Colchester®
GLOBAL INVESTORS

ESG Engagement Report

December 2023

Introduction

In our previous engagement report we noted the 28th United Nations Climate Change Conference (COP28). It was held from 30th November to 13th December 2023 in Dubai. The climate talks went over time by one day, as the 198 nations were divided over how the fossil fuel phase out should be conducted. Whilst views on the success of the Conference will differ among countries and participants…

What were the main highlights?

1) Transition away from fossil fuels in the energy system, which has been described as "***the beginning of the end of fossil fuels***" by Heléne Fritzon (S&D, SE), Vice-Chair of the delegation[1]
2) **Climate Finance**
   - Green Climate Fund (GCF) - US$12.8bn[2] with contributions from 31 countries and more to contribute.
   - Least Developed Countries Fund and Special Climate Change Fund – US$174mn with pledges up to US$188mn[3].
   - Operationalize the Loss and Damage Fund, first agreed upon during COP27, to be managed by the World Bank[4].
   - Given the established funds are falling short for the global decarbonisation requirement, new and innovative sources of finance being established as well as the reforming of the multilateral financing architecture.
3) Tripling of **renewable energy** capacity and doubling **energy efficiency** improvements by 2030, phasing out of inefficient fossil fuel subsidies and phasing down unabated coal power as well as tackling methane emissions.[5]
4) Health, food, nature and socially **just transition** were addressed during a COP meeting for the first time.

Where from here…

COP28 marked a milestone with regards to the transition away from fossil fuel. Despite critics noting the wide stretch of "transition", it is an achievement having addressed this issue in the first place. Furthermore, COP28 stressed that tackling climate change is essential via climate finance, that it is necessary to advance new and innovative financial products, and that continued growth in the sustainable or ESG bond market is required as issuers need to tap private investors to facilitate their future transitions.

Assuming COP28's climate policy actions will be implemented by almost 200 nations, it would lay the foundation for delivering on net zero investor targets. The timing of the **Assessing Sovereign Climate-related Opportunities and Risks (ASCOR)** framework, which Colchester has joined forces with global investor networks, asset managers, and asset owners, couldn't be more timely in having delivered the first 25 pilot countries' results in December 2023.

[1] COP28 climate talks agree on transitioning away from fossil fuels | News | European Parliament (europa.eu)
[2,3,5] COP28 Agreement Signals "Beginning of the End" of the Fossil Fuel Era | UNFCCC
[4] COP28 Presidency unites the world on Loss and Damage

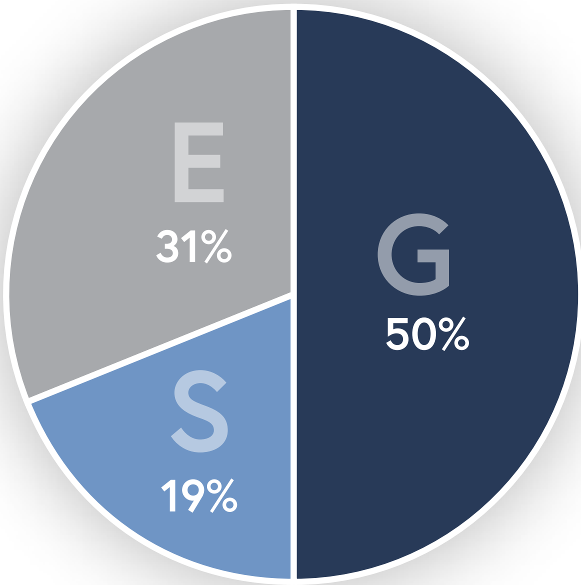
Summary of Engagements: H2 2023[6]

30 Engagements and 52 Issues

57% of engagements with Government Officials

40% of engagements are Industry-level collaborations

3% of engagements are with non-Issuer Stakeholders



H2 2023 Engagement Report highlights

- Country engagement examples for Angola, Japan, Poland, Portugal and Turkiye.
- A progress update on the ASCOR Project and
- Our other collaborations with industry-level peers

[6] Engagement period ending 31st December 2023

Global Bond Strategy Engagements

Japan

In October 2020, Japan announced its commitment to achieve net zero by 2050[7] and in April 2021 it announced its plans to reduce greenhouse gas emissions by 46% compared to its 2013 levels by 2030[8], while ensuring a stable energy supply.

