



# Ardea Engagement Framework

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Ardea Investment Management is a specialist fixed income investment manager serving a diverse range of global clients from pension funds, government entities, insurers, and retail investors.

Founded in 2008, Ardea became a signatory of the UN Principles for Responsible Investment in 2010; aligning with our goal to deliver long-term value to our clients while contributing to sustainable benefits for the broader community.

## Our Investment Approach

Ardea adopts a pure 'relative value' (RV) investment approach to generate alpha that identifies government bonds that are closely related and have similar underlying risk characteristics but are priced inconsistently with each other - known as 'relative value mispricing' - and therefore have the potential for their prices to rise or fall independently of broader market direction. An essential element of this pure RV investing approach is to isolate these positions from unwanted market risks, including those stemming from ESG-related factors, by using a wide range of risk management strategies which allows low volatility returns to be generated independent of broader market movements, including the level or direction of interest rates.

In prioritising ESG integration into our investment process, Ardea has focused on system-wide risks such as climate change and the financial sustainability of governments' fiscal burdens. Given the threat climate change poses to the global economy and the fast materialisation of transition risk, these risk factors are most likely to be material determinants of sovereign bond markets.

Whilst focusing on climate change and transition risks may convey an emphasis on the environment in our ESG integration, we remain cognisant of the potential flow-on social and governance impacts to underlying communities and the broader economy. Through our research, engagement and corporate activities, these important and interrelated factors are further considered.

We strongly advocate for engagement, in contrast to exclusion or divestment, to influence change and encourage long-term value creation.

## Engagement with Sovereigns

Engagement with sovereigns is fundamentally different to engagement with corporate issuers. This in part reflects the nature of the government bond market as having a small number of issuers each of whom are very large in size, when compared to the corporate bond market which offers thousands of issuers, each of whom issue much smaller amounts. This difference, alongside regulatory, prudential, and portfolio construction requirements that necessitate owning government bonds, gives governments considerable influence over the demand for and pricing of their bonds. This is very different to the competitive, mostly-level playing field apparent in the demand and supply of capital in the corporate bond market.

Notwithstanding this difference, government bond investors, as long-term stakeholders in the governments they invest in, are well-placed to intervene to influence government actions or policies to secure their interests as investors, and to ensure that governments pursue effective policies that benefit citizen stakeholders over the long term.

For these reasons, engagement is the most effective tool at our disposal to encourage and shape long-term, best practice ESG outcomes. Divestment or exclusion are, to our mind, punitive and short-term levers and, given the central role of government bonds in investment portfolios, of limited practical usefulness.

We take seriously our rights and responsibilities as an active owner and participant in the global government bond market. We view a well-functioning government bond market as an essential component of a modern economy and financial system, and essential for investors seeking low-risk, predictable returns, and high liquidity. Government bonds are also critical for the functioning of monetary policy, as a secure asset held for prudential regulatory purposes, and for use as a risk-free rate when pricing a wide range of other asset classes.

Given the large number of investors in advanced economy sovereign bond markets, we acknowledge that our ability to influence is limited. Furthermore, much of the governance and social risks which may present in government bond markets are reduced by default given Ardea's strategies restrict the investable universe to countries with high governance and transparency standards.

However, environmental risks are not currently adequately addressed by credit ratings given the longer time horizon of some of these risks. Further, we believe that environmental risks (and climate change) will become increasingly important over time and that sustainability factors will increasingly become more material to the pricing and performance of sovereign bonds.

We therefore place a reliance on engagement and specific initiatives, such as growing green bond turnover, to deliver change. As government bond investors, we have direct access to issuers and can leverage the alignment present between issuers and investors in ensuring that securities continue to perform within the expectations of end investors. The focus on ensuring consistent investment returns above all else ensures that other issues that may be deemed overly political in nature do not detract from the core objectives of engagement.

With an objective to promote the development of the green government bond market, Ardea regularly engages with all major government bond issuers across the markets it invests. This engagement is to:

- help sovereigns better understand the increasing ESG demands of investors
- convey expectations and concerns on behalf of our clients
- promote discussions between investors, sovereign issuers, and other stakeholders
- increase the information provided to the market on ESG matters
- extract ESG information important for our analysis, and
- encourage ESG data transparency.

## Methods of Engagement

The primary method of engagement has been through meetings with senior representatives of government bond issuers and through follow up telephone calls. As well as meeting with issuers, we have, in some cases, also engaged with government officials. In our view, this approach is effective as the concentrated representation of the issuer universe allows ongoing engagement with each issuer. Meetings can also be an effective form of laying out areas of concern and for communicating sensitive information and expectations in relation to markets and issuance.

