



HEXAVEST



Annual Report on the Integration of Environmental, Social  
and Corporate Governance (ESG) Issues

2018

As a portfolio manager, Hexavest has a duty to act in the best long-term interests of its clients and their beneficiaries. In this fiduciary role and as a signatory to the United Nations PRI, Hexavest commits to report on its activities and progress toward integration of the Principles for Responsible Investment. The objective of this Annual Report is to provide an overview of our efforts and progress with the integration of ESG issues into our investment practices.

# Approach

Hexavest's approach to responsible investment is based on the belief that companies lacking strong governance standards or social and environmental responsibility take business risks that may adversely affect them as well as their stock's performance. Our investment philosophy is strongly geared to preservation of capital; thus consideration of environmental, social and governance (ESG) factors is consistent with our processes and is a natural fit with our portfolio management activities. We also believe that ESG factors can represent investment opportunities on medium- and long-term horizons.

Our approach to responsible investment is based on the following principles, which we adhere to:

1. Sound management of ESG factors promotes stability and aims to create long-term value for companies and for their investors.
2. Consideration of ESG factors in investment strategies is in line with asset managers' fiduciary obligation.
3. Responsible investment practices help preserve and promote our clients' long-term interests by contributing to the sound management of risk and of investment opportunities.
4. Shareholder engagement—through active exercise of voting rights, dialogue with issuing companies and dialogue with regulatory bodies—is the preferred practice for improving the quality of companies' governance along with their environmental and social practices. It leads to better risk management by such companies.
5. Proper disclosure of ESG factors by publicly traded companies is important, for it enables investors to compare and evaluate these companies' practices thoroughly in connection with investment decision-making processes.
6. Responsible investment and shareholder engagement practices promote sustainable and prosperous economic and social development, benefitting all stakeholders.

## Coverage

Our general approach to integrating responsible investment principles is applied to all the assets managed by the firm. Even so, some of our assets are treated differently to meet the specific needs of certain investors:

1. Our voting policy, which is strongly focused on ESG issues, does not apply to certain clients who have chosen to exercise their own voting rights or who adhere to a policy other than that of Hexavest (4% of our clients).
2. The assets of certain portfolios use a combination of our standard integration strategy (see "Integration in the investment process") and of a screening strategy, according to criteria established in their respective investment policy. Portfolios using this combination of ESG strategies account for 11% of the firm's total assets.
  - Separately managed portfolios with exclusions: Hexavest manages multiple mandates in segregated accounts on behalf of investors who wish to exclude controversial sectors, such as tobacco, gambling, controversial weapons production and nuclear energy.

- Climate Focus Fund: Since February 2016, Hexavest has been managing a portfolio aimed at investors who wish to reduce their exposure to climate-change risks, using an exclusion strategy. This portfolio invests in the MSCI All-Country World Index (ACWI) universe, from which are excluded all companies owning proven or probable oil, gas or coal reserves, as well as those using coal as a source of energy.

# Resources

Because responsible investment practices involve a large number of activities and evolve very quickly, they require several resources and expertise to ensure proper implementation. Hexavest has given the members of its management team and its qualitative research team responsibility for incorporating ESG factors into its portfolio construction process. To complement our in-house expertise, we retain specialized resources, essentially to carry out shareholder engagement activities and to obtain ESG research and data. Lastly, an in-house resource is dedicated to responsible investment and coordination of internal and external efforts.

## Internal Responsibilities

### **Board of Directors**

The members of Hexavest's Board of Directors are responsible for approving the Responsible Investment Policy.

### **Co-Chief Investment Officers and Management Team**

The integration of ESG factors into the portfolio construction process is overseen by the firm's Investment Committee and supervised by the Co-CIOs. Analysts and portfolio managers are required to consider ESG risks and opportunities in their fundamental and quantitative research.

### **Vice-President, Communications and Responsible Investing**

This person monitors the integration of ESG factors into the firm's activities and oversees the implementation of the Responsible Investment Policy, coordinates the accountability and reporting procedures, and acts as liaison with external resources.

