HYMANS ROBERTSON

Responsible Investment *News and Views*

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The Mansion House Compact could lead to a further £50 billion of investment into high-growth companies. Will it also help make the world a better place?

Following the Mansion House speech in July 2023, the pensions sector saw a slew of regulatory updates. One piece of news was the Mansion House Compact, which aims to allocate a minimum of 5% of default funds to unlisted equities by 2030 and was endorsed by nine major pension providers. This echoes the 5% requirement for Local Government Pension Schemes (LGPS) as part of the Levelling Up agenda, which has galvanised interest in local and impact investing, and raises two questions:

- **How much will this increase the amount of money invested in funds labelled as 'impact'?**
- **How much impact will this actually have?**

People are increasingly interested in impact investing, which appears to be a natural evolution of the focus on ESG over recent years. There's also a widely held belief that asset owners can have more impact by investing in private markets rather than listed assets, which, in our view, is largely correct.

Although this could unlock the potential for more impact investing, it isn't a foregone conclusion. First, the Compact doesn't stipulate the use of impact investments. Second, impact investing is complex, and Mansion House Compact participants, along with other providers, may be nervous about being implicated in 'impact-washing' ie selling or allocating to products or strategies that are labelled as 'impact' but which actually create little real-world change.

However, advice from impact experts is available, and, given the interest in considering how capital (re)allocation can drive sustainability and impact goals, it seems likely that impact investing will receive a boost.

There are two broad principles we believe all potential impact investors should consider.

1. Theme prioritisation

Which theme you focus on, be it climate change, homelessness, or something else, is one of your most important decisions as an impact investor. Unlike the Levelling Up agenda, which is tied to 12 'missions', the Mansion House Compact is not constrained to specific themes, allowing providers and investors access to the whole universe of impact possibilities.

2. Ensuring additionality

Investors' impact is additional if it goes above and beyond what would have happened anyway. While assessing this is difficult, and investors are likely to need support in this area, they should be able to make a genuine impact by allocating capital to underserved areas.

It's unclear how this will play out. As scale increases, there may be a desire to invest in bigger ticket sizes to simplify investor governance. A concentration towards larger providers may shift the dynamics of the market, with unclear implications for the impact achieved or the risk/return characteristics of investments. Further, the Compact focuses on private equity, and it's unclear whether there will be more interest in private debt as a result. However, lenders have a better capacity to 'vote with their feet', because equity is perpetual, but borrowers must come back to the market every few years.

> The Mansion House Compact presents an opportunity, not just to diversify asset classes, but also to make the world a better place. Achieving a positive impact is hard, but support from the experts is available. You can always reach out to a contact at Hymans Robertson – it may be an opportunity that you don't want to miss.

Reflecting on the proxy voting season

As anticipated in our Q2 RI News and Views, this year's oil and gas AGMs were contentious, with dissatisfaction expressed both by climate activists (who stormed BP's and Shell's AGMs) and through investment managers' votes. This quarter, we reflect on the results of those votes and some of the measures asset owners have taken to force better outcomes.

While none of the climate shareholder proposals passed, their support was significant at both Shell and BP:

Company	AGM date 2023	Vote for	Vote against
BP	27 April	16.7%	83.3%
Shell	23 May	20.2%	79.8%
Exxon	31 May	10.5%	89.5%
Chevron	31 May	9.6%	90.4%

Of note were several investment managers who've been accused of backtracking on their support of the climate resolutions. Below, we show a snapshot of some of the largest managers and how they voted on the climate resolution at Shell from the 2022 to 2023 voting season:

Manager	2022	2023
LGIM	Against	Against
BlackRock	Against	Against
Schroders	For	Against
Aviva	For	Against
Robeco	For	For
HSBC AM	For	For

Leading investors of the Climate Action 100+ (CA100+) MN and PGGM encouraged other investors to vote in favour of the climate resolution at Shell's AGM by pre-declaring their votes and flagging the resolution in the CA100+ alliance. Despite all the investment managers listed above being signatories to CA100+, four voted against this recommendation, which calls into question whether investment managers are box-ticking by signing up to numerous initiatives.

This step change in support by investment managers contrasts with the direction that some of the largest pension funds and asset owners in the UK have taken, with NEST, USS and London CIV all voting against Shell's Chair and the Church of England (CofE) opposing every director.

The discrepancy in voting decisions by investment managers and asset owners hints at a misalignment of interests and is prompting greater scrutiny, with the UK Asset Owner Roundtable announcing its intention to monitor investment managers over the 2023 proxy season. At question is the extent to which investment managers served asset owners' long-term climate-related interests when conducting stewardship and voting activities at European oil and gas majors.

