their future expectations on past performance (i.e. Copenhagen). However, the last six years have changed the fundamentals of the negotiations significantly.

> "We believe climate change is one of the biggest systemic risks we face."
>
> **120 investment institution chief executives in open letter to G7 finance ministers, May 2015**

China's air pollution concerns and the planned introduction of an emissions trading scheme are moving the country's energy mix away from coal and making the country the largest renewable energy investor in the world. In the US, wind is now the cheapest form of energy in much of the country and with the fall of natural gas price, it has reduced carbon dioxide output by c. 10% since 2007. India has just set a 100 gigawatt (GW) target for solar deployment by 2022.

Most importantly however, the main argument against action on climate change — that it requires too great an economic sacrifice — has disappeared. According to recent estimates, the cost of following a 2°C pathway is actually on par, if not slightly lower than a business as usual pathway (even without considering climate related damages). Independent reports by the International Energy Agency (IEA), **Citigroup**, Oxford's Martin School and the New Climate Economy suggests that due to the falling in the costs of clean technology, the increased investment in low-carbon, efficient infrastructure now will be more than offset by substantial fuel savings in subsequent years. Following this pathway however, requires specific policies to facilitate the higher up-front costs. Interestingly, this investment stimulus may not be such a bad idea in the context of a global economic slow-down and historically low interest rates.

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Building momentum

The Paris meetings have been a catalyst for a wave of stakeholder action on climate change.

Environmental Non-Governmental Organisation (NGOs) have been focusing on climate change for decades, and now a new generation of organisations focused on the financial sector has come to the fore — the 350.org Divestment Movement and the Carbon Tracker Initiative are examples of these. Companies have also been very vocal and have come out with unilateral commitments to reduce their emissions or to shift energy procurement to renewables — 60% of the Fortune 100 have set such targets. Also, they are working collectively through groups like We Mean Business, the Oil and Gas Climate Initiative (OGCI) and the Magritte group (of utilities). The OGCI recently convened a meeting, which we attended, between seven oil and gas company chief executives — including those from **BP, Royal Dutch Shell, Total,** and **Saudi Aramco** — with institutional investors and the Secretary of the United Nations climate process, Christiana Figueres. The CEOs stated that they too support a 2ºC development pathway. Leading companies within the OGCI confirmed that the intense engagement on the stranded assets issue by BMO Global Asset Management and other investors has been pivotal in the formation of this group and the desire to send a clear signal at CEO-level.

Within the financial sector, multilateral development banks have been on the forefront of bold climate action, with the **World Bank's International Finance Corporation** rebalancing its lending portfolio away from coal. The **European Investment Bank** has also been active in creating financial products which reduce the risk of investing in low-carbon infrastructure and has been the largest issuer of green bonds to date.

Institutional investors have also been active. Through the Global Investor Coalition, which BMO Global Asset Management is an active member of through the Institutional Investors Group on Climate Change (IIGCC) — investors have become outspoken advocates of predictable, long-term policies which will result in a smooth transition path to a more sustainable climate. We contributed to a framework for investors to help integrate the impact of climate change into their investment decisions published in the "Climate Change Investment Solutions: A Guide for Asset Owners"[1] report.

Financial regulators are now becoming increasingly involved. France passed its Energy Transition Bill in the summer of 2015, which includes requirements for certain institutional investors to prepare a carbon footprint, ensure their investment processes incorporate climate risks, and describe how their investments are aligned with a 2ºC economy. The Bank of England published a report in September 2015 on the risks the insurance sector faces from climate change. The Financial Stability Board and the European Central Bank are now conducting assessments of impacts of climate change on financial stability.

Disruptors and disruptees

While the global political path to action has been far from smooth, forward-looking businesses — spurred by national government actions, and seeing the future opportunities from the energy transition — have been investing in solutions. With the scaling up of renewable energy and clean technology deployment has come a dramatic reduction in costs which means that the need for costly public subsidies is fast declining. The deployment and cost reductions of solar has been particularly dramatic. Last year, around 170GW of solar capacity had been installed, compared with the IEA's prediction back in 2007 of 20GW. Costs have fallen by around 90% compared to 2008. Other technologies are also becoming cheaper. This has been particularly so with battery storage (60% cost reduction in the last three years) which would allow renewables to overcome the intermittency issue (i.e. not providing power on demand).

The deployment of these technologies will have profound consequences to incumbent companies even at moderate penetration rates. A good example of the disruptive impact is the European utility sector which has, over the past five years, lost half of its €1 trillion market value. Weak energy demand, and a growth in output from renewable sources, led to a price collapse in wholesale electricity markets across Europe. The largest 12 utilities in the European Union have only 7% market share of renewable energy generation (excluding hydro power). This means that they are not benefiting from the new technology trends, and face losing market share.