To facilitate this transition, the Japanese government approved the Green Transformation (GX) Plan and its associated legislation in February 2023.

"Green Transformation (GX) refers to the transformation of the entire economic and social system from an economy, society, and industrial structure dependent on fossil fuels to "structures driven by clean energy" – the aim of the initiative is to drive economic growth and development through emissions mitigation."[9]

The Basic GX Policy consists of two pillars as follows:

Stable energy supply	Pro-growth carbon pricing measures
1. Energy Efficiency 2. Renewables 3. Nuclear Power 4. Others (hydrogen, ammonia, LNG, batteries, carbon recycling to fuels and others)	• More than 150 trillion yen in public-private investment for 10 years • 20 trillion yen support from the government • Carbon pricing measures - auction for power generators (FY2033~) - levy for fossil fuel importers (FY2028~) • Asia Zero Emission Community (AZEC) concept

Source: Ministry of Economy, Trade and Industry, Japan and Climate Integrate

Japan intends to issue up to ¥20 trillion in transition-labelled bonds over 10 years to help fund the country's Basic Policy for the Realization of Green Transformation (GX) and tries to catalyse ¥150 trillion in overall investment in the country's economic transition towards 2030.

Government bond issuance form part of the pro-growth carbon pricing concept of the GX Policy, which combines upfront debt issuance, future carbon pricing and public-private partnership (PPP) investment promotion.[10]

[7] https://www.meti.go.jp/english/policy/energy_environment/global_warming/roadmap/

[8] COP26 World Leaders Summit Statement by Prime Minister KISHIDA Fumio (Speeches and Statements by the Prime Minister) | Prime Minister's Office of Japan (kantei.go.jp)

[9] gr_japan_overview_of_gx_plans_january_2023.pdf (grjapan.com)

[10] https://www.icmagroup.org/assets/Uploads/Documents/Keynote-Shinichi-Kihara-METI.pdf

The framework is aligned with the principles of the Green Bond and Sustainability Linked Bond Guidelines 2022 (Ministry of Environment), ICMA's Green Bond Principles 2021, ICMA's Climate Transition Finance Handbook[11] 2023 and the Basic Guidelines on Climate Transition Finance (FSA, METI and MOE).

Japan is issuing the first sovereign transition bond framework and in this context we wanted to understand more of the authorities' definition of "transition", the "use of proceeds" and in its applicability within the SFDR framework. Our impression was to await the first issuance of the transition bond on 14 February 2024 with a 10-year size of ¥800 billion and another ¥800 billion in the 5- year on 27 February 2024.

We are encouraged to see a major developed sovereign to come with a new sustainable bond issuance to the market. However, the framework, methodology and measurement of them is uncertain and this is something that needs further consideration and assessment. We will also be keeping an eye on the fiscal and net government debt level positions, given its balances of -5.5% of GDP and 159% GDP, respectively, with regards to the transition finance. However, at this point in time, there wasn't any need to adjust the current financial stability score of -2.

Portugal

Portugal was one of the economies worst impacted by the Eurozone debt crisis more than 10 years ago, losing access to market financing and seeking a bailout package from the EU and IMF in April 2011. Portugal's economy struggled with low productivity, rising debt and declining competitiveness in the years prior to the bailout, however the recovery in the subsequent years was impressive. Portugal reduced its budget deficits, recapitalised its banks, and made its labour market more flexible. In the five years before the Covid pandemic, the Portuguese economy grew at an annual real rate of 2.6%, a relatively strong performance given the population of the country declined over that time. The public deficit shifted from over 7% of GDP in 2014 to a balanced budget in 2019, whilst the government debt/GDP ratio declined from 133% to 117% over the same period.

