QUILTER CHEVIOT

Responsible Investment Quarterly

Quarter 4, 2023

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QUILTER CHEVIOT

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Welcome

As 2023 comes to a close we are delighted that Quilter Cheviot has been able to join the Climate Action 100+ as an investor participant. Put simply, and in its own words, Climate Action 100+ is an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change. Being an active participant in collaborative engagement initiatives is an important element of our overall stewardship agenda.

The final quarter of the year is always busy with the focus on upcoming reporting such as the Taskforce for Climate-related Financial Disclosures and the Stewardship Code, as well as setting priorities for 2024. Our focus remains on our key mega-themes of climate change, human rights and natural capital; with the additional focus of disclosure and best practice within the investment trusts and third-party funds that we invest in on behalf of our clients.

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Voting activity

Over the fourth quarter we voted at:

Over the quarter we voted on:

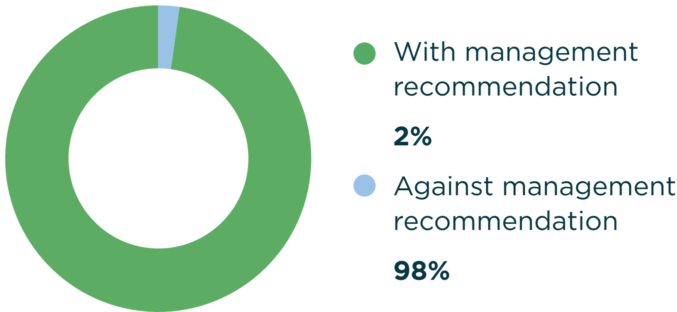
760 RESOLUTIONS

We enabled clients to instruct votes at 16 meetings

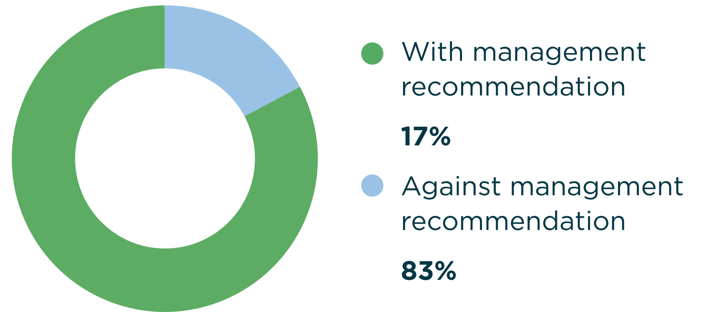
It is important to note that on a number of occasions having engaged with the relevant company we did not follow ISS' recommendations.

Voting activity

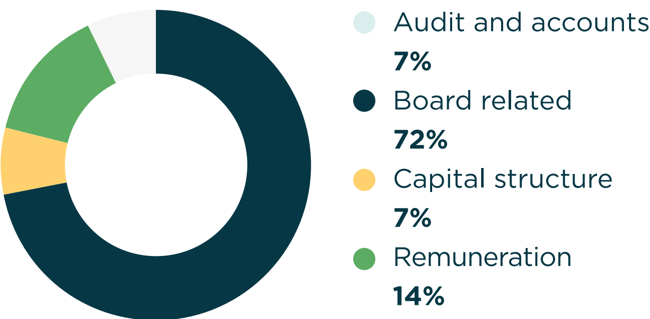
Management resolutions voted in Q4 2023
(excluding shareholder proposals)



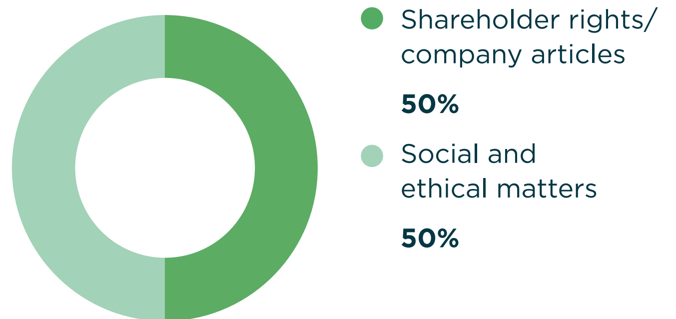
Meetings with votes against management in Q4 2023
(including shareholder proposals)