The group of asset owners was primarily concerned with the perceived misalignment between their long-term interests and how investment managers had cast significant votes, given that *"Delayed action on climate increases the chances of a disorderly climate transition and missing the goals of the Paris Agreement. This in turn increases the risks to pension funds' long-term interests and the ability of those funds to serve the interests of their members/beneficiaries."*[1]

Reasons given by investment managers for voting against the proposals have included the relatively prescriptive nature of some of the resolutions, which would overly constrain the operations of the companies. While they may be supportive of the broader intent, the goal of both asset managers and asset owners should be to find an appropriate balance between the micro-management of companies and ensuring that a climate transition strategy is sufficiently ambitious and cognisant of the risks faced.

One route some asset owners are taking is to develop or at least adopt their own voting policy. The introduction of split voting has enabled asset owners to ensure that it is aligned to their beliefs on climate change. However, the potential consequences must also be considered.

Transferring voting power to asset owners may address misalignment but could also reduce the effectiveness of broader stewardship activities, with many investment managers using voting as an escalation strategy. While choice empowers asset owners to vote more consistently and in line with their beliefs, there is inherent merit in having investment decisions, engagement and the vote as part of a coherent stewardship strategy to enact change in companies. Asset owners need to ensure they're clear in their aims, while being aware of the potential consequences.

What should asset owners do?

Considering the perceived differing interests, asset owners should consider the voting policies and patterns of their investment managers. In so doing, asset owners should consider whether (1) their investment manager's voting policies are aligned with their own RI beliefs, and (2) their investment managers' voting decisions are aligned to the manager's own voting policy.

Where there is material misalignment between the investment managers' voting policies and patterns, asset owners might consider various options from escalating the issue with the investment manager in engagement discussions to potential divestment if no change or progress is made.

1 UK Asset Owner Roundtable Chair and Brunel Pension Partnership Chief Responsible Investment Officer Faith Ward

ESG snippets

Sustainability standards and oversight

The need for comprehensive and effective regulation and standards of sustainability has sustained its position in the spotlight this quarter. Given the continued boom in the sustainable products market, clear and consistent reporting standards will help to prevent greenwashing.

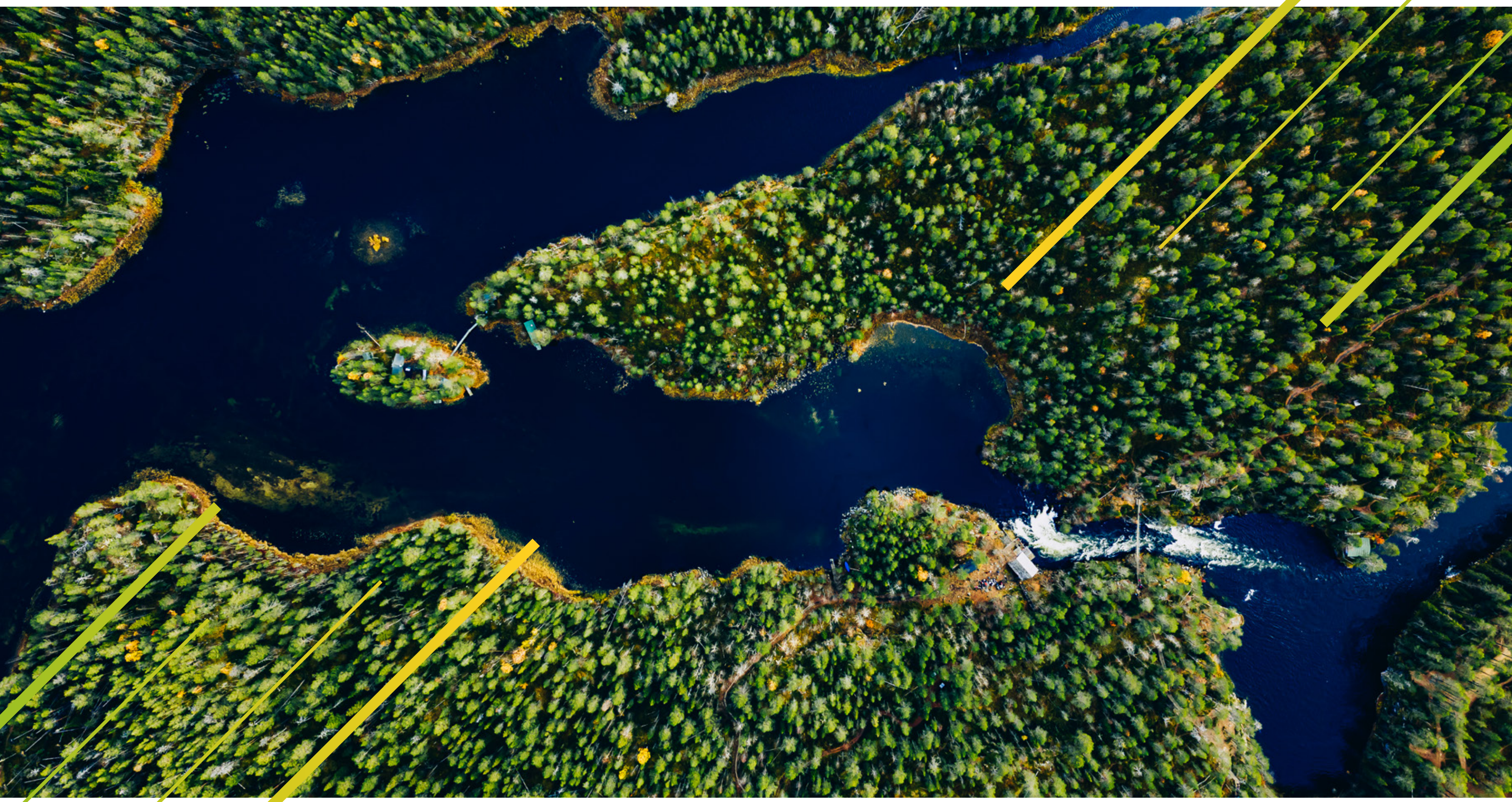
The International Sustainability Standards Board (ISSB) has launched new global sustainability disclosure standards. These aim to improve trust and confidence in company disclosures to help inform investment decisions and provide a universal set of requirements that companies can be benchmarked against.

