CIBC Wood Gundy | Blue Heron Advisory Group

Blue Heron Portfolios: Investment Principles

The Blue Heron Investment Principles constitute a methodology to remove subjectivity from our Environmental Social and Governance (ESG) screening and create a reasonable, objective, and repeatable means to help identify the best-rated ESG companies.

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The Blue Heron Portfolios are a family of Discretionary Portfolios, managed by CIBC Wood Gundy Portfolio Managers Graham Isenegger and Neil Chappell, (hereafter "we") that invest exclusively in the securities of companies that meet stringent requirements when assessing their Environmental, Social and Corporate Governance (ESG) performance.

The Blue Heron Investment Principles are an attempt to remove most subjectivity from our ESG screening and create a reasonable, objective, and repeatable methodology to help identify the best rated ESG companies. We may modify or add to these Investment Principles at our discretion as our clients' views on social, environmental and other issues evolve.

The Blue Heron Investment Principles set out the screening criteria by which the ESG performances of companies are assessed. Companies who screen well against these criteria are placed in the "Blue Heron Investable Universe," which is a list of companies whose securities can be held in the Blue Heron Portfolios. The Blue Heron Investable Universe is then screened against our non-ESG related qualitative and quantitative criteria and an actively managed portfolio of 25-40 companies is created.

We assess the ESG performance of companies to identify industry leaders through best-in-class analysis while screening out companies with a record of significant negative impact on stakeholders.

We developed the Blue Heron Investment Principles using ESG research provided by MSCI Inc. These principles are comprised of three distinct screening methods that the we use in combination. Firstly, we use MSCI's Intangible Value Assessment (IVA) methodology that provides an objective framework to evaluate the absolute and relative ESG performance of companies. Secondly, we use MSCI's Business Involvement Screening to eliminate companies with involvement in specific businesses that involve an unacceptable level of risk or that are involved in businesses that we choose not to profit from. Finally, MSCI's ESG Impact Monitor research is used to identify and consistently track the impact of ESG controversies on companies. Investment decisions are the sole responsibility of the Portfolio Managers.

ANALYTICAL FRAMEWORK

The Blue Heron Investment Principles outlined in the next section are divided into three types: qualitative ESG screening, exclusionary screening criteria and controversy screening.

Qualitative ESG Screening Criteria

Qualitative ESG screening criteria are applicable to areas such as community, employee relations, corporate governance and environment, in which it is possible for a company to perform both positively and negatively. It is therefore possible to implement positive screening criteria – that is, screening criteria designed to select companies with desirable attributes – as well as negative screening criteria – that is, criteria designed to screen out companies with undesirable attributes. We have a strong emphasis on positive screening criteria reflecting the goals of most social investors, which is to focus not only on screening out companies with poor records, but also on encouraging positive social performance by "screening in."

MSCI Research's **Intangible Value Assessment** (IVA) is the application of qualitative ESG criteria is a three-stage approach:

Step 1: Identify Key ESG Drivers of Risk and Opportunity for Each Industry

This involves identifying 4 – 7 key ESG trends and issues by industry that represents the greatest risk and opportunity.

Step 2: Evaluate Company Risk Exposure and Risk Management

This weighs a company's strategy and performance against its specific level of risk or opportunities and thus identifies gaps in companies' risk management systems.

Step 3: Rank and Rate Each Company Against Industry Peers

Using an industry-specific key issue weighting model, companies are rated and ranked in comparison to their peers. Each company and industry undergoes an update on an annual rolling basis as well as in response to major events.

MSCI assigns an **overall company rating** on the "AAA – CCC" scale. They also assign an Industry-Adjusted Company Score and a Weighted Average Key Issue Score. Each "Pillar" of **Environment, Social, and Governance** for each company is also assigned a score and a weight. Key industry issues identified in Step 1 are for each company given a Risk Exposure Score and a Risk Management Score.

Universal Issues

Regardless of key issues by industry each company is also assigned a score by MSCI on the following "Universal ESG Issues":

- Carbon Emissions
- Water Stress
- Toxic Emissions
- Labour Management
- Health and Safety
- Corporate Governance
- Business Ethics, and
- Anti-Competitive Practices.

These scores are researched and analyzed using identical methodology and are not weighted by industry, so are thus fully comparable across all companies.

Qualitative ESG screening criteria by Pillar:

Each "Pillar" (Environment, Social and Governance) has a number of Sub-Pillars and each Sub-Pillar has a number of Key Performance Indicators (KPI).

