HYMANS ROBERTSON

Responsible Investment *News and Views*

Q4 2023

Participants in financial markets face an array of complex challenges in navigating climate change. While we've seen progress in policy commitments, asset owners need to hold their managers and providers accountable to their commitments. This demand for accountability represents another element of stewardship for asset owners.

In its 2023 report, ShareAction notes that despite more asset managers setting a net zero goal (53% of those surveyed), less than a quarter (22%) have published a climate transition plan that aligns their business and assets under management with credible science-based pathways. 42% stated they intend to publish such a plan in future (16% within the next year) while 12% reported they don't intend to publish a plan at all.

While we're delighted that more pledges are being made, we believe that action is less likely without clearly defined action plans. We've focused on this over 2023 by helping our clients develop their own Climate Transition Action Plans (CTAPs), but we also expect asset managers to play their part. Given the importance of capital markets in shaping our economy, greater leadership from key industry players is necessary to ensure consistency of message.

This is vital for asset managers who exercise stewardship, as it emphasises to investee companies that it must be done by all. Investee companies typically lie beyond the direct sphere of influence for asset owner stewardship. Rather, when it comes to issues such as climate change and broader stewardship goals, the role of asset owners is to ensure that their engagements with asset managers are being effectively framed, that expectations are being properly defined and that managers are being held to account for their action, or inaction.

We've approached this need for greater accountability in two ways: building engagement frameworks with our clients and launching our own Manager Engagement Programme.

Asset owners are used to decision-making frameworks. Pension scheme trustees, for example, have recently faced the need to revisit liquidity frameworks. However, while the focus is often on financial factors, having a clearly defined stewardship framework is helping many clients prioritise their dialogue with managers, including on climate change. In addition to scrutinising their own stewardship activity, managers are increasingly being tested on how they're delivering their climate commitments and the alignment with the pledges and policies they've put in place.

Our own dialogue with asset managers through our Engagement Programme has sought to expand this. We want managers to demonstrate both forcefulness and thoughtfulness in their processes and be catalysts for change. While this may be considered by managers as being outside their remit, it prompts discussion about where responsibility for driving change truly lies and places a greater scrutiny on whether policies and pledges are being upheld. This, in turn, allows us to help our clients hold their managers accountable.

> As asset owners increasingly set climate-related objectives, understanding in detail how those objectives will be delivered is vital. With stewardship being a core element of CTAPs, being able to exercise stewardship over investee companies, asset managers and other providers is essential. We encourage asset owners to spend time thinking about what goals they want to set and how they will be delivered. Focusing on holding managers accountable against their own climate pledges, through the development of a clear stewardship framework, should be an action for all in 2024.

Stewardship matters: voting choice

Voting is a powerful instrument in the stewardship toolkit, and there's growing pressure from regulation and various stakeholders for voting decisions to reflect asset owners' RI principles and priorities. However, as outlined in our **Q3 News and Views**, there are mounting instances of mismatch between how asset managers are voting and the stewardship priorities of the asset owners they're voting on behalf of. To mitigate these differences, the industry has begun to evolve, with large asset managers such as BlackRock and now LGIM launching voting choice for clients.

While it's impractical to expect asset owners to identify and act on every vote, managers are filling the gap by offering a range of 'voting policies' that investors can choose from. Investors may continue with their asset manager's default 'house' approach, or, where they believe more should be done (for example in relation to environmental or social issues), select an alternative voting policy to be employed on their behalf.

One way for asset owners to consider voting choice is to determine how aligned their current asset manager's voting policies are to their own areas of focus. To do so, asset owners could consider setting priority stewardship themes that address financially material ESG issues. For example, our own broad stewardship focus is on the following five themes:

- Climate change
- Biodiversity
- Modern slavery
- Artificial intelligence
- Pandemic risk

Asset owners can then analyse significant votes on these topics (when they arise) and consider how their asset manager has voted on their behalf. Where there's a significant mismatch, asset owners might consider some of the alternative voting policy options available to them, to determine if these offer greater alignment.

However, asset owners should be cognisant that while transferring voting choice may address misalignment, it could also reduce the effectiveness of an asset manager's stewardship activities. Understanding the reasons why a vote was cast is therefore important.

Voting is a powerful stewardship tool. It can send a clear message to company management on investor thinking and is used as an escalation strategy to signal dissatisfaction with management approaches. Removing this from an asset manager's stewardship toolkit might dilute their ability to engage for real-world change.