### **Risk Committee**

As part of its market risk monitoring, the Risk Committee is responsible for analyzing ESG risks and presenting the results of its analysis to the management team.

### **Quantitative Research Team**

This team is responsible for the integration of ESG variables into the quantitative tools used by the management team. It also assesses the quality of the ESG data used by the models.

### **Middle Office and Compliance**

The members of these teams are responsible for integrating the specific ESG constraints of the relevant accounts into the firm's systems to ensure that the portfolios comply with the restrictions set out in the investment policies. Middle Office analysts are also responsible for adapting portfolios with significant restrictions so as to respect the active strategy favoured by the management team.

### **Client Servicing**

The firm's representatives are responsible for understanding ESG issues and communicating client needs and expectations to the internal and external resources involved. They are also responsible for disclosing the Responsible Investment Policy and the firm's ESG efforts to clients and consultants.

## External Resources

In 2018, Hexavest used various external providers as part of its responsible investment and ESG integration practices.

- Sustainalytics: research and ESG data for companies
- AEquo: shareholder engagement
- MSCI: benchmark for the Climate Focus Fund
- Groupe investissement responsable (GIR): proxy voting agent
- Independent brokers and research firms: ESG research

# Shareholder Engagement

## Proxy Voting

Hexavest has incorporated ESG issues into the guidelines in its Proxy Voting Policy. Our main basis of analysis when we exercise our voting rights is maximization of returns for our clients, which requires sound risk management. We therefore require that companies submit to the regulations in force in the countries and jurisdictions where they do business, that their conduct be socially responsible and that they submit to high standards of governance and ethics. By actively exercising our voting rights, we hope to improve the quality of the governance, environmental and social practices of the companies in which we invest and thereby contribute to better management of risks for specific securities.

Our Proxy Voting Policy is based on the principles of responsible investment of the United Nations and is applied to all portfolios managed by our firm (with the exception of the portfolios of clients who have decided to exercise their own voting rights). [Hexavest's Proxy Voting Policy](#) is public and available on the firm's website.

### Statistics for 2018

In 2018, Hexavest exercised its voting rights at the meetings of 569 companies and voted on 7,976 resolutions.

In 50% of cases, we voted in opposition to the board's recommendations and we rejected a large majority of the advisory resolutions on compensation (241 out of 379).

NUMBER OF VOTES "FOR" AND "AGAINST"

HEXAVEST VOTE	BOARD RECOMMENDATION	
	AGAINST	FOR
Abstention	0	506
Against	52	3,404
For	123	3,974

In the majority of cases, it was the inclusion of option grant plans in the executive compensation program that accounted for our negative vote, for we believe that this type of plan is not aligned with shareholder interests.

Lastly, Hexavest supported 157 shareholder proposals during the year.

## Engagement with Companies

We engage in shareholder dialogue in an individual and collaborative manner through AEquo, a service provider that specializes in this area. The AEquo experts carry out engagement activities on behalf of Hexavest according to an action plan predetermined each year and also on an ad hoc basis. Each quarter, AEquo reports on the various dialogues in a report submitted to our team of managers and analysts.

In this way, Hexavest maintains a constructive dialogue with companies located mainly in North America. The companies are selected as a function of the weakness of their ESG practices or their leadership positions in their industries. The objective is to increase the impact of each dialogue. The dialogue themes for each company are identified as a function of the most material ESG risks and opportunities, depending

on their sector of activity and geographic location. We define objectives for each dialogue and we track the progress achieved.

Our 2018 engagement plan focused on companies with which we want to continue a dialogue begun in 2017 and other companies whose ESG issues corresponded to the expertise developed by AEquo, our supplier of engagement services. We engaged in dialogue with 36 companies in 2018, as summarized in the table below. Please note that the details of the dialogues with these companies are available on request.

