Janus Henderson INVESTORS

ESG Quarterly Review

May 2021 For professional investors only

Welcome to the latest edition of our ESG Quarterly Review

Janus Henderson is committed to maintaining an open dialogue about environmental, social and governance (ESG) principles and market trends. The information we share in this review highlights the work that is being implemented across the firm, as well as providing insight into what our key stakeholders are thinking about ESG.

ESG Evolution

Kelly Hagg, Global Head of Product Strategy & ESG, Distribution

Over time the ESG scene has evolved from “should we?” to “how do we?”. The effect on asset managers is at both a corporate level (think: authentic commitment) and investment strategy level (think: impact, integration and engagement).

More and more asset managers are making commitments regarding their environmental impact and social causes. Often, these span ambitious and demanding targets. How should clients assess these promises and how can they be sure that the investment manager is authentic? What proof points and plans should be expected?

This cuts both ways. Janus Henderson and other asset managers are having to consider how to cater for different ESG values and requirements within their client segments. For example, the term “ESG” generally means something different for those in Denmark versus China versus Brazil.

ESG, like many changes in the asset management industry, is an evolution, and at Janus Henderson we recognise the challenges for clients and asset managers. Our approach includes providing insights from across our distribution and investment teams with future articles planned on the challenges and opportunities they see in relation to ESG. Our corporate ESG web page reflects some of our latest thinking and will evolve with our approach in this area.

Our corporate view of ESG

In the previous ESG Quarterly Review, we highlighted new ESG leadership within the firm and discussed our near-term focus. We have continued to make meaningful progress, highlights from the last few months include:

- Delivering an internal ESG Distribution Roadshow – highlighting client expectations from all regions and explaining our strategy to our employees.
- Deployed our first two Sustainable Finance Disclosures Regulation (SFDR) / European Union Taxonomy products in the Article 9 and Article 8 categories in Europe. Developed our preliminary list of Phase II SFDR products.
- Our latest Impact Report was published, which includes detailed information on our corporate sustainable strategy, programmes, initiatives, and partnerships.
- The Janus Henderson Diversity & Inclusion (D&I) committee continued to progress discussion on future definitions, statistics, and goals. Our latest D&I Report was published to our website (and is also available upon request) while an internal D&I survey was conducted to gain a more detailed picture of representation within our firm.

Our clients and ESG

ESG requirements and expectations differ globally. It is interesting and informative to explore how clients see the evolution and their partnerships with Janus Henderson, so we asked colleagues around the globe to provide some insight into the impact ESG is having in their regions.

Scandinavia

Preben Oeye, Head of Nordics

ESG has been at the forefront of investing for Nordic and Scandinavian institutions for many years. What started with simple exclusion lists has developed over the years into a more integrated approach. Today, most pension funds operate with more of a positive inclusion policy where the emphasis is on the environmental and social aspects of ESG. The governance part is still very important but has always been taken into account to some degree across all investments.

Investors vary in their focus and in some jurisdictions climate change has taken the front seat. This is addressed through the measuring of carbon emissions from the investments and scoring systems from external providers, such as MSCI and Sustainalytics. Separate reports are being produced for some clients, breaking down the carbon emission scoring from all portfolio holdings. Some clients have taken this even further and want all holdings to be linked to climate change, although this is rarer.

Clients across the Scandinavian region are feeling pressure politically to change the way they invest and avoid companies that are seen to do harm to the planet or to society. The ‘Greta Thunberg effect’ has been strong, especially in Sweden but also in the other Nordic countries. COVID seems to have derailed the climate focus for the time being as saving lives has become more important than saving the environment. However, it is expected that this is only short term and that we will soon be back on track.

For many investment managers, the expectation to deliver strong outperformance as well as perform well from an ESG perspective can be tricky. This is because many companies need time to change the way they operate and to switch their focus from, for example, fossil fuels to a sustainable energy source. In these instances, the engagement between investors and the companies is seen as key in terms of bringing about change.

The way that asset management firms like Janus Henderson are perceived from an ESG perspective continues to grow in importance. It is key to take the right steps and to build a good ESG profile from a top down perspective that is in line with clients’ expectations. These days meetings focus on investments and the firm’s position on ESG considerations.

