The ESG ecosystem update - week ending 30 April 2021

ESG Integration Series

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Starting this week, my blog will also be available from the IHS Markit website. The usual disclaimer applies.

Summary:

This week, we discuss the changing regulations landscape in the EU and Latin America, key features of new 'ESG' funds, stewardship of multi-assets, and best practice examples on agribusiness. We finished the week with an interesting webinar on Responsible AI in healthcare. Thanks for the different thought pieces from colleagues Soffia Alarcon Ailsa Rosales Cristina Brooks Kevin Adler Sandro Barbato Kathy Benini

#esgintegration #sustainablefinance

Sovereign

Should hydrogen and gas be included in the EU climate taxonomy? According to the latest European Commission (EC) 'agreed principles', new information from low carbon steel pilot production processes using hydrogen is expected to be further considered for the manufacturing of iron and steel.

More can be found in this blog by @Christina Brooks – EU taxonomy act embraces hydrogen, delays call on nuclear, gas.

Whilst the EU is moving ahead on sustainable finance, so is Latin America. @Soffia Alarcon-Diaz and @Ailsa Rosales put together a paper where they highlighted progress on how Colombia, Chile and Mexico are working on improving the definition of indigenous groups under ILO-C169 to address the risk of disenfranchisement and to improve free, prior and informed consent (FPIC) of local communities. Central to their paper was the role of NGOs, social media and shareholder engagement that are driving on the ground changes. As a proof, I want to highlight that ShareAction and 17 investors and stewardship service providers covering US$4.3 trillion, including Amundi, EOS at Federated Hermes, Man Group and Nordea, have written to **Barclays**' CEO, calling on the bank to tighten its policies concerning financing for coal and oil sands activity – among the most carbon-intensive forms of fossil fuel – ahead of its AGM on 5 May.

As we have seen in last week's blog, banks are under pressure to set enhanced net zero targets. Banks' decisions to withdraw from trading oil derived from Ecuador's Amazon have taken place alongside a tightening of ESG-related regulations across the global financial sector. Argentina, Chile, Colombia, and Mexico have enacted carbon taxes and Chile, Colombia, and Mexico are adopting an Emissions Trading Scheme (ETS) before 2025. However, amid the political rhetoric regarding sovereignty over natural resources, political will to enforce these regulations is low and implementation thus faces delay. On a positive note, the authors shared trends of sustainable finance (including sustainability and SDG bonds) at the country level.

Indices

The move to passive with an increase in custom-sustainability indices is an interesting trend for sustainability focused investors and companies.

Investors often consider companies with a clear dividend policy and healthy dividend payment as a proxy for both financial resilience and positive business outlook. As noted by Aye Soe, the Global Head of Product Management at S&P Dow Jones Indices, "*Market participants closely monitor companies' long-term dividend payment track records as indicators of corporate maturity and balance sheet strength. Investors also often utilize dividend-based strategies to help manage risks and returns especially in bearish and volatile market conditions*." This is consistent with the ancient wisdom which we also learn in primary school on the power of compounding, or if one prefers, through reading Benjamin Franklin.

S&P's Dividend Aristocrats series focuses on companies that have consistently increased dividend payments on an annual basis over time. For example, the S&P500 Dividend Aristocrat index, launched in 2005, consists of companies that have increased dividend paid for 25 consecutive years or more - genuinely long term. The question though is whether an increasing trend is sufficient, or should there be some other conditions? What happens when there are exceptional circumstances such as COVID in 2020? The details remain to be debated. Nonetheless, it is worth monitoring best practices published by proxy advisory firms as they continue to improve specificity of their guidelines.

The new sustainability-focused Dividend Aristocrat series measures the dividend yield-weighted performance of companies from each index's underlying parent index that meet specific ESG criteria and have followed a managed-dividends policy for 10-20 years. Eligibility is determined using

S&P Global's ESG scores, and through the application of additional screens and exclusions for companies involved in specific business activities, such as those not aligned with the principles of the UN's Global Compact, and those that are involved in ESG controversies. The toolbox for ESG has just expanded.

