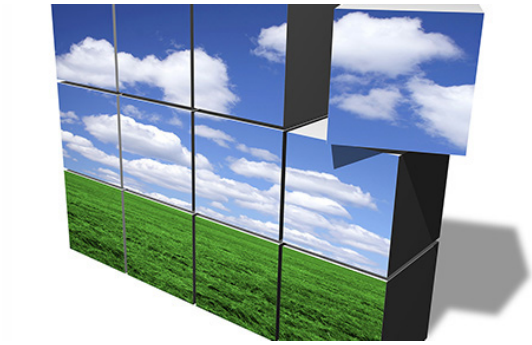
ESG: From Philosophy to Practice



Vicki Bakhshi - Director in the Governance and Sustainable Investment team at BMO Global Asset Management (EMEA)

Jamie Jenkins - Director and Head of Responsible Global Equities

As Environmental, Social and Governance (ESG) factors become more of a driving force behind the investment decisions of asset managers and institutions globally, Responsible Investing (RI) experts Vicki Bakhshi and Jamie Jenkins of BMO Global Asset Management (EMEA) discuss how to successfully deploy an ESG focus that's entirely complementary to long-term performance goals, through an award-winning vehicle that's now accessible to Canadian institutional investors.

Leading the ESG Train

In a world where macroeconomic trends have confronted us with unprecedented social, environmental and economic challenges, regulators and policymakers have increasingly moved to mandate ESG integration across investment portfolios. Now, more so than ever, it's important for asset managers, investors and consultants to take their lead, and work together to create a sustainable financial system for the future.

From an expanding and ageing global population to the impacts and threats of climate change, biodiversity and urbanization, we need to harness the creativity and dynamism of companies and capital markets to focus on businesses that are proactively – and effectively – managing their ESG risks and opportunities.

But this doesn't – and shouldn't – exclude long-term performance. In fact, companies providing solutions to these global challenges position themselves to benefit from growth opportunities, resulting in the potential for alpha generation. While the historical perception would equate investing responsibly with the need to sacrifice returns, increasingly, a growing body of evidence suggests the opposite is true. Turning the historic theory on its head, recent academic studies have shown a positive link between robust sustainability practices and stronger company-level operational performance.[1] As a result, there's been a wide awakening of interest around global sustainability and RI.

As a leader in the evolution, BMO Global Asset Management has long taken sustainability seriously. Launching Europe's first social and environmental screened strategy more than three decades ago, we've since worked to expand our dedicated suite of RI strategies, which now covers US$2.0 billion[2] across a mix of asset classes, including bond and equity funds. All of the strategies offer a way to invest in companies that strictly adhere to certain ethical standards, and are managed to provide capital growth – underpinned by our belief that the prudent management of ESG issues can have a fundamental impact on the creation of long-term investor value.

A history of innovation in Responsible Investment...

1984	1987	1997	2000	2006	2007	2010	2011	2014	2016
Launch of Stewardship Growth - first ethical strategy in UK	Launch of Stewardship Income & Stewardship North American strategies	Stewardship North America becomes Stewardship International strategy	Launch of Responsible Engagement Overlay (***reo***®)	Founding signatory to Principles for Responsible Investment (PRI)	Launch of Responsible UK Sterling Bond strategy	Launch of Emerging Markets ESG Strategy	Launch of ESG Risk Tool	Rebranded as Responsible Strategy Range	Launch of Green Bond Strategy

Source: BMO Global Asset Management, August 2017.

How to Turn Sustainability into Opportunity

Our approach to responsible investment within our Responsible Funds range is based on three pillars: ***Invest, Avoid and Improve*** – investing in companies meeting positive sustainability themes; avoiding those with damaging or unsustainable business practices; and improving by using our influence as an investor to encourage appropriate practice on ESG issues through engagement and voting rights.