Clients have become sophisticated in terms of how they assess ESG and it is clear there is no ‘one size fits all’ approach, so a spectrum of approaches is acceptable provided related issues are being addressed.

US Insurers

Chris Wong, Head of Financial Institutions, North America

Janus Henderson's US Financial Institutions team covers the US life insurance space, focusing on insurers with large annuity or defined contribution asset bases, or both. These firms use our investment expertise via sub-advisory or use our funds as investment options within their various product platforms. This can include annuities, variable life, and defined contribution plans.

Inquiries around the firm's ESG efforts have increased over time and were initially driven by advisor demand. As most did not have dedicated ESG portfolios on the platform, they wanted to understand how their asset managers incorporated ESG into the investment process so that they could use existing managers as solutions. Not surprisingly, they found that most of the managers were already incorporating ESG factors in their investment process to a meaningful extent.

On the heels of this, insurers began to explore the launch of dedicated ESG portfolios within their products, but adoption has been slow. One analyst commented in 2019, "we are waiting to see if the flows follow the publicity" and at least within the retail markets, where insurers play, this has not seemed to materialise.

Amongst variable annuity issuers, there are only seven ESG or Socially Responsible Investment (SRI) funds currently in existence, and three of these are firms that might be described as a natural audience for ESG – religious, not-for-profit, or educational client bases. Defined contribution platforms placed their priorities elsewhere in the wake of the Trump administration's Department of Labor (DOL) guidance in 2020, which created fiduciary questions for plan sponsors who were considering the addition of ESG funds to their plan menus.

With the Biden administration having provided more positive guidance, we have seen inquiries on the rise. Despite the muted commercial success of existing options within insurance platforms, interest in ESG remains strong, as insurers are experiencing higher demand from their advisors and their distributors and see that as a leading indicator.

Indeed, almost without exception, every insurer – if they do not already offer a dedicated ESG investment option – continues to explore the idea. This has led to productive meetings where we have been happy to provide education to clients on ESG and our capabilities.

It is this enthusiasm for the space that has our team excited to engage clients and proactively share Janus Henderson's ESG story.

Australia

Greg Clarke, Director, Institutional Solutions, Australia

There are few Australians who have not been impacted by recent weather events in the country – droughts, bushfires, floods and the ever increasingly intense storms. This has rapidly forced all investors (and in turn their superannuation funds) to reconsider their role in contributing to and responding to issues such as climate change.

This alone has been a key driver for growth in ESG-driven investing in Australia. It has also combined with the impacts of COVID and a greater focus on global social injustices, leading investors of all types to advance their commitment to ESG-focused investing, pushing it into mainstream investment activities. As a result, responsible investing in Australia has been evolving rapidly in the past few years, driven by the demands of all investors, institutional and retail alike.

It is now clear that the 'tick a box' approach to responsible investing will no longer satisfy investors. Only a few years ago, being a member of the Principles for Responsible Investment (PRI) and having a responsible investment policy was standard industry practice. Today, investors analyse at length an investment manager's PRI submission and the practice of "greenwashing" is likely to cause damage to their reputation.

Superannuation clients across the spectrum (and their consultants) are quickly demanding comprehensive information at all stages of the investment, sales and client servicing process. This includes not only additional mandate restrictions but greater levels of information in RFP's and ongoing due diligence (including the consultant ratings process). Annual ESG reviews by client's specialist ESG teams is increasingly becoming the norm and the breadth of topic is expanding exponentially.

Some of these key demands from clients include:

1. Improved measurement and transparency of holdings, including:
    - Key climate indicators such as measuring carbon emissions.
    - Greater disclosure of high risks investments.
    - Disclosure of diversity and inclusion measurement of underlying holdings.
2. A greater focus on ESG factors of tier investment managers at a corporate level including:
    - Carbon footprint.
    - Diversity and Inclusion metrics.
    - Exclusions on key topics such as modern slavery.
3. Greater levels of transparency on their company engagement policy. For example, topics raised with company management as well as publishing company voting records, with underlying explanations for pooled vehicles.
4. Investment products and strategies with implicit and explicit ESG objectives.

Australian regulators such as APRA, ASIC and The Reserve Bank increasingly continue to highlight key financial risks and provide guidance on the importance of understanding and reporting of their ESG risks and opportunities. Many listed companies in Australia already produce sustainability reports (although they are not legislated to do so) and regulators already require companies with revenue of more than A$100 million to report on the risk in their business on modern slavery.

