HYMANS ROBERTSON

Responsible Investment News and Views

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With only a couple of weeks until COP27, we are reminded of one of the 'wins' from Glasgow last year – consensus on carbon markets. The task ahead in implementing net-zero (NZ) strategies is significant and investors are, understandably, considering the potential role of carbon offsetting.

Research suggests that trillions of dollars of investment are needed each year to deliver a NZ transition. NZ strategies in the first instance should be focused on what can already be achieved within existing assets. For example, by encouraging portfolio companies to decarbonise along their value chain and to support them in their transition towards less carbon-intensive activities. Areas for consideration may include: changes to energy generation, efficiency and storage; lifecycle considerations of materials, including in improving recoverability and recycling of materials, as well as support for a more circular economy; and a focus on land use, land use change and sustainable agriculture.

We acknowledge that an absolute reduction of emissions (to zero) will be impossible for some players, particularly in those hard-to-abate industries, like materials or transportation, and offsetting will thus be appropriate. Investment in change is also necessary, so some investment is likely to be focused on carbon removal projects as a means of creating offsets for these residual emissions. The expectation is that organisations that cannot reduce carbon emissions by any other means can purchase 'offsets' on these emerging carbon markets to demonstrate NZ alignment and that carbon markets will become increasingly mature as a consequence.

The vast majority of carbon offsets today come from avoided emissions, such as clean energy projects or avoided deforestation. But these activities are more focused on maintaining the status quo than actively reducing emissions. Carbon reduction (and thus carbon offsets) in the future must come from both nature-based removal solutions (eg reforestation) or technology-based removals (eg mineralisation or direct air carbon capture and storage) that create further emissions reduction.

Organisations developing these solutions and technologies may expect to monetise emissions reduction through the sale of carbon offsets on global markets. However, carbon markets today are in their infancy, facing a multitude of issues. There is a general lack of regulation, carbon pricing is disparate, opaque and often unsustainably low, the permanence of projects is not guaranteed and reversal remains a possibility. Some projects underlying carbon offsets are also mired in controversy.

The challenge for asset owners and asset managers alike, whether judging companies or products, has to be on ensuring that any use of offsets and carbon markets follows robust guidance and practice, such as that outlined in the Oxford Principles. These principles cover issues such as additionality and transparency, and a focus on the direct removal of emissions, which is long-term and permanent. The Principles also emphasise the importance of monitoring and reporting emissions, and supporting the development of carbon markets.

For asset owners, the goals must be threefold. First is to demand more from the companies they invest in, decarbonisation plans must be both ambitious and robustly implemented. Second is to seek accountability from asset managers and encourage more forceful stewardship where needed. Finally, asset owners can invest in emissions-reducing solutions. Some, such as forestry, we have highlighted before, but other technologies are still emerging and will demand capital to deliver at scale.

Carbon offsetting is not the panacea for an NZ strategy, but rather the last resort for a company that has taken every other action possible. That said, the development of carbon markets offers a potentially important means through which investors can support the NZ transition.

Exploring climate-related lobbying & a significant vote: Tesla

Shareholder resolutions filed over 2022 reflect continuing concern over the lobbying activities of companies, particularly whether these are consistent with their public positions on issues like climate change.

In response to the perceived misalignment, investors have launched a global standard for corporate climate lobbying. built on research undertaken by members of the Institutional Investor Group on Climate Change ('IGCC') as part of Climate Action 100+. This particularly focused on corporate climate lobbying in Europe.

The resulting Global Standard for Responsible Climate Lobbying includes 14 indicators and calls on asset owners and managers, and the companies in which they invest, to commit to responsible climate lobbying. The standard urges companies to disclose the support given to trade groups lobbying on their behalf and to act if this lobbying runs counter to the world's climate goal. Where companies do not stick to the standards, they risk having their actions put to a shareholder vote.

Tesla

Last quarter, we focussed attention on a climate related lobbying shareholder resolution filed ahead of Tesla's AGM. Resolution 10, Report on Paris Aligned Climate Lobbying, was filed by Green Century and Nathan Cummings Foundation and was one of eight shareholder resolutions at Tesla's AGM, outnumbering the six management resolutions.

The proposal's supporting note highlighted that there are critical gaps between climate commitments and the action needed to prevent the worst effects of climate change and stated that companies such as Tesla have a crucial role in empowering policymakers to close these gaps.