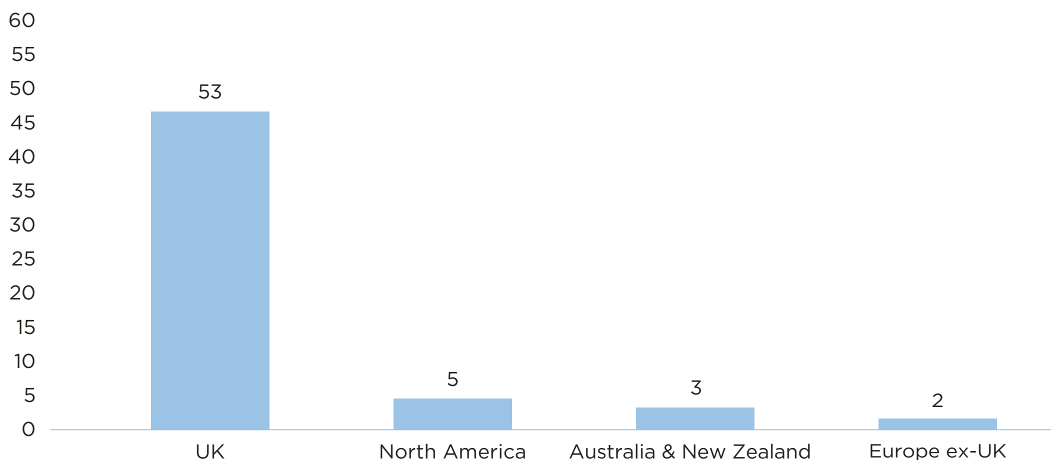
Management resolutions voted against by topic in Q4 2023
(excluding shareholder proposals)



Shareholder proposals supported in Q4 2023



Meetings voted in each geography in Q4 2023



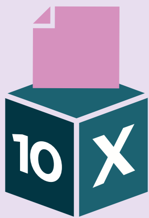
* Includes the Crown Dependencies of Jersey and Guernsey

Q4 2023 Voting

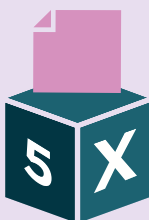
Key voting activity:

Q4 was a relatively quiet period, evidenced by 63 meetings voted at in comparison to 82 in Q3 and 284 across Q2 (proxy season). Fewer votes against were placed too, both in terms of management items, and shareholder proposals, as fewer of these were filed. Voting activity on governance related items remained our primary focus where the most contentious votes related to director elections and executive compensation. There were fewer general meeting agenda items related to social and environmental topics in Q4, relative to other quarters. We have therefore focused on the key governance voting issues across the period.

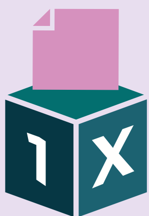
Governance voting activity by numbers



10*x votes against electing / re-electing director (management items)
We voted against a number of election related items for several reasons: at Dechra, we placed an abstention vote where the director had stepped down from the board, during the election process. At the Renishaw meeting, we voted against two directors following ongoing concerns with the board composition where we believe shareholders would benefit from a board refresh.
Companies voted on: Darktrace, Dechra, Hipgnosis Songs Fund (x6), Renishaw (2)



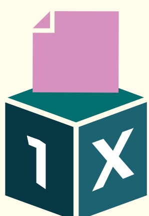
5x votes against management on compensation related resolutions (management items)
We have voted against remuneration reports and policies where there are not robust long-term incentive performance metrics and sufficient vesting periods in place. Additionally, where in-flight salary increases were paid without a compelling justification raising concerns about excessive pay-outs.
Companies voted on: Frontier IP, Haydale Graphene Industries, Palo Alto (x2), Seeing Machines



1x vote against management on authorising equity issuance (management items)
We voted against management in this instance as the conditions of the proposed equity issuance (level of disapplication of pre-emption rights), is not in line with best practice.
Company voted on: Frontier IP

* Withheld and abstention votes have been included within votes against figures.

Social voting activity by numbers



1x vote in favour of reporting on human rights concerns (shareholder proposal)

We supported this proposal at Microsoft as shareholders would benefit from increased disclosure regarding how the company is managing human rights-related risks in high-risk countries.
Company voted on: Microsoft

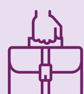
Engagement activity

Here, we outline examples of our engagement in the three months to the end of December 2023. In line with the Shareholder Rights Directive II (SRD II) disclosure regulations, we have included the name of the company, investment trust or fund in most cases. In some cases, we will not, as this would be unhelpful in the long-term to the ongoing engagement process.