### Canadian Companies

INDUSTRY	COMPANY	ESG ISSUES		
		ENVIRONMENT	SOCIAL	GOVERNANCE
Consumer discretionary	Alimentation Couche-Tard	✓	✓	
	Dorel	✓	✓	✓
	Loblaw	✓	✓	
	Metro	✓	✓	
Energy	Canadian Natural Resources	✓	✓	✓
	Enbridge	✓	✓	
	Husky Energy	✓	✓	✓
	Imperial Oil	✓	✓	
	MEG Energy	✓	✓	✓
	Suncor Energy	✓	✓	
	TransCanada	✓	✓	
	Whitecap Resources	✓	✓	
Financials	Scotia Bank	✓	✓	✓
	TD Bank	✓	✓	✓
Materials	Agnico Eagle		✓	✓
	Barrick Gold	✓	✓	✓
	Eldorado Gold	✓	✓	✓
	Goldcorp	✓	✓	✓
	Yamana Gold		✓	✓
Utilities	Fortis	✓	✓	
Technologies	CGI		✓	✓

### Non-Canadian Companies

INDUSTRY	COMPANY	ESG ISSUES		
		ENVIRONMENT	SOCIAL	GOVERNANCE
Consumer discretionary	BMW	✓	✓	
	Costco Wholesale	✓	✓	
	CVS Health	✓	✓	
	Dollar General		✓	
	Dollar Tree		✓	
	Kroger	✓	✓	
	Walgreens Boots Alliance		✓	
Energy	Repsol	✓	✓	
Financials	BB&T	✓	✓	
Utilities	American Electric Power	✓		✓
	DTE Energy	✓		
	Duke Energy	✓		
	Entergy	✓		
	Public Service Enterprise Group	✓		
	Southern Company	✓		✓



## Collaborative Initiatives

Hexavest works with multipartite organizations to make businesses and investors more aware of responsible investment practices, consideration of ESG factors and disclosure of how they are managed. By working with other key players on the financial markets, we combine our efforts with theirs to maximize our collective influence on companies. The table below shows the 11 initiatives in which Hexavest participated in 2018.

Initiative	Summary
1. Investor Statement on the 5th Anniversary of the Rana Plaza Tragedy	Hexavest signed a letter asking clothing retailers and franchises supplied by Bangladesh to join the new Accord on Fire and Building Safety. This agreement was originally signed by 220 companies as well as labour organizations in 2013, in the aftermath of the Rana Plaza building collapse. It specifically enabled the implementation of a number of corrective measures at factories with questionable safety standards. Renewed for three more years, the Accord brings together 180 companies.
2. Investor Statement on Supply Chain Modern Slavery Legislation in Canada	Hexavest signed an investors' letter urging the Canadian Government to enact effective laws to help Canadian investors and companies identify and fight against modern slavery and child labour in global supply chains. The letter specifically asks for more-effective legislation that would require companies operating in Canada to draft and report annually on their efforts and due diligence in terms of preventing and mitigating the risk of modern slavery and child labour in their supply chains.
3. Letter from global investors to governments of the G7 nations	Hexavest signed a statement sent privately to the G7 leaders ahead of their June 8-9 Summit, asking them to: <ol style="list-style-type: none"> <li>1) meet the Paris Agreement objectives;</li> <li>2) accelerate private sector investments in the transition to low carbon intensity; and</li> <li>3) commit to improving climate-related financial reporting.</li> </ol>
4. Investor statement on forced labour in global supply chains	Hexavest signed KnowTheChain's statement outlining investor expectations regarding the fight against forced labour in global supply chains. More specifically, it invites companies to: <ol style="list-style-type: none"> <li>1) evaluate and manage risks related to forced labour by implementing adapted policies and practices;</li> <li>2) collaborate with stakeholders in order to reduce systemic risks and identify industry-specific solutions; and</li> <li>3) disclose efforts undertaken to prevent and counteract forced labour in the global supply chain.</li> </ol>

