



Colchester[®]
GLOBAL INVESTORS

Colchester ESG Policy

August 2023



Responsible Investment

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Introduction

Colchester Global Investors (Colchester) is a medium-term value-driven investment manager. Investments are made in fixed interest securities issued by sovereigns and supranational institutions and their currencies. The factors that underpin the Colchester investment process are wide ranging incorporating macro-economic and financial analysis alongside environmental, social and governance (ESG) factors. Responsible investing is and has been integral to the investment process employed by Colchester since the inception of the company in 1999.

Colchester believes that countries with better ESG standards tend to produce better economic growth, more stable balance sheets, and better long-term and sustainable financial outcomes. Our investment strategy therefore rewards those countries with better and penalises those with weaker ESG standards, as we believe that this will deliver better risk-adjusted returns for our clients over the medium-term.

Colchester's investment programs invest primarily in sovereign bond markets that offer attractive real yields adjusted for the strength of their balance sheet and in undervalued real exchange rates adjusted by the strength of their external financial balance sheet. Colchester does not rely upon external credit rating assessments as we perform our own research. Our portfolios are highly transparent, liquid, unlevered and do not utilise securitization vehicles, credit or other corporate bonds. All portfolios managed by Colchester follow a similar investment management strategy based on the analysis of inflation, real interest rates and real exchange rates, supplemented by an assessment of sovereign financial balances - fiscal, external, monetary and ESG factors.

Colchester invests on a global basis in both developed and developing/emerging markets. Risks associated with the investment process include, but are not limited to the following:

1. Currency exchange-rate risk;
2. The possible imposition of withholding, income or excise taxes;
3. The absence of uniform accounting, auditing and financial reporting standards, practices and disclosure requirements and weak government supervision and regulation;
4. Financial, economic and political risks, including capital controls; and
5. Global market turmoil.

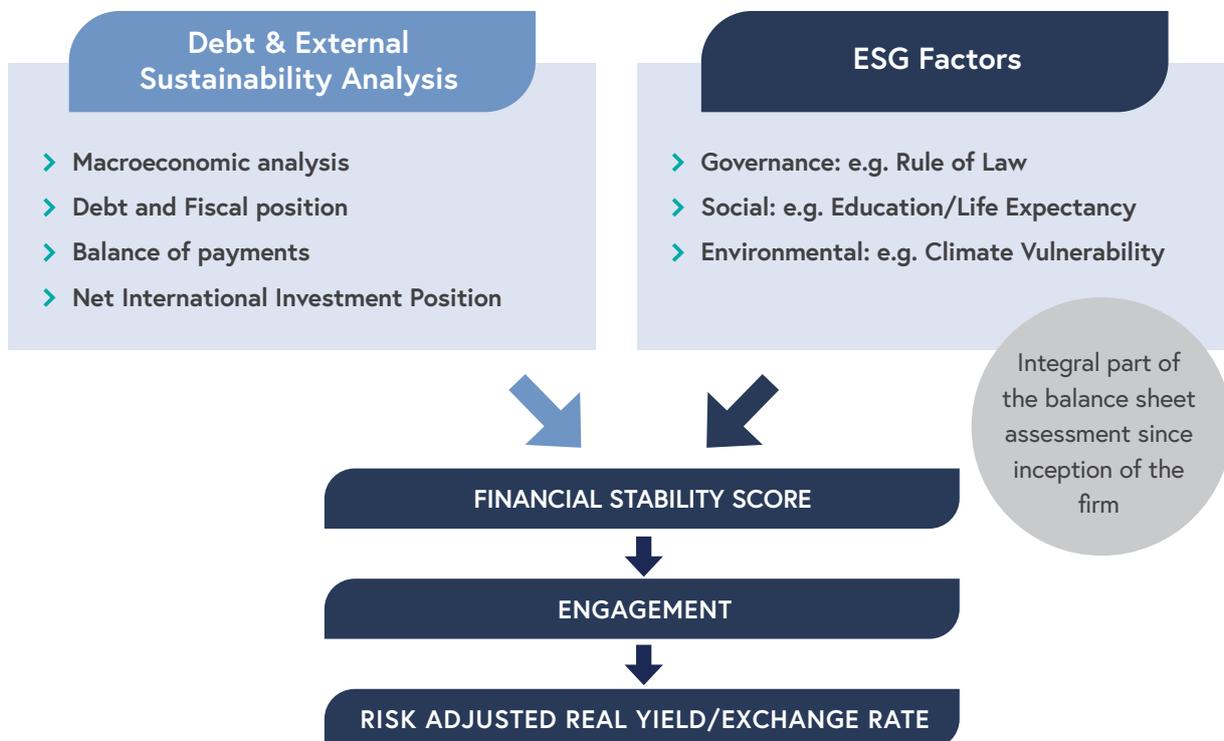
While ESG considerations are inherent in our financial stability analysis, they also inform our assessment of these, and other risks, that impact on the construction of our portfolios. ESG factors are not as easily identified, measured or acted upon for sovereign debt as they are for equity or corporate debt, but can still be incorporated into the investment process. Governance is clearly a key consideration, although environmental and social considerations also play a role in determining the medium-term stability and economic performance of a country.