While specific regulation for investors is not currently overly prescriptive, some of the larger superannuation funds have moved ahead of regulators in anticipation of more onerous reporting requirements but also to satisfy member interests. The increasing regulatory burden and demand from investors for increased ESG reporting means that reporting obligations on asset managers are only likely to grow into the future.

European Union Regulations

Kathryn Scott, Business Management and Projects, Distribution

On 10 March 2021, the Sustainable Finance Disclosure Regulations (SFDR) and Autorité des Marchés Financiers (AMF) Doctrine (similar rules specifically for the French market) came into force. Initially, the high level SFDR regulations affect funds and segregated accounts either domiciled or marketed in the European Union (EU).

The key items to note are:

- Article 9 funds include environmental and or social characteristics in their investment objective and must invest in sustainable investments.
- For Article 8 funds there are no binding requirements to invest in sustainable investments, however, they must have a mandatory characteristic that promotes environmental or social factors.
- All other financial products in scope are considered Article 6 (non-green). Article 6 funds may take into account sustainability risks in their investment process and must disclose it is not Article 8 or 9 under SFDR.
- A new Sustainability Risk Policy was created and is available on our European websites (or upon request).
- The Remuneration Policy was amended to take sustainability risks into account and is available on our website (or upon request).

Where next?

- Planned launches/conversions of Article 8 and Article 9 funds in Europe.
- Ongoing discussions with clients to assess their future needs.
- EU regulators continue to update the draft regulations.
- SFDR detailed rules come into force on 1 January 2022.
- Taxonomy regulations start with the introduction of two environmental factors on 1 January 2022.

UK

After Brexit the UK decided not to onboard the EU's SFDR or Taxonomy Regulations. We await the start of the Financial Conduct Authority's (FCA's) consultation process, which is expected to issue draft regulations for comment during the course of this year.

On 22 April 2021, the UK Treasury Committee made a series of recommendations in its report for how the UK government can achieve net-zero carbon emissions by 2050. We wait to see how this plays out in the regulations affecting the asset management industry.

Janus Henderson ESG thought leadership

As ESG issues continue to evolve and mature, we are committed to maintaining an open dialogue with our clients, shareholders, employees, and industry groups. As part of our Knowledge Shared approach we seek to make the thinking of our investment teams widely available with articles, videos and white papers available on our website. A selection of recent articles, including some of the following, can be found within the ESG section of the site at www.janushenderson.com

The ABC's of ESG
ESG investing has become a central theme across the investment community. Paul LaCoursiere, Head of ESG Investments, introduces the three main categories of ESG investment strategies and explores some of the considerations to be aware of.

Shining a light on 'hidden' ESG in European smaller companies
European smaller companies' managers Ollie Beckett and Rory Stokes discuss the impact that the rise in ESG has had on the market and why it is important to look beyond ESG ratings.

Technology: solutions for a sustainable future in transport
Technology portfolio managers Alison Porter, Graeme Clark and Richard Clode highlight how technology companies are providing solutions for a future of sustainable transport.

Why should investors care about ESG?
Paul LaCoursiere, Head of ESG Investments, examines three key reasons why investors should care about ESG and the main challenge faced by the investment industry.

Analysing ESG factors for risk and opportunity
Brian Demain and Cody Wheaton explain that ESG factors have become a significant risk/opportunity consideration for both companies and investors.

Taking stock of the mining sector
Tal Lomnitzer discusses the drivers of change in the mining sector and why ESG credentials matter in the move towards a digitised, electrified and fossil fuel-free future.

China decarbonisation: the emergence of a mega-theme
Daniel Graña, Matt Doody and Jennifer James look at how China decarbonisation has the potential to be one of the biggest investment themes over the coming years.

We hope you found this ESG Quarterly Review informative. We welcome any feedback you may have on it and please speak to your usual Janus Henderson representative if you would like any further information relating to anything covered in this update.

IMPORTANT INFORMATION

Environmental, Social and Governance (ESG) or sustainable investing considers factors beyond traditional financial analysis. This may limit available investments and cause performance and exposures to differ from, and potentially be more concentrated in certain areas than, the broader market.

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