The highly correlated nature of government bond markets also means that engaging broadly across a number of the key sovereign and semi-sovereign issuers is necessary. Therefore, this engagement approach has been consistent across markets and similar across our global offices.

Our approach to engagement utilises our long-standing communication channels with government issuers to raise ESG issues that are deemed of importance by investors. We also believe it is important to receive feedback and communication from government issuers as to the challenges and constraints they are facing, with a view to raising awareness within the investor base and promoting two-way conversations.

Engagement is undertaken by the Investment team with support provided by the Research team.

## Promoting the Growth and Development of a Government Green Bond Market

An inherent and distinctive feature of our investment approach is its highly active trading style, which results in frequent and high-volume trading of government bonds. We aim to utilise this strong presence in the market to foster growth of the green bond market, contributing materially towards improving market liquidity and price discovery for green government bonds.

To practically integrate these ideas into our investment process, Ardea is committed to:

- Preference trading green bonds over conventional bonds when the relative value is similar, and
- Regular engagement with government bond issuers to advocate for more green bond issuance, including participation in new bond syndications when the relative value is attractive.

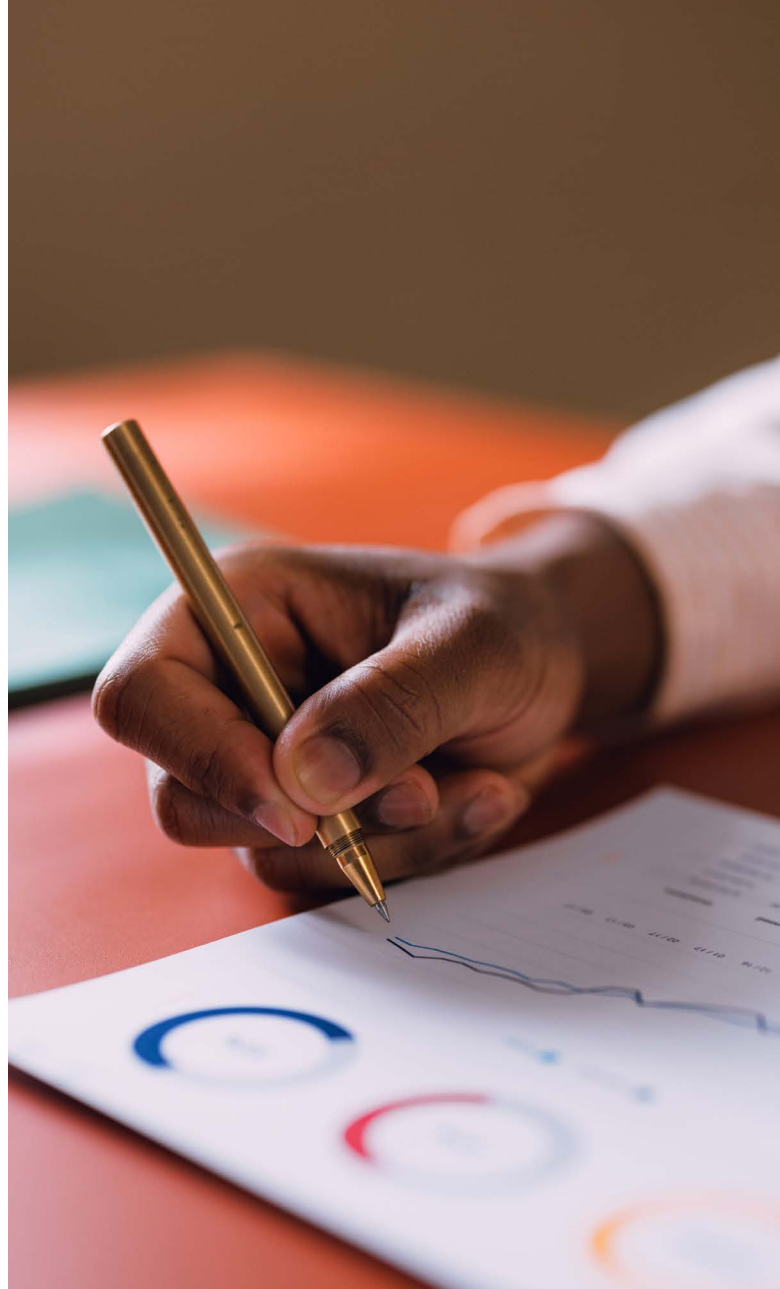
By creating more opportunities for trading and enhancing price discovery, our aim is to contribute to advancing the development and growth of the green bond market globally, including to further develop our participation in the issuance of different instrument types, currencies, and maturities with a skew towards market segments which need developing.