We have structured the engagement report broadly into the following areas which reflects our thematic, collaborative and our ongoing engagement agenda:

Environment: climate and biodiversity

Social: cyber-security, supply chains in apparel and product safety in the healthcare sector



Governance: companies and our thematic engagement with investment trusts (this quarter primarily focused on infrastructure and renewables)

Environment: climate and biodiversity

BP – Environment

Objective: We recommenced our ongoing thematic engagement on climate transition plans and disclosures with the largest emitters among our direct equity holdings (scope 1 and 2 emissions). This systematic engagement process is conducted on a 24-month cycle. The first phase was very much engagement for information and this second iteration will look to assess progress against previously stated plans. We will be speaking with c.ten companies representing c.85% of direct equity Scope 1 and 2 emissions exposure within Quilter Cheviot's centrally monitored direct equities. We will be reassessing the quality of transitions plans and whether they are taking (or not taking) appropriate measures to align with a future lower carbon economy.

BP has announced some of the most ambitious carbon reduction and capital expenditure targets of the global oil and gas majors, but in February 2022 pared back elements of climate transition goals including a watered-down target to reduce oil & gas production. A destabilising factor, from a strategic perspective, includes the dismissal of CEO Bernard Looney over misconduct allegations. Looney was a key architect of the climate transition plan, with questions being raised not only on the future commitment to the transition strategy but also the governance performance and company culture in light of his exit.

This engagement gave us a clearer view on the strategic importance of the company's 'transition growth' pillars – convenience, EV (Electric Vehicle) charging and bioenergy being the short-medium term drivers of performance – with more capital expenditure dedicated to these areas. At this point investment in renewables power volumes is playing a supportive role in feeding into EV charging provision and energy trading – rather than creating a scalable mass generation business of itself. Hydrogen activities are nascent and again centred on decarbonising existing activities rather than forming scalable and commercial businesses themselves. On methane emissions – current reduction targets are related to estimated intensity measures, but this will switch to an absolute reduction target of 50% by 2030 once the ability to measure (rather than estimate) is realised. A focus on methane is welcome – more work needs to be done on working with partners and non-operating entities on expanding this effort, as it is one of the most effective ways of reducing emissions in the short-term.

Outcome: This update on progress is set in the context of weakened oil and gas reduction targets and a departing CEO who was key to driving their transition strategy. Externally the company is committed to the current, ambitious transition plan that is in place (and will be restated in 2025), but whether an incoming CEO would have a different strategic focus remains unclear. Pressure from a segment of shareholders to focus on more of a US-orientated oil and gas expansion strategy remains (versus European-based transition demands). We requested a commitment to shareholder voice on transition strategy by committing to regular general meeting agenda item approval. Our conversation was consistent with previously stated plans, and we will monitor developments moving forward.

Tesco – Environment

Objective: As part of IIGCC's collaborative Net Zero Engagement Initiative (NZEI), we engaged with Tesco's regarding its emissions disclosures and preparedness regarding climate transition plans. Our collaborators were Premier Miton, a UK-based asset manager and AP3, a Swedish pension fund manager.

Tesco has a relatively robust climate strategy across disclosures, targets, and implementation plans. It published its renewed SBTi (Science Based Targets Initiative) in August 2023, which included several progressive additions to its previous targets including a specific target addressing emissions from Forestry, Land and Agriculture-related activities (FLAG). It is in select company, being only the second UK-based company to set FLAG-specific SBTi targets and is one of only 16 companies worldwide with FLAG SBTi. It has also set renewed targets for its operations and supply chain emissions, supported by strong progress to date (a 55% reduction in operations' emissions as of 2023, against a target of 60% by 2025).

Given how well-positioned Tesco is with its recently renewed climate strategy, our line of questioning was primarily to query the detail behind its new emissions targets and interrogate how the company's transition plan preparation is proceeding. Tesco was unable to provide further detail on what these aims entail – e.g., where it states, 'suppliers to commit to net zero ambition by end of 2023', no specific number or proportion of suppliers was provided – but pointed out the range of supportive measures Tesco is undertaking to work with its supply chain on these emissions.

