

PGGM Responsible Investing in Investment Grade Credits

February 2014



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1. Introduction

On behalf of its clients, PGGM's Beta Investments Grade Credit team (Beta-IG) manages investment grade credits. PGGM recognizes the impact corporate bond investments may have on the environment and society and vice versa. This document addresses PGGM's management of environmental, social and governance (ESG) issues with regard to corporate credits.

The guideline is part of PGGM Investments' Responsible Investment Framework and its implementation guidelines. These are a more detailed elaboration of the PGGM Beliefs and Foundations for Responsible Investment.

The Implementation Guidelines on Exclusion are applicable to the Investment Grade Credit Fund.

The rationale for formulating a set of specific responsible investment guidelines for the Investment Grade Credit Fund is that the internally managed nature of the fund lends itself particularly well for managing ESG risks. Furthermore, the internal management of the Credit Fund also provides leeway to explore "investments in solutions" and green bonds. This document sets out the approach used to identify and manage ESG risks within the investment process, with the goal to embed ESG-related analysis more clearly in the decision-making process and enable oversight of ESG risk exposure at fund level.

The scope of these guidelines covers investments made by the Investment Grade Credit Fund. It will be effective as of **[February 2015]**.

With the introduction of these guidelines Beta-IG aims to effect an overall improvement in transparency and governance. Beta-IG follows relevant developments closely and will update the guidelines when necessary.

This policy does not confer any rights to any third parties.

2. Vision on ESG in Investment Grade credits

Definition

ESG risks encompass aspects related to the operations of an issuer, which may inhibit their ability to meet their financial commitments and/or may have significant reputational implications for both issuers and investors.

Beta-IG Beliefs

PGGM believes that ESG factors can have a material impact on the financial performance of its investments. PGGM sees it as its responsibility to capture the value and mitigate the risks related to ESG factors.

Academic literature shows compelling evidence that ESG factors can be correlated with credit quality. One of the key investment philosophies in credit investment is that avoiding the companies at risk of default is more important than picking every winner due to the fact that bondholders have maximum downside risk but limited upside potential. Therefore, incorporating ESG information into credit analysis is a natural fit for the Beta IG investments.

Beta-IG integrates ESG analysis of the companies in its credit research framework. We believe that ESG factors provide important additional information which improves our possibility to mitigate the downside risk.

Developed Investment Grade Credit Markets

Investment Grade Credit for the Developed Markets enjoys a good reputation in terms of ESG performance. This largely results from the economic reality of being 'developed' and operating in a good economic and social infrastructure.

Nevertheless the companies operating in the developed markets are also exposed through their supply chains to ESG risks more common in the emerging markets. This is another reason why Beta-IG takes a holistic view of the companies we invest in and integrate ESG analysis in our credit research framework.

Sector views

As a beta investor the fund is equally exposed to all the sectors in the benchmark: financials, cyclicals, non-cyclicals, TMT and utilities. In line with PGGM's Implementation Guidelines on exclusion, the fund excludes investments in the tobacco sector. Beta-IG has an unbiased approach towards sectors, and it differentiates between good and bad ESG performers within a sector.

Green bonds

There are also opportunities in the corporate green bond space. Green bonds enable capital-raising and investment for new and existing projects with environmental benefits. Beta-IG may also search to improve the ESG quality of the fund by investing selectively in corporate plain vanilla green bonds with the intent to reduce the impact on climate change. Beta – IG will only invest in the 'the use of proceeds bond or plain

vanilla green bond (see table 1: Green Bond Principles eligible green bond structures). The reason why Beta-IG has chosen for this instrument:

- They are senior unsecured bonds.
- Risk relates to the issuer.
- The green bonds are issued under the company's EMTN program.
- The bonds are part of the Beta-IG's investment universe.

The supply of corporate plain vanilla green bonds which are eligible to invest has been limited. At this moment the market is in an infancy stage and for this reason the market needs a standardization in order to attract a diverse investor base.