While our process involves comprehensive screening and exclusion, it doesn't stop there: we actively mine for companies that are ESG leaders and provide solutions to global sustainability challenges – in sectors like healthcare, clean technology, waste management or natural resources. Known as thematic-oriented investing, not only do these companies work in favour of the social good, but they also stand to benefit financially, as these trends develop further. And because of our belief in using our role – and our rights – as a shareholder to create positive change, we're able to invest in businesses that are intrinsically high-quality, but have encountered short-term challenges that we can help overcome through our active ownership approach. Particularly relevant now is how we've put our three-pillar approach into practice to develop a detailed and comprehensive strategy addressing climate change across all of our RI strategies, engaging with both companies and policymakers.

Responsible investing is not just about managing risk – it's also about finding opportunities.

Engaging with ESG

As a responsible investor, we now assess the progress of our investments against the framework of the Sustainable Development Goals (SDGs), a set of 17 ambitious goals developed by the United Nations and agreed by 193 governments. By doing this, we're able to understand if our investee companies are strong or weak ESG performers in relation to a universal policy agenda, carefully determining the extent to which our strategies align with each goal, and our approach thereafter.

This forms part of BMO Global Asset Management's extensive engagement efforts, and it's how we distinguish ourselves in the marketplace. Crucially, ESG considerations are integrated throughout our investment process – from idea generation through to portfolio construction, and *beyond*. Because investment is never straightforward, there will always be ESG risks and opportunities that need to be continually addressed and monitored, on an ongoing basis, as part of every strategy.

Engagement is the cornerstone of our ESG philosophy, and as shareholders, we aim to play a constructive role in working with companies to achieve the best long-term results and enhance value for our investors. Engagement is not simply an initial discussion with management about operational issues; it's the front and centre of our entire approach, with multiple touchpoints to make a difference. By engaging effectively, asset managers can encourage companies to harness the business opportunities presented by the SDGs, estimated at $12 trillion by 2030.[3]

The need for engagement is clear: with encouragement from regulators, pension plans in Canada – and globally – are seeking to actively pursue their shareholder rights to promote sustainable ESG practices in their investee companies, with the Canadian Coalition for Good Governance and the UN Principles for Responsible Investment providing valuable networks for Canadian plans to implement this into practice. The challenge, though, is that *good-quality stewardship* is resource-intensive and difficult to achieve across global portfolios.

Engagement is the cornerstone of our ESG philosophy – we believe that as shareholders we have a responsibility to take our ownership rights seriously.

As a solution to the problem, BMO offers the ***reo***© (responsible engagement overlay) engagement and voting service to promote improved ESG disclosure and performance, and address global ESG risks. The service, established in 2000, provides in-depth engagement by BMO's 13-strong Governance and Sustainable Investment (GSI) team for asset owners seeking to use their influence for positive change. ***reo***© represents over US$130 billion in assets, engaging 768 companies across 52 countries in 2016, with 191 instances of change achieved.[4]

Our in-house GSI team is instrumental to our engagement initiatives – defining and continually evolving the standards by which we measure our investments, and deciding whether companies meet the stringent criteria for our RI strategies. Working closely with our fund managers, the dedicated group of experts maintains the credibility of the ethical and ESG screening process, and levers its 17 years of experience with ***reo***© to execute on all voting and engagement tactics surrounding shareholder ownership – understanding precisely at what level to intervene, and how to fit environmental and social policies into a business context.