Tesco was similarly non-committal when asked about timeframes for publishing its first Climate Transition Plan (CTP) citing concerns around its inability to examine suppliers' emissions impact at granular, individual product-level. When asked how a forthcoming CTP might apply to the company's owned subsidiary businesses (e.g., corner shop chains), Tesco demurred on specifics but noted that historically, its approach has been developed in the UK before being applied to other geographies the company operate in. We closed our discussion by asking whether Tesco would consider putting its forthcoming CTP forward for shareholder vote at its next AGM, as we consider this to be best practice. The company declined to answer directly, considering this a "board-level question" and that the board would be more comfortable with advisory-level votes on CTPs in the early iterations, until more is understood about how and whether such votes would become mandatory.

Outcome: Our assessment of Tesco's climate strategy remains positive overall, particularly considering the renewed SBTi with the industry-leading inclusion of FLAG emissions targets. Tesco reiterated its commitments and seemed generally open to further conversations. We will follow up to clarify some of the points of detail in the new year when the climate lead returns to work.

Veolia engagement – Environment

Objective: To address concerns related to allegations of human rights abuses and biodiversity management at the company's San Silvestre landfill site (Santander, Colombia).

We received an alert from one of our controversy monitoring providers that highlighted allegations of human rights abuses and poor biodiversity management at one of the company's Colombian landfill sites. A large NGO had documented continued alleged impacts to nature and the health of the local Patio Bonito community from contaminants entering waterways. There were also allegations of human rights defenders, who were raising these concerns, being threatened by local actors (with no alleged direct connection to Veolia). We were frustrated in attempts to clarify the details of the situation which the company. It took us over four months to establish a dialogue. We eventually did receive a detailed response from the local management team who claim that many of these concerns are legacy issues from the poor management of the site prior to acquisition in 2019. According to the company the site has now obtained the highest

internal certifications on operational management (ISO 9001, ISO 14001, ISO 45001). In the first year of operations Veolia reconstructed (and reinforced) the lagoon's holding waste that could be a potential source of contaminants. Senior management continue to play an active role in monitoring the site (deemed as high risk). Surface water continues to be monitored on a biannual basis at four runoff points near the site and analysed by an accredited external laboratory. The findings continue to show compliance with local norms and show extremely low (or undetectable) levels of heavy metals – one of the principal water quality complaints. The company also highlighted the efforts to engage local stakeholders through meetings with communities, municipal authorities, environmental authorities, and local universities. Over the past year 400 external participants from the above institutions have visited the site.

Outcome: There were significant difficulties in getting a response from the company, which does not reflect well on the quality of shareholder engagement. However, the eventual response provided was detailed. Veolia has made specific efforts to remediate a recently acquired, previously mismanaged site. The measures from regular water quality monitoring to senior management attention does provide some degree to comfortable that the situation is being managed. We will continue to monitor the situation moving forward and will consider reflecting our disapproval at the quality of shareholder engagement at the 2024 AGM.

Social: cyber-security, supply chains in apparel and product safety in the healthcare sector

Cellnex – Social

Objective: We continued our thematic engagement on cyber security with Cellnex. We have used this conversation to better understand the quality of the cyber governance of companies within the information technology software and telecommunications industry groups.

The board receives semi-annual updates on cyber security risk from the Global Head of Risk Management and the Chief Information Security Officer. With regards to the threat landscape, Cellnex has a low risk profile due to the company's business model being focused on the operations of telecommunication infrastructure, and the company does not have any retail customer data to manage. In the event of an incident, the company has a cyber crisis plan which has been approved by the board and this plan has defined key phases to managing a crisis.

All employees complete regular cyber training and receive email alerts. This training involves simulations to prevent phishing and cyber breaches. The company is also involved in multiple industry frameworks such as the open brand initiative and the European Wireless Infrastructure Association (EWIA). These initiatives enable Cellnex to learn from industry peers and contribute to knowledge sharing. The final area discussed in the meeting was cyber spending as a percentage of revenue and cyber security insurance. The cyber security budget was disclosed and there is also a cyber security risk insurance in place, which has a global coverage.

Outcome: This was a positive meeting which we have used to improve our understanding of best practice cyber security governance. The level of disclosure provided on all topics was comprehensive, and we will be using this engagement as a benchmark for assessing other telecommunication service companies focused on infrastructure.

DSV – Social

Objective: We engaged the company to better understand how DSV will be managing potential human rights risk in its joint venture with the Saudi Arabian government in providing logistics services to the country's flagship Neom project.