Investors

Since the publication of the 2020 UK Stewardship Code that highlights the need for stewardship to cover all asset-classes and be outcomes-driven, more engagement examples and tools have become available. On fixed income, my colleague @Sandro Barbato published an article on corporate bond stewardship. On real assets, **UNPRI** published a 36-page Technical guide on TCFD for real assets investors, covering real estate, infrastructure, forestry or farmland. Worth noting two cross-industry climate initiatives: The Coalition for Climate Resilient Investment (CCRI) and the NetZero Carbon Buildings Commitment. CCRI aims to increase the resilience of infrastructure investments by seeking to develop the accurate pricing of physical climate risks in the investment process. This initiative was launched by the World Green Building Council (WorldGBC) to push for net zero carbon buildings around the world. The report covers investors examples on all four pillars of TCFD reporting, including due diligence processes, materiality analysis, climate scenarios, action plans, metrics Q&A and a library of tools and resources.

Nuveen, the $1.2 trillion AUM investment manager of TIAA, announced the launch of the Nuveen Core Plus Impact Fund (NYSE: NPCT), raising $575 million in the fund's IPO. According to Nuveen, it is is the industry's first impact investing-focused closed-end fund. Impact investment originates from smaller scale projects with a venture philanthropic tilt rather than issuers-based opportunities. However, this has changed over time as investors demand liquidity, transparency as well as impact. This closed-end fund will include both issuers and individual projects with direct and measurable social and/or environmental benefits. It is a fixed income fund covering Affordable Housing, Community and Economic Development, Renewable Energy and Climate Change, and Natural Resources.

Companies

Unilever's 88-page Regenerative Agriculture Principles outlines the company's new commitments to nature-based solutions beyond limiting harm to actively preserving and revitalising our environment. This is the exact mindset that businesses should have – limiting harm is not enough;

proactively creating positive impact should be the goal. There are specific implementation guidance for Soils, Water, Climate, Biodiversity and Livelihoods. This is where ESG meets SDGs where we consider a cycle of prosperity.

Nestle updated its Labour Rights Action Plan for Palm Oil following an assessment by Verite, a non-profit organisation to illuminate labour rights violations in supply chains. The plan covers a new programme assurance framework to develop corrective action plans for suppliers and put monitoring systems in place to track against a set of key performance indicators. The company has also developed specific guidance and tools and will participate in initiatives to deploy solutions that can be scaled to improve conditions for workers.

Events

OECD Forum on Responsible Mineral Supply Chain, World Benchmarking Alliance Just transition multi-stakeholder roundtable; The Future of Carbon pricing @Kathy Benini and Healthcare's AI Future.

Great to see continued progress of the Better Mining programme integrated into the RMI assurance framework, ensuring responsible artisanal and small scale (ASM) mining and livelihood of local communities. For more on the concept of this programme, see the joint paper from November 2018: Supply chain human rights risk management: Blockchain and emerging technology.

"We need better data curation and data repository for AI" - Professor Fei-Fei Li

AI continues to be a passion of mine especially having started the work on the responsible use of AI a few years ago before it became officially an 'ESG' issue, from focusing on Big Techs, to financials and then healthcare. The journey continues. As Fei Fei mentioned, to ensure privacy, fairness and integrity in Healthcare AI, like in other sectors, ethical design must take precedent. From user privacy protected cameras, awareness of upstream bias in data, data integrity, data encryption, pros and cons of different learning models, and the ethics of consent as in any research processes are crucial. Both Professor Andrew Ng and Fei-Fei highlight the importance of having multi-stakeholders in the brainstorming stage to discuss what could go wrong and design measures around identified issues.

"Bias is something we need to address even before collecting data." – Professor Curtis Langlotz

This reminds me of the book recommended to me by a US tech Chief Privacy Officer and her AI team colleagues – Medical Data Privacy Handbook by A Gkoulalas-Divanis and G Loukides (2015). The various differential privacy methods that optimises use case or minimises impact are fascinating. A preview is available on Google Books.

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