ESG Integration Series

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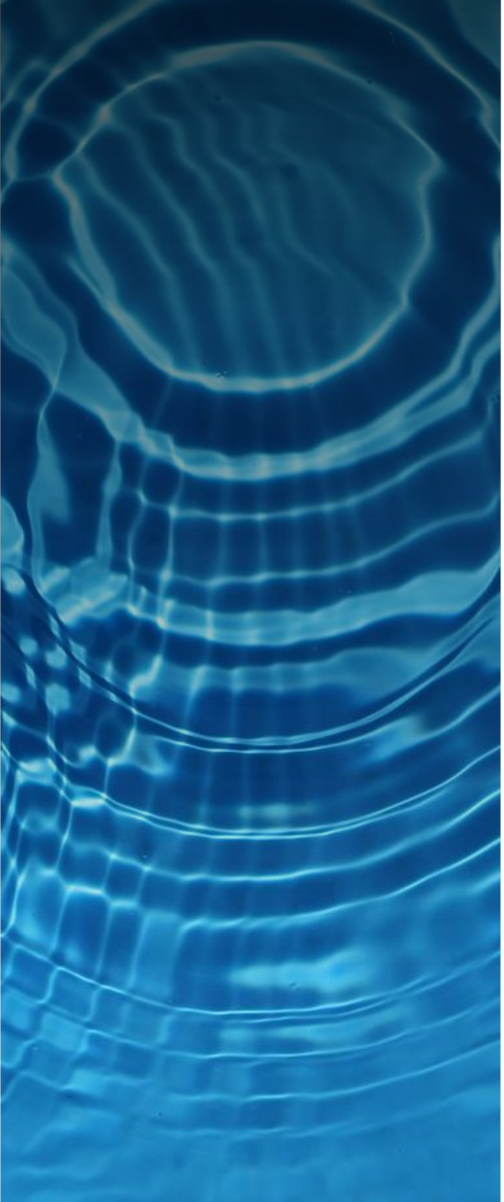

The ESG ecosystem update week ending 4 June 2021

In the ESG circle, we often speak of the ecosystem – the importance of regulations, the influence of reporting standards, changes in investors' preferences and behaviours, the voices of industry organisations and interests' groups, and the sustainable value creation capabilities of companies. Making sense of the information we receive every week is a positive challenge. I write this blog to share my highlights of the week and hope you will find it useful.

Summary:

TNFD official launch this week. Amazon shareholders asked for more plastics disclosure. IHS Markit database and special report Changing Course: Plastics, carbon and the transition to circularity may be able to help. We discuss whether sustainability-linked financing is becoming the norm, vote statistics on Say on Pay and link to director election; ESG ratings of managers by LGT Capital; insurance companies rating by ShareAction; ING's report on SFDR, third party data validation and fair global taxation.

Sustainability-linked becoming the norm?

B&Q owned **Kingfisher**, a UK home improvement company secured a £550m sustainability-linked three year revolving credit facility according to targets set in its responsible business plan, covering science-based emissions reduction by 2026, becoming forest positive by 2026 and community-targets to meet housing needs of 2 million people. Keppel Land, a real estate company secured its maiden 5 year sustainability loan of S$150 million with DBS. Targets include 5 star GRESB rating. The trend is also accelerating in the US with 292% more sustainability-linked loans in 2021 than 2020.

Despite the trend, investors are encouraged to pay attention to the targets set. **Nuveen** published a thought piece on sustainability linked bonds (SLB) encouraging proper and more stretching targets used. It highlighted that in the most egregious case, a structure included a KPI that had already been achieved; another goals-based coupon step ups are not steep enough as penalty.

Taskforce on Nature-related Financial Disclosures (TNFD) official launch this week. The new initiative aims to build on the success of the Task Force on Climate-related Financial Disclosures (TCFD), established by the Financial Stability Board in 2015. It seeks to broaden the climate view to consider the inter-connectedness of natural capital and biodiversity, covering water, soil, minerals and living nature. See the 43 page technical scope report. The informal working group includes 49 financial institutions and companies, 8 governments and regulatory bodies and 17 think tanks and consortia.

Investors

ING published a 26-page SFDR rules report in a comprehensive yet easily understood format. The report highlights the potential of ESG investment in sovereign fixed income. For example, Markit iBoxx EUR sovereign index represents 56% of the overall EUR investment grade index domain; the sustainability bonds that are part of the EUR sovereign index make up only 17% of the total amount of sustainability bonds included in the five major IG indices. On the contrary, sub-sovereigns have a 15% share in the total Markit iBoxx EUR bond space, but a 42% share in the sustainability segment.

