HYMANS ROBERTSON

Responsible Investment News and Views

August 2022

We care if Florida is underwater in 100 years. It means we will have collectively failed to curb the physical effects of climate change. Many people will have suffered much before then and there will inevitably have been significant financial losses.

The misconception is that these losses will only be realised over the long term, ignoring the prospect of short-term harm, particularly from extreme events, and the ability of markets to rapidly reprice risk. Against this, there has been growing criticism of the Environmental, Social and Governance (ESG) ‘industry' over recent months, pointing perhaps more at a communication failure than negating the importance of addressing ESG issues.

We should perhaps pose the question of why ESG has been such a focus over recent years. Much attention has been paid to an ‘outside-in’ approach, namely the need to protect and enhance financial return by integrating financial material ESG issues. The drive for better data, and the use of different metrics and ratings, have both largely sought to understand the extent to which organisations are taking account of ESG factors in their investment processes.

Consequently, the role of ESG data and its use needs to be put into context. That different firms end up with different ESG ratings is perfectly acceptable if different weightings are being applied to different ESG data points. The challenge is to examine the data being captured and the methodology employed to make an informed judgement on what the information is telling us. Gaps in data also need to be addressed, but that doesn’t necessarily mean that it is essential to capture every single data point on a company or portfolio unless there is a reason for its measurement.

So, there has been a focus on ESG issues because they can help us make better decisions from an ‘outside-in’ perspective. But what of the ‘inside-out’ approach to ESG? Does the data allow us to look at investments and judge their impact?

Strategies that invest in companies that deliver goods and services to meet particular social and environmental challenges may be considered to have a positive impact. The revenues generated from this activity perhaps offer some measurement of how aligned a company is with particular impact goals. However, this measures activity, not outcomes. Investing in companies that have a positive impact is different from ‘impact investing’. Impact investing requires the investment to have a clear intention to have a particular impact, and the ability to demonstrate their impact is additional to what would have been otherwise without the investment. ‘Intentionality’ and ‘additionality’ are not immediately available for measurement unless it was clear what the objective was at outset.

Therein lies a key challenge. We can measure the extent to which ESG factors have an impact on our investments and use this information to inform decision-making. Measuring the impact that decisions have on the real world is far more challenging. Yet this is the information that matters. To address the long-term effects of climate change, understanding the impact that capital allocation decisions have is increasingly important. After all, impact arises not by simply reallocating to companies with low Green House Gas (GHG) emissions, but by delivering an actual reduction in real-world emissions through time.

As asset owners increasingly set climate-related targets under Task Force on Climate-Related Financial Disclosures and net-zero frameworks, they should take the time to ask themselves, “what are we really measuring?”

Focus on stewardship: Forthcoming significant votes

The Department for Work and Pensions recently finalised its statutory guidance for the trustees of private sector pension funds, addressing the importance of stewardship. Although targeted at pension schemes, the guidance is more broadly relevant. On significant votes, the guidance notes that these should be aligned with asset owners' stewardship priorities, and where they use a manager's policy, asset owners should summarise whether the managers' voting behaviours were aligned with their own priorities.

The case study below looks at a recent climate-related vote at Shell's AGM, and we have also identified a small number of votes that asset owners may wish to monitor and discuss with their managers below.

Engaging with asset managers on stewardship policies and the exercise of voting rights is a means for asset owners to better understand policies and hold managers to account for their decisions. Our recently updated stewardship guide provides some practical tips as to how practices can be developed.