Illustrative votes for consideration

Below, we highlight some upcoming and prior significant votes around our priority themes, which could be used to test asset manager practices.

Theme: Climate change	**Resolution:** Emissions reduction target in supply chain
Company: Boeing	**AGM Date:** Upcoming - 2024

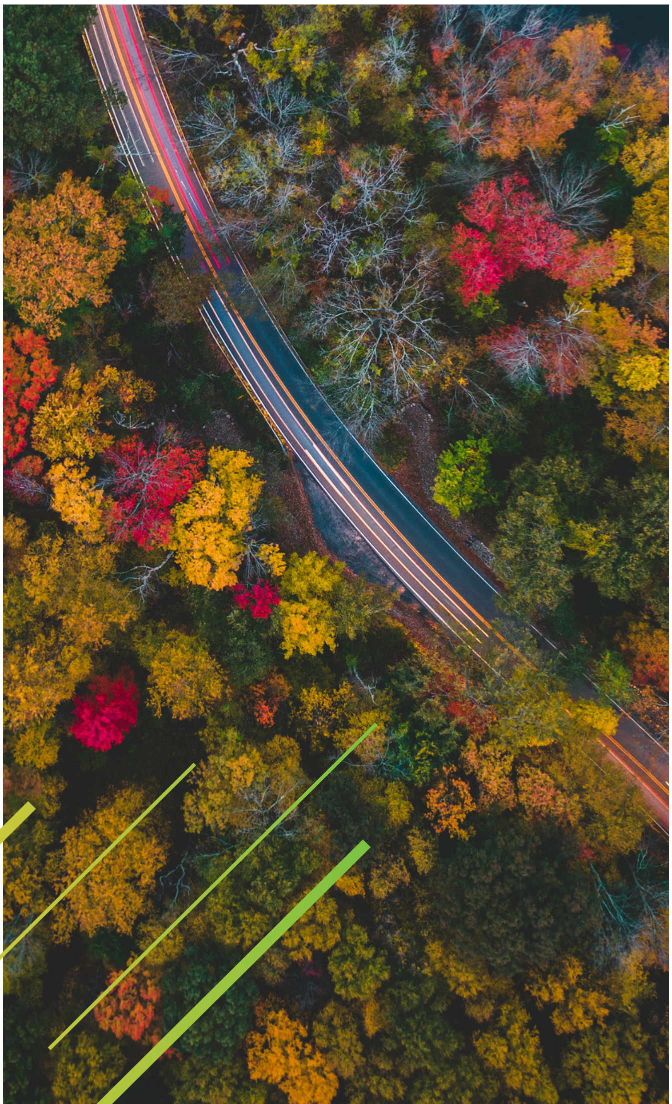
The Intergovernmental Panel on Climate Change (IPCC) reports that immediate and significant reductions are required of all market sectors to stave off the worst consequences of climate change. In addition, Boeing is subject to substantial emerging regulation and increasing costs in the US and abroad regarding its emissions-intensive processes and products. Therefore, the resolution requests Boeing adopt a value chain emission reduction target covering all significant emission categories in alignment with the Paris Agreement's 1.5°C goal, requiring net zero emissions by 2050 or sooner.

A similar resolution has also been filed with Lockheed Martin for the same reasons.

Theme: Biodiversity	Resolution: Regenerative Agriculture
Company: Kellanova	**AGM Date:** Upcoming - 2024

Industrial agriculture's reliance on synthetic pesticides threatens farm sustainability, biodiversity, climate resilience, water quality, and farmworker and fenceline community health and safety. It also decreases long-term farm productivity due to the proliferation of pesticide-resistant weeds and insects, loss of topsoil and soil-nutrient degradation (all contributors to loss of biodiversity).

While the resolution acknowledges that Kellanova has identified 'Sustainable Agriculture', it does not address risks related to pesticide use, which is not in line with best practice or peers, including General Mills, Lamb Weston and Conagra. The resolution asks Kellanova to issue a report on the risks to the Company associated with pesticide use in its supply chain.



Theme: Modern Slavery	Resolution: Child and Forced Labour in Supply Chains
Company: Tesla Inc	**AGM Date:** May 2023

The proposal asked Tesla's board to issue a report describing if and how Tesla plans to eradicate child labour and forced labour from its supply chain. The resolution noted that Tesla's supply chain is exposed to significant human rights risks that have not been meaningfully addressed.