Climate Change and Water Stress: How We Engage and Add Value

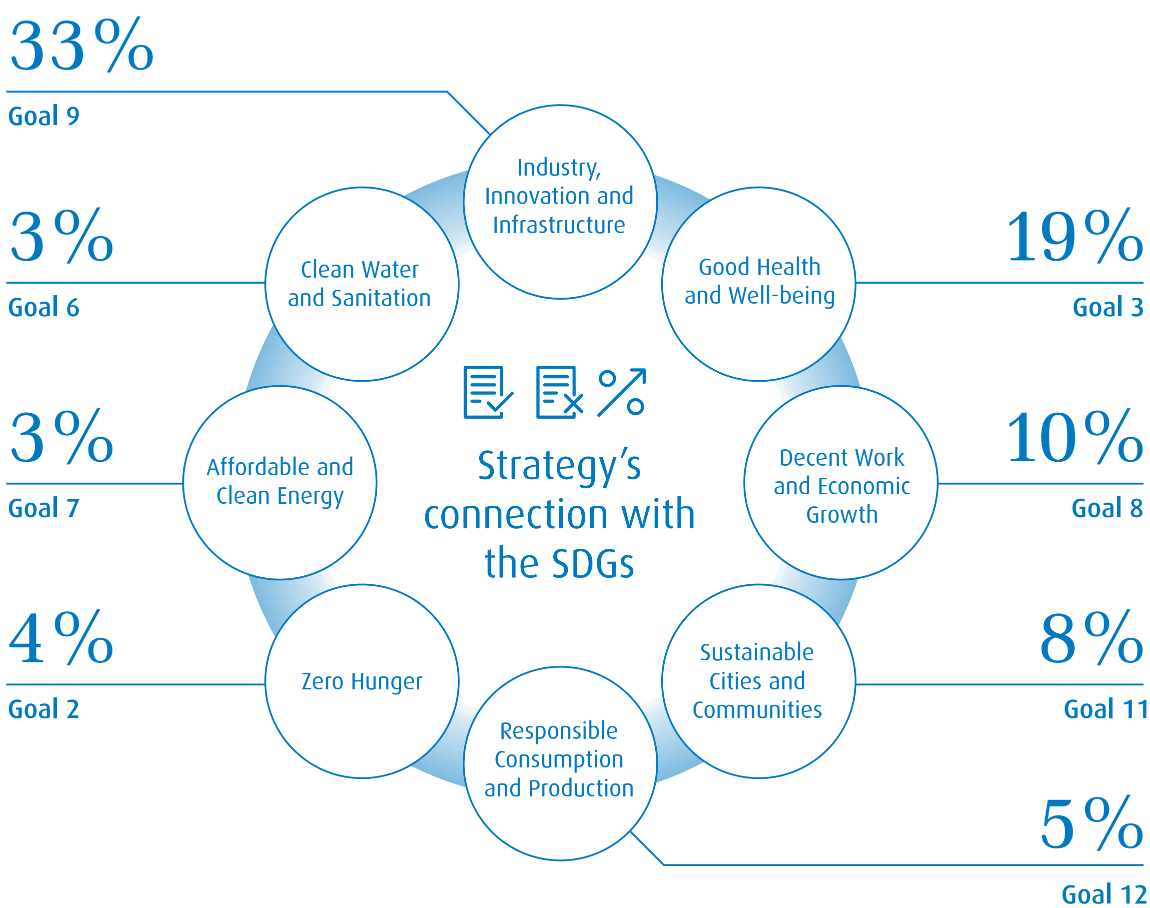
The integrated assessment of ESG opportunities and risks, twinned with our ongoing engagement, is what make our strategies *truly differentiated*, as we're dedicated to increased transparency and investing in companies with improving ESG profiles. As a testament to this, our team just released the ESG Profile and Impact Report 2017 for our BMO Responsible Global Equity Strategy, which tracks the Fund's connection to the SDG goals, including an assessment of its carbon and water exposure, ways to reduce its footprint, and mitigate risk. *What follows are two examples of how we've addressed two growing issues of global importance: climate change and water stress.*

1. After the 2015 United Nations Climate Change Conference in Paris, we asked U.S.-based industrial gas group Praxair, one of our investee companies, to provide information about its climate change management strategy, including scenario planning to understand how the COP21 carbon reduction commitments could impact its future profits, and shareholder value.

2. Given that the World Economic Forum listed the water crisis as a top-three societal risk in terms of impact for the third straight year, our strategy has been to increase exposure to companies actively addressing this critical challenge, such as Suez, an industrial services business at the forefront of the shift towards a circular economy. It returned 4.7 million tonnes of secondary raw materials to the market in 2015, and supplied 14.7 million people in developing countries with drinking water, up from 14.1 million in the previous year.

