QIC

GLOBAL LIQUID STRATEGIES ESG REPORT

JULY 2016

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QIC RESPONSIBLE INVESTMENT

We believe environmental, social and corporate governance (ESG) factors can have a material impact on the long-term returns of investment portfolios. This was the motivation for QIC becoming a signatory to the United Nations backed Principles for Responsible Investment initiative (UNPRI) in 2008.

ESG factors are integrated into our investment decision-making processes as part of our commitment to delivering strong, long-term returns for clients. Our Responsible Investment (RI) policy outlines our commitment to the six UNPRI Principles. The six Principles are:

1. Incorporate ESG issues into investment analysis and decision-making processes.
2. Be active owners and incorporate ESG issues into our ownership policies and practices.
3. Seek appropriate disclosure on ESG issues by the entities in which we invest.
4. Promote acceptance and implementation of the Principles within the investment industry.
5. Work together to enhance our effectiveness in implementing the Principles.
6. Each report on our activities and progress towards implementing the Principles.

INTRODUCTION

QIC Global Liquid Strategies (GLS) team has a robust and scalable ESG capability. We aim to enhance returns and protect value for clients by integrating ESG factors into the GLS investment process.

The team's investment philosophy is based on the belief that fundamental factors drive fixed interest markets over medium to longer term timeframes, with other transitory and technical influences causing markets to deviate from 'fair value' over shorter timeframes. This is then overlaid with recognition that ESG factors can affect the operational and financial performance of bond issuers.

TEAM PROFILE

GLS has an experienced global team of more than 29 professionals[1] located in Brisbane and London.

At the forefront of our ESG programme is Arti Prasad-Naidu, Head of Responsible Investment, who provides expertise, guidance and sets the strategy of the programme.

As the team's ESG Champions, Philip Miall, Head of Credit Research & Strategy, and Marayka Ward, Senior Credit Manager focus on implementation of the ESG strategy.

Arti Prasad-Naidu,
Head of Responsible Investment

Philip Miall,
Head of Credit Research & Strategy

GLS ESG Champion

Marayka Ward,
Senior Credit Manager

GLS ESG Champion

ESG is embedded in our investment process & values

- ESG is integrated into our bottom-up issuer analysis
- Independent research (e.g. MSCI ESG) enhances our views
- QIC's dedicated team and process supports engagement/dialogue with companies

We tailor ESG solutions for clients

- Ability to screen countries, industries or companies
- Experienced in the Green Bond market
- At forefront of ESG research and developments (e.g. tobacco & cluster munitions exclusions)

Transparent ESG disclosure

- QIC is a signatory to the United Nations backed 'Principles for Responsible Investment' initiative (UNPRI)
- QIC reports on its Responsible Investment (RI) activities to the QIC Board and clients annually. Reporting is also made to the UNPRI annually

Together as a team, in addition to integrating ESG considerations across our investment process, an ongoing focus for us has been climate change, and engaging with companies on fossil fuels. This engagement assists us in understanding how companies are transitioning to a low carbon economy.

1. As at 30 June 2016

PROMINENT ESG THEMES

Following the December 2015 Paris Agreement on climate change targets, we believe climate change is a theme that will have growing investment implications. Under the Paris climate change agreement, participating nations agreed to aim to limit global warming to 2°C above pre-industrial levels, and to pursue a 1.5°C limit where possible. We believe two key aspects of climate change that warrant consideration for investors are:

1. Constraint on fossil fuel consumption – this will see winners and losers over time at both an industry and company level. We are particularly focussed on the increasing risk of stranded assets as the transition to a low carbon economy plays out globally.
2. The physical change in climate – QIC is looking at which assets are likely to incur physical impacts due to climate change (sea level rises, heat waves, flooding, and frequency of storms etc). According to the Intergovernmental Panel on Climate Change (IPCC)[2] such influences will financially and socially impact many parts of the world.

Climate change and its impact on investments are an increasingly important focus of QIC's RI framework.

QIC has been strengthening our internal capability, thinking and participation in industry events to ensure we are an industry leader on the issues and delivering the best client solutions for the changes envisaged. Moving forward, the GLS team will focus on integrating and embedding specific climate change risks and opportunities within our investment decisions. The QIC Board has also endorsed and approved a set of recommendations for QIC to focus on climate change.

Our ESG framework consists of three key elements, Integration, Screening and Engagement.

ESG INTEGRATION

Our ESG integration approach is based on the following principles:

- By integrating ESG factors into the GLS investment process, we aim to enhance returns and protect value for clients.
- We recognise that ESG factors can affect the operational and financial performance of the companies and countries we invest in.
- The GLS team systematically reviews the potential significance of ESG issues and analyses these for corporate issuers.