With increased public attention on child labour and forced labour in supply chains, and the ever-expanding regulatory framework and enforcement, Tesla's sourcing policies and practices expose the Company to significant material risk. The resolution requested that the Board issue a public report describing if, and how, Tesla plans to eradicate child labour and forced labour from its supply chain by 2025.

The proposal was not approved by shareholders. However, CEO Elon Musk addressed the concern during his presentation at the annual general meeting, announcing that Tesla would conduct a third-party audit of its suppliers. This demonstrates that outcomes can be achieved even where votes are unsuccessful.

As a first step in considering voting choice, why not ask your asset manager how they intend to vote on upcoming resolutions, or how they've voted on previous resolutions that match your unique stewardship priorities? Then reflect on whether this aligns with your own responsible investment beliefs.

Where there's a material mismatch, start by engaging with your asset manager to determine the rationale for their decision-making, and whether there might be room to better align their voting principles with your own beliefs. Where this is unsuccessful, a final step might be to consider other voting policies to determine where the greatest alignment lies.

ESG snippets

Taskforce on Nature-related Financial Disclosures release final recommendations

Nature plays an essential role in sustaining our world and the global economy. However, there's a lack of transparency and comparability in nature-related financial reporting that hampers investment decision-making. The Taskforce on Nature-related Financial Disclosures (TNFD) recently published its final recommendations, which aim to inform better decision-making by companies and capital providers, ultimately shifting global financial flows toward nature-positive outcomes and the goals of the Kunming-Montreal Global Biodiversity Framework.

The recommendations, which are consistent with other global sustainability standards, build on those of the Task Force on Climate-related Financial Disclosures (TCFD). There are 14 recommended disclosures across four pillars: governance, strategy, risk and impact management, and metrics and targets. These recommendations, which have an accompanying suite of guidance, will assist market participants in getting started with integrated assessments and corporate reporting relative to nature in a manner that will meet the requirements of different jurisdictions. The TNFD will encourage and support voluntary adoption of the recommendations.

You can read a more detailed summary of the TNFD in our recent **publication**. Adoption of TNFD recommendations could allow companies to demonstrate leadership in this space, creating opportunities for investors. For asset owners, we believe it's appropriate to start by building knowledge while also using the growing availability of nature-related datasets to explore portfolios and set engagement goals. Dialogue with asset managers on the actions they're taking is also an early step.

Transition Plan Taskforce target climate disclosure

Disclosure is a targeted area for the Transition Plan Taskforce (TPT), which has released its disclosure framework for companies and financial institutions to tackle climate change. As we transition to a low-emissions economy, financial markets will increasingly seek better information on how companies plan to adapt their business models, their operations and their products and services. The framework provides the basis for companies to set out credible and robust climate transition plans as part of annual reporting on forward-looking business strategy. The framework will support the creation of consistent, comparable company reports, and reduce the level of complexity faced by firms disclosing climate-related information.

The TPT framework aligns with the transition planning guidance of the Glasgow Financial Alliance for Net Zero (GFANZ) and builds on the reporting standards developed by the International Sustainability Standards Board (ISSB). The FCA notes that it is committed to drawing on the TPT Framework as it develops its disclosure expectations for listed companies, asset managers and FCA-regulated asset owners.

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

The push for social initiatives

In an open letter to the EU Commission, several European organisations have urged the Commission to create a social investment framework to boost financing of social initiatives, citing the High-Level Task Force on Investing in Social Infrastructure in Europe's finding that there is a major financing gap of up to €150 billion for social investment. They note that regulation focuses on avoiding negative social impacts without giving any guidance on how sustainable investments could positively contribute to social goals, missing an opportunity to tap into the transformative potential of socially minded investors. The letter also notes a lack of orientation on what constitutes a social investment.

Separately, the UK's Taskforce on Social Factors published draft guidance that aims to provide pension scheme trustees with the tools to help identify and monitor social risks and opportunities. The goal is for trustees to embed social factors within their investment decision-making processes and stewardship policies. Our recent **blog** highlights some of the features of this guidance.

> Social factors are often considered to be the poor relation in the world of ESG, but this seems to be changing. The push for regulatory consistency and the provision of tools supports a growing focus by asset owners on how investors can have an impact. This is an area where asset owners could spend more time on building understanding before taking action, and we believe it's appropriate for this to be a subject for training over the course of 2024.

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