3. Objective

The objective of this guideline is to ensure that PGGM, and the Beta-IG team structurally and systematically take material environmental, social and governance issues into account in their investment process.

Beta-IG manages an investment mandate that is evaluated first and foremost by benchmarked financial returns. Beta-IG's high-level ESG objective is to be a best-practice investor within the confines of a benchmarked financial mandate.

Systematic approach and integration of third party output to improve knowledge and understanding

ESG analysis is an integral part of the internal credit research framework of Beta Investment Grade Credits. Introducing a more systematic approach also works towards improving transparency and consistency of Beta-IG's ESG analysis. In order to improve the transparency and consistency Beta-IG integrated third party research in its credit research framework. Coverage by external ESG rating agencies is nearly 100% for companies in the Fund.

Actively discuss/ engage ESG with Issuers

Beta-IG does not invest in companies that are included on PGGM's Exclusion List. Due to the emphasis on capital preservation, the Beta-IG team does not invest in companies which have excessively poor ESG performance. We may invest in companies with weak ESG practices when we see an improving trend. When possible we will engage with the company to raise awareness at the company level of the concerns and communicate the expectations of improvement.

PGGM notes that engagement from fixed income investors is a new phenomenon. Historically, equity holders as shareholders have voting rights and can use these, alone, or in consort with other investors to achieve change. Bondholders have no such direct control over a company's behavior and will have to rely on alternative tools.

Beta-IG will focus on applying soft pressure, such as raising concerns, educating and raising awareness. Beta-IG may consider

reducing or exiting an investment if it considers the response to engagement activities inadequate or unsatisfactory.

PGGM further notes that in the global capital markets, there is still considerable room to improve communication between the various asset classes (such as equity and fixed income), and even between investors

Green Bond Structure	Repayment Structure	Example transaction
1 Use of proceed bonds (plain vanilla bond)	Recourse to issuer	EDF, Iberdrola, Hera, GDF Suez
2 Use of proceed revenue bond	Pledged project CF's	
3 Project bond	Direct exposure to project (and recourse to issuer)	Solarcity, North Island Hospital Project
4 Securitised bond	Collateralised asset CF	Toyota, SolarCity

Table 1: GBP's eligible green bond structures (source: ICMA)

within an asset class (such as corporate credits) and there is no established platform to effectively coordinate actions. Beta-IG encourages cooperation between investors with the goal of promoting best practices in the industry.

Beta-IG actively participates in the investor discussion of standardizing the green bond category and working on clarifying the common dilemmas related to monitoring of the proceeds, assurance, ring-fencing and what constitutes a green bond.

4. Implementation

Investment process

With the implementation of this set of guidelines, Beta-IG aims to ensure that it structurally and systematically takes material environmental, social and governance issues into account in the investment process. The ways to approach ESG issues are illustrated by PGGM's Sustainability Stairway (Figure 1) and set forth the expectations PGGM has with regard to the ESG performance of investments.

One of the key beliefs of Beta-IG is that avoiding losers is more important than picking every winner because bondholders have maximum downside but limited upside potential. Therefore, most of the focus of Beta-IG will be on the left side of the stairway.

Beta-IG considers the exclusions, legal compliance and voluntary standards as minimum requirements.

ESG-factors has been incorporated within the credit research framework. Integrating ESG factors into fundamental analysis fits in the 'avoiding the losers' philosophy because it strengthens the ability to assess primarily the downside risk of credit investments

Exclusion

The Implementation Guidelines on Exclusion of PGGM are implemented and the Exclusion List is consulted for all potential investments.