ESG integration is an important part of our bottom-up credit process, and when assessing the counterparties with whom we trade (see Figure 1). Our credit security selection recommendations combine the bottom-up analysis of our credit experts (encompassing both the issuer's credit profile/trajectory and the issue covenants) and relative value views that are supported by our proprietary relative value model.

The team's deep independent bottom-up analysis ensures we truly understand each credit security we invest in. Our strong risk management focus underpins every decision we make. We focus on intelligent diversification, rather than diversification for diversification's sake.

2. Source: http://www.ipcc.ch/ipccreports/tar/wg2/index.php?idp=650

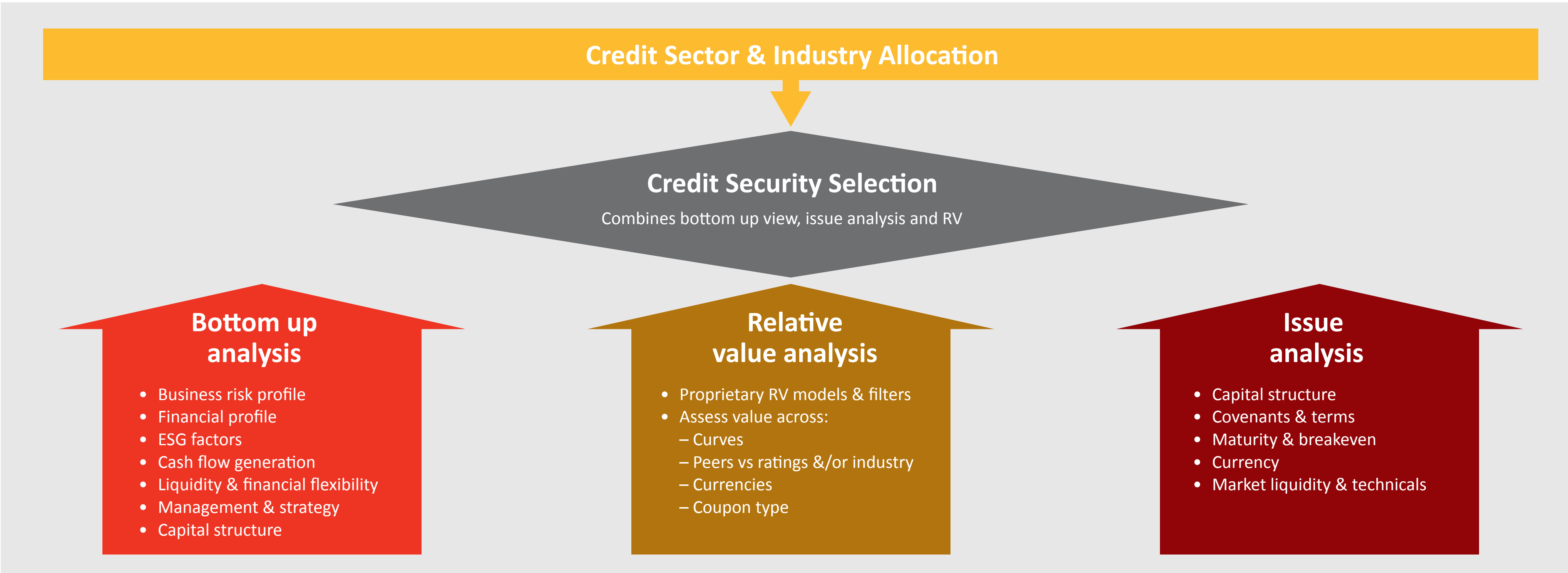
Our credit research team has a long track record of successfully identifying sound companies both within Australia and offshore. Included in this research framework is the consideration of ESG factors that could potentially impact long term returns of investment portfolios. In particular, our evaluation of ESG factors includes:

- Analysing the issuer's exposure to material ESG risks and their capacity to manage those risks.
- Understanding the financial implications of those risks materialising. Forming a view as to whether ESG risks are likely to impact an issuer's spreads and whether or not this is adequately reflected in current market pricing.

SCREENING

GLS has the ability to screen companies based on their business involvement in certain products or sectors and we can do this based on clients' requests. We currently have a QIC-wide policy to exclude companies involved in the manufacture of cluster munitions, landmines and tobacco. Country screening is also possible, especially in the case of emerging markets where social risks can be more prominent.

Figure 1: QIC's Bottom-up Credit Process



ENGAGEMENT

Company engagement is a fundamental part of GLS's responsible investment effort. We believe the key to engagement is utilising constructive communication and dialogue with companies to influence better corporate practices. Engagement lets us share our philosophy and approach on specific investment and ESG factors with portfolio companies and to use our influence to enhance their understanding of our objectives. Equally, we believe it gives us an opportunity to improve our understanding of investee companies and their management of ESG risks and opportunities.