Our engagement with the utility sector has focused on ensuring the changing dynamics within the sector are being integrated into companies' strategic planning. The decision of the German utility **E.On** to split the company into conventional power generation (to be called Uniper) with E.On itself focusing on renewables, grids and energy services going forward, is the most notable example to date of this being put into practice. CEZ has followed suit last month. We are now seeing nearly all utility companies in Europe reworking their corporate strategies and putting a stronger focus on their renewables and energy services divisions. The debate with the oil and gas sector, which we described in a previous Viewpoint[2], also focuses on the fundamental question of the future business model in an industry where the core product may be under threat.

"The stranded asset debate is a red herring, frankly... There seems to be the idea that policies will materialise that will leave assets in the ground. I don't think so."

Ben van Beurden, Royal Dutch Shell Chief Executive

[1] http://www.iigcc.org/publications/publication/climate-change-investment-solutions-a-guide-for-asset-owners
[2] ***reo***® Viewpoint Stranded Assets: Planning for a carbon constrained world, June 2015

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Public policy

As well as engaging with companies, our Governance and Sustainable Investment team has worked primarily through the IIGCC to engage with policymakers on climate change. We drafted the letter sent to G7 and G20 finance ministers highlighting the nature of climate risk and the role finance ministries have in giving climate negotiators the necessary mandate to achieve a binding climate deal. The letter attracted the support of 120 finance CEOs and contributed to the momentum behind the G7 announcement of its intention to decarbonise their economies within this century. We will travel to Paris for the climate summit to engage directly with country representatives during the negotiations.

Other activities included:

- Travelling to Brussels to discuss with Members of the European Parliament, the European Commission and country representatives the need for integrating the EU's climate goals into the structure of the European Fund for Strategic Investments (the Juncker Plan). We also discussed the need to reform the EU Emissions Trading Scheme in order to remove the large surplus of allowances in the market.
- Contributing to a paper on the issue of climate finance[3], which highlighted policies and tools which can be employed to improve the risk-return ratio of investments in infrastructure in developing and emerging economies; this was shared with Angela Merkel's office as part of their G7 chairmanship.

Beyond Paris

Our engagement on climate change in the run up to the Paris negotiations has focused on two main workstreams: the first focusing on corporates and ensuring they are integrating climate risks within their strategies, and the second targeting policymakers to make these changes come about. Whilst the Paris meetings are without a doubt important, we see the more significant development as the technological revolution underway in energy systems, which we believe will continue, even if global policy efforts fall short of what is being hoped for.

From an investor's point of view, once the Paris meetings are over the question will remain about how to integrate climate change into investment portfolios in a meaningful way. Much of the focus, to date, has been on risk – on divestment or cutting down the carbon footprint. If the Paris meetings send a strong signal that the 'green' industrial revolution is set to continue, investors may switch their attention to looking at the opportunities this could bring. Timing will be key, regardless of whether the focus is on opportunities or risks.

"Once climate change becomes a defining issue for financial stability, it may already be too late."

Mark Carney, Governor of the Bank of England, Chairman of Financial Stability Board, September 2015

[3] http://www.iigcc.org/publications/publication/climate-finance-for-developing-and-emerging-economies-five-recommendations

ESG Viewpoint

December 2015

Vicki Bakhshi, Director, Head of Governance and Sustainable Investments and Kajetan Czyz, Analyst, Governance and Sustainable Investment

Paris climate deal: the investor reaction

- Paris Agreement meets all key investor expectations.
- Long-term ambition of global carbon neutrality.
- Review mechanism: country plans to increase in ambition every five years.
- Global regulators to focus on financial sector's role in addressing climate change in 2016.

The United Nations (UN) Climate Summit in Paris, which saw the attendance of the largest group of heads of state in history, has delivered a strong deal to maintain temperature increase 'well below two degrees Celcius (2°C)'. This will have a profound impact on the energy producers and users alike. The implementation of the Paris Agreement (the Agreement) will have implications for both fund management and strategic asset allocation decisions.

Paris: did it meet investors' expectations?

Investors – including BMO Global Asset Management – engaged with policymakers in the run-up to the Paris talks. The key questions asked were to give the investment community a clear direction of travel including a long-term target, supported by country-level plans.

The Paris Agreement[1] (PA), supported by 195 countries, met all these expectations. Key points were:

- Long-term goal: the Agreement sets out an ambition to achieve 'a balance between sources and sinks of greenhouse gases in the second half of this century' while 'peaking emissions as soon as possible'. In other words, the world should become carbon-neutral.
- National commitments: every participating country is obliged to produce a national emissions reduction plan (Nationally Determined Contributions or NDCs). All but six countries have already done so.
- Review mechanism: NDCs will be reviewed in 2018 and then every five years to make ensure they are in line with the Agreement's aim to hold the global temperature rise to 'well below 2°C' and 'pursue efforts to limit the temperature increase to 1.5°C'; a key clause states that the NDCs cannot be weakened.
- Transparency: the agreement has introduced a monitoring and verification requirement for all countries with a global stocktaking of reduction efforts in 2023. This will not only increase the certainty that measures are being implemented, but also serve as peer pressure through 'naming-and-shaming' of countries lagging behind.
- Finance: developed countries have now agreed to fully fund the Green Climate Fund up to $100 billion per year from a 'variety of sources' which will also include private finance.

