Environmental, Social and Governance Investment

Annual Report 2016
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Foreword

Welcome to BlueBay’s first annual Environmental, Social, and Governance (ESG) investment risk report, covering our 2016 activities. This is an exciting development, consistent with our commitment to ongoing transparency in managing ESG investment risk across portfolios.

Fixed income ESG investing is in its relative infancy and we believe it is likely to become an increasingly prominent part of many investor decision making processes.

As a specialist fixed income manager, we believe BlueBay is well placed to leverage its expertise and skill base to develop innovative fixed income solutions to help clients meet their ESG commitments while also achieving target investment outcomes.

This report provides some highlights of our progress over the last year. This includes work with our investment teams on ESG credit risk and consolidation of our efforts for routine communications, the establishment of a formal framework for ESG integration in our private debt business, and our active industry collaborative efforts, via PRI, in fixed income and ESG working groups.

Incorporating ESG into our investment activities is a dynamic and evolving process. While we have made good progress, we recognise the need to continue initiatives to expand the scope of and further embed ESG across our investment teams.

We hope you enjoy these insights into our activities and achievements, and look forward to any client feedback on how we can improve our future efforts.

Alex Khein
Chief Executive Officer
2014-2017

Erich Gerth
Chief Executive Officer
2017 -
About BlueBay

Fixed income specialist providing progressive investment solutions

BlueBay is one of Europe’s largest specialist managers of fixed income, entrusted by clients with over US$50 billion in AuM in corporate and sovereign debt, rates and FX.*

Investment philosophy and approach focused on delivering absolute-style returns, with an emphasis on capital preservation.

Established track record of innovation and performance, providing a broad range of relative return, total return and alternative investment portfolios in both public and private debt markets.

BlueBay is a wholly-owned subsidiary of Royal Bank of Canada with full investment autonomy and operational independence.

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2001
BlueBay is established at the advent of the euro to capitalise on inefficiencies in the growing pan-European corporate bond market, and in response to the evolving opportunity set in emerging market (EM) debt

2003
With a focus on capital preservation, pioneered the use of credit default swaps in traditional benchmark funds, applying short positions and other hedge fund investment techniques in both long-only and long-short strategies

2008
Launch of flagship European credit long-short hedge fund strategy and the first long-only EM debt fund in UCITS format

2010
Launch of sovereign debt strategy to capitalise on new total return opportunities as a result of European peripheral stress

2015
Launch of financial capital bond strategy to capitalise on the new sub-asset class of bank contingent capital debt instruments

2017
Launch of unique environmental, social and governance (“ESG”) high yield strategy to meet the growing demand for ethical investment strategies

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AuM by strategy (US$m)

*Data as at 31 December 2016

For further information about BlueBay, please visit www.bluebay.com
ESG Investment
Risk Management
ESG investment risk management at BlueBay

A focus on ESG analysis to enhance long-term returns

ESG factors can have a material impact on an issuer’s long-term financial performance. Poorly-managed ESG risks can lead to inefficiencies, operational disruption, litigation and reputational damage. These may impact an issuer’s ability to meet its financial responsibilities. Supplementing traditional financial analysis with ESG analysis is prudent and in-line with our fiduciary duty to optimise investor returns.

Our approach

In 2016 we employed a range of complementary ESG investment strategies for our managed assets, varying in scope and relevance.

ESG integration forms the core of our efforts and is applied across all our assets, supplemented by engagement where appropriate.

ESG negative screening based on controversial weapons is applied to our pooled funds, and proxy voting in more limited instances to our convertibles and global leveraged strategies.