- **Environmental Sub-Pillars and KPIs**

  Climate Change
  - Carbon Emissions
  - Product Carbon Footprint
  - Energy Efficiency
  - Insuring Climate Change Risk

  Natural Resource Use
  - Water Stress
  - Biodiversity and Land Use
  - Raw Material Sourcing
  - Financing Environmental Impact

  Waste Management
  - Toxic Emissions and Waste
  - Packaging Material and Waste
  - Electronic Waste

  Environmental Opportunities
  - Opportunities in Clean Tech
  - Opportunities in Green Buildings
  - Opportunities in Renewable Energy

- **Social Sub-Pillars and KPIs**

  Human Capital
  - Human Capital Development
  - Labour Management
  - Health and Safety
  - Supply Chain Labour Standards
  - Controversial Sourcing

  Product Safety
  - Product Safety and Quality
  - Chemical Safety
  - Financial Product Safety
  - Privacy and Data Security
  - Responsible Investing
  - Insuring Health and Demographic Risk

  Social Opportunities
  - Opportunities in Nutrition and Health
  - Access to Communications
  - Access to Healthcare
  - Access to Finance

- **Governance Sub-Pillars and KPIs**

  Corporate Governance
  - Corporate Governance

  Business Ethics
  - Corruption and Instability
  - Business Ethics and Fraud
  - Anti-competitive Practices

  Government and Public Policy
  - Financial System Instability

In the Blue Heron Portfolios we apply the qualitative ESG screening as the first screen and exclude all companies with a rating lower than BBB. This excludes the BB, B and CCC rated companies. For example, by applying this screen to MSCI's Canada Investable Market Index (Canada IMI) 321 companies are screened down to the 160 best rated. Similarly, applying this screen to the 672 US companies we follow results in an eligible pool of 333 companies before further screening.

Exclusionary Screening Criteria

Exclusionary screening criteria are used to screen out companies that manufacture products and/or provide services that investors may wish to avoid. Some of these criteria are based on a threshold of involvement that is defined in terms of percentage of annual revenues. Other criteria exclude companies with any involvement in a product or service.

Any company that meets any of the exclusionary screening criteria will be removed from the investable universe and thus will not be eligible for inclusion in the Blue Heron Portfolios, regardless of any positive aspects of the company's social and environmental performance.

General Exclusionary criteria:

- Gambling
- Civilian Firearms
- Military Weapons
- Adult Entertainment
- Tobacco
- Genetic Engineering
- Fossil Fuel Production

Specific Exclusionary Screening Criteria

Blue Heron Portfolios will not invest in the securities of companies meeting any of the criteria listed below.

(i) Gambling

- Companies that derive 5% or more of their annual revenue from gambling related business activities are excluded.

(ii) Civilian Firearms

- Companies that have an industry tie to the manufacture or retailing of civilian firearms are excluded.

(iii) Military Weapons

- Companies engaged in the manufacturing of cluster munitions or landmine systems or components are excluded.
- Companies that are 50% or more owned by companies with involvement in cluster munitions or landmines are excluded.
- Companies (excluding financial institutions) that own 20% or more of a cluster munitions or landmine company are excluded.
- Companies that derive any revenue from biological/chemical or nuclear weapons systems or components are excluded.
- Companies who derive more than 20% of their revenue from weapons systems, components and support systems and services are excluded.

(iv) Adult Entertainment

- Companies that derive 2.5% or more of their annual revenue from adult entertainment are excluded.

(v) Tobacco Products

- Companies that manufacture tobacco products such as cigars, blunts, cigarettes, beedis, kreteks, smokeless tobacco, snuff, snus, and chewing tobacco are excluded. This also includes companies that grow or process raw tobacco leaves.

(vi) Genetic Engineering

- Companies with any tie to the production of genetically modified organisms (GMOs) are excluded.

(vii) Fossil Fuels Productions

- Integrated Oil and Oil, Gas and Coal Exploration and/or Production companies are also excluded as our screening of these stocks identified an industry that presented an array of risk that taken together we felt could not be adequately mitigated.

Controversy Screening

We also use controversy screening via MSCI's ESG Impact monitor to provide timely and consistent assessment of companies involved in ESG controversies and remove them from the Blue Heron Investable Universe as described in detail below.

A controversy case is defined as alleged company violation of laws and regulations or an alleged company action or event that violates commonly accepted norms, including but not limited to norms represented by global conventions such as the UN Global Compact. A controversy can also include actions by stakeholders (such as lawsuits or protests) criticizing a company over an event or an alleged negative impact, as well as involvement in controversial business activities.

A controversy case is typically a single event such as a spill, accident, or regulatory action. It may also be a set of closely linked events or allegations such as health and safety fines at the same facility, multiple allegations of anti-competitive behaviour related to the same product line, multiple community protests of the same company location, or multiple individual lawsuits alleging the same type of discrimination.