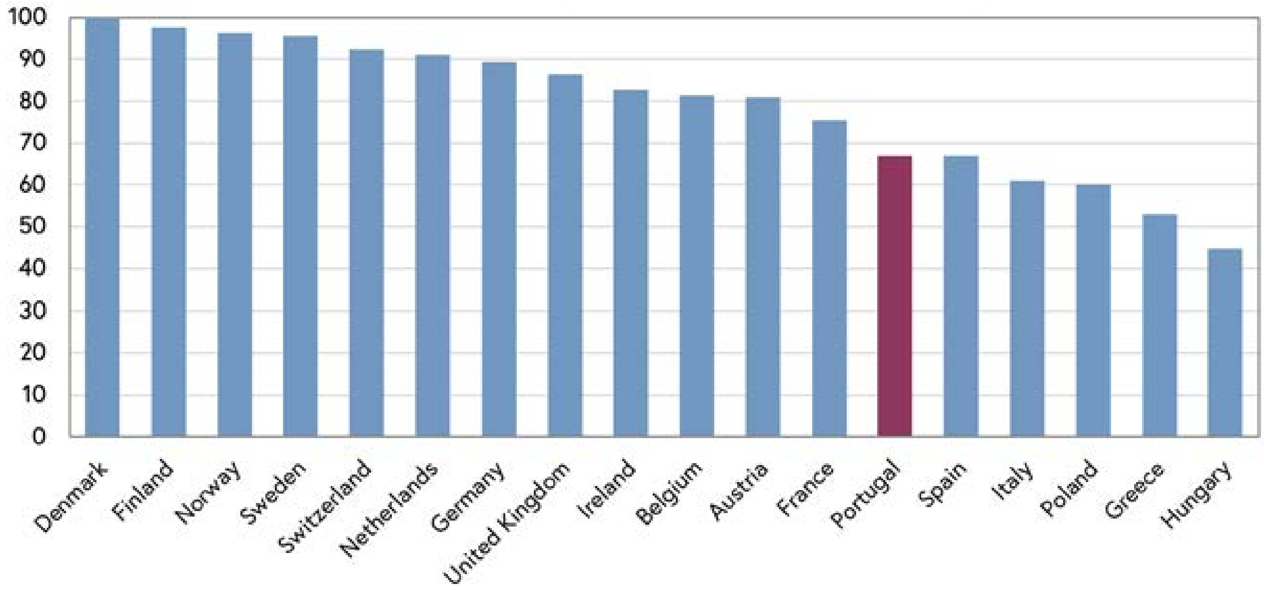
Whilst the pandemic obviously led to a reversal of many of these positive economic trends, the economy has once again rebounded strongly in the years after 2020. Colchester engaged with the Portuguese debt management office and local representatives of a large supranational organisation on a recent trip to the country, with the primary objective of understanding the structural improvements that have taken place. Despite obvious improvements in the economic sphere, our standard ESG analysis had identified relative weaknesses compared to developed market peers in advance of the trip to Lisbon in areas such as education and labour markets, as well as the control of corruption.

The discussions proved to be timely in that corruption in Portugal hit the headlines in the months subsequent to our meetings in Lisbon as the former Prime Minister resigned in November 2023 after investigators searched his official residence as part of an inquiry into alleged corruption. In a global comparison, Portugal (like most European countries) ranks relatively highly with

[11] Climate-Transition-Finance-Handbook-CTFH-June-2023-220623v2.pdf (icmagroup.org)

respect to perceived corruption. For example, it ranks 32nd amongst 183 countries in the Government Integrity component of the Heritage Foundation's 2023 Index of Economic Freedom. Nonetheless, in a comparison against European peers the chart below shows that the country does compare unfavourably, in particular relative to Northern European countries.

Government Integrity (component of 2023 Index of Economic Freedom)



Source: the Heritage Foundation, 2023. The score for Government Integrity shown here is on a scale of 0-100 and captures factors such as perceptions of corruption, and bribery risk.

Legislation and effective enforcement to both prevent and punish corruption is essential to maintain the rule of law and preserve citizens' and companies' trust in public institutions. As such a comprehensive anti-corruption framework requires a robust legal and institutional framework, as well as sufficient administrative and judicial resources, and political will. In our engagement in Portugal, we discussed these areas with an independent supranational organisation, who noted that measures to address inefficiencies in the justice system have been enacted, with others in preparation. Challenges still remain regarding the allocation of adequate human resources, however. It was also noted that the application and monitoring of rules on conflicts of interest for high-level public officials was not as robust as it could be.