SPOTLIGHT: Policies

- ESG Investment Risk Policy
- Controversial Weapons Investment Policy
- Proxy Voting Policy on Corporate Governance & Corporate Responsibility
- Statement on UK Stewardship Code
- Statement on UK Modern Slavery Act

Our ESG investment strategies

<table>
<thead>
<tr>
<th></th>
<th>ESG integration</th>
<th>ESG engagement</th>
<th>Ethical (negative/exclusions) screening</th>
<th>Norms-based screening</th>
<th>ESG tilting</th>
<th>ESG best in class</th>
<th>ESG (positive/thematic) investing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pooled funds</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>×</td>
<td>×</td>
<td>×</td>
<td>×</td>
</tr>
<tr>
<td>Segregated accounts</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>×</td>
<td>×</td>
<td>×</td>
<td>×</td>
</tr>
</tbody>
</table>

For the UK market, we also have policies which focus on ESG-related matters which are investment relevant and/or which have a broader scope (such as the organisation as a whole). These are our Statement on UK Stewardship Code and Statement on the UK Modern Slavery Act 2015.
Integration

ESG integration involves the identification and assessment of material ESG risk factors within the investment process. This approach does not necessarily mean excluding issuers from investments solely on ESG grounds, but ensures informed decisions are taken on ESG factors.

We have a systematic framework for incorporating ESG investment risks into our investment process, ranging from evaluating issuer-specific risks to sector, country and regional risks. We overlay this with our investment exposure information to help focus our efforts.

Our model is for our in-house ESG function to act as a facilitator and enabler, working to empower our investment teams (primarily credit analysts) to make the ultimate investment decisions.

One of our key internal mechanisms for this is our cross-desk sector analyst forums. These were set up in 2015 to promote the sharing of insights and investment ideas about specific sectors.

Through this initiative we produce ESG briefings outlining key ESG credit issues for each sector. These also include questions on critical ESG matters, providing credit analysts with a useful tool to address these issues in their engagement efforts with companies.

**SPOTLIGHT: Cross-desk sector analyst forums**
- Consumer related
- Energy and mining
- Financials
- Healthcare
- Industrials
- Real estate/REITs
- Technology, media and telecoms
- Utilities and infrastructure

A message from our Chief Investment Officer

*Embedding ESG within our investment risk framework is a strategic goal for BlueBay.*

We believe our core focus on ESG integration is well suited to the heterogeneity of the fixed income asset class.

Given our primary approach of ESG integration, it is acceptable for an analyst to recommend a credit with a weak ESG management score, or for a portfolio manager to hold an issuer in a fund with such a rating (as long as it is consistent with that fund’s guidelines).

However, we would expect the individuals to consider the ESG performance before the investment recommendation is made, as well as to monitor this on an ongoing basis post the investment.

Credit is an asymmetric asset class where strong bottom-up stock picking is essential for long-term success. We believe supplementing traditional credit analysis with ESG can help enhance our ability to do this.

Raphael Robelin
Chief Investment Officer
Debt providers have a role to play in engaging with issuers on matters that may impact investment returns. However, client expectations should be managed around the scale and effectiveness of engagement as we are lenders, not owners.

As part of our research process our teams meet issuers and are able to raise questions including those related to ESG. Given our integration focus, we prioritise looking at material ESG risk factors.

**SPOTLIGHT: How we approach engagement**

**Purpose of engagement:**
- Insights into the issuer’s ESG practices which may have investment implications
- Facilitation of change/improvement in specific ESG areas

**Origins of engagement:**
- Proactive – initiated by the company or investors
- Reactive – in response to a corporate action or incident

If ESG engagement is deemed necessary, it is prioritised following a risk-based approach taking into account considerations such as:
- Absolute/relative exposure size
- Investment thesis (long term versus short term)
- Focus on issuers with high exposure to ESG controversies
- Overall company ESG performance scores and trends

Engagement may be led by:
- Investors – as part of a proactive or reactive engagement programme
- Companies – as part of a proactive effort by the company to engage with investors on ESG practices

Engagement may be via face-to-face meetings with management or through conference calls and e-communications.

NOTE: Beyond issuer-specific engagement, we may also engage on a thematic/sector level which may involve working with other stakeholder groups.

**Negative screening**

We apply a controversial weapons investment exclusion (covering corporate producers of cluster munitions and anti-personnel landmines) policy to all our pooled funds. The data on restricted issuers is sourced from a third party and coded into our internal investment dealing systems by our Compliance function.
Proxy voting

Given our focus on fixed income investing, we have limited scope to participate in proxy voting. But where we do (e.g. in some instances in our high yield, convertibles and private debt businesses), we ensure we exercise our duties responsibly.