Investment Process

The Investment Team perform detailed research assessments for all countries within the investment opportunity set. This country research process is performed independently by Colchester's investment professionals and is supplemented, where possible, by meetings with government finance departments, economists, political analysts, major corporates and independent 'think tanks' to develop a rounded picture of a country's status and prospects. Colchester's Investment Team also engage with stakeholders, where possible, during country research trips.

ESG factors are integrated holistically into our valuation framework. Countries are assigned a proprietary Financial Stability Score (FSS) that combines an assessment of their overall balance sheet strength and ESG factors (Figure 1). Bond and currency scores range from +4 to -4¹ and are determined through an extensive assessment of the macro-economic environment, policy framework, ESG standards and other country specific factors. The data used in the financial health assessment comes from government statistical offices, central banks and international institutions such as the OECD, IMF and BIS. Similarly, ESG data comes from standardised internationally recognised organisations such as the United Nations and the World Bank, as well as relevant databases and other independent sources such as the Notre Dame Global Adaptation Initiative and the YALE Environmental Performance Index. The ESG data is standardised into a proprietary ranking or ESG score for each country, which in turn is incorporated into the overall FSS along with the assessment of balance sheet strength and qualitative analysis.

Figure 1: Financial Stability Score a function of Balance Sheet and ESG Factors



Responsible investing is an integral part of the investment process however Colchester never makes investment decisions based solely upon ESG factors. Unless specified in the client Investment Management Agreement or offering documents, specific assets with poor ESG ratings may not be excluded from portfolios.

¹ The scoring range of +4 to -4 applies to countries typically considered for inclusion within Colchester's Global Bond and Emerging Market programs. The lower bound has been extended to -8 to allow for the application of the framework to Frontier Markets.

Sovereign ESG Scoring Framework

Whilst there are strong interlinkages between ESG factors and traditional balance sheet or "credit" metrics, Colchester has developed a sovereign ESG Scoring Framework to measure and compare countries' exposures specifically to ESG risks, in a systematic and consistent fashion. A series of publicly available metrics are used to assess ESG risks under a variety of categories. For example, environmental metrics consider a country's vulnerability to climate through two lenses, namely physical risk and transition risk. Physical risk relates to a country's sensitivity to the implications of climate change such as extreme weather events, whilst transition risk is concerned with the implications of adjusting to a low-carbon economy. Social characteristics of a country are assessed via Human Capital (the knowledge, skills and experience of the population) and Social Cohesion (the levels of trust, accountability and equality prevailing in society). Governance standards such as the rule of law, property rights and financial freedom are also measured.

The indicators and risk factors considered are set out below in Figure 2. These indicators are combined and distilled into a composite ESG score for each country on a normalised scale of 1-100.

