



Understanding ESG & Responsible Investment

RBC Global Asset Management (RBC GAM)¹ believes that the proper disclosure and consideration of environmental, social and governance (ESG) risks and opportunities by the companies or countries in which we are invested will enhance the long term, sustainable performance of our investments. While our investment teams have always considered these issues to some extent, they have begun to more formally integrate ESG factors into their investment decisions. We have also created a dedicated Corporate Governance & Responsible Investment

group to consolidate and lead our efforts in ESG integration and responsible investment generally.

Reflecting those efforts, RBC GAM recently became a signatory to the United Nations Principles for Responsible Investment (PRI), which is an international framework for ESG integration. Currently, there are over 1,500 institutional investor signatories to the PRI which together represent US\$60 trillion in assets under management.

PRI signatories commit to implement the six Principles of Responsible Investment and report on their activities and progress in implementing them.

What are the six Principles?

- 1** We will incorporate ESG issues into investment analysis and decision-making processes.
- 2** We will be active owners and incorporate ESG issues into our ownership policies and practices.
- 3** We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- 4** We will promote acceptance and implementation of the Principles within the investment industry.
- 5** We will work together to enhance our effectiveness in implementing the Principles.
- 6** We will each report on our activities and progress towards implementing the Principles.

What is ESG?

ESG refers to environmental, social and governance factors that may have a material impact on an investment. For example:

- **Environmental:** Environmental factors include the impact of a company's activities on the climate, including greenhouse gas emissions, and the risks and opportunities presented by climate change, energy efficiency, pollution, water and waste management, site rehabilitation, biodiversity, and habitat protection.
- **Social:** Social factors include human rights, community consent/impact, respect for indigenous peoples, employee relations and working conditions, discrimination, child labour and forced labour, health and safety, and consumer relations.
- **Governance:** Governance factors include the alignment of interests between executives and shareholders, executive compensation, board independence and composition, board accountability, shareholder rights, transparency/disclosure, anti-corruption measures, financial policies, and the protection of private property rights.

¹References to RBC GAM include one or more of the following: RBC Global Asset Management Inc. (including Phillips, Hager & North Investment Management), RBC Global Asset Management (U.S.) Inc., RBC Alternative Asset Management Inc., RBC Global Asset Management (UK) Limited and the asset management division of RBC Investment Management (Asia) Limited.

What is ESG integration?

ESG integration involves assessing ESG factors as part of the overall investment decision making process. The potential impact of ESG factors may not be apparent in the financial statements of companies but can have as much impact on the value of an investment as more traditional financial factors. For example, if a mining company is facing community opposition to a new mine, a failure to acknowledge and resolve the community's concerns could eventually lead to the company losing its license to operate. As another example, a company that does not invest in staff training or ignores health and safety issues will eventually face staff retention and labour productivity issues. These ESG-related issues represent real financial risks that must be factored into the assessment of any potential debt or equity investment in the company.

Conversely, if a company is doing a good job of identifying and managing its ESG risks and opportunities, it may be better than its competitors at identifying and exploiting competitive advantages that may result in superior, sustainable returns for investors. In fact, when a company manages ESG risks well, it is often a good indication that it manages other risks well. It is perhaps not surprising, therefore, that a considerable amount of academic research has concluded that companies that manage their ESG risks well have a lower cost of capital (for debt and equity), stronger operating performance and stock price outperformance over the longer term.²

Integrating ESG is often linked to the obligation of institutional investors to be 'active' owners/investors. The concept of active ownership includes integrating ESG, monitoring ESG issues in

our investments, voting our shares in companies responsibly and communicating with companies to help improve their ESG-related policies and practices.

For example, when evaluating an investment opportunity, the following ESG issues may impact risk and potential returns:

Environmental

- Are there ongoing environmental investigations and/or have environmental fines been levied?
- Is the company's business subject to increasing risks as a result of climate change?
- Is the company in a high carbon emitting industry and if so, is it disclosing its carbon emissions and taking meaningful steps to reduce them?

Social

- Does the company monitor its supply chain for potential human rights violations or health and safety issues?
- Does the company have high employee dissatisfaction and turnover which could impact productivity?
- Are there any significant product safety concerns?