Voting decisions are made by our investment teams, with support from our ESG Investment Risk function where appropriate.

Industry memberships

BlueBay has been a member of the UN-supported Principles for Responsible Investment (PRI) since July 2013.

The PRI is an independent membership-based organisation for stakeholders active in the investment value chain seeking to work to support members to incorporate ESG factors into their investment and ownership decisions.

Signatories sign up to the six principles of the PRI.

During late 2016, BlueBay became a signatory to the CDP, formerly the Carbon Disclosure Project.

The CDP is an international, not-for-profit organisation providing a global reporting framework for companies to measure, disclose, manage and share critical environmental information.

These include material on climate change, water and natural resource usage which is consulted by a range of stakeholders (including investors) to inform decision making.
In 2016 we dedicated two employees to ESG, who reside in our Investment Risk function.

Our Head of ESG Investment Risk is responsible for our ESG investment risk strategy, policies and processes. She represents BlueBay externally in ESG-related initiatives, and updates clients on our efforts.

Oversight and management of our ESG investment risk management process resides within our Investment Risk function. Our ESG Investment Risk function reports directly to the Head of Investment Risk & Performance – Attribution, who in turn reports to the Chief Operating Officer.

Our ESG Investment Risk function also provides regular progress and performance updates to the Market Risk Committee.

**SPOTLIGHT: ESG investment data**

We have access to a range of fee-based and open-access resources. We source ESG data at the corporate and sovereign issuer level and at the sector level from specialist independent ESG and political risk research providers.

We utilise ESG-related investment insights from sell-side brokers and other stakeholder groups as well as via the in-house issuer, sector and country expertise of our investment teams.

**SPOTLIGHT: Market Risk Committee**

**Membership**

Head of Investment Risk & Performance – Attribution (Chair), Chief Investment Officer, Chief Operating Officer/Chief Risk Officer, Head of Investment Operations, Senior Risk Manager.

**Mandate**

Ensures effectiveness of the risk management process, internal guidelines and policies related to investment risk frameworks; review and assessment of performance and risk of fund products; review and approval of counterparty relationship; review ESG investment risk.

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**Jean-Philippe Blua**  
Head of Investment Risk & Performance – Attribution  
*Industry experience: 14 years*

**My-Linh Ngo**  
Head of ESG Investment Risk  
*Industry experience: 16 years*

**Freya Buck-Emden**  
ESG support  
*Industry experience: 6 months*
2016 Highlights
2016 highlights

Embedding ESG within our investment activities

In 2016, we continued to raise awareness and enhance understanding of ESG investment risk factors within our investment teams.

**SPOTLIGHT: Sector analyst forums**
Below are some examples of our ESG discussions within our sector analyst forums:

**Energy and mining**
Discussion on oil price dynamics included the consideration of climate change/carbon bubble risk, as well as the potential threat to demand from transportation in light of the increasing market penetration of electric vehicles.

**Technology, media and telecommunications**
Conducted a teach-in on key ESG risks in the sector, including the exploration of challenges of cyber security/freedom and privacy risk and how to assess management competency in this area.

**Consumers**
Provided educational overview of key ESG risks, highlighting trends in wage increases and water risks.

**Financials**
Numerous discussions around the role of culture and conduct in the banking sector and how to effectively evaluate it.

**Industrials**
Range of topics covered include environmental risks facing the cement industry, as well as a discussion on disruptive technologies in the auto sector around electric vehicles and shared autonomy.

