HYMANS ROBERTSON

Responsible Investment *News and Views*

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Good intentions and ambitions need to be translated into tangible actions, with measurable goals that deliver real-world outcomes. Putting transparency and accountability at the core of the net zero journey, developing a Climate Transition Plan should be a step taken by all asset owners.

The Transition Plan Taskforce (TPT) was launched by HM Treasury in April 2022 to develop the gold standard for private-sector climate-transition planning. Drawing on existing work including TCFD, GFANZ and other transition frameworks and guidance relevant to the financial sector, TPT is grounded by three guiding principles: ambition, action and accountability. The aim is to recommend a Transition Plan Disclosure Framework that enables science-based, standardised and meaningful transition plans covering, for example, short-, medium- and long-term targets; specific actions to scale up new investments in solutions; and specific sectoral considerations.

While the FCA requires listed companies and large FCA-regulated asset owners like insurance companies and asset managers to disclose transition plans on a 'comply or explain' basis, regulatory requirements do not yet extend to trust-based pension schemes.

However, asset owners can draw on the work of the TPT in considering how to frame their plans. The TPT has already noted that "a climate transition plan should translate ambitious strategic objectives into concrete steps to be taken in the short and medium term." The TPT also recommends that entities consider the full range of levers at their disposal to contribute to and prepare for an **economy-wide transition** to net zero. This will help avoid unintended consequences with limited real-world impact, such as 'paper decarbonisation'.

For asset owners like pension schemes, including those with less formal commitments, a sensible transition plan should cover **four key areas.**

Specific actions should be developed from a more detailed understanding of investment strategy and the underlying portfolio holdings.

1. PORTFOLIO EMISSIONS

- Understand which asset classes are covered and which scopes of emissions will be captured by targets.
- Be clear on how progress will be measured consistently and the key areas that will drive portfolio decarbonisation.

2. ALIGNMENT

- Explore which portfolio holdings are not aligned with the transition, considering sector differences and societal needs.
- Act to direct capital to those companies that are more aligned and engage with laggards to press for strategic change.

3. SOLUTIONS AND OPPORTUNITIES

- Explore investments that can enable the process of transition or positively impact social/environmental outcomes.
- Act to increase allocations to asset classes/mandates that target clear climate outcomes and set a target allocation.

4. ENGAGEMENT

- Understand how actively managers are engaging with portfolio holdings on climate issues and the goals being set.
- Act to challenge managers who are not sufficiently demanding of portfolio companies.

> Setting a net zero ambition is a positive first step, but the hard work comes from being clear on the actions that are being taken to drive change and help achieve these goals. Developing and publishing a Climate Transition Plan serves to support transparency and accountability for those actions.

Forceful stewardship

This year's proxy season has seen a rise in shareholder resolutions filed by advocacy groups. These organisations, registered as non-profits and holders of minority equity, have filed climate resolutions that vary in prescription.

Of the shareholder advocacy groups, As You Sow has filed the most resolutions (with over 40 resolutions in 2023). They're known as 'downstream specialists', focusing on companies within consumer, financial services and food and beverage industries. Another key shareholder advocacy organisation is the Sierra Club, which aims to promote

> *"…climate solutions, conservation and movement building through a powerful combination of strategic philanthropy and grassroots advocacy."*

An area of focus for the latter group has been climate accountability in the financial sector. In 2023, they've focused on large American banks, including Goldman Sachs, Wells Fargo, JP Morgan Chase and Morgan Stanley, in an attempt to halt the financing of fossil-fuel expansion, as covered in our Q1 Responsible Investment News and Views.

Follow This

Follow This is a Dutch advocacy group known for its persistent fight against the oil and gas industry. In many ways, Follow This has been seen as a pioneer in uniting a range of shareholders, having rallied investors to sponsor climate-related resolutions at Shell since 2015.

To date, Follow This's climate-related resolutions have focused on encouraging publicly listed oil and gas companies to set Paris-aligned targets to reduce Scope 1, 2 and 3 emissions. Past support for these resolutions has varied.