The company was recently brought under coverage which, as per our responsible investment process, triggered a deeper analysis into the ESG performance of the company. The company performs well on the material indicators reviewed, but on controversy screening the association with the Saudi Arabian Neom project is negatively flagged. Neom is a new urban area planned by the Saudi Arabian government in the northwest of the country. There are multiple reports of human rights abuses associated with the development including forced displacement of the local tribal population and punitive legal action against protesters. DSV is in the final stages of agreeing a joint venture to provide a range of logistic services for the project.

Although the company has not been implicated in any adverse events, we wanted to understand how DSV will be managing the risk associated with operating in a potentially contentious area with a high level of risk related to human rights abuses. On engagement the company outlined its commitment to its human rights policy and code of conduct, adherence to which has been built into the partnership agreement. DSV suggested that appropriate break clauses related to any events that had an unacceptable level of reputational risk, were built into the agreement. Such a break would not be cost free but there was some contractual protection. In terms of managing more endemic risks such as modern slavery, DSV was keen to highlight its history of operating in the Middle East as well as its established processes. The company does use agencies to contract workers but will be using third party auditors to assess subcontractor performance on an ongoing basis. Intensive training programs are also provided. High quality reporting will be essential to monitoring performance and the company has committed to publishing a series ESG-related KPIs (Key Performance Indicators) related to operations, once underway. One KPI we have requested are identified incidents of modern slavery and remediation action. We have requested to view the human rights due diligence conducted as part of the project scoping. The company agreed that this would be made available and admitted an error in not releasing this sooner.

Outcome: This was a useful conversation in establishing the company's due diligence efforts and approach. It is positive to see that certain thresholds have been included in the partnership agreement. We will monitor the development of the partnership moving forward and are unlikely to put the company forward for clients with more robust responsible investment preferences until a significant positive track record related to the project is established.

GSK – Social

Objective: We engaged with GSK as part of our 2023 thematic engagement on product safety and litigation risk. The aim of the conversation was to better understand how companies in the pharmaceutical and healthcare industries are managing risks in these areas.

We welcome the company's openness to engage on the topic, but the discussion was very much limited to high level commitments and a general review of risk oversight structures. The information provided on structural governance was helpful and gives us insight into the efforts to integrate product safety culture across all employees. Litigation is a common event for pharmaceutical companies so it would have been helpful to have more specific detail on how GSK sizes potential risks and manages potential compensation events. It is positive to see the company has a well-resourced global quality management system, this meets expectations. The link between the executive risk oversight mechanisms and the board levels ones

(through the audit and risk committee) appears robust – theoretically helping to manage any emerging product safety risks efficiently. The company's investment in risk monitoring, risk analytics and predictive behavioural models also aims to improves channels of escalation related to potential adverse events.

Outcome: This was an engagement for information. The conversation did give us a sense of the executive impetus to create a positive culture around product safety, one in which all employees are accountable, and the company has a relatively clear risk governance oversight structure. Like peers, the company was unwilling to discuss much in the way of litigation strategy, which limited the reach of the engagement.

Next – Social

Objective: We engaged Next as part of our 2023 thematic engagement on labour standards in supply chains in the apparel sector.

Next is an apparel retailer with 89% own label products and the remainder are third-party brands. Next has a well-resourced team of 52 employees focused on supply chains situated in the top ten geographies the company sources from, this is led by the finance director who is ultimately responsible for Environmental, Social, Governance (ESG) matters. The company carries out all its audits in house and does not utilise third party auditors. This is a legacy approach which allows internal teams to benefit from building long-term relationships with the factories and suppliers. Where breaches in human rights activities are identified, the company adopts a 'stay and change' approach to any health and safety breaches, rather than a 'cut and run' approach. Local networks of Next employees will work alongside suppliers and external experts to address and remedy the issue through its Corrective Action Plan (CAP). The company will cease to continue the relationship if remedial action is not successful, however this is the last resort. In terms of supplier transparency, Next discloses its Tier 1, 2 and partial Tier 3 supplier lists. Next has introduced an app in recent years which enables employees to voice grievances anonymously. This operates alongside a more traditional grievance process through its whistleblowing hotline. Next acknowledges the merit of addressing the topic of living wage across its supply chain, however in the absence of specific targets, change remains challenging.

Outcome: Overall, this was a useful conversation on polices and processes. Next maintains a good level of transparency across its Tier 1, 2 and 3 suppliers and has a dedicated team to carry out audits. It is common for companies that maintain long-standing relationships with its suppliers to prefer 'a stay and change approach' when human rights issues arise. On governance of supply chain activities, it was unclear whether a member of the ESG Steering Group also attends board level meetings. This would be beneficial. The company's labour standards management process appears robust, and continued development in this area, namely, the expansion of its app and living wage work is encouraging.