**ESG-integrated in private debt investment process**

<table>
<thead>
<tr>
<th>Pre-investment: Company analysis</th>
<th>Post-investment: Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>* Ethical business screening</td>
<td>* Providing transparency</td>
</tr>
<tr>
<td>* ESG due diligence checklist</td>
<td>* Measuring impact</td>
</tr>
<tr>
<td>* Sector ESG briefing</td>
<td>* Portfolio ESG review</td>
</tr>
<tr>
<td>* ESG specialist involvement in review process</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Post-investment: Monitoring</th>
</tr>
</thead>
<tbody>
<tr>
<td>* Regular dialogue with management</td>
</tr>
<tr>
<td>* Monitor ESG risks</td>
</tr>
<tr>
<td>* Address any developments</td>
</tr>
</tbody>
</table>

**Environmental factors**
- Ethical business screening
- ESG due diligence checklist
- Sector ESG briefing
- ESG specialist involvement in review process

**Social factors**
- Regular dialogue with management
- Monitor ESG risks
- Address any developments

**Governance factors**
- Providing transparency
- Measuring impact
- Portfolio ESG review

**SPOTLIGHT: Private debt and ESG**
We believe ESG risk factors are particularly pertinent for the private debt market, given the illiquid nature of the loans and the need for a longer-term credit view on borrowers. We have developed and implemented a process to systematically incorporate ESG considerations in the management of our private debt funds.

Our approach addresses ESG risks at the pre-investment phase (e.g. due diligence and investment decision making), and post-investment phase (e.g. monitoring and interaction with management), with formalised processes in place at each stage.
In 2016 we were involved in ESG engagement with individual issuers as well as with other stakeholders on a sector and issuer level. Below are some examples of our activities in each area. The focus has primarily been on corporate issuers.

<table>
<thead>
<tr>
<th>SPOTLIGHT: Companies</th>
<th>SPOTLIGHT: Sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Continued to highlight the importance and encouraged public disclosure of ESG</td>
<td>• Attended investor events on banking culture and conduct and its broad relevance</td>
</tr>
<tr>
<td>credit risks, emphasising quality and consistency to enable benchmarking of</td>
<td>in the sector with particular geographic focus on the UK. This included</td>
</tr>
<tr>
<td>management quality to inform our analysis</td>
<td>engaging with representatives of the Banking Standards Board on the topic of</td>
</tr>
<tr>
<td>• Engaged with a leading European autos manufacturer in light of news about internal</td>
<td>fostering a responsible banking culture and conduct in the UK banking industry,</td>
</tr>
<tr>
<td>internal practices on reported product vehicle emissions</td>
<td>and gaining some useful insights on the challenges and ways to identify</td>
</tr>
<tr>
<td>• Attended company ESG investor presentations on their ESG approach and performance</td>
<td>effective companies</td>
</tr>
<tr>
<td>and provided feedback on areas of strengths and potential improvements. This</td>
<td>• In addition to engaging directly with issuers, we held dialogue with the</td>
</tr>
<tr>
<td>included market-leading companies across sectors including mining, software and</td>
<td>International Council on Mining and Metals (ICMM), the trade body for the</td>
</tr>
<tr>
<td>financials</td>
<td>global mining industry on ESG-related matters</td>
</tr>
<tr>
<td>• Contributed to formal ESG stakeholder consultations convened by companies in the</td>
<td>• Provided feedback on the issue of access to medicines in the context of the</td>
</tr>
<tr>
<td>utilities and banking sector in both emerging markets and Europe, and shared our</td>
<td>pharmaceutical industry. As investors, we recognise this issue not only poses</td>
</tr>
<tr>
<td>views on the most credit-relevant ESG issues</td>
<td>reputational risk in terms of the industry and individual companies’ license to</td>
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<tr>
<td></td>
<td>operate, it also provides insights into matters such as a company’s approach to</td>
</tr>
<tr>
<td></td>
<td>product innovation and stakeholder relations</td>
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</tbody>
</table>
Proxy voting

As previously stated with our focus on fixed income investing, our exposure to proxy voting relative to our overall assets under management is immaterial. However, where we have exposure (mainly through our convertible bonds and high yield assets) we seek to exercise proxy voting.

SPOTLIGHT: Summary – proxy voting activities in 2016
(applicable to convertible and high yield assets)

• Proxy voting occurred in a total of 13 instances, relating to 11 separate securities (with voting occurring for the same 2 securities on 2 separate occasions)

• In all instances, decisions related to standard corporate governance matters

• In total, in 12 out of the 13 instances of voting, we voted in-line with management recommendations

• Only in 1 instance, in relation to 1 security, did we vote against management recommendations

The big picture – ensuring a sustainable financial system

Contributing to the integrity of financial markets

Financial markets need to function effectively and efficiently to maintain public confidence in the system and ensure the continued allocation of assets generating attractive returns.