With the aim of increasing transparency and better understanding how Tesla's lobbying efforts are aligned to its NZ commitment, the shareholder resolution called Tesla to *"conduct an evaluation and issue a report describing if, and how, Tesla's lobbying and policy influence activities (direct and through trade associations and social welfare and non-profit organizations) align with the Paris Agreement's goal to limit average global warming to 1.5°C, and how Tesla plans to mitigate risks presented by any misalignment."*

While the resolution recognised Tesla's role in the transition, it went on to state that it is unclear as to how Tesla uses public policy engagement or other forms of lobbying to achieve their aim to 'accelerate the world's transition to sustainable energy.'

Proxy advisor firms Institutional Shareholder Services (ISS) and Glass Lewis both recommended voting **for** the resolution, while Tesla management 'strongly disagreed' with the proposal. Management argued that such reporting would be an unnecessary distraction and wasteful use of resources commenting that they have based the success of their business model upon values that align with the Paris Agreement.

More than a third of votes were cast in favour of the shareholder proposal, which garnered 34.6% of the vote, a level of support that can be regarded as significant. However, the resolution required two thirds support and was not passed.

Those voting **for** the resolution included **abrdn** who stated: *"The requested report would provide greater transparency in relation to how the lobbying is overseen and applied in practice. Enhanced disclosure would help shareholders to assess the company's management of its lobbying-related activities and to better understand the associated risks and benefits",* **Legal and General Investment Management** (LGIM) who shared: "*LGIM expects companies to be taking sufficient action on the key issue of climate change"* and **Storebrand Asset Management** who commented: "*A vote for this resolution is warranted, because an evaluation of how the company's lobbying activities align with the Paris Agreement goals would provide information that would allow shareholders to better evaluate the company's risk related to its lobbying activities."*

What should asset owners do?

Failure to reduce greenhouse gas emissions is not only a threat to the value of future investments but also to the health and well-being of society at large and needs urgent and consistent action.

There are multiple levers that asset owners can pull to support the issue of climate change. Firstly, asset owners should engage with their managers and ask that they publicly disclose their voting decisions and rationale, so that these decisions can be challenged where they are not aligned to investment beliefs. Asset owners can also engage with their managers to understand their position and policy approach with regards to various issues around climate action, including their position on climate related lobbying.

Secondly, asset owners may consider collaborating with other investors to bring attention to topics such as climate related lobbying. As an example, asset owners could add their voice in support of The Global Standard of Responsible Climate Lobbying.

The future role of the PRI

The Principles for Responsible Investment (PRI) has launched a consultation named "PRI in a Changing World" for signatories regarding the future of responsible investment; the PRI's vision, mission and purpose; and the value PRI provides to signatories.

The consultation is taking place via roundtables from September and online submissions from November, and due to last until January 2023, with the intention of addressing the significant changes occurring within RI and how the PRI can best support investors in adapting to this change and advancing the agenda. The PRI also hopes to gain greater insight from investors and stakeholders on how they can respond to any barriers to achieving sustainable outcomes.

PRI's decision to launch this consultation provides asset owners with the opportunity to consider and give feedback on value of PRI's offering, and shape the future work of the organisation, global collaboration and the trajectory of RI, especially at a time when fractures are emerging. Asset owner signatories should ensure that they share their views and asset owners may wish to ask asset managers for their own views.

EU Regulations on Forced Labour

The European Commission has proposed new regulation that prohibits all products made with forced labour from being traded in EU markets. The proposed regulation does not target specific companies or industries, but covers all products made in the EU for domestic consumption as well as international trade through import and export goods. The main aim of this regulation is to effectively ban the selling of goods produced by forced labour in all industries, hence its overarching inclusion of products across the market.

If enacted, this will reflect the broadest scope in a regulation of its kind with organisations being prohibited from placing or making available products made with "forced labour" on EU markets, drawing upon the ILO Forced Labour Conventions definition of forced compulsory labour.

This proposed EU regulation attempting to tackle the significant issue of forced labour is a vital step forward in making organisations accountable for their supply chains. Asset owners should ask their managers how they are assessing risks of forced labour within their decision making and the steps they are taking to engage with companies on this topic.