Resolution Name	Company	Lead Filer	Date of AGM
Human & Labour Rights: Adopt Policy on Sourcing from China	**Nike, Inc**	**Domini Impact Equity & Vancity Investment Management**	**09/09/2022**
A shareholder proposal regarding Nike's policy on sourcing from China has been put forward by Domini Impact Equity and Vancity Investment Management, asking the company to adopt a policy to pause sourcing of cotton and other raw materials from China until the US Business Advisory (on forced labour in Uyghur Region) **is** lifted or rescinded. While the proposal noted Nike's leadership in supply chain transparency, it said that in this situation, Nike's efforts have been inadequate given reports that as many as 1.8 million Uyghur people have been detained and forced to endure severe human rights abuses, including forced labour, torture and political indoctrination. Nike's manufacturing data suggests that around 30% of its materials are from Chinese factories. Nike's advisory board has advised voting against the proposal, noting that 'it does not directly source cotton or raw material, and is deeply committed to responsibly and sustainably sourcing products.'			
Climate Change: Report on Paris Aligned Climate Lobbying	**Tesla, Inc**	**Green Century and Nathan Cummings Foundation**	**04/08/2022**
Shareholders have requested that Tesla report on how its lobbying efforts are aligned with its net-zero commitments. The proposal asks Tesla to disclose how its lobbying and policy influence activities align with the Paris Agreement to limit average global warming to 1.5 degrees Celsius and how Tesla plans to mitigate risks presented by misalignment. The proposal noted that despite Tesla's notable role in the transition, they have not explicitly disclosed their climate-related lobbying or trade associations and it is unclear how Tesla uses public policy engagement or other forms of lobbying to achieve their aim to 'accelerate the world's transition to sustainable energy.' Management has recommended a vote against this proposal, commenting that it would not serve the best interests of the company or its shareholders.			
Diversity & Inclusion: Report on Racial Equity	**Oracle Corporation**	**Service Employees International Union**	**TBC**
Racial Equity Audits is a relatively new and growing ESG initiative that asks for an independent review of a company's policies and how well they foster diversity, inclusion and racial equality. Service Employees International Union are the lead filer on this resolution, urging the Board of Directors at Oracle to oversee an independent racial equity audit analysing the company's impacts on non-white stakeholders and communities of colour. A similar proposal gained over 30% shareholder support in 2021, while management have yet to declare whether they recommend voting for or against this shareholder resolution.			

Exploring a significant climate vote: Shell

Last quarter, we focused attention on Resolution 21 filed by NGO *Follow This*, at the Shell AGM in May 2022. This requested that Shell "*set and publish GHG targets for scope 1-3 emissions that are consistent with the goal of the Paris Agreement. These targets should cover short, medium and long-term greenhouse gas emissions of the company's operations and the use of its energy products, and the proposal also requests that the company report on the strategy and underlying policies for reaching these targets and on the progress made*".

The proposal received support from just 20.3% of shareholders, a reduction from the 30.5% who had supported a similar resolution in 2021. In contrast, the management resolution on Shell's own Energy Transition strategy received the support of 79.9% of shareholders.

Shell was keen to point out that the shareholder resolution received less support than a similar proposal last year, with the CEO, Ben van Beurden, noting: "Shareholder support is critical as our business continues to change and we work towards our target to become a net-zero emissions energy business by 2050. We are pleased that the overwhelming majority of shareholders continue to support Shell, our energy transition strategy and the progress we have made in the past 12 months… We will consult shareholders to understand these votes and formally report back to investors within six months."

A tale of two managers

Of those voting for the proposal, Schroders communicated their intention to vote for the resolution prior to the AGM. Pre-declaring voting intention sends an important signal to the company on matters the manager deems as priority and can form part of their public escalation strategy. To see progress on key areas of focus, it is important that managers must be transparent with companies, clients and other key stakeholders about their active ownership priorities. Schroders pre-declared their voting intentions for three oil & gas majors, Chevron, ExxonMobil and Shell, with the aim of encouraging a faster shift towards net zero.

In this instance, Schroders commented that while they acknowledge the progress Shell has made in strengthening and broadening their climate targets, their decision to vote for the resolution was a signal of their desire for Shell to continue to demonstrate their focus on reaching net zero. More specifically, they voted for the shareholder resolution given its ambition with regards to Paris Agreement alignment and evolving best practice for the industry in terms of setting ambitious, absolute emissions reduction targets.

BlackRock, who voted against this shareholder resolution, released an Investment Bulletin outlining their rationale for voting with management. In their reasoning, BlackRock commented that they did not believe the resolution to be beneficial to Shell's Energy Transition Strategy. They noted that they view reporting on scope 3 emissions as complex, with Shell's ability to set absolute-and-medium scope 3 emissions reductions targets also impeded by the current uncertainty around the pace of declines in oil and gas demand as well as energy security considerations. This accords with similar views communicated to the SEC.

BlackRock believes that the board and management are best positioned to determine what approach will best equip the company to navigate climate risks and opportunities. They went on to say that they believe Shell is actively addressing the risks and opportunities stemming from the global energy transition. While BlackRock voted with management on both climate proposals, they noted an ongoing engagement with Shell over the last few years on a range of corporate governance and sustainable business matters. This includes engagement on climate risk, which BlackRock believes can be a defining factor in Shell's long-term prospects.

What should asset owners do?

The differing stances taken by two prominent asset managers indicate that there is not yet a consensus on how the fossil fuel industry should address the transition to a low-carbon economy. Given policy uncertainty, that is to be expected, although the urgency of the climate crisis demands rapid progress. This means that asset managers and the companies they invest in and engage with should be challenged.