This active approach has encouraged governments to issue more green bonds and contributes to a reduction in sustainability risk for issuers, and therefore economies overall. This has direct implications for the sustainability of the government bond market in aggregate and therefore all investors in government bond strategies as well as potentially to investors in other asset classes priced off the government curve.

## Approach to Escalation

The ability of the business to escalate stewardship issues has limitations given that, as government bond holders, we do not have access to conventional channels of investor engagement, such as proxy voting or meeting with company management. The dominant role of government bond markets, and the dominant role of governments themselves, means that governments have a much greater degree of control over the very markets they seek to raise capital from.

This is another reason for placing heavy reliance on direct engagement with government issuers in seeking to achieve stewardship outcomes. We continue to use our direct access to issuers and focus our efforts on advocacy that is aimed squarely at achieving good outcomes for investors in sovereign bonds.



## Collaborative Engagement

As a specialist investor in advanced economy sovereign bonds, it is critical that we collaborate across the industry to amplify our influence and impact. As such, Ardea actively participates in roundtables, roadshows, webinars, and conferences to promote discussions relating to ESG and government bond investing.

Engagement seeks to move beyond demonstrating the impact of ESG factors for investment returns and risk. We view engagement with stakeholders including clients, media, academia, and issuers as the most efficient and logical way to promote sustainable outcomes generally, not just within our industry or asset class. Engagement also broadens the scope to include a wider discussion on ESG issues across the key governmental entities that produce the supply of a large part of the fixed income universe, including debt management offices, governmental departments, national authorities, regulators, and other policy makers.

While issuers remain the primary focus for engagement, Ardea's approach also encompasses the following stakeholders, including:

- Our clients to understand their ESG expectations
- The media to help increase information provided to the market on ESG matters
- Research houses to understand risks and opportunities and to highlight the need for targeted research on sovereign bond ESG matters
- Academia so that we can highlight the need for additional research on ESG outside of equities, corporate debt, and property
- Other key participants within financial markets, such as clearing houses and exchanges, which have the potential to perform new and innovative functions with respect to ESG
- Investment bank capital market desks and dealer panels, who through their market-making role, can advise sovereigns on ESG issues that might be material to pricing and would increase the attractiveness of their bonds, and
- Specific engagement with banks to promote secondary market turnover and liquidity in the global green government bond market.

## ESG Research

Research is integral to Ardea's investment process and helps to inform our broader ESG engagement activities as well as to raise awareness of the importance of sustainability risks and opportunities when it comes to investing in government bonds.

In response to the limited literature and principles on managing ESG risks in advanced economy sovereign bond markets, Ardea is committed to conducting and promoting research that complements existing materials on equities, corporate bonds, and private assets. We have a formalised research partnership with academic institutions with the express goal of understanding how climate and transition risks impact government bond markets.

It is our intention to contribute to the development in the narrative on ESG matters specifically related to government bond investing via additional engagement with the media, clients and across the industry more broadly. Our research findings are also published on our website.



## Engagement Reporting

In addition to the UNPRI reporting requirements, we have established a log which tracks our engagement activities and the outcomes sought. File notes are prepared as a record of our engagement activities with the issuers, banks as well as other industry stakeholders. This ensures that engagement activities are not only tracked but progress can be assessed.

Reporting on the results of engagement activities occurs at our weekly portfolio construction meetings.

We also share these activities, as well as additional ESG research and analysis, with clients during periodical portfolio reviews.

## Managing Conflicts of Interest

We are committed to providing high quality investment services that create long term value and puts the interests of our clients first.

Ardea's Conflict of Interest policy ensures that any actual, potential and/or perceived conflict of interest that may arise both between itself and its clients, a staff member and a client, and between clients are identified, prevented, or managed and disclosed in the best interests of clients. This Policy sits within our Governance Risk and Compliance (GRC) Framework and the Ardea Compliance Manager is responsible for ensuring adherence with this conflicts policy.

## Review

Our aim is to engage in a way that benefits all and encourages improved outcomes across the environment, broader society, and the economy. We are continuously seeking to improve our analyses, processes, and transparency around sustainable investing. We are always very keen to learn about new ideas in sustainable investing and to understand how these might be complementary to and an improvement on our existing approach. As such, we welcome feedback from our clients and stakeholders.

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