Vulnerabilities in the labour market were also discussed as part of this engagement exercise. Youth unemployment remains high in Portugal despite successful enactment of a number of labour reforms since the crisis in 2011. Indeed, youth unemployment has declined from a peak of 38% in 2013 to 18% in 2022[12]. Nonetheless, further labour reforms to reduce rigidities and resulting duality in the labour market are contained in Portugal's Recovery and Resilience Plan ('RRP'). The RRP sets out a series of reforms and investments which enable Portugal to obtain EUR 22 billion in grants and loans from the EU Recovery and Resilience Facility[13].

The Investment Team will review the Financial Stability Score of Portugal, which is currently -4, on account of the improvements in the balance sheet over recent years. ESG considerations feed into that holistic assessment also, and so we will monitor closely ongoing anti-corruption measures as the government continues to implement its National Anti-Corruption Strategy for 2020-2024. Implementation of the RRP will also be monitored and assessed carefully.

[12] Source: World Bank.

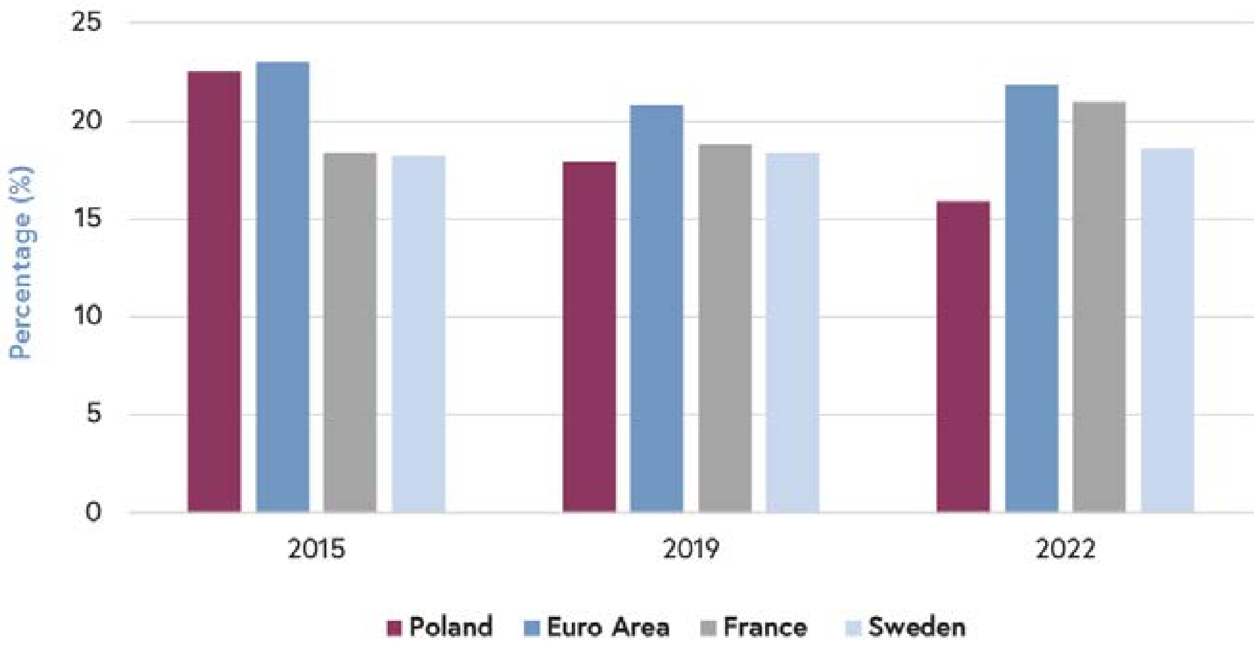
[13] Through the RFF the European Commission raises funds on the capital markets by issued debt on behalf of the EU. These funds are then made available to member states to implement reforms and investments in areas including green and digital transition.