Company	2020	2021	2022
BP	*	21%	15%
Shell	14%	30%	20%
Exxon	**		28%
Chevron	**	61%***	33%
Equinor	27%	39%	26%
Valero			42%

* Resolution withdrawn
** Blocked at SEC
*** Resolution to 'Reduce Scope 3 emissions' passed

While support of these climate-related resolutions can be seen as significant, there was a drop from the 2021 to 2022 proxy season. This prompted Follow This to refine the climate proposal in 2023, narrowing its focus to medium-term Scope 3 emissions-reduction targets.

The group also further refined its focus companies to four 'super majors': BP, Shell, Exxon and Chevron. These companies are viewed by Follow This as some of the largest and most influential companies, with significant impact on global emissions.

Company	AGM date
BP	27 April
Shell	23 May
Exxon	31 May
Chevron	31 May

Follow This founder Mark van Baal commented that

> *"The focus on Scope 3 by 2030 leaves the oil majors no wiggle room for smokescreens about 'net zero emissions by 2050' or reduction targets for operational emissions (Scope 1 and 2, which are around 5% of emissions)."*

BP: a case study

In February 2023, after reporting historic profits, BP announced that it was cutting its 2030, or medium-term, operational emissions reduction goal for oil and gas production from 35–40% to 20–30%, compared to a 2019 baseline.

This reduction was prompted by the decision to increase investment in oil and gas projects by roughly $1 billion per year until 2030. The announcement comes less than a year after shareholders supported BP's climate plan via a 'Say on Climate' vote, which received 88% support in 2022.

The 'Say on Climate' report stated that BP would reduce Scope 3 emissions intensity by 50% by 2050. The company had also stated it would reduce its operational, or Scope 1 and Scope 2, emissions by 35–40% by 2030.

Such action, without going to a vote and in absence of any consultation or dialogue with shareholders, undermines the confidence shareholders have in the board and their corporate governance. The head of Follow This, Mark van Baal, noted disappointment with the significant shift in strategy, saying that BP had "backtracked" on its emissions plan and could no longer claim to be aligned with the Paris climate deal.

Several institutional investors chose to use their vote to voice dissatisfaction, by either announcing intentions to vote **against** the re-election of BP's Chair or for the Follow This climate-related resolution.

Pre-declaring the decision to vote against the re-election of the Chair, and providing rationale, sends a strong message that shareholders are not happy with the strategic direction the company has taken.

Ahead of the AGM, which took place on 27 April, several pension schemes including Nest, Brunel Pension Partnership, Border to Coast, Local Government Pension Scheme Central and Universities Superannuation Scheme all signalled their intent to vote against the re-election of BP's Chair.

In response, BP commented that:

> *"We took careful account of what we heard ahead of our update on strategy announced in February, but we recognise that some shareholders and other stakeholders have different perspectives on the decisions we take. These decisions are taken in good faith and we remain confident that they are in the best interests of the company and its shareholders."*

BP's April AGM saw disruptions from climate protestors, with four demonstrators forcibly removed from inside the shareholder meeting while BP's Chair was giving opening remarks. This backlash is illustrative of the reputational risk stemming from BP's decision to scale back its climate commitments.

Results from the resolution to re-appoint the BP Chair confirm this dissent, with 10% of shareholders voting against re-election, compared with just 3% who voted against re-election in 2022. The Follow This climate resolution also received 17% support from shareholders, up from 2022.

Beyond the AGM

While the actions of advocacy groups have had limited success through voting, other routes to building accountability for climate inaction are also being pursued.

In February 2023, ClientEarth – an organisation that uses the law to try and create systemic change – filed a lawsuit against Shell's Board for *"failing to manage the material and foreseeable risks posed to the company by climate change"*.

This action was backed by global investors including the London CIV and Nest. However, in a ruling on 12 May, ClientEarth's action was dismissed and not allowed to proceed.

Driving the action was a belief that the company hadn't sufficiently invested in the transition and is failing to protect the long-term interests of shareholders, with ClientEarth seeking to hold directors personally liable. This is not the first climate-related litigation that Shell has faced. A 2021 Dutch court ruling instructed Shell to cut carbon emissions from its oil and gas products by 45% by 2030, although the verdict is being appealed.

Litigation risk is the third, but often ignored, pillar of climate risk – much greater focus is placed on physical and transition risks. Seeking accountability through the courts may be a route that is increasingly pursued in future.