We are committed to contributing to discussions to facilitate this, as well as promoting good practice in order to strengthen the integrity and sustainability of financial markets.
SPOTLIGHT: Contributing to industry best practice in ESG fixed income

Our PRI membership has enabled our active participation in the investor work streams focused on ESG in fixed income investing.

Since 2015, we have been members of the Fixed Income Engagement Working Group, engaging with credit rating agencies (CRAs) on the need for more explicit and systematic ESG credit analysis.

In May 2016, a key output of the group’s efforts was the publication of the Statement on ESG in credit ratings, which secured the support of 100+ investor signatories (managing US$16 trillion in assets) and six CRAs including Moody’s Investor Service and S&P Global Ratings. As of the end of 2016, we have seen new signatories, bringing the total to 7 CRAs and 111 investors.

The launch of the Statement marks the start of a two-year programme to bring investors and CRAs together in a series of global events to discuss the links between ESG and creditworthiness.

We are committed to playing an active role in the two-year programme as well as the broader work of the PRI in fixed income.

As such, we have signed up to become a member of the newly-created Advisory Committee on Credit Ratings (which takes over from the Working Group) as a Co-Chair. We will continue to engage directly with CRAs on ESG-related matters.

We have also joined the Bondholder Engagement Working Group, set up to explore how best to engage with issuers on credit-relevant ESG risks.
SPOTLIGHT: generating positive economic benefits by supporting SMEs

Small-to-medium-sized enterprises (SMEs) play a key role in economic and social transition. These firms typically account for more than 90% of all firms outside the agricultural sector, and constitute a major source of employment as well as generate significant domestic and export earnings.

Our private debt (Direct Lending) business, which represent €5 billion of AUM (as of 31 December 2016), is directly focused on providing financing needs to the SME market to fill the funding gap left by banks, creating economic and wider social and environmental value.

The graphic below summarises the positive impact of investments made collectively in our Direct Lending funds.

BlueBay Private Debt’s ESG value creation and economic impact assessment

<table>
<thead>
<tr>
<th>Growth partner</th>
<th>Social impact</th>
<th>Value creation</th>
<th>Facilitating sustainability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supporting the expansion of 35+ companies valued at almost €8.0 billion ¹</td>
<td>Portfolio companies currently employ c.32,000 FTEs across more than 40 geographies ²</td>
<td>Portfolio companies generating €5.5 billion of revenues per year ²</td>
<td>Investing in solutions-oriented companies</td>
</tr>
</tbody>
</table>

Notes: 1. Based on TEV at time of funding, including both realised and unrealised investments (as of August 2016); 2. BlueBay internal calculations, including both realised and unrealised investments (as of August 2016)

SPOTLIGHT: A comment on green bonds

We recognise the green bond market will be critical in financing the low-carbon transition. However we do not currently manage dedicated green bond funds, partly a reflection of our view on the relatively small size of the market, and also due to our approach of filtering issuance based on an investment being attractive.

However we can, and do, consider such issuance on a case-by-case basis and may participate for our conventional fund offerings. We have provided feedback on our thoughts on the market and practical aspects of green bond issuance. For instance:

- We continued to have exposure in some of our emerging market (EM) debt strategies to a leading Latin American financial institution with a green bond issuance for eligible green projects
- Our EM debt team met a leading financial institution in the Middle East seeking to issue a green bond to provide project financing for eligible environmental activities
The Sustainable Development Goals (SDGs)

In 2015, the Millennium Development Goals (MDGs), which were launched in 2000 to make global progress on poverty, education, health, hunger and the environment, expired. 193 country leaders agreed to 17 new Global Goals for Sustainable Development (or Sustainable Development Goals (SDGs)), replacing the MDGs and emphasising the continued need for worldwide progress on these issues. The ultimate objective of these goals is the eradication of extreme poverty, hunger and inequality as well as the prevention of dangerous climate change by 2030.