Emerging Markets Strategy Engagements

Poland

In 2022, during a research trip to Poland we actively engaged with the government on female labour participation rates, childhood poverty rates and the Family 500+ programme. We followed up on our initial engagement in September 2023 where we spoke to the government on a variety of issues, and once again the family 500+ programme. The government launched the Family 500+ programme in 2016 as a systemic support for Polish families by improving living conditions. Parents and guardians of children up to the age of 18 can receive a tax-free benefit of 500 Polish zloty per month for every second and next child. Whilst the social aims of the programme are positive, one adverse effect could be on the existing tight labour market. Workers with low wages could have a lower incentive to return to the workforce, and women in particular could be encouraged to stay home and take care of children. That being said, the number of children at risk of poverty has materially reduced in Poland since the programme was introduced when looking at data from Eurostat. In 2015, 22.5% of children were at risk of poverty in Poland and 23% of children when looking at the Euro area. By 2022, the rate in Poland had reduced to 15.9% whilst in the Euro area the rate was 21.8%.

Children at risk of poverty or social exclusion



Source: Eurostat as of end 2022

Speaking to the Ministry of Finance, we once again highlighted the labour force participation rate of women. In 2016, the rate for Poland was 62%, one of the lowest in the OECD. However, the OECD average was only marginally higher at 63%. By 2022, the labour force participation rate of women had increased in Poland to 67% whilst the OECD average was 66%. Whilst the Ministry told us that the programme was not launched to improve women's participation, it is encouraging to see Poland on an upwards trajectory and surpassing the OECD average. Studies suggest that with an increase in labour force participation, and in this case in female participation, productivity levels can improve which in turn improves GDP growth.

We also asked the Ministry for their view on the proposed increase of the Family 500+ programme from 500 Polish zloty a month to 800 zloty a month. In July 2023, the Senate passed an amendment to the bill on state aid increasing the benefit to 800 Polish zloty starting in 2024. It was conveyed that the 500 Polish zloty has not been adjusted since 2016 and this upwards adjustment is expected to bring the amount in line with inflation. This is a notable increase, and an increase in government subsidies could be inflationary and also have a negative effect on the government deficit causing it to widen. We raised these concerns with the Ministry who stated that they forecast that inflation should be low in the new year. At the time of writing, the average rate of inflation during 2023 was over 12%, and the headline print as of December 2023 was 6.2% whilst core remains sticky at 6.6%. Despite the potential inflationary impulse, it is encouraging to see a decrease in childhood poverty rates combined with an increase in the female labour force participation rate. As such, there is no change to the financial stability score that we apply to Poland of -2, and will continue monitoring the progress.

Turkiye

In May 2023, general elections took place in Turkiye that saw the incumbent President Erdogan extend his rule for the third time, making him the longest serving ruler in modern Turkiye. Moreover, Erdogan's AK Party, within an alliance that includes extreme rightwing parties, maintained a comfortable majority in parliament as well.

A key tenet of Erdogan's economic policies over the years has been one of low interest rates, even in the face of rising price pressures that saw inflation hit a peak of 85% last year, according to official figures. In addition, Turkiye's central bank, under the guise of President Erdogan, introduced several macroprudential measures in an effort to stem the flow of hard currency out of the country which caused numerous imbalances in the economy.

However, contrary to most analysts' expectations, the post-election period saw President Erdogan instate a new economic team composed of Mehmet Simsek as Minister of Treasury and Finance, well-known for his orthodox stance, and Hafize Erkan as the new central bank governor. The new team introduced a significant U-turn to economic policy making, which encompassed raising the policy rate from 8.5% to 42.5% within 6 months, amongst other measures aimed at unwinding existing policies.

During our country visit to Turkiye, we engaged with a number of stakeholders to discuss the effectiveness as well as the sustainability of the reforms undertaken thus far. The investor community has shied away from the Turkish bond market over the recent years given Erdogan's unorthodox policy stance and lack of institutional credibility, reflected in foreign participation averaging around 2% over the past three years, having been around 20% in the past decade. Whilst Turkiye's principal problems lie in double-digit inflation and a near balance of payments crisis, there is a clear deterioration in the government's budget balance with the latest Medium-Term Program (of September 2023) forecasting a budget deficit of 6.4% of GDP in 2024, with 2.5% mainly stemming from the tragic earthquake that took place earlier in the year. In that regard, increased foreign participation in both the bond and equity markets would help fund the deficit. This point is well recognised by everyone we met during our visit.