What should asset owners do?

In the absence of open engagement and dialogue on important decisions and changes to strategy that have already been supported by voting, shareholders may consider alternative escalation options.

Exercising voting rights is an important element of active ownership, as how votes are cast can influence the actions of companies. With many now focused on the management of climate-related risks, scrutinising the actions of asset managers in how they engage with oil and gas companies on these issues and cast votes is an element of active stewardship.

The UK Asset Owners Round Table has already announced its intention to monitor the actions of asset managers during the 2023 proxy voting season, particularly whether they are effectively reflecting the long-term interests of investors. While collective action is welcome, asset owners can also subject managers to individual scrutiny.

Ask your managers for their views on this topic, what dialogue they have had with oil and gas companies on these issues, and how and why they voted on climate resolutions at the oil majors. Where asset managers vote against climate resolutions, ask what engagement they've had with companies on climate-related strategy and how they've gained confidence that companies are acting in the long-term interests of shareholders.

ESG snippets

Biodiversity to the forefront

Biodiversity has continued to gain momentum over the quarter, with international and regional efforts spurred from the top through the new G7 nature-focused initiative and the EU's decision to legislate on deforestation-linked products.

The international collective effort has been prompted by G7 ministers, who committed to increase global expenditure on nature and have agreed to actions in line with the Global Biodiversity Framework (GBF). The G7 ministers also launched the 'G7 Alliance on Nature Positive Economy', which will serve as a voluntary forum to share best practice and resources on nature-positive topics, as well as provide guidance on the implementation of the GBF terms.

Regional efforts have culminated in a new EU law banning deforestation-linked products. Under the new regulation, companies must ensure that products sold in the EU have not contributed to deforestation or forest degradation after 2020. Companies will be required to issue a due diligence statement confirming this, with the level of assessment required based on perceived risk. A penalty is set to be imposed for non-compliance, which could reach up to 4% of annual revenue.

Efforts to address biodiversity loss, particularly the potential imposition of financial penalties, are reinforcing the need for asset managers and asset owners to integrate the topic into investment and stewardship processes. This stance is supported further by Scottish Widows, who have called on the UK to make nature-related disclosures mandatory for all mandates. We believe asset owners should ensure that managers are assessed on how they're integrating biodiversity.

Better stewardship: more guidance

Industry groups continue to provide guidance to help support effective stewardship activity. Both the Net Zero Asset Owners Alliance (NZAOA) and the UK Pension and Lifetime Savings Association (PLSA) have published new guidance on the matter.

NZAOA's guidance is focused on engagement, particularly on best practices for evaluating manager efforts around climate policy engagement, in line with climate mitigation and the journey to net zero.

Guidance regarding managers' approaches to climate policy engagement is organised into four themes of governance, alignment, stewardship practices and transparency.

PLSA places greater focus on stewardship and voting, with the introduction of three new themes for 2023 based on current environmental and political circumstances. The three themes in focus are the cost-of-living crisis, climate change, and the impact of a company's operations on its workforce and wider society. Guidelines have been designed to help those with voting capabilities decide how to exercise votes at annual general meetings and support engagement efforts with investee companies against these themes.

Evolving standards: SFDR review

The three European Supervisory Authorities (ESAs) have launched a consultation with the intention to extend, simplify and amend existing SFDR disclosures. Proposals include an increase in the number of mandatory Principal Adverse Indicators to include four new 'Social' indicators.

The ESAs have also expanded the pioneering 'do no significant harm' principle of the disclosures. For companies to be classified as a 'sustainable investment', they must abide by the principle of 'do no significant harm' in relation to certain EU and environmental objectives. It's been proposed that these objectives should be more precisely defined to remove current uncertainty and minimise the potential for greenwashing.

While the SFDR classifications (and the forthcoming UK labels) are useful signals to investors on how 'green' or 'sustainable' a product is, this shouldn't replace due diligence. What is or isn't 'sustainable' is likely to be subject to ongoing discussion. Therefore, asset owners should continue to question their advisers and managers, potentially building their own sustainability criteria.

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London | Birmingham | Glasgow | Edinburgh

T 020 7082 6000 | www.hymans.co.uk

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