There are two strands to the new ISSB standards. First is a set of disclosure requirements enabling companies to demonstrate the sustainability-related risks and opportunities they face over the short, medium and long term. The second sets out specific climate-related disclosures. These standards align with the TCFD and coincide with the Financial Stability Board's decision to pass on oversight and monitoring of TCFD to the IFRS Foundation, the ISSB's parent.

Separately, the EU has adopted final sustainability reporting rules, the European Sustainability Reporting Standards (ESRS). The ESRS will require companies to report on sustainability-related impacts, opportunities and risks under the EU's Corporate Sustainability Reporting Directive (CSRD), which came into effect in January 2023, with the ESRS set to apply from January 2024. The new CSRD will significantly expand the number of companies required to provide sustainable disclosures and introduce more detailed reporting requirements on company impacts on the environment, human rights and social standards and sustainability-related risk.

Finally, the Financial Conduct Authority (FCA) has again deferred the publication of its policy statement on the Sustainable Disclosure Requirements until Q4 2023.

The broadening of sustainability disclosure requirements represents a concerted effort by regulators to address greenwashing claims and should ultimately aid asset owners. However, as with any investment, asset owners should check what lies under the label of a sustainable strategy. We've developed our own sustainability framework to help our clients assess the claims being made by asset managers.



EU increases environmental protection

The EU leads the way in developing crucial environmental protection legislation within the bloc. The passing of the Nature Restoration Law and proposed legislation on textiles waste highlight the EU's focus and drive for environmental protection.

The new law will provide binding targets to restore degraded ecosystems, particular those that are key to combatting climate change and biodiversity loss or reducing the risks to food security. However, the law will only apply when the European Commission has provided data on the necessary conditions to guarantee long-term food security and EU countries have quantified the area that needs to be restored to reach the restoration targets for each habitat type.

The EU Commission has also proposed new rules targeting fast-fashion retailers, placing the responsibility for the full textile-products lifecycle in the hands of producers in a bid to address the 12.6 million tonnes of textile waste generated each year. The proposed scheme mirrors similar schemes managing waste arising from packaging, batteries, and electric and electronic equipment, with producers required to cover the costs of management of textile waste.

> Making companies responsible for the cost of 'environmental externalities' such as waste is one means of creating change. Given the costs will ultimately be borne by either shareholders or consumers, we expect this to be a subject on which asset owners can engage with their investment managers.

Climate transition plan implementation

Following on from the FCA's initial 'comply or explain' regulation around company climate transition plans alongside TCFD disclosures, more concrete efforts are being made to develop mandatory climate transition plan standards. The Transition Plan Taskforce (TPT) is developing sector-based guidance, which will supplement the final Disclosure Framework due to be published in October 2023.

> We believe it's essential for asset owners with climate objectives to have a clear Transition Action Plan covering areas such as emissions, alignment, solutions and engagement. We covered this in our Q2 2023 RI News & Views. For more information, speak to your usual Hymans Robertson consultant.

Simon Jones
Head of Responsible Investment
0131 656 5141
simon.jones@hymans.co.uk

Jaid Longmore
RI Associate Consultant
0207 082 6103
jaid.longmore@hymans.co.uk