> "There are hundreds of billions of dollars ready to deploy to countries around the world if they get the signal that we mean business this time. Let's send that signal."
>
> **Barack Obama, COP21 Opening Ceremony Speech.**

[1] http://unfccc.int/documentation/documents/advanced_search/items/6911.php?priref=600008831

The combined effort of the national emission reductions plans submitted ahead of the Paris meetings still falls short of the 2°C limit – let alone the 1.5°C ambition the Paris Agreement refers to. But in our view, the direction of travel is now unambiguous, and there are mechanisms in place for countries to be held to account for their actions. This gives investors greater clarity than there has even been about the political willingness to transition the global energy system to a post-fossil fuel future

Private sector involvement was pivotal

French President François Hollande praised the support of 'businesses and investors' in the negotiating process. Non-state participants have shown their strong support: over 7,000 cities representing 32% of global GDP, and 5,000 companies representing the majority of global market capitalisation and over $38 trillion in revenue had made low-carbon pledges. BMO Global Asset Management's Governance and Sustainable Investment (GSI) team has been at the forefront of investor action, taking a leading role in promoting joint investor activity through the Institutional Investors Group on Climate Change (IIGCC).

Key activities in 2014-15 included co-authoring, with the IIGCC, the Global Investor Statement on Climate Change[2], which attracted 409 supporters with over $24 trillion in assets and was delivered to Heads of State at the UN Secretary General's Climate Summit in September 2014. We have also co-authored an open letter to G7 and G20 finance ministers[3] expressing investors' concerns regarding the systemic nature of climate risks, which was signed by 120 investor CEOs, and had the support of four regional investor groups on climate change and the Principles for Responsible Investment.

We were present during the climate summit in Paris as part of the IIGCC observer delegation, helping to represent investors' voices during meetings with a number of country negotiating teams, including the US, EU, and G77.

"Paris deal is nothing else than an historic milestone for the global energy sector".

Fatih Birol, Executive Director, International Energy Agency

What next for investors?

The Paris conclusions did not contain any surprises that would have an immediate impact on company or portfolio valuations, with all the country-level policy announcements having been made well in advance. It will take time to understand these implications and for them to filter through to valuations, which will be dependent on investors analysing the NDCs themselves at a national level to identify which policies will impact on which companies and sectors.

Significantly, 2016 may see a scaling up of actions by financial regulators on climate change, with potential consequences for investors. The Paris Agreement commits governments to 'making financial flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development'. As implementation of the Agreement gets underway, investors may be expected to take actions to support this – but what form this will take is as yet unclear. Key developments in financial regulation to watch include:

- Financial Stability Board: Mark Carney, head of the Bank of England and chair of the Financial Stability Board (FSB), announced at the Paris Summit that the FSB was establishing an industry led Task Force on Climate-related Financial Disclosures (TCFD) to be chaired by Michael Bloomberg; this is expected to conclude at the end of 2016.
- France: the Energy Transition Law requires institutional investors to provide the carbon footprints of their investments, to review their portfolio's alignment with a low-carbon development pathway, and to disclose methods of integrating climate related risks; guidance on implementation is expected to be finalised shortly.
- Sweden: Sweden was the first country to announce a review aimed at creating an obligation for its financial regulator to ensure the financial system is 'financing sustainable development'.

These developments follow the extensive work by the Organisation of Economic Co-operation and Development (OECD), United Nations and others to understand which policies hinder or support the deployment of capital towards sustainable solutions. As stakeholders at the highest ministerial levels were consulted during this research, it is now firmly embedded within the G20 process – with the Chinese G20 presidency making 'Green Finance' a priority area for 2016.

[2] Global Investor Statement on Climate Change http://investorsonclimatechange.org/statement/
[3] Open letter to Finance Ministers in the Group of Seven .http://www.iigcc.org/publications/publication/open-letter-to-finance-ministers-in-the-group-of-seven-g-7

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"We are sending a clear signal to business, as one voice of 190 nations that the world is now on a new path."

John Kerry, US Secretary of State, After the Adoption of Paris Agreement

The Paris Agreement makes climate change, and the energy transition, a mainstream investor issue. The focus now shifts to implementation. We expect regulators' attention to climate change to continue to increase, both as a result of the deal itself and in the broader context of a trend toward encouraging investors to consider environmental, social and governance (ESG) issues – as seen in developments including the introduction of Stewardship codes in Asia, the revisions to the EU Shareholder Rights Directive, and the Ontario ESG legislation for pension plans. Existing investor initiatives to improve the understanding of climate risks and opportunities, such as the 'Climate Change Investment Solutions: A Guide for Asset Owners' compiled by the Global Investor Coalition, provide a strong foundation for the discussions we expect to continue into 2016 and beyond.

BMO Global Asset Management