Our discussion with the central bank was of utmost importance in demonstrating the understanding the new economic team has with regards to tackling inflation, as well as the resilience of the country's institutions. As investors we emphasised with the authorities again the need for orthodox monetary policy to anchor inflation expectations. We posed the question what the level of structural inflation in the country going forward would be. The authorities highlighted that they have realistic forecasts for growth and the output gap to be able to achieve a strong disinflationary path over the next couple of years, as exemplified in their latest inflation report, however the question remains whether it is politically palatable. Furthermore, the central bank emphasised repeatedly that their short-term aim was to eradicate all existential tools in play and to reinstate the policy rate as the primary tool to tackle inflation. This is a significant step forward in building back the trust and credibility of the central bank as an independent institution and improve the country's level of governance.

In conclusion, we found the meetings with the various stakeholders to be encouraging and led us to become somewhat more cautiously optimistic on the prospects for Turkiye's level of governance improving going forward. Colchester, along with the other investors present, made it clear in our meetings with various local stakeholders that we welcomed the improvements in Turkiye's investment environment, particularly from the perspective of more transparency and overall enhanced governance standards. Having said that, we have not made any changes to our existing Financial Stability Score of -4 and will monitor and keep assessing the reforms progress.

Frontier Markets Strategy Engagement

Angola

In October 2023, we had the opportunity to speak with representatives from the central bank of Angola regarding the economy, inflation, currency regime, as well as around the reporting and clarification of financial statistics on the Balance of Payments.

The Angolan economy is heavily geared towards the energy sector, generating around 70% of the country's GDP. Thus, swings in the price of oil have a large impact on the economy, whether that's GDP growth, fiscal revenue, or the country's external accounts. At the end of 2022, Angola enjoyed a current account surplus of US$11.8bn, supported by high oil prices. However, in 2023, the country faced challenges due to a decline in oil prices and production, impacting the year-to-date current account figures which showed a surplus of only US$3bn.

Although an issue from last year, we wanted to touch on the Angolan Central Bank's definition of FX reserves for full clarification. Typically, deposits by a country's national Treasury at its respective Central Bank are accounted for in gross reserves, although a country can choose what to include as part of IMF guidelines. In 2022, Angola decided to shift from reporting 'gross reserves' to a 'net net' basis, meaning that it no longer includes liabilities – in this case deposits from the Treasury – in the reserves figure, presenting a more precise representation of available funds. Treasury deposits at the Central Bank, which previously appeared in gross reserves, now show only US$500mn when looked at from the financial account perspective in the Balance of Payments.

Additionally, we discussed the reclassification of an 'escrow account' which is used to service loans to the country provided by China. Authorities told us that this account has now been accounted for in the Balance of Payments and explains the increase in the Financial Account for the first half of 2023. Furthermore, the sharp depreciation in the Kwanza in May and June was due to the government pausing its regular selling of foreign currency to the market in order to repay debt. Whilst it is welcome news that the central bank is properly accounting for what was previously 'off balance sheet', we encouraged the authorities to continue being transparent in their communications, especially around FX policy. In conclusion, whilst this will help further strengthen policy credibility, we will maintain our Financial Stability Score unchanged at -8, and keep continuing to monitor and assess the country's progress.

Industry Collaboration

As reported in our previous engagement reports, Colchester continued its collaboration with industry partners to share and encourage best practices in ESG integration. Amongst the main achievements was the release of the methodology for the Assessing Sovereign Climate-related Opportunities and Risks (ASCOR) framework in November 2023. This joint project pulls together the Principles for Responsible Investment (PRI), the Transition Pathway Initiative (TPI), asset owners and managers, and aims to provide investors and stakeholders with a common lens and framework to understand sovereign exposure to climate risk and how governments plan to transition to a low-carbon economy. Claudia Gollmeier, has been acting co-Chair for the ASCOR project with the group's aim to devise a framework and set of tools that will enable the current and future climate change governance and performance of sovereigns to be fairly and appropriately measured, monitored and compared. This assessment framework will then be used to produce an annual public assessment of the climate change governance and climate change performance of sovereigns[14]. It consists of three pillars:

1) Emissions pathways
2) Climate policies
3) Funding Opportunities

25 pilot countries have been identified, with their results having been published in December 2023 (see ASCOR Country Assessment Tool next page). These countries cover nearly 70% of global greenhouse gas emissions and large portions of major sovereign bond indices. The intention is to expand the coverage to include up to 70-100 countries in the coming years.