Assessment of Controversy Severity:

Each case is assessed for level of severity:

- **Minor:** Small potential negative impact on stakeholders. Typically harm to stakeholders is limited or ties to the company are indirect or unconfirmed.
- **Moderate:** Moderate potential negative impact on stakeholders. Typically involve either modest harm where the scope of stakeholders affected is (society, environment) is moderate or more limited harm where the scope of stakeholders is large (e.g., a larger number of people or area of land).
- **Severe:** Large potential negative impact on stakeholders. Typically involve either serious harm where the scope of stakeholders affected is relatively small or more moderate harm where the scope of stakeholder affected is broad.
- **Very Severe:** Egregious cases where potential negative impact on stakeholders may be widespread and very large. Often there may also be financial risk to the company and long-term brand damage.

R **RED:** Indicates that a company is involved in one or more very severe controversies

Y **YELLOW:** Indicates that the company is involved in severe-to-moderate level controversies

G **GREEN:** Indicates that the company is not involved in any major controversies

Assessment of Controversy Type:

Each case is assessed to determine if the controversy is structural or non-structural.

- **Structural:** is assigned to a controversy case when the same problem arises across many parts of the company, senior line executives are involved, management negligence is apparent, or the case is related to a controversial line of the company's business.
- **Non-Structural:** where there is no evidence of negligence or senior line executive involvement.

Assessment of Controversy Status:

Each case is assessed for its status:

- **Ongoing:** the case is active, with the last known development occurring within the last three years and it has not been dealt with, withdrawn or resolved.
- **Concluded:** the case has been resolved, closed, or withdrawn. Concluded cases are upgraded over time and eventually archived.
- **Historical Concern:** the case is not ongoing and is older than three years but is high profile and forms an important part of the company's ESG history. These cases remain in the company's history and are not archived although they do not affect scoring.

Upgrading and Archiving:

"Concluded" controversies, other than Very Severe cases, retain their final severity assessment for one year from the date of conclusion, at which point it is upgraded by one severity level (e.g., from Severe to Moderate). The following year the concluded case will be upgraded again and after a year at Minor level is archived. Very Severe controversies upgrades are conditional on the company's response to the controversy and the lack of new allegations or developments surrounding the same issue.

Assessing KPI, Sub-Pillar, Pillar, and Overall Performance

MSCI assigns scores and flags at the KPI, Sub-Pillar, Pillar and Overall company levels. Pillar/Sub-Pillar/KPIs are the same as described earlier in the qualitative ESG section.

The KPI type assessment is derived at two levels. If the most severe controversy within the KPI is assessed as Structural then the KPI assessment will also be Structural. If there are three or more controversies within a given KPI, the KPI will be assessed as Structural even if the individual controversies are assessed as Non-Structural.

At each level the score is driven by the lowest-scoring components below it. So the Sub-Pillar score is driven by the lowest scoring KPI within the Sub-Pillar and the flag is driven by the score. (See table)

KPI Assessment	KPI Type	KPI Score	KPI Flag
No Value	No Value	10	GREEN
Minor	Non-Structural	8	GREEN
Minor	Structural	7	GREEN
Moderate	Non-Structural	5	GREEN
Moderate	Structural	4	YELLOW
Severe	Non-Structural	3	YELLOW
Severe	Structural	2	YELLOW
Very Severe	Non Structural	1	RED
Very Severe	Structural	0	RED

Each company receives an overall score and flag based on MSCI's assessment of performance across the three Pillars (E, S and G) with the score driven by the lowest scoring pillar.

Blue Heron Application of Controversy Screening

Each of the Pillars is assigned a Flag level at which companies are excluded. For the Governance and Social we use the Red Flag and for the Environment Pillar we use the Yellow Flag. In practice, most companies with Red Flag Controversies are screened out by the initial screen but the Yellow Flag for Environmental controversies proves to be quite aggressive in screening out companies. In consultation with our clients this was deemed desirable.

Pillar Score	Pillar Flag
10	GREEN
8	GREEN
7	GREEN
5	GREEN
4	YELLOW
3	YELLOW
2	YELLOW
1	RED
0	RED

Blue Heron Principles in Action

To highlight the efficacy of the Blue Heron Principles the MSCI Canada IMI unscreened has 321 companies. The first qualitative ESG screen refined this to 160 of the most highly rated ESG companies and the Exclusionary and Controversy screening further refined this to 121 companies. These 121 companies represent the best quality 1st and 2nd Quintile ESG rated sub-set of the Canadian market – the Blue Heron Canadian Investable Universe.

Similarly, applying this qualitative screen to the 672 US companies we follow results in an eligible pool of 333 companies before further screening. Exclusionary and Controversy screening and focusing on companies with a US$5 Billion market capitalization further refined this to 213 companies. These 213 companies represent the top third ESG rated sub-set of US market – the Blue Heron US Investable Universe.

The Blue Heron Portfolios are constructed only from the constituents of the Blue Heron Investable Universe ensuring that the portfolios are constituted only of the highest rated ESG companies in the world.

Overall Score	Overall Flag
10	GREEN
8	GREEN
7	GREEN
5	GREEN
4	YELLOW
3	YELLOW
2	YELLOW
1	RED
0	RED