LGT Capital has a 4 step rating for its co-investment fund managers and its 2021 ESG report provide more information on how it assess the activities of 344 managers globally (including 267 private equity managers) and assesses the improvements made in ESG practices. Aside from refinement of ESG practices, a shift from process to outcomes is notable. The report focuses mainly on established ESG trends such as climate change and diversity.

LGPS invests in affordable housing with CBRE, a leader in responsible real estate investment as per GRESB; a natural next step is to enhance impact through alignment with the heritage of the pension fund. Similar to industry specific pension funds whose members tend to have a focus on their sector or profession (e.g. PKA on social services and healthcare), local government pension scheme has a natural interest in local communities. Place-based investments make sense, strengthening local communities and shortening supply chain. Given some projects may be of smaller scale and have a different risk-return profile for this alternative asset class, specialist investment expertise may be needed.

Ranking Insurance

@Catherine Howarth **ShareAction** strikes again! A new ranking covering 70 global insurance companies published the leaders and laggards in insurance on sustainability issues covering governance, climate change, biodiversity and human rights. Three European insurers – **Axa, Allianz** and **Aviva** – lead the ranking of insurers with a property and casualty business, each receiving an A rating.

Regulation

A great summary and key takeaways from a conference organised by **Wharton's Pension Research Council** titled "Sustainable Investments in Retirement Plans: Challenges and Opportunities."

Fiduciary duties have long been a bottleneck that prevent pension funds, especially those in the US, from sustainable investing. A bill the Financial Factors in Selecting Retirement Plan Investment Act was submitted to amend ERISA to consider ESG factors 'in connection with carrying out an investment decision, strategy, objective or other fiduciary act.' The bill would also amend ERISA to make clear that plans can consider ESG factors as tiebreakers when deciding between otherwise comparable options.

The MIT Aggregate Confusion Project is a fantastic name that backs an important project to bring clarity to ESG-driven investment flows and corporate behaviours, involving a long-time colleague from the PRI Academic network @Julian Koebel.

I strongly support Professor Witold Henisz proposal of third-party validation of proprietary data. In the era of data explosion, and increasingly layers of tools are built on layers of data - raw, cleaned then synthesised – absolutely necessary for quality assurance purposes as companies and investors make capital allocation decisions, people management decisions based on it.

"Even the studies that use the best available data are not convincing the skeptics," Henisz continued. That is because "the time horizons aren't long enough, the assumptions aren't clear, and the processes aren't transparent. We need to have good data, but we also need to make progress from where we are if we're going to mainstream this [pursuit of ESG values]."

Companies

35% Amazon shareholders supported a proposal filed by **As you Sow** and **Green Century Funds** to reduce single use plastics. The proposal requests the board to issue a report by December 2021 on plastic packaging, estimating the amount of plastics released to the environment due to packaging attributable to Amazon operations. **Amazon** has not disclosed plastics use information before. Given the different types of plastics in the market, different pricing and recyclability potential, it is important that companies start with a robust definition of plastics type, and establish a comprehensive data collection mechanism to help set targets for reduction of use. This IHS market special report Changing Course: Plastics, carbon and the transition to circularity may help.

Semler Brossy, an executive compensation consultant published its 2021 Say on pay and proxy results. 22 Russell 3000 companies (3.3%) failed Say on Pay as of May 2021. Over the past five years, average Director election vote support at companies that received a Say on Pay vote below 50% in the prior year is five percentage points lower than at companies that received above 70% support. A summary on Harvard Law School Forum on CG.

Fair Taxation

In the article How do OECD Initiatives provide Insights into ESG Investment Trends?, we discussed that the OECD has been urging collaborative actions on global tax for years and it should be an area to monitor given the momentum behind global tax disputes of Big tech companies. The Biden Administration is giving this initiative a recent push seeking 'comprehensive scoping' for Pillar One. The comprehensive explanation of Pillar One and Two can be found on the OECD tax and digital: inclusive framework on BEPS consultation and a simple explanation can be found here).

Pillar seeks market-based allocation of a percentage of corporate profits outside of the scope of transfer pricing by certain companies. Domestic companies remain concerned that the current reliance on transfer pricing creates tax differentials between those companies that can profit-shift offshore and those that cannot.

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