25 Pilot countries

Australia	Chile	India	Kazakhstan	South Africa
Bangladesh	China	Indonesia	Mexico	Thailand
Barbados	Egypt	Italy	Morocco	United Kingdom
Brazil	France	Japan	Poland	United States
Canada	Germany	Kenya	Saudi Arabia	Uruguay

ASCOR is the first collaboratively developed sovereign climate assessment tool allowing investors to evaluate sovereigns on climate change and sovereigns to showcase progress. We finally have a unique tool that will improve issuer reporting and allow us investors to have a more informed engagement dialogue with issuers.

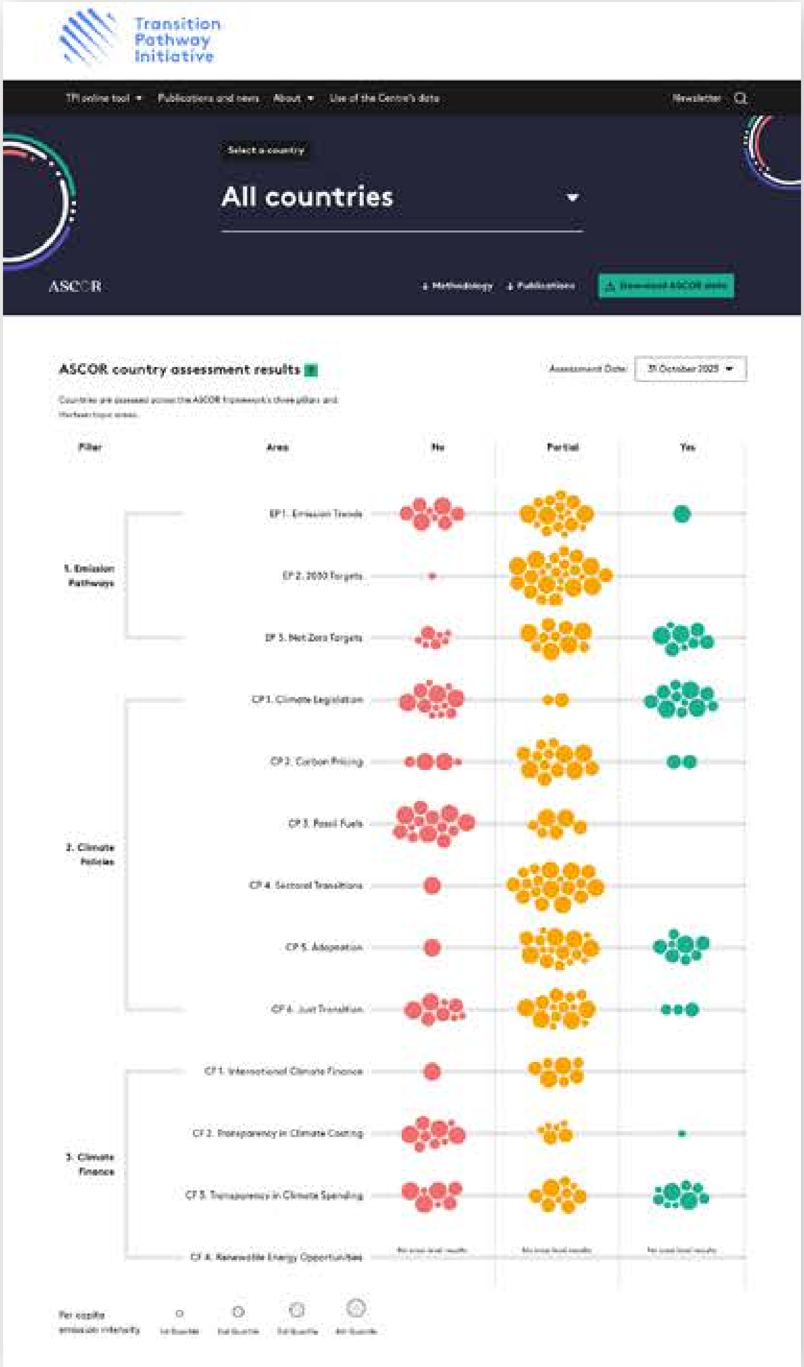
Claudia Gollmeier

Co-Chair of ASCOR and Managing Director (Singapore) & Senior Investment Officer, Colchester Global investors