Over the last six months QIC's ESG engagement program has conducted meetings with senior management of 10 companies across five industries. Key aspects of the meetings are outlined in the following table. All of these companies are bond issuers and the engagement meetings have enhanced our understanding of their approach to growing ESG risks in their respective sectors as well as provided an opportunity for QIC to enunciate its desire to favour issuers with strong ESG practices. Understanding the risks and opportunities of climate change, and how issuers are considering transitioning to a low carbon economy has been a focus. Overall, we were impressed with the depth, understanding and level of work in place in assessing and addressing stranded asset risk, climate change and ESG risks more broadly. Our discussions positively influenced our assessment of the companies' progress in these areas.

Insights from recent company engagements

INDUSTRY	DISCUSSION HIGHLIGHTS
Metals and Mining Stranded assets Climate change risks Transitioning to a low carbon economy	• Risk of stranded assets and possible implications for the companies • How the companies are taking steps to understand the risks of climate change and the actions that are either underway or planned in transitioning towards a low carbon economy • Strategies and resourcing the businesses are deploying to understand and reduce the risks to their businesses over the long term • Engagement the companies are having with regulators and stakeholders in keeping abreast of climate change policy changes impacting their business
Transportation (resources focus) Stranded assets Climate change risks Transitioning to a low carbon economy	• How the company considers stranded asset risk in the context of the lifecycle of the commodities that its transport services are involved in • Strategies to diversify operations • Reporting
Financial Climate change risks Stranded assets Green Bonds	• Processes for assessing and integrating climate change risks and opportunities across the organisation • Implications of climate change risk for the lending appetite and structuring of each bank's loan originations • Opportunities in relation to growth of the domestic Green Bond market
Insurance Climate change risks Social resilience and education	• Actuarial risk assessment framework required to model the growing frequency of extreme weather events and weather related disasters • Pricing for climate change risk • How the company is acting to reduce the social and insured costs of natural perils through collaboration and education
Energy & Utilities Transitioning to a low carbon economy Climate change risks Renewables strategy Stranded assets	• The companies are both on decarbonising paths and have active plans to switch from coal-fired generation to renewable energy sources • Gas, wind and solar are key elements of their strategies to decarbonise • Engagement the companies are having with regulators and stakeholders in keeping abreast of climate change policy changes impacting their business

CONFERENCES AND EVENTS ATTENDED

QIC's ESG Champions are always keen to be stay abreast of ESG trends and advance our thinking in this area.

The following conferences and events were attended:

CONFERENCES AND EVENTS ATTENDED	
Principles for Responsible Investment – Annual In Person Conference September 2015	Arti Prasad-Naidu, Head of Responsible Investment, attended as a delegate at the Principles for Responsible Investment – Annual In Person Conference, which was attended by over 1,000 delegates. QIC is a signatory to the UNPRI. The PRI is the largest investor collaborative network of its kind globally. The PRI In Person conference in London provided a platform for PRI signatories and other investment professionals to learn, network and collaborate in person on ESG issues impacting investments. HRH The Prince of Wales, gave a passionate address via video on the topic of investors fiduciary duty and ESG considerations. Other inspiring addresses included Brad Katsuyama, Founder IEX on building markets that work. The growing divestment debate was raised in a number of sessions. Professor Elroy Dimson, Chairman of the Newton Centre for Endowment Asset Management spoke about the conflict between engagement and divestment, putting forward three motives for acting responsibly – the guilt, the opportunity to influence, universal ownership – and used the analogy of a washing machine to describe the necessary investor engagement that is more conducive to long-term investing.
Responsible Investment Association Australasia – Annual RI Conference November 2015	The Responsible Investment Association of Australasia (RIAA), of which QIC is a member, had its annual RI conference in Sydney. Arti Prasad-Naidu, Head of Responsible Investment, attended as a speaker/presenter. The conference was attended by over 300 delegates. Key note speakers included CEO of NZ Super (Adrian Orr) and Chair of UNPRI (Martin Skancke). The key themes included latest developments on responsible investing, the rise of the engaged consumer and how to meet their expectations, insights into navigating the complexities of the rapidly changing market and key ESG and ethical issues and themes impacting ASX companies. QIC presented on how we embed the PRI into our investments and learnings from the "PRI in Person" conference which QIC attended in London in September 2015.
Responsible Investor – Asia Conference February 2016	QIC was invited to present its learnings and insights into ESG integration in direct investments at the Responsible Investor (global organisation), Asia conference in Tokyo – investing for resilience. Keynote speakers included Noboru Yoshioka (CEO, Quick Corp) and Priya Mathur (CalPERS Board). Arti Prasad-Naidu, Head of Responsible Investment, attended as a speaker/presenter. This year's conference had over 400 delegates and focussed on the critical information and practical discussions on environmental finance for pension funds, asset managers, insurers, banks and corporates. The conference also focused on reassessing the relationship between asset owners and investee companies, incorporating ESG to generate sustainable alpha. QIC was able to share its experiences and journey in the risks and opportunities of ESG factors and the impacts this has on investments.