Source: BMO Responsible Global Equity Strategy: ESG Profile and Impact Report, 2017.

BMO Responsible Global Equity Strategy – Our Alignment with UN SDGs



Source: BMO Responsible Global Equity Strategy: ESG Profile and Impact Report, 2017.

BMO Responsible Global Equity Strategy: Performance with Principles

At BMO Global Asset Management, our sophisticated and thorough investment process is supported by three layers of experience and insight, including the respective portfolio managers; the specialist GSI team; and the Responsible Investment Advisory Council, an external board of experts created in 2014 to enhance the standards on which our Responsible Fund range is based, and discuss any pertinent ESG issues, or borderline cases relating to our investments. While each team has its own responsibilities, all three work in concert to achieve our ***Invest, Avoid and Improve*** goals.

Within the BMO AM Responsible Global Equity ESG Fund, which launched in Canada in September, we lever this expertise to focus on growth companies that are demonstrating **a clear commitment to sustainability** and can *prosper in spite of economic and policy-driven volatility*. Risk management is at the core of our disciplined process, recognizing risks posed by ESG issues – such as natural resource constraints and climate change – to broader material threats. In keeping with our ESG philosophy, embedded in the DNA of our strategy is an increasing focus on positive sustainability themes and the wider societal responsibility of every company in which we invest. It's not enough to meet the ethical screening standards of our GSI team, or MSCI Research- this is a mere starting point for our analysis, and requires skilled, in-depth interpretation, and often, further investigation. From here, we select – from a pool of approximately 1,000 stocks – companies that are **demonstrably** and **proactively** working towards the UN SDG framework, whether this means supporting gender equality and good governance within corporations, or managing energy-water linkages to curb water stress as we support the transition to a decarbonised economy.

Green Bonds: *Another* Example of Proactive ESG Investing

BMO Global Asset Management is also now managing specialist, segregated green bond mandates for our institutional clients, allowing them to channel their fixed income investments directly into green technologies, such as renewable energy projects or climate change solutions. The US$188 billion[5] fast-growing green bonds market is continuing its meteoric expansion, and we see it as a powerful, and efficient way to allocate capital at scale towards environmental challenges, while investing in low-risk, investment-grade bonds. The development of robust, enforceable standards in this market still lags, so we rely heavily on our own due diligence to ensure bonds are *genuinely green*.

As part of our fundamental analysis, our Responsible Global Equities team intelligently utilize ESG data to feed reliably into our valuation processes, enhancing mainstream investment analysis. A prospective company's ESG profile is integrated directly into our discounted cash flow (DCF) valuation models through a quality checklist, with ESG momentum representing one of the 10 factors used to calculate an overall quality score, or "Q-score", which is then incorporated into the discount rate we use to value businesses. ESG momentum, which is often reflected in several of the other quality factors as well, can interestingly enough have a sudden and drastic impact on the term value.

Ultimately, as managers of BMO AM Responsible Global Equity ESG Fund, we are investing, through an ESG filter, in a portfolio of 50 to 70 diversified, high-quality businesses that should outperform over the long term, due to their robust cash flow; focus on growing franchise value; and sheer dedication to improving shareholder returns – all the markings of a sound investment proposition. It's a win-win situation for Canadian institutions seeking a vehicle with a bottom-up, fundamental approach, which is philosophically aligned to their moral and ethical values, while meeting fiduciary objectives and delivering credible, attractive long-term performance. A mere glance at the Fund's returns will confirm this: its 1-year and 3-year returns, on a gross basis, are both 14%, compared to MSCI World benchmark returns of 11.70% and 11.80%, respectively.[6] Our commitment to consistently achieving these results is reflected in our policy to benchmark the strategy against the mainstream MSCI World Index, critical to demonstrating that we are an **absolute bedrock option for investors**, and competitive against every other global equity fund on the market.