<p>5. Letter to General Electric</p>	<p>Hexavest signed an investors' statement asking General Electric to reconsider its recently announced plan to acquire an interest in the controversial Lamu coal-fired power plant in Kenya, Lamu having been designated a world heritage site by UNESCO. This coal power plant especially threatens the ecosystem and health of local communities.</p>
<p>6. Investor Letter to the Roundtable for Sustainable Palm Oil (RSPO) on their five-year Standards Revision and ESG Factors</p>	<p>Hexavest signed an investors' letter to the RSPO (the globally recognized standard for sustainable palm oil), in connection with its five-year review of its Principles and Criteria. The letter invited it to strengthen its standards in order to reflect best practices aimed at ensuring that palm oil production does not degrade the environment and respects human rights.</p> <p>The letter encourages the RSPO to:</p> <ol style="list-style-type: none"> <li>1. better integrate the NDPE engagement "No Deforestation, No Peat, No Exploitation policy";</li> <li>2. use the High Carbon Stock Approach (HCSA); and</li> <li>3. improve its complaint and sanction approach aimed at companies that do not comply with these standards.</li> </ol>
<p>7. Letter to Standard Chartered about its financing activities in the coal sector</p>	<p>Hexavest signed an Investors' Statement calling on Standard Chartered to strengthen its policy regarding coal. More precisely, the statement demanded that the bank integrate into its new policy:</p> <ol style="list-style-type: none"> <li>1) a prohibition on financing projects in new coal mines and new coal-fired power plants across the planet;</li> <li>2) a prohibition on offering general financing and consulting services to companies that are highly dependent on coal extraction or production;</li> <li>3) a clear plan with specified timeframes for eliminating its existing exposure to coal-related assets.</li> </ol>
<p>8. Letter to the Government of Bangladesh related to work and environmental risks of the leather industry</p>	<p>Hexavest signed a statement in which investors urged the government of Bangladesh to:</p> <ol style="list-style-type: none"> <li>1) inspect tanneries for evidence of child labour and propose alternatives to benefit child labourers;</li> <li>2) publish a formal evaluation of the environmental deterioration at Hazaribagh and draft an action plan to clean up the river and adjacent areas on the basis of the findings; and</li> <li>3) put in place fully functional waste management infrastructure at Savar, so that tanneries operating there stop polluting the Dhaleshwari River.</li> </ol>
<p>9. Investor Working Group on Sustainable Palm Oil Expectation Statement</p>	<p>Hexavest endorse the position paper on sustainable palm oil. This position paper was drafted by the PRI's investor working group on sustainable palm oil to highlight what investors expect of companies operating across the palm-oil value chain.</p>
<p>10. Letter requesting better disclosure regarding water management (CDP-formerly the Carbon Disclosure Project) in the energy sector</p>	<p>Hexavest signed a letter urging companies in the energy sector — if they have not already done so—to provide their water-management information through CDP. Sound, comparable information about oil and gas companies' water must be made available, if investors are to understand their exposure to water-related risks and their strategies</p>

	to mitigate such risks. CDP offers a standardized reference framework that allows investors to evaluate and compare how companies in this sector compare, in terms of managing this issue.
11. Investor expectations statement on deforestation in soybean supply chains	<p>Hexavest signed a letter aimed at food retailers and highlighting the risks related to deforestation in the soy supply chain. The letter asks retailers to improve their practices in the following four areas:</p> <ol style="list-style-type: none"> <li>1) sensitization and governance;</li> <li>2) risk management and traceability;</li> <li>3) risk strategy and mitigation; and</li> <li>4) metrics and monitoring.</li> </ol>

# Integration into the Portfolio Construction Process

## ESG Philosophy

We believe that companies lacking strong governance standards or social and environmental responsibility take business risks that can have an adverse effect on the companies themselves and their stock performance. Our investment team is mindful of the risks associated with ESG issues, which it therefore considers from a risk-assessment standpoint. We also believe that certain investment opportunities may arise from ESG factors.

