FIXED INCOME

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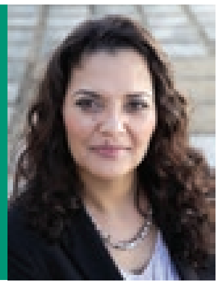

AN UNWAVERING COMMITMENT TO ESG INTEGRATION

KEY TAKEOUTS

- **ESG risks can impair an issuer's credit quality**
- **There is no standard set of ESG risk parameters for fixed income, it differs across issuers and sectors**
- **ESG is full of judgement and biases; as managers we should exercise judgement**
- **Build investment processes that earn sustainable returns**
- **ESG should never compromise risk/return principles**

Futuregrowth manages approximately R185 billion of assets in the fixed income space, ranging from money market, vanilla and inflation-linked bonds to high-yielding credit bonds, and a suite of developmental (impact) funds across a variety of asset classes.

As defined by our Responsible Investment philosophy, we seek to promote sustainable environmental, social and governance (ESG) best practice in our investee companies. We believe that ESG issues are key components in managing investment risk. A lack of attention or management of ESG issues can have a negative impact on risks and rewards – as evidenced in many recent headlines relating to governance failures in the South African market.

APPLYING ESG ANALYSIS TO FIXED INCOME

Our primary objective is to earn appropriate risk-adjusted returns at all times for our clients. As such, it is necessary that ESG screening and analysis forms part of an integrated investment process across our wide range of mandates. In this way, non-financial ESG indicators are assessed along with financial and credit indicators in order to produce a holistic risk profile of any new or existing loan, at a given point in time. We use a variety of tools and inputs for this purpose, and these are constantly fine-tuned as new learnings arise. The fixed income asset class is complex due to the wide variety of issuers, and therefore there is no "one-size-fits-all" solution to analysing companies on sustainability issues. Therefore, there will be variances in our approach to, for example, issuers in the listed space versus those in private debt.

EXAMPLES OF SCREENING CRITERIA COULD INCLUDE:

ENVIRONMENTAL
Does the company assess the environmental risks arising from its operations, and what processes are in place to do this and how do they mitigate these risks?

SOCIAL
What impact do the company's activities have on local communities and other stakeholders?

GOVERNANCE
Does the company routinely disclose material transactions that involve conflicts of interest of any directors, and any fines or regulatory non-compliance – and is there a record of how these situations have been addressed?

ENGAGEMENT IS KEY

We have a large, skilled credit team and we're able to negotiate specific terms in loan agreements on behalf of our clients – and have the added benefit of being able to structure many of these loans internally. As lenders, we seek strong covenants in order to protect our clients during the term of a loan, for example, we require borrowers to report timeously on any material events that could affect the credit quality of the loan. Examples of such events could be reputational damage to the company due to a failure to respond timeously to poor product quality that resulted in harm to consumers, extreme weather incidents that caused unforeseen production losses, or unanticipated expenditure relating to health and safety non-compliance, among others. On these occasions, we engage with the borrowers to ensure that the risk is minimised as far as possible, and, importantly, that long-term, proactive strategies are devised and implemented to manage the risk and the impact on future revenues. Learnings from these events are shared internally and applied across all our investments, where applicable, to the benefit of all our clients in the end.

A COMPETITIVE ADVANTAGE

In our rapidly changing environment where responsible investment practices are gaining momentum and evolving, the financial services industry continues to grapple with risks of an ESG nature. We believe that our focused and dynamic approach has set us apart in this field. We add value to our clients' portfolios by integrating ESG into our investment processes and engaging borrowers on material issues that affect the sustainability of their business. We also strive to add value to our industry by engaging the market around improving capital market standards while being mindful of the issues summarised in this article's key takouts aforementioned.