[14] https://www.unpri.org/investment-tools/fixed-income/sovereign-debt/ascor-project

The tool displays a summary of all 25 pilot countries' performance by indicator and it can be drilled down to the individual country level and downloaded into Excel. The bubbles represent countries and are sized based on income per capita. The colour of the bubbles indicate whether the country was assessed as Yes (green) / No (red) / Partial (yellow) based on the results for each indicator within that area.

The tool indicates that 14 of the 25 pilot countries have decreased emissions over the past 5 years and 13 have passed climate change into law. More needs to be done as only 4 of the 25 assessed pilot countries were found to have emission reduction targets aligned with a 1.5C pathway, when population, income and historical emissions are taken into account.[15]



Source: https://transitionpathwayinitiative.org/ascor

[15] https://transitionpathwayinitiative.org/publications/66/show_news_article

The table below displays our full list of ongoing Industry Initiatives and Collaborations.

Industry Initiatives/ Collaborations	Acronym	Description
Principles for Responsible Investment	PRI	Colchester is a signatory to the PRI, a UN-supported network of investors that works to promote sustainable investment through the incorporation of environmental, social and governance considerations.
Task Force on Climate- related Financial Disclosures	TCFD	Colchester is a supporter of TCFD since May 2019 and this is our third Sustainability Report providing a status report of our progress.
Transition Pathway Initiative	TPI	Colchester is a supporter of TPI – a global, asset-owner led initiative which assesses companies' preparedness for the transition to a low carbon economy. However, as a sovereign only asset manager, we are a research funding partner to develop a sovereign climate assessment framework via the ASCOR project.
Emerging Market Investors Alliance	EMIA	Colchester is a member of the Alliance, a not-for-profit organisation that enables institutional emerging market investors to support good governance, promote sustainable development, and improve investment performance in the governments and companies in which they invest. We are a member of the steering committee of the carbon transition initiative.
Green Bond Transparency Platform	GBTP	Colchester is a supporter to the GBTP led by the Inter-American Development Bank (IDB) and IDB Invest. IDB Invest is an innovative digital tool that brings greater transparency to the green bond market in Latin America and the Caribbean. GBTP supports the harmonisation and standardisation of green bond reporting, boosting investors' confidence that the proceeds from bond issuances are being spent on green projects whose impact are adequately measured.
Assessing Sovereign Climate-Related Opportunities and Risks Project	ASCOR	The project goal is to develop an assessment framework that enables the current and future climate change governance and performance of sovereigns to be fairly and appropriately measured, monitored and compared.
Investors Policy Dialogue on Deforestation	IPDD	The objective of the IPDD initiative is to ensure long-term financial sustainability of investments in the countries they are invested in by promoting sustainable land use and forest management and respect for human rights. The IPDD will engage with relevant government authorities, and industry associations and other relevant stakeholders to encourage adoption and implementation of regulatory frameworks that ensure protection of tropical forests and human rights.
Investment Management Association Singapore	IMAS	Colchester is a co-chair of the IMAS ESG Working Group, which jointly support industry ESG capacity building.
Nasdaq Sustainable Bond Network Advisory Board	NASDAQ	Colchester is a member for the Nasdaq Sustainable Bond Network. It connects issuers of sustainable bonds with investors, empowering them to evaluate impact and make informed investment decisions on sustainable bonds.
PRI Collaborative Sovereign Engagement on Climate Change Australia	PRI	The Collaborative Sovereign Engagement on Climate Change is a pilot PRI-led investor initiative to support governments to act on climate change. The Australian initiative consists of three sub-groups focusing on different parts of sovereign systems: a) National governments b) National regulators and authorities and c) Sub-sovereigns.[16]

As of December 2023

[16] Investors with ~US$8 trillion AUM engage sovereigns on climate change in PRI-coordinated pilot focused on Australia | News and press | PRI (unpri.org)

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