Figure 2: Sovereign ESG Indicators

	Pillar	Risk Factor	Indicator	Source
Environmental	Transition Risk	Decarbonisation	Renewable Energy Coal/Oil rents CO ₂ emissions per capita Total CO ₂ emissions Scenario Analysis*	Bloomberg NEF World Bank EDGAR EDGAR Colchester Global Investors
	Physical Risk	Environmental Damage Vulnerability to Climate Change	Air Quality Sanitation & Drinking Water Biodiversity Vulnerability Index Scenario Analysis*	YALE Environmental Performance Index YALE Environmental Performance Index YALE Environmental Performance Index Notre Dame Global Adaptation Initiative Colchester Global Investors
Social	Social Cohesion	Political Stability/ Representation Equality Health & Education	Voice and Accountability Political Stability & Absence of Violence Gini coefficient Life Expectancy at Birth Education (Expected/Mean years of schooling)	Worldwide Governance Indicators Worldwide Governance Indicators World Bank World Bank UN Human Development Report
	Human Capital	Demographics Labour Market	Old Age Dependency Ratio Prevalence of Modern Slavery Female Labour Force Participation Youth Unemployment	World Bank Global Slavery Index World Bank World Bank
Governance	Government Effectiveness	Government Effectiveness	Government Effectiveness Regulatory Quality	Worldwide Governance Indicators Worldwide Governance Indicators
	Rule of Law	Corruption/Property Rights	Freedom from Corruption Property Rights World Press Freedom	The Heritage Foundation The Heritage Foundation Reporters Without Borders
	Economic Environment	Economic Freedom	Trade Freedom Investment Freedom Financial Freedom	The Heritage Foundation The Heritage Foundation The Heritage Foundation

*For more information on the climate change scenario modelling undertaken by Colchester, please refer to the December 2022 Sustainability Report on the website www.colchesterglobal.com.

ESG Scoring Methodology

Colchester's ESG score is a composite one, combining data on 11 risk factors, using 27 different indicators listed above. Each country is scored on each individual indicator, using a 1-100 scale. As each indicator is measured differently, we normalise (or rescale) the underlying data as follows:

$$\text{Indicator Score} = ((100-1) \cdot (X - \text{min value}) / (\text{max value} - \text{min value})) + 1$$

where X is the unadjusted indicator value, and the min and max values are the largest and smallest indicators values within the universe of countries.

Indicator scores are aggregated within each Risk Factor into a composite score. For example, under the Risk Factor Environmental Damage, the average of the indicator scores of Air Quality, Sanitation & Drinking Water, and Biodiversity is used to create a Risk Factor score on a scale of 1-100. Under the Vulnerability to Climate Change Risk Factor, as there is only one indicator, the score for the Vulnerability Index is the value for the Vulnerability to Climate Change Risk Factor. Countries can be compared and assessed on these Risk Factors, whilst the Risk Factor scores are averaged within each Pillar such as Transition Risk, or Physical Risk. The scores for each Pillar are then averaged within each of Environmental, Social and Governance to create E, S and G scores. All of these scores are comparable, being on a 1-100 scale. The separate E, S and G scores are equally weighted to arrive at the final ESG score for each country.

As mentioned, the ESG scores are incorporated into the Financial Stability Scores assigned to each country. Whilst the ESG methodology outlined above is a systematic and structured approach to assessing sovereign ESG risks, the translation of this into our FSS does involve an element of qualitative analysis and judgement. We believe that qualitative judgement is required as no systematic or model-based approach can be expected to capture all relevant information, and the relative importance of the various elements can and do vary across countries. The ESG score is combined with this qualitative judgement, along with an assessment of the country's balance sheet and macro-economic stability by the relevant Investment Officer, and a proprietary Financial Stability Score is recommended to the Investment Management Committee (IMC).

With regard to debt issued by supranational institutions or multi-lateral banks, country exposure for the purpose of applying the appropriate FSS is based on the currency of denomination of the bond in question rather than on the country of the issuer. Such debt is priced relative to the respective government yield curve in the currency of denomination, and so the financial stability assessment, incorporating ESG factors, of this government/currency and the wider economy is relevant. For example, the FSS score of the eurozone and the euro is applied to debt issued by the IBRD (World Bank - domiciled in the US) debt issued in the eurozone, in euro's. Our investment process will focus primarily on higher quality supranational issues with credit ratings better than BBB+.

Engagement

Colchester's Investment Team seeks to engage with sovereigns, helping to inform, promote and potentially drive best practices delivering better social, environmental and economic outcomes. The conclusions drawn from our ESG analysis, and the Framework outlined above, can help to identify areas of potential engagement with sovereign issuers. Findings during the engagement work can also feed into the qualitative aspects of the FSS. We produce an ESG Engagement Report bi-annually, sharing our country engagements in respect of ESG matters. The Engagement Report and further information on Colchester's Sovereign Engagement Framework is available on the website www.colchesterglobal.com.