CONFERENCES AND EVENTS ATTENDED

Bloomberg Fixed Income Session

February 2016

Also in Asia (following the Responsible Investor conference), Bloomberg held an ESG session – opportunities and challenges of ESG integration in Fixed Income, which was attended by approximately 100 delegates. QIC was invited to speak about our approach in ESG in Fixed Income, alongside First State Investment and Bloomberg's Greg Elders (Bloomberg's ESG Analyst). Arti Prasad-Naidu, Head of Responsible Investment, attended as a speaker/presenter. Attendees mostly included Bloomberg's Tokyo office staff, and invited investment managers and asset owners.

KangaNews Socially Responsible Investment Seminar

February 2016

Philip Miall, Head of Credit Strategy & Research, and Petar Bogdanovic, Portfolio Manager attended as delegates. The conference had a total of 83 delegates and centred on Green Bonds and Social Impact Bonds. Green Bonds are likely to be an important source of capital to help finance the considerable investment required to meet climate change targets of the Paris Agreement. Key themes of the conference in relation to Green Bonds were Issuer and Investor perspectives on the development of the domestic Green Bond market and approaches to Green Bond accreditation.

The Social Impact Bond market is in its infancy and the conference focussed on understanding their nature and measuring performance and impact.

Mercer Climate Change meeting

February 2016

LGT Capital Partners, together with Mercer hosted a climate change lunch seminar sharing insights on the risks and opportunities of climate change on portfolios. QIC partnered with Mercer on their climate change study, and was able to share our own experience and learnings from the study and how we are applying this to our portfolio management. This event was attended by Arti Prasad-Naidu, Head of Responsible Investment and Marayka Ward, Senior Credit Manager.

CASE STUDY: POWERING AUSTRALIA WITH RENEWABLES – AGL

AGL announced in April a new Greenhouse Gas Policy ("the Policy") that provides a pathway to decarbonise its electricity generation by 2050, including the closure of all its existing coal-fired power stations within that timeframe. GLS is an investor in senior unsecured bonds of AGL and we consider the company's policy to be an important initiative and a major commitment given AGL's position as one of Australia's leading integrated energy companies. AGL is also the country's largest ASX-listed owner, operator and developer of renewable energy generation.

QIC, together with a group of Australian investors, met with AGL in May this year and visited AGL's 102MW solar facility, the Nyngan Solar Plant. Our objective in meeting with AGL was to understand their motivations and drivers to transition away from coal-based electricity generation to renewables. AGL confirmed that the national electricity market (NEM) needs to be refreshed - 75% of the NEM (predominantly coal based) is past its original design life. In addition to undertaking major investment in renewable energy (outlined in more detail below), AGL recognises the path forward is to decarbonise. AGL is also investing in consumer based technology like smart meters, with digital capabilities enabling enhanced monitoring of energy use as well as remote control from smart phones and other devices.

In July 2016, AGL announced QIC, on behalf of its clients the Future Fund and those invested in the QIC Global Infrastructure Fund, as its equity partner in the Powering Australian Renewables Fund (PARF).

PARF is a strategic partnership created to develop more than 1,000MW of large-scale renewable energy projects to help meet the Australian Federal Government's Renewable Energy Target and support Australia's transition to a low-carbon economy.

Wind and solar power generation are considered mature and established technologies. Wind and solar energy resources are well understood and able to be forecast with a high degree of accuracy. The lifecycle O&M requirements are well known.

GLS will continue to monitor AGL's decarbonisation policy as we believe the successful management of this strategy will be important for its credit profile. We expect this will be a measured and gradual transition and our engagement with the company provides us with confidence in its ability to deliver on its objectives over time.

AGL Energy in action.®

CONCLUSION & FOCUS AHEAD

GLS is committed to ensuring that its ESG framework enhances returns for clients. We continue to integrate ESG in our bottom-up issuer analysis and engage with companies on key ESG factors, as we weigh whether these considerations will impact an issuer's fundamentals and/or market pricing.

In the last 12 months we have focused on engagement with several of our larger bond issuers on ESG issues and we will continue to focus on building these relationships going forward. Further, our attendance and leadership at key industry conferences ensures we can keep our clients abreast of the latest practices.

Over the coming months we are focusing on enhancing our ESG Reporting to clients with our MSCI Reporting Tool. Furthermore, QIC is focused on climate change as a central ESG topic. Climate change has the potential to impact a wide range of asset classes and investments. It requires understanding and action. QIC has been strengthening our internal capability, thinking and participation in industry events to ensure we are an industry leader on the issues and delivering the best client solutions for the changes envisaged. Moving forward, the GLS team will focus on integrating and embedding climate change risks and opportunities within our investments.

IMPORTANT INFORMATION

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