Responsible Investing & Fixed Income: DK Focus

Stockholm (HedgeNordic) – Fixed Income comprises a number of areas that lend themselves naturally to SRI/ESG principles. In a preview of the forthcoming (September 2016) HedgeNordic report on Fixed Income, we take a look at the SRI/ESG approaches taken by Danish fixed income funds, which provide examples of the successful convergence of civil legislation with optimized opportunities for investor returns, particularly through corporate governance. While many still play the short-term game, SRI/ESG may be winning out longer-term.

The Nordics have a global reputation for excellent performance in SRI-related international rankings such as the Human Development Index and the Environmental Performance Index, with their business communities and government policies often held up as an example to other countries. When it comes to SRI/ESG KPI (Key Performance Indicators)'s in Fixed Income funds, one could do worse than have a look at the smallest country among them, Denmark:

Small Denmark, such SRI!

According to the European Fund and Asset Management Association's Report on Responsible Investment, Denmark has a very high proportion of UNPRI signatories, there being a statutory requirement from the Danish government dating from 2008 that large companies must take a position on CSR in their annual reports. This includes reporting on SR (Socially Responsible) policies, how companies translate SR into action, and evaluations of yearly progress on SRI initiatives. The same reporting requirement has been introduced for institutional investors and investment funds, and is considered to be particularly relevant for financial companies.

In addition, the Danish Council on Corporate and Social Responsibility was established in 2009, comprising members across all sectors of society, and providing guidelines for SR considerations in investment decisions according to the preambles of the UNPRI. The guidelines, written in cooperation with Danish investment and pension funds, give an overview of methods, strategies and approaches to RI used increasingly normatively by investors. The objective is to optimize financial gain in tandem with societal gain.

Denmark's high number of UNPRI signatories is mostly gathered in DANSIF, an impartial forum for players with a substantive interest in SRI. The most recent DANSIF Responsible Investment Study (December 2015) reports that (among other factors):

- 44 of the 50 largest institutional investors in Denmark have an RI policy, representing 98% of combined AUM;
- 66% of investors, representing 93% of AUM, have a specific engagement policy, up 10% from the previous survey in 2014;
- 52% of respondents confirm the responsible investment policy covers all AUM (up 11% since 2014), with 41% saying it covers the majority of AUM;
- Use of proxy voting continues to grow, with 68% of respondents casting votes on some or all listed equities, and 88% using negative screening;
- 60% confirm that a process for responsible investment in government bonds is in place, up 12% from 2014.

Among Danish hedge funds, such developments are already very much in evidence. To take but three:

Nykredit Asset Management's Fixed Income Nykredit KOBRA Hedge Fund is subject to its sustainable investment policy that covers not only associations but also investment in its own funds, thereby covering a value of 198 billion (DKK). Nykredit's sustainable investment policy is built upon two KPI pillars:

1) Whether companies live up to sustainability expectations, with all companies in shares and bond portfolios screened biannually for transgressions against UNPRI and Global Compact principles (with the most recent screening revealing 22 such transgressions, prompting Nykredit to belabour changes in conduct through Active Ownership), and 2) The use of sustainability criteria e.g. environmental, social relations and corporate governance issues in the investment process, with increasing consideration of non-financial data such as CSR reporting in the evaluation of a company's future results.

Nykredit also offers specialized products such as Global SRI, where every company in conflict with UN conventions or which has in excess of 5% of its revenue from tobacco, alcohol or weapons is excluded from the portfolio.

The **PFA Investment Fund**, recently renamed (July 2016) from the Midgard Fixed Income Fund incepted in 2009 (with Midgard re-domiciled as a sub-fund of the PFA Investment Fund) follows similarly stringent policies for RI, as Denmark's largest pension fund. PFA claims its experience has already been obtaining optimal results by investing in responsible companies that meet UNPRI and Global Compact standards, partly a result of its Responsible Investment Board consisting of investment and CSR executives overseeing implementation of SRI policy and also through seeking to be an Active Owner. This includes implementing measures such as voting rights, exclusion lists and norm-based screening based on the UN Global Compact, such as the systematic exclusion of companies involved in the production of controversial weapons.

Finally, **Danske Invest**, which also has the Hedge Fixed Income Strategies and the Fixed Income Relative Value funds under management, recently announced (July 2016) the creation of a special Sustainable Investment fund, the **Danske Invest European Corporate Sustainable Bonds** fund. Corporate bonds are selected on the basis of two criteria: a financial assessment of the company, and an evaluation of the company's sustainability efforts. "The fund's philosophy is to have a sustainable profile that is clear about what you should not invest in and which simultaneously places high demands on what one actually invests in, which is forward-looking and actively scales to support sustainable development," says Thomas H. Kjærgaard, head of Sustainable Investments. For Danske Invest to consider investing in a company at all, it is similarly contingent that the company complies with the UNPRI and the UN Global Compact. At least 90% of the fund's portfolio will consist of companies in the top half of the ESG rankings for each relevant sector, e.g., companies already well positioned in terms of ESG criteria. Fund holdings should consist of at least 75% corporate bonds with a high credit rating, thus "investment grade."