Governance

- Does the board of directors have relevant expertise and are they independent?
- Does the compensation plan align the interests of management with the interests of shareholders?
- Does the company's disclosure provide meaningful information to investors?

How does ESG integration differ from socially responsible investing?

ESG integration is very different from socially responsible investing (SRI) or ethical investing. SRI investing involves screening out or excluding investments based on a particular set of values. For example, SRI funds may screen out investments in companies related to the tobacco, alcohol or gambling industries. RBC GAM offers a suite of SRI funds for clients who want to exclude certain industries they may find objectionable. In contrast, integrating ESG does not involve negative screening or values-based judgments about a

particular security or sector. Instead, ESG integration involves an enhanced analysis of companies, beyond traditional financial metrics, in order to better understand their ESG-related risks. For example, a fund that integrates ESG factors may hold companies with high ESG risks or poor ESG practices, but it will be able to better identify and understand those risks and then engage with those companies to improve their ESG-related policies and practices.

² See, for example, the following two meta-studies: From the Stockholder to the Stakeholder, 2015, University of Oxford & Arabesque Partners Asset Management, available at: http://www.arabesque.com/index.php?tt_down=51e2de00a30f88872897824d3e211b11; Sustainable Investing Report, Deutsche Bank, 2012, available at: https://institutional.deutscheawm.com/content/media/Sustainable_Investing_2012.pdf

How is RBC GAM integrating ESG and working as an active investor?

Our approach to ESG integration and active investment includes:

1 Research: Our Corporate Governance & Responsible Investment group ensures that the investment teams have access to industry-leading research on ESG issues and supports them by helping ensure that research is relevant, accessible and easily integrated.

2 Proxy voting: Voting responsibly is part of our fiduciary duty and we make our voting decisions independently, in accordance with our custom Proxy Voting Guidelines, which we update every year and publicly disclose on our website. All of our proxy voting records for our prospectus qualified funds are posted on our website. Our Corporate Governance & Responsible Investment group votes all of the shares held by any of our funds centrally, in order to ensure that the votes for all of our holdings are cast consistently across all funds and markets.

3 Engagement: Engagement refers to direct communication between shareholders and the board or management of the company, depending on the nature of the issue. Its purpose may be to better understand a company's approach to ESG issues or it may be to encourage the company to adopt better practices, including improved ESG-related disclosure and/or more effective identification and management of ESG issues. Engagement is an important tool for shareholders to encourage companies to make changes designed to improve shareholder value over the longer term. As Canada's largest asset manager, our considerable scale uniquely positions us for a constructive dialogue with the boards and management of the companies in which we are invested.

4 Collaboration: When appropriate, we work together with like-minded investors, either directly or through organizations/coalitions, to allow us to have greater influence over the ESG practices of the companies in which we are invested.



RBC GAM is a founding member of the Canadian Coalition for Good Governance (CCGG) and our Chief Investment Officer in Canada, Dan Chornous, is the chair of the board. CCGG works to improve shareholder rights and engages collectively on behalf of all of its members with Canadian public companies in which they have invested.



RBC GAM is a sustaining member of the Responsible Investment Association, Canada's association for responsible investment. A member of our Corporate Governance & Responsible Investment team is the Chair of the Board.



RBC GAM is an active member of the International Corporate Governance Network and the Council of Institutional Investors.

5 Engaging with regulators and lawmakers: As a firm, we engage constructively with regulators and other lawmakers to ensure the shareholder perspective is heard when changes to laws or regulations are being considered.

The future of responsible investment at RBC GAM

RBC GAM believes that the number of large and small investors who want to invest in strategies that integrate ESG will continue to grow and we are well-placed to meet that growing demand. We are confident that integrating ESG and acting as a responsible, active investor will provide us with more robust information that will help us deliver superior, sustainable results for our clients. Through our formal and informal collaboration with other investors, we will continue to refine our approach and develop ways to better identify and understand ESG issues that may have a material impact on our investments.

More detail about our approach can be found in the RBC GAM “Approach to Responsible Investment” which is available on the Corporate Governance & Responsible Investment page of our website at www.rbcgam.com.

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