## ESG Factors in Portfolio Construction

Hexavest favours an active, top-down investment approach to build a highly diversified equity portfolio while minimizing stock-specific risks. Our global portfolios therefore hold more than 300 stocks. Our efforts are focused on top-down decisions, such as selection of regions, countries, currencies, sectors and industries. Stock selection represents a smaller proportion of our decision-making process. We actively manage several decision-making levels, using mainly fundamental analysis and an investment horizon ranging from 12 to 18 months. Our fundamental analysis is based on three vectors: the macroeconomic environment, market valuation and investor sentiment.

### Integration of ESG Factors into the Selection of Countries, Sectors and Industries

Material ESG factors are considered under the first vector, i.e. the macroeconomic environment. For example, if a sector is likely to be adversely affected by new privacy protection regulation or if a country benefits from improved corporate governance standards, the portfolio managers will take these factors into account in their research and analysis, which may have a positive or negative impact on their decision.

### Integration into Stock Selection

The managers use quantitative tools to support them in the portfolio construction process, including a stock selection model. This model ranks companies according to the main families of variables. Sustainability's overall ESG score represents one of these families of variables. Thus companies' ESG performance affects their rank among their peers and can ultimately influence their presence in the portfolio. The image below, taken from our quantitative model, illustrates an example of rankings based on the automotive industry in Europe. Each family of variables positions companies at a percentile rank; the last column represents the overall percentile rank of each security.

## Hexavest Securities Analysis Model – Ranking of European Automotive Companies (Percentile Ranking)

As at March 31, 2019

Name	Growth	Revisions	Value	Momentum	Quality	Volatility	ESG	Percentile rank
PEUGEOT	66	12	98	80	92	14	74	94
VOLKSWAGEN AG	47	98	96	85	14	33	1	91
PORSCHE AUTOMOBIL	68	18	92	67	92	18	27	79
FIAT CHRYSLER AUTOMOBILE	48	69	96	10	83	9	18	61
FERRARI	99	69	5	47	73	15	34	52
BMW PREFERENCE	35	7	69	76	17	42	26	18
BAYER MOTOREN WERK	35	7	70	66	17	49	26	16
DAIMLER	22	8	87	29	15	31	11	11
RENAULT	32	4	84	6	10	13	53	4

Note: The rankings in the top and bottom two deciles are highlighted (in blue and red).

## Monitoring

Every month, a risk report is presented to the Investment Committee as part of a formal meeting. The team members then discuss the elements of greatest concern. These discussions may lead to analysis by regional teams and occasionally to decisions to adjust certain portfolio positions.

# Developments and Objectives

## Developments in 2018

As a UN PRI signatory, Hexavest is committed to incorporating ESG issues into its analysis and decision making. Through our Responsible Investment Policy, we are also committed to continuing to develop our ESG approach. Here is the progress that our firm made in 2018:

- **Increase in the number of companies we engage with**  
The number of companies with which we have a dialogue with went from 16 in 2017 to 35 in 2018. As well, the number of initiatives we collaborated on rose from seven in 2017 to 11 in 2018.
- **Formalization of a training plan**  
In 2018, we organized structured training activities for our in-house resources and developed a formal training plan for 2019.
- **Acquisition of new carbon-footprint data**  
We carried out research to identify a supplier of carbon data and signed a contract with MSCI, the selected supplier, early in 2019.

## Objectives for 2019

We have set specific objectives for the next year to ensure we constantly progress with our responsible investment practices:

1. Incorporate carbon-footprint data into our systems and integrate them into our research and analysis.
2. Add new sources of complementary ESG data to our quantitative models to improve this family of variables.
3. Expand our offering of ESG portfolios to meet the needs of the increasing number of investors concerned about responsible investment criteria.
4. Systematize the analysis of ESG issues in our research reports on sectors and industries.
5. Increase the number of companies with which we carry out shareholder engagement.

# Contact Information

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