Exclusion List

As a sovereign debt investor, we recognise the inherent dilemma in considering whether to exclude countries from the investment universe based on an assessment of sustainability indicators. In many instances such indicators are positively correlated to income per capita, and hence such exclusions run the risk of cutting off access to international capital for lower income countries. Such countries are often highly dependent on foreign capital to develop infrastructure, build human capital and underpin social stability, hence we give careful consideration to the implications for a particular sovereign issuer when assessing whether to include it in the investment universe or not.

That being considered, Colchester does maintain an exclusion list of countries that do not comply with international norms and standards, the sovereign debt of which we will not invest in. The list is comprised of countries subject to a United Nations Security Council arms embargo and may also include other countries as determined by the IMC. In deciding on the exclusion list, the IMC will have regard to financial sanctions imposed by the UN, the EU, the US, and the UK, as well as the research and analysis of the investment team. Colchester will not invest in debt issued by the government of the countries on the exclusion list, nor in debt issued by government-related entities based in the relevant country.

Debt issued by supranational institutions, multi-lateral banks and other similar entities is not covered by this policy.

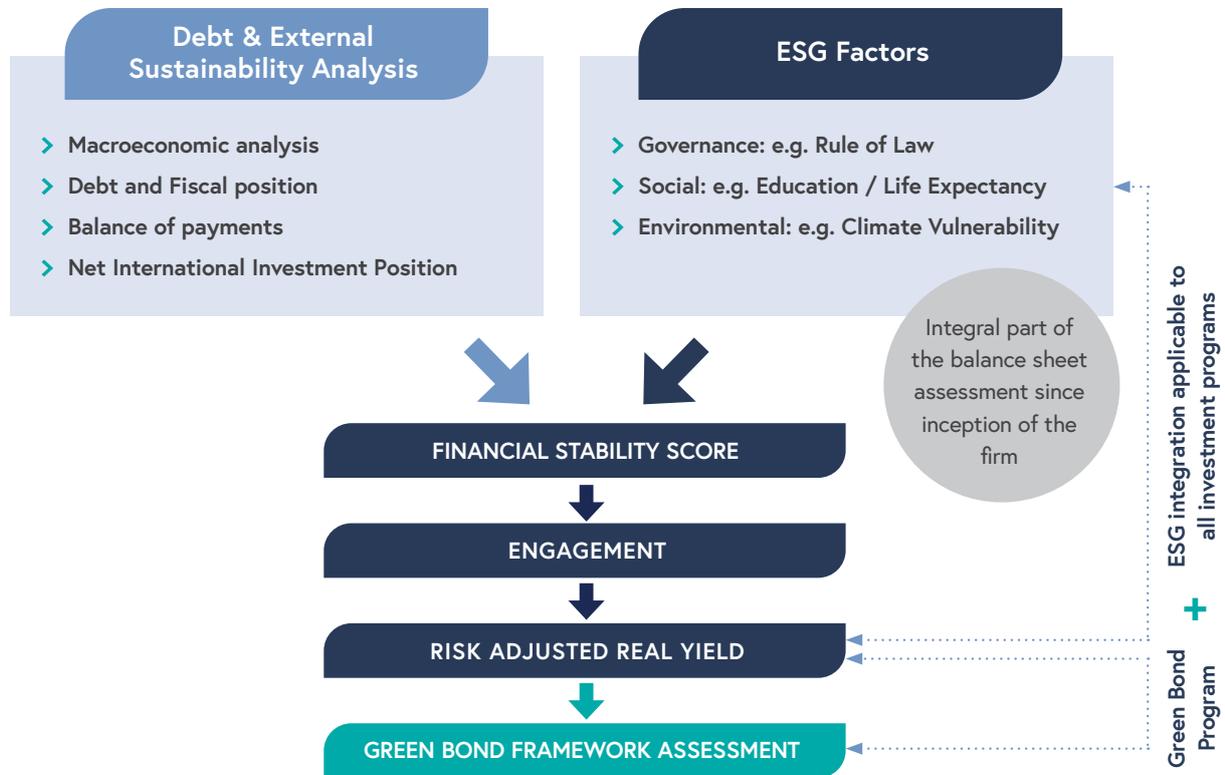
Colchester's Green Bond Framework

Our Global Green Bond Program uses the same valuation framework, portfolio construction and risk management techniques as our other investment programs. On occasions, we may buy green bonds issued by supranationals, due to the lack of availability of green bonds issued by governments, yield curve segments or valuations. We then apply two additional steps that impact on which bonds are considered within the opportunity set, and our ongoing willingness to continue to hold them.

