HYMANS ROBERTSON

Responsible Investment News and Views

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What does “good” look like?

Over recent years, asset owners have been increasingly expected to embrace the consideration of Responsible Investment practices, to develop their policies and scrutinise their managers. But expectations continue to change with the focus shifting towards being outcomes based. Asset owners and investment managers can increasingly expect to be challenged not on what they are doing, but what the impact of what they have done has been.

What we can learn from RI ratings

How do asset owners know how good their managers are at responsible investment? Clearly, one way to go about this is to ask them a series of questions and, based on their responses, assign them a rating based on how good they appear to be. This is what we’ve been doing for several years now.

The efficacy of having a separate RI rating for a manager seems illogical, particularly when one of the ambitions is to ensure that RI considerations are wholly integrated into investment processes. That said, until such time as the industry as a whole has taken RI seriously, there is logic in continuing to assess and call out managers on their approach, particularly as standards and expectations are continuing to build.

In developing our own approach, we have considered four key aspects of what we expect from managers: a **culture** than embraces RI, clear **integration** of ESG risks into decision making processes, the exercise of ownership rights through effective **stewardship** practices and **transparency** of practices to stakeholders. In making these assessments, we also ensure that contentions made by managers are well evidenced.

Our research has informed this understanding of “good” and our RI ratings. But it has also suggested both that practices must evolve and, if we are to help this process of change, we must be clear in our feedback and expectations of others. We cannot sit in a silo and not engage; as market participants, we and our clients are also responsible for delivering the change we want to see.

We have done this by providing detailed feedback on our ratings process and the reasons why we have reached the conclusions we have. We are engaging with asset managers to highlight the need for change and, through time, our own expectations of managers are likely to increase.

It seems increasingly clear that the focus of responsible investment is shifting towards outcomes. Stewardship Code reporting must consider what has been achieved and the PRI’s Active Stewardship 2.0 represents a higher, aspirational standard focused on the achievement of real-world goals. The emphasis is therefore shifting from “what is being done” to “what has been achieved from your actions".

What this means for investors is that they need to continue to evolve their approach to RI. Manager ratings are a useful tool for beginning a conversation, but they must drive engagement and to make that engagement effective, investors must be clear on their own objectives and what they want to achieve.

Change is possible. The financial services industry is both expected to change and expecting change. But all must make that change happen.

2020 Stewardship Code

The FRC's revamp of the UK Stewardship Code is gaining increased scrutiny as market participants gear up to the first round of reporting ahead of the 31 March 2021 deadline. With a number of organisations having already reported, the FRC has helpfully commented on what it has seen to date. It noted that while good evidence of stewardship was provided, reporting needs to improve by reflecting on effectiveness of approach, demonstrating continuous improvement and disclosing outcomes, as well as providing specific evidence from the reporting period to support.

Standardising standards

Whilst there are a range of industry frameworks and standards in existence in relation to RI, there is growing demand for better disclosure, more consistency and less complexity. Various industry bodies are seeking to tackle this issue by developing cross-cutting standards that can be adopted by all, with some of the current initiatives outlined below:

The International Financial Reporting Standards (IFRS) recently launched a consultation into developing a Sustainability Standards Board, which would look to develop and maintain global standards for sustainability reporting, importantly looking to work with and build on existing initiatives and frameworks.

The **CFA institute** recently concluded a consultation on the development of ESG disclosure standards for investment products. This would aim to achieve consistency on definitions of ESG terms used by asset managers, making it easier for investors to differentiate between funds. The standards introduced would be voluntary.

The Institutional Investors Group on Climate Change (IIGCC) has developed a Net Zero Investment Framework, covering recommended methodologies and actions that asset owners and asset managers can use to assess portfolios and meet net zero targets in alignment with the goals of the Paris Agreement.

Climate Action 100+ push for net zero

Climate Action 100+ is calling for firms to commit to net-zero business strategies and plans to benchmark the largest greenhouse gas emitters on their climate progress. CA100+ has written to 161 CEOs and Board Chairs at the largest greenhouse gas emitters requesting that these companies commit to work towards providing disclosures consistent with the new CA100+ Net-Zero Benchmark and aim to achieve net-zero emissions by 2050.

China pledges Net Zero

On 22 September 2020 President Xi Jingping announced that China would aim to become carbon neutral before 2060. This is the largest single climate commitment to date, as China currently produces 28% of global emissions. China is also the largest investor, producer and consumer of renewable energy and is well placed to implement its pledge. The pledge also has the potential to nudge other countries into adopting similar policies and provides a further indication that the transition is accelerating.

Community stakeholders matter

Rio Tinto, a global mining group, destroyed two 46,000-year-old archaeological sites in Australia in order to access ore deposits. The company refused to consider alternative plans whilst avoiding destruction of the sites and neglected to inform Aboriginal groups that alternative solutions existed. Subsequent media and investor pressure resulted in three executives, including the CEO, stepping down.

Climate litigation

Rest, a large Australian pension fund with assets over $41bn, was sued by member Mark McVeigh in 2018 for not doing enough to protect their retirement savings against the financial impact of climate change. Two years after the lawsuit was filed, Rest acknowledged the impact climate change could have on its members and pledged to achieve a zero carbon footprint by 2050, alongside other climate related pledges. Although not tested in court, this acknowledgement is seen as further clarifying asset owners' fiduciary duty with regard to climate change.

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