**SPOTLIGHT: Thematic investing through the lens of the SDGs**

During 2016, we had debt investments in corporate issuers whose core business (in revenue terms) provided solutions to a range of environmental or social challenges, which can be mapped onto specific SDGs. Some examples include:

**SDG 3 – Good health and wellbeing**

Funds across our investment teams have debt issuance in companies in the healthcare sector, providing drugs, medical devices as well as services to maintain and promote good health. This is particularly critical in developing countries in regard to enhancing access to vaccinations and medicines.

**SDG 4 – Quality education**

We have loan exposure in some of our Direct Lending funds to companies active in the education space with a particular focus on operating academic facilities.

**SDG 7 – Affordable and clean energy**

In some of our strategies, we offer loans for companies active in providing renewable energy for residential and commercial power customers.

**SDG 13 – Climate action**

One of our investment desks holds bonds in a leading North American autos manufacturer and energy storage company active in promoting electric vehicles.
PRI assessment of BlueBay’s efforts

As a signatory to the UN-supported Principles for Responsible Investment (PRI), we produce an annual self-completed questionnaire about how we implement the Principles in terms of our ESG investment efforts.

In 2016, we participated in the PRI’s annual PRI Reporting & Assessment process covering 2015 and received our assessment on how we performed on ESG integration in our investment process. See our 2016 Transparency report via our website bluebay.com for more detail.

In summary the results are as follows:

<table>
<thead>
<tr>
<th>Module</th>
<th>Score</th>
<th>Score – median (signatories who complete the module)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategy and governance</td>
<td>A*</td>
<td>B</td>
</tr>
<tr>
<td>Fixed income – SSA</td>
<td>A</td>
<td>C</td>
</tr>
<tr>
<td>Fixed income – corporate financial</td>
<td>A</td>
<td>C</td>
</tr>
<tr>
<td>Fixed income – corporate non-financial</td>
<td>A</td>
<td>C</td>
</tr>
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</table>

For further information on the PRI, please visit: [www.unpri.org](http://www.unpri.org)
Looking Ahead
Looking ahead

With geopolitical, social and macroeconomic instability on the rise, and growing environmental challenges such as climate change, ESG-related investment insights appear more relevant than ever in helping us navigate the path ahead.

Nevertheless, doing ESG investing risk management well takes time and effort. Developing and implementing policies, processes and procedures are only part of the task.

Perhaps more challenging, but even more critical, is the work on building internal ESG awareness, understanding and the capacity of our investment teams so it becomes common practice.

Although we believe we have made some good progress in 2016, we will continue to push ahead in 2017.

Internally, specific areas we will seek to make headway on include:

- Focusing on pre-investment efforts for our public debt assets: establishing a formal process for investment teams to systematically consider and document ESG risks in their issuer credit analysis
- Expanding our roll-out of our sector ESG briefing documents – key internal tools for our credit analysis in public and private debt teams
- Continuing roll out of ESG process for Direct Lending funds
- Increasing ESG resources to step up efforts to embed ESG investment risk within our investment process
- Working to develop more dedicated and tailored ESG investment solutions for our clients

Externally, we are committed to playing our part in ongoing industry collaboration efforts such as:

- Working with other investors via the PRI to continue to engage credit rating agencies on ESG credit analysis and identify ways to effectively engage with issuers on ESG credit risks
- Continuing to share our learning with the industry on ESG in fixed income investing, to advance thinking and best practice

As clients transition from a ‘tell me’ narrative to a ‘show me’ one in terms of tangible examples of how we are implementing ESG investment risk management, we look forward to continuing the conversation and sharing our learning as part of our ongoing journey.

My-Linh Ngo
Head of ESG Investment Risk
Feedback and contact us

We hope you have found our annual ESG investment risk report useful.

To ensure we continue to meet our key stakeholder needs and interests, we welcome feedback on how we can improve our future efforts.

Contact us

Email: ESG@BlueBay.com
BlueBay Asset Management
77 Grosvenor Street
London, W1J 3JR
Tel: +44(0)20 7389 3775

For further information on BlueBay’s ESG investment risk management, please visit: www.bluebay.com/en/environmental-social-and-governance/overview/
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