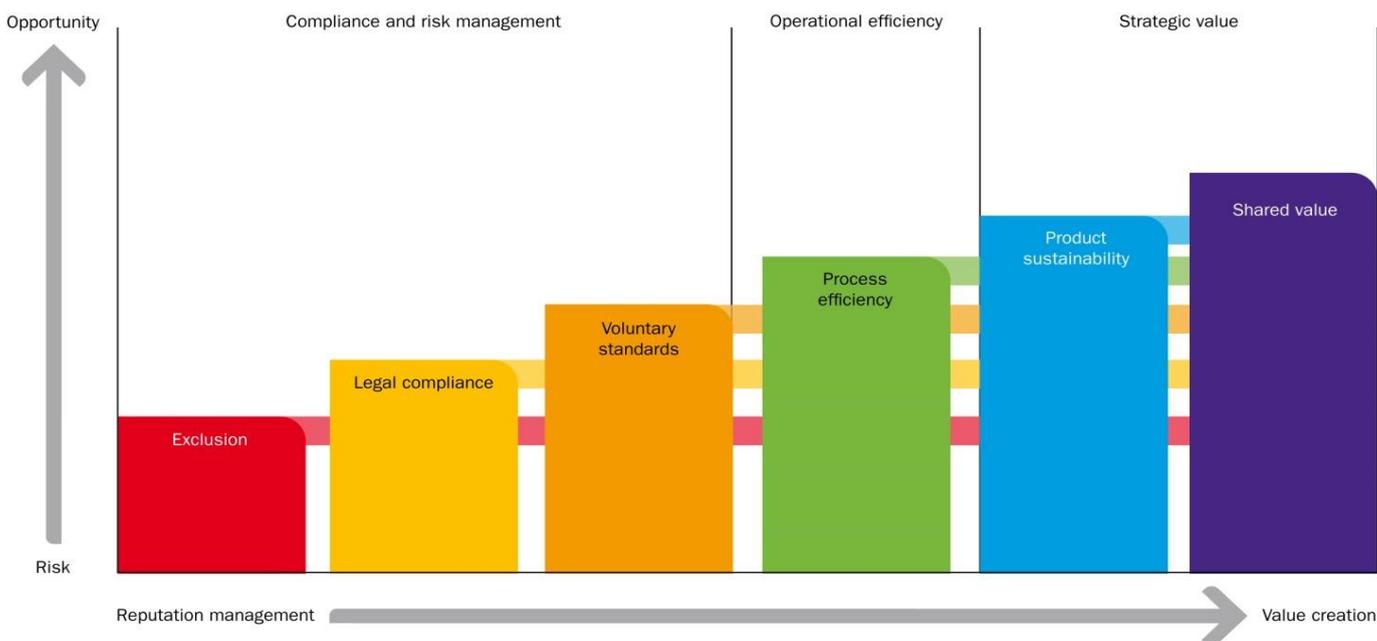


Figure 1. Sustainability Stairway (source: PGGM)

Legal compliance

Beta-IG expects the invested companies to adhere with all applicable environmental and social laws and regulations. The team consults different ESG sources for any red flags in this area.

Voluntary Standards

- Beta IG will consult third party ESG research of the concerned company.
- Beta IG will screen all the individual holdings on UN Global Compact and check for potential violations of the principles.
- Beta IG will rate the individual companies. Beta-IG will consult the Responsible Investments department (RI) for the high ESG risk companies, and where needed on medium ESG risk companies. Any opinions and considerations provided by RI will be taken into considerations in Beta-IG's decision process.

Strategic value/Investing in solutions

Beta-IG may also search for green bond opportunities within the objectives 'product sustainability' and 'shared value' (the right side of the stairway) to create social added value. Within PGGM, such investments are labeled investment in solutions and are annually reported on in the PGGM Responsible Investment Report.

For the corporate plain vanilla green bonds in the portfolio the Beta-IG team has developed a decision tree which allows for structural integration of ESG in the process. This improves the quality of the investment process.

Monitoring

Beta-IG continuously monitors its investment portfolio and on a periodic basis reviews all of its investments. At least once a year there is an intensive analysis of the individual names in the portfolio. The issuers who issued a green bond will be monitored whether they fit the criteria at the time when they were added in the portfolio.

For more information on PGGM Responsible Investing in IG Credits please contact our Responsible Investment department, +31 30 277 99 11 or visit our website www.pggm.com

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