Consultation on TCFD for LGPS

The UK Government has opened a consultation on policy proposals which would require the administering authorities of Local Government Pension Schemes (LGPS) to manage and report on climate-related risks in accordance with the Taskforce on Climate-related Financial Disclosures (TCFD) requirements.

The proposals are largely in line with those that are now in force for private sector pension funds although DLUHC will seek some commonality across the LGPS to ensure that comparisons can be made between funds. For example, there are some differences in the metrics proposed for evaluation and reporting. Much of the detail of the requirement is expected to be provided through statutory guidance.

Bringing the LGPS into line with other pension schemes in the UK is a natural step and we have set out our initial comments on the consultation here. We will shortly be responding formally on this and encourage all stakeholders within the LGPS to respond to the consultation by 26 November 2022.

ESG backlash in the US

The polarisation of political views in the US has led to a backlash against investors consideration of ESG issues. As one example of this growing divide, BlackRock has been issued letters over the last quarter from both the New York City Comptroller, accusing the fund manager of not doing enough to meet climate commitments and from the Louisiana State Treasurer condemning the managers 'anti fossil fuel policies' which he feared would 'destroy the Louisianan economy'.

While the NYC Comptroller listed three steps they would like to see BlackRock take to meet their NZ commitments, the Louisiana Treasury has pledged to divest and stated they will liquidate all BlackRock Investments by the end of 2022 given their vocal stance on the climate emergency.

These tensions once again give rise to the importance of a just transition, ensuring that the benefits of the transition are shared equally, while supporting those who stand to lose economically. Asset owners need to repeatedly test commitments their asset managers make on climate change, seeking evidence that promises are being delivered and challenging any weakening in commitment.

Focusing on stewardship: Significant votes

The DWP's statutory guidance for trustees of private sector pension funds addresses the importance of stewardship and comments that asset owners should summarise whether their managers' voting behaviours are aligned with that of the Scheme. While targeted at pension schemes, the guidance is more broadly relevant, with the aim of ensuring that asset owners' stewardship priorities are aligned with that of their managers'.

We have therefore identified a small number of significant votes focused on climate change and biodiversity that asset owners may wish to monitor and discuss with their managers.

Resolution Name	Company	Lead Filer	Date of AGM
Say On Climate: Net Zero Targets & Climate Transition Planning	**KLA Corporation**	**As You Sow**	**Nov 2022**
This Shareholder proposal requests KLA, a provider of technological systems for semiconductors and nanoelectronics industries, disclose how the company intends to reduce its GHG emissions in alignment with the Paris Agreement. While the resolution acknowledges that KLA currently disclose their GHG emissions and is undertaking energy initiatives, including using efficient lighting and resource efficient manufacturing processes, it continues to comment that more than 99% of KLA emissions are related to its supply chain, which the company's renewable electricity goals and other initiatives do not address. As such, the proposal seeks that the company set Paris-aligned GHG reduction targets for its Scope 1-3 emissions, disclose a net zero climate transition plan and demonstrate progress towards achieving these goals.			
Climate Change: Climate Transition Plan & GHG Reduction Goals	**Deere & Company**	**As You Sow**	**Feb 2023**
Shareholder advocate, As You Sow, has filed a shareholder proposal urging Deere, the equipment manufacturer, to issue a climate transition report. The proposal states that Deere not only faces climate-related risks and could be negatively affected by "unfavourable weather conditions or natural calamities that reduce agricultural production and demand for agriculture equipment" but also actively contributes to climate-related risks through the production of fossil fuel intensive equipment. As such, the proposal asks the company to disclose long-term science-based greenhouse gas ('GHG') targets covering Scope 1, 2 and 3 emissions and to disclose progress made in achieving these targets.			
Pesticides & Biodiversity: Disclosure of Pesticide Use	**Post Holdings**	**As You Sow**	**2023**
Pesticides threaten farmer resiliency and productivity and have a detrimental impact on biodiversity. The resolution argues that in a 2021 investor scorecard on management of pesticide risks in agricultural supply chains, Post Holdings ranked last and the company does not disclose how it tracks, reports, or reduces the use of synthetic pesticides in its agricultural supply chains, representing an important blind spot in risk management. The proposal requests that Post issue a report explaining if and how the company is measuring the use of its agricultural supply chains of pesticides that cause harm to human health and the environment.			