Sustainable Success: Mettler Toledo International

Why it has performed: A multi-national manufacturer of scales and analytical instruments, the Company is a strong incremental market share expansion story that is supporting the transition to a culture of greater health and safety and precision in manufacturing. With a rarefied market position and a track record for value creation, there is a high client-retention rate. Mettler is also in a sweet spot in terms of its product and the value-add it provides China, as the country undergoes an industrial transition. While it's not a household name, it is a business that has grown consistently in our portfolio over the last 20 years, with broad platform exposure that is valued by customers for its precision, reliability, value and low environmental impact.

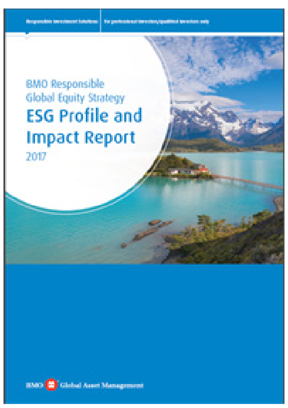
GET STARTED

Detail	Strategy Specifics
Strategy	BMO Responsible Global Equity
Launch Year	1997
Fund Currency	CAD and EUR
Universe	Global Equities
AUM	CA$953 million
Number of stocks range	50 to 70
Tracking error range	No explicit limit
Turnover	Internal target 30%
Benchmark	MSCI World
Internal stock limits	Max 5% per stock in large cap Max 3% per stock in small cap

Source: BMO Global Asset Management, as at August 31, 2017.

To learn more about BMO AM Responsible Global Equity ESG Fund**, or our comprehensive RI fund range, and other ideas to enhance your portfolio, please contact your** Regional BMO Asset Management Institutional Sales & Service Representative**,** click here**, or access the materials below.**

BMO Responsible Global Equity Strategy: ESG Profile and Impact Report 2017



[1] University of Oxford and Arabesque Partners, 2015. Study reviewed 190 independent academic papers, found that 88% showed a positive link between robust sustainability practices and stronger company-level operational performance.

[2] BMO Global Asset Management, as of March 31, 2017.

[3] Business & Sustainable Development Commission, January 2017. Better Business World Report.

[4] BMO Global Asset Management, as of December 31, 2016.

[5] Natixis Research, February 2017.

[6] BMO Global Asset Management, as of August 31, 2017. Annualized CAD gross returns for Responsible Global Equities Composite. Benchmark used is MSCI World TR, CAD gross of fees. Inception Date of Composite: December 12, 2005. For additional information regarding the firm's policies for reporting of performance returns, please refer to the disclosure section below.

* The reo© engagement and voting service is not utilized by all legal entities of BMO Global Asset Management.

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On 6 July 2015 BMO Global Asset Management became the trading name of the F&C group of companies and claims compliance with the Global Investment Performance Standards (GIPS®). Prior to 31 December 2015 F&C Asset Management claimed compliance with GIPS and was independently verified. GIPS Compliant Presentation reports are available upon request. BMO Global Asset Management has prepared and presented this report in compliance with the GIPS standards. BMO Global Asset Management has been independently verified for the periods 1995 through 2016. The verification report(s) is/are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

The Responsible Global Equities Composite includes all discretionary portfolios managed according to F&Cs core Global ESG investment strategy. Portfolios within this composite are measured against the MSCI World index but are restricted to investing in companies that are considered to be making a positive contribution to society whilst avoiding those considered to be detrimental. The universe of acceptable companies available for investment is created by F&Cs Governance and Sustainable Investment team and approved by an independent Committee of Reference. The portfolios within this composite have a typical tracking error range of 0-8%.

Gross of fees performance is calculated gross of investment management fees and where available, administrative fees. Gross of fees performance is net of all trading expenses. Net of fees performance is presented net of all investment management, administrative fees and trading expenses. This composite uses actual fees. A full breakdown of fees for this composite is available on request.

Additional information regarding the firm's policies and procedures for the preparation of compliant presentations, valuation, calculation and reporting of performance returns is available on request.