While there may be extenuating circumstances arising from the war in Ukraine and the consequential issues of energy security, our climate has limited scope to remain patient. Asset managers who have committed to net-zero goals and who support climate action need to ensure that they can fully justify their stance.

Asset owners need not only to review how managers have voted, but also to consider and challenge managers on how they are engaging with companies on key issues. While managers may vote in line with management recommendations, they should still be actively engaging with companies on key issues, such as climate change. Asset owners should ask managers to confirm the expectations of their engagement activity and the action they will take if and when they determine that progress has been insufficient. By setting time-bound expectations asset owners can truly demand accountability.

ESG Snippets

SEC amends proxy voting rules

The Securities & Exchange Commission (SEC) in the US is making amendments to its rule governing proxy voting advice. This rescinds the requirement that proxy advisory firms, such as ISS and Glass Lewis, inform companies of their recommendations when they are sent to shareholders and give companies an opportunity to respond ahead of AGMs. This rule was adopted in 2020 but never enforced.

Voting requires significant time and expertise to do properly. While large asset managers can dedicate significant resources to the process, smaller managers are unlikely to be able to devote resources to conduct these activities on the same scale. The use of third-party proxy advisors is therefore an important cost-effective means of satisfying fiduciary and regulatory voting obligations. The final amendments aim to avoid burdens on proxy voting advice businesses and ensure that clients of these firms receive independent and timely advice.

While proxy advisors do influence shareholder votes and subsequently the governance choices of publicly traded companies, asset managers should use their advice as an input to the voting decision. Understanding the managers' process for reaching a voting decision through case studies is a means for asset owners to engage with managers.

A taskforce on social factors

Following a 2021 consultation on the consideration of social risks and opportunities by pension schemes, the government is seeking to establish a new minister-led taskforce on social factors. The taskforce is expected to help schemes in three broad areas: (1) identifying reliable data sources and other useful resources so that consideration of social factors can be more effective, ensuring that managers do not leave social factors off the agenda; (2) to provide a steer on the monitoring and reporting of international standards and (3), to look at the ESG implications of the war in Ukraine.

The focus on 'S' factors is growing, as noted below and while this can be more challenging, selecting an issue such as human rights or working practices can be a means of creating more focused engagement with asset managers.

Financing a Just Transition

As we transition to a low-carbon economy, it is important to consider the impact on workers and communities. We explored this in our recent article on good work. This begs the question as to how investors can ensure they can effectively direct capital to investment strategies that foster a just transition.

An investor coalition has been formed which aims to address this by developing a "Just Transition" label for investment products. Bringing together a broad range of stakeholders who are committed to financing a Just Transition, the coalition aims to release a draft of a common set of criteria for the new label, which will then be open to public consultation. The label aims to recognise three key elements of a Just Transition: climate and environmental action; socio-economic equity and distribution; and community voice.

The Just Transition is an important concept that asset owners can incorporate into their stewardship and engagement with asset managers and companies. The public consultation on a new investment label will offer asset owners the chance to provide input. We will respond to the consultation and would encourage asset owners to provide their own input.

Investing in forestry

As the risks from environmental and climate change become clearer, the understanding of the importance of investment in and protection of biodiversity has increased. Biodiversity is essential for life and the long-term future of business. If the reversal of human impact on biodiversity isn't implemented, many of the ecosystem goods and services that this 'natural capital' provides will become scarcer, harder to access and therefore more expensive.

Planting new forests will help sequester carbon and aid the journey to net zero. This can also contribute to increasing biodiversity. We explore the attractions of forestry in our briefing note. Avoiding deforestation is equally also important and a stewardship consideration for investors, as highlighted by recent guidance for asset owners.

Forestry offers the potential for both a positive financial return and a positive environmental impact, making it an attractive opportunity for consideration by long-term investors. Asset owners can also ask their managers about policies for engaging with companies on deforestation.

This communication has been compiled by Hymans Robertson LLP, and is based upon their understanding of legislation and events as at date of publication. It is designed to be a general information summary and may be subject to change. It is not a definitive analysis of the subject covered or specific to the circumstances of any particular employer, pension scheme or individual. The information contained is not intended to constitute advice, and should not be considered a substitute for specific advice in relation to individual circumstances. Where the subject of this document involves legal issues you may wish to take legal advice. Hymans Robertson LLP accepts no liability for errors or omissions or reliance on any statement or opinion. Hymans Robertson LLP (registered in England and Wales - One London Wall, London EC2Y 5EA - OC310282) is authorised and regulated by the Financial Conduct Authority and licensed by the Institute and Faculty of Actuaries for a range of investment business activities. A member of Abelica Global. © Hymans Robertson LLP.