Sage Group – Social

Objective: We engaged with Sage Group as part of our thematic engagement on cyber security. This is the first phase of the engagement, which we will use as a risk assessment on the cyber governance of companies within the information technology software and telecommunications industry groups.

Cyber security is a strategic priority at Sage. This is exemplified through the company's development in cloud technology involving use of Amazon Web Service (AWS) as a hosting solution to improve automation and governance of customer data. Over the last five years, the company has created programmes to focus on ransomware, as this is a predominant risk to the business.

Cyber security threats are reported to the board and key risks are presented at all board meetings. The board does not have a dedicated committee or named person who is dedicated to cyber security, as all members are expected to be knowledgeable on the topic so there is a good level of understanding across the board. However, the audit and risk committee is the direct point of contact and will hold conversations on cyber security more frequently. The company also has training and awareness programmes on cyber security for all staff and there is a network of security champions who sit within technical teams.

The final discussion points were on the company's cyber security budget and internal resource. Sage Group has increased the staff in its technology unit by approximately 400% over the last five years. The cyber security budget is managed by the office of general counsel as part of the overall technology budget. This budget covers cyber security which will range between 5-10% of the overall technology spend.

Outcome: This was an engagement for information which we have used to improve our understanding of best practice cyber governance. We are pleased with the level of disclosure provided on all topics discussed and will continue to monitor the company's progress on cyber security governance.

Governance: companies and our thematic engagement with investment trusts (this quarter primarily focused on infrastructure and renewables)

American Express – Governance

Objective: The company requested a meeting to gather shareholder feedback on the company's remuneration policy. Significant shareholder dissent was registered at the 2023 AGM.

We used the discussion to reiterate feedback provided prior to the 2023 AGM. We held concerns regarding the structure of the remuneration package, including the one-off equity grant made to the CEO. We also registered concern related to the transparency of the annual bonus outcomes. Specifically, a majority of the award was based on metrics for which quantified metrics were not disclosed.

Outcome: We welcome the proactive outreach from the company, and we will monitor the issue moving forward to see if our detailed feedback is taken onboard.

Craneware – Governance

Objective: To discuss concerns regarding the re-election of a non-executive director (NED).

Our proxy advisor recommended voting against the re-election of a NED owing to independence concerns. We requested additional context on the tenure of the director, who has been a member of the board for ten years. This exceeds the nine-year term which is considered best practice. The board has noted these concerns but believes the director in question brings invaluable experience to the board as well as contributing to the board's overall diversity. Requiring the NED to step down from her role would result in the board not meeting the FCA's gender diversity targets (which it currently adheres to). While this is not a long-term solution, we appreciate the board's efforts in meeting the diversity guidelines.

The NED in question also sits on the Audit and Remuneration committees, resulting in both committees not adhering to best practice guidelines related to independence criteria. Given the board is due to review the membership of both committees during the upcoming year, we believe cautionary support for election this year is a reasonable outcome, with the expectation for changes to be made ahead of next year's meeting.

Outcome: The board has provided a reasonable rationale for the support of the re-election of the NED in this instance. We expect changes to be implemented over the next 18 months, so all board committees adhere to best practice tenure guidelines.

Darktrace – Governance

Objective: To address concerns over the headline risk created by the involvement of Invoke Capital on the board of directors. To do so we opposed the election of non-independent non-executive director (and Invoke's representative), Patrick Jacob.

In collaborative with our equity research team, we decided that in order to secure the best shareholder outcome, we would vote against the election of Patrick Jacob as a non-independent director due to his association with Invoke Capital and Mike Lynch. Mike Lynch's trial in the US creates unhelpful headline risk for Darktrace, which we view as unwarranted, so any move to distance Darktrace from these headlines is a positive in our eyes. Additionally, we do not believe granting a board seat to Invoke is conducive to helping Darktrace develop and mature as a global business and investment. Following our stewardship process, we wrote to the company to inform them of our intention to vote against the appointment of Patrick Jacob.

Outcome: At the AGM, 56.67% of votes were cast against the election of Patrick Jacob. As a result of this, Patrick Jacob is no longer on the Board.