1. Firstly, we make an assessment to determine whether an issuer's green bond framework is aligned with International Capital Market Association (ICMA)'s Green Bond Principles² or any other applicable standards (including the future EU Green Bond Standard). We then assess that the issuer has arranged for an independent second party opinion on the labelling of the issue as "green". In the absence of an independent second party opinion, Colchester will make its own determination that the issue can be labelled "green".
2. Secondly, we will monitor on an annual basis issuers' use of proceeds reporting by looking at their allocation report. In the absence of an allocation report we will either engage with the issuer or make an appropriate determination based on the information available.

² Green-Bond-Principles-June-2021-140621.pdf (icmagroup.org)

Figure 3: Colchester's Green Bond Framework



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SFDR and Sustainability Risk

The EU Sustainable Finance Disclosure Regulation (SFDR) came into force on 10 March 2021 and imposes mandatory ESG disclosure obligations on financial market participants. As defined by SFDR "Sustainability risks" means environmental, social or governance events or conditions that, if they occur, could cause an actual or a potential material negative impact on the value of the investment. Sustainability risk is applied in conjunction with Colchester's ESG integration approach and applies to all of Colchester's funds and mandates.

United Nations Principles for Responsible Investment

Colchester is a signatory to the UNPRI, implements and adopts the six principles of responsible investment. We see no conflict of these principles with our fiduciary duties and responsibilities to our clients. Colchester is cognisant and supportive of these principles. In summary, we put into action each principle as follows:

Principle 1 - We will incorporate ESG issues into investment analysis and decision-making processes.

Colchester incorporates ESG factors directly into its investment process via the country research process and Financial Stability Score which forms part of the portfolio construction and determination of the investment opportunity set.

Principle 2 - We will be active owners and incorporate ESG issues into our ownership policies and practices.

Colchester's Investment Team discusses ESG issues with investing clients at regular meetings as well as with issuers during country research trips when possible and appropriate to do so. In this way, we aim to influence, engage and improve ESG metrics for sovereign issuers.

Principle 3 - We will seek appropriate disclosure on ESG issues by the entities in which we invest.

During the Investment Team's country research trips, they will seek more ESG-related information, and discuss ESG-related issues further, where possible.

Principle 4 - We will promote acceptance and implementation of the Principles within the investment industry.

We hold regular meetings with clients, prospective clients and consulting firms that represent wide groups of investors in which we explain our investment process. These meetings regularly include specific discussion of ESG matters and particularly the impact of the Financial Stability Score.

Principle 5 - We will work together to enhance our effectiveness in implementing the Principles.

Colchester believes in a process of continued improvement and constant review of the quality of data and information used in its research effort. We review data on an ongoing basis and monitor how a country is developing and changing. Discussion, consideration and the continuous assessment of which ESG metrics or issues to be included in the investment process is a key component of this analysis.

Principle 6 - We will each report on our activities and progress toward implementing the Principles.

Colchester explains to clients, prospective clients and consultants how ESG factors are incorporated into, and are supportive of, our investment process. We report annually on our approach to integrating ESG factors into our investment process and disclose our engagement activities.

Philosophy

Colchester believes that Responsible Investment supports our medium-term value-driven investment process. We believe that countries with higher governance standards, healthier and better educated workforces should, on average, generate better economic and financial outcomes. Countries with better ESG standards are therefore associated with stronger balance sheets. Colchester never makes investment decisions based solely upon ESG factors, but we do believe that these factors are an important determinant of identifying sustainable value, and as such, is in the best interests of our clients.

Governance

Our ESG policy is reviewed at least annually and updated as required. The IMC reviews and implements the responsible investment approach with the final sign off by Colchester's Chief Investment Officer or his designee.