3i Infrastructure – Governance

Objective: This engagement was part of the investment trust thematic engagement and the first-time meeting 3i Infrastructure's board.

We started the engagement by discussing the board's oversight of responsible investment. The board has recently hired a new non-executive director with previous sustainability experience to bolster the board's knowledge in this area. According to the trust's board matrix, four of seven directors have environmental, social, and governance (ESG) experience. As the ultimate decision-maker, the board stays informed of all new investments and potential ESG-related risks. At every board meeting, there is a section dedicated to ESG matters. The current disclosures outline the ESG integration process; however, practical case studies would help add some colour to the disclosure.

The board is currently composed of seven directors. The board does not meet the Parker Review target of having at least one director from an ethnic minority background. The chair assured us that diversity is being factored into the next director search (two directors are leaving the board next year as they will reach a nine-year tenure).

3i Group has the right to appoint a director as long as it owns more than 20% of the trust, which it has done. Our preference is for boards to be fully independent - additionally the non-independent NED is paid a fee which is highly unusual.

The board is disappointed with the level of discount. However, the trust does not currently have the cash to make a buyback that would significantly impact the discount. The chair further explained that if the discount were to continue over several years, then more drastic measures would need to be considered.

Outcome: There is room for improvement within the responsible investment disclosures and, we believe that a fully independent board is the best structure to defend the interests of shareholders. We do not believe that manager representatives should be paid fees, particularly when the manager employs them. We have relayed our views formally to the board.

Aquila European Renewables Income Fund – Governance

Objective: To discuss the board's response to the high opposition to the latest continuation vote, and to review the board's oversight of responsible investment and general governance as part of the investment thrust thematic engagement.

During the last AGM, the trust conducted a continuation vote, which was opposed by 26% of investors; a further continuation vote is scheduled for September 2024. Currently, the trust is trading at a significant discount, which is wider than some of its larger peers. We asked the chair about the outcome of the consultation with shareholders, and he explained that there has been a range of opinions. In general shareholders welcomed the decision to start buying back shares proactively, but this is limited by the size of the trust. The trust is one of the smaller players in the renewable space, and further downsizing could result in liquidity issues, making it harder for larger institutional investors to invest in it. The trust is exploring all options ahead of the next continuation vote.

The chair explained that responsible investment is discussed at every board meeting and the manager includes a ESG section on the board packs. The chair believes that given the investment mandate of investing on renewable energies, there is a presumption that the investments have a positive impact. We clarified that investing in renewables is not always responsible investment and ESG factors need to be taken into consideration. This can even be observed in the trust's own investments, as it has had issues with wind assets built on land used by Norwegian reindeer herders.

The board is ultimately responsible for investment decisions. The investment advisor presents a pipeline of potential investments, and the board selects which investments to pursue. After further due diligence, the board gives final approval.

Outcome: The board has achieved a good balance in terms of diversity. The board has good infrastructure experience, but responsible investing experience seems to be limited. However, the latest continuation vote faced significant opposition, and a second continuation vote is scheduled for September 2024. The trust trades at a significant discount and is small compared to peers, along with issues related to the Norwegian wind farm, these uncertainties might also pose challenges for the next continuation vote. We are pleased to hear that the board is open to considering options, and we will closely monitor developments leading up to the next continuation vote.

BBGI Global Infrastructure – Governance

Objective: To discuss the board's oversight of responsible investment as well as the broader governance of the trust including board composition. This engagement was part of the wider investment trust thematic engagement.

Unlike most investment companies that are externally managed, BBGI is internally managed; as such, it has a dual structure board, with a supervisory and an executive board. The trust also employs c.30 direct employees. The trust's investment strategy is to invest in PFI (Private Finance Initiative which involves the public sector financing big public-works projects through the private sector) and PPP (Public Private Partnerships which are partnerships between the public sector and private companies to finance public

infrastructure such as roads, hospitals, or correctional facilities) assets.

The trust has been labelled by the manager as Article 8 under the EU's Sustainable Finance Disclosures Regulation (SFDR). The executive board is responsible for making new investment decisions and the supervisory board does not have to approve these investments. During board meetings, new and potential investments are reviewed. The chair is confident that if the supervisory board had concerns with an investment, the executive board will be open to listening. The chair has obtained the CFA ESG certification.

The board has a 60% female representation with women occupying both the chair of the board and the audit committee roles. The board also meets the Parker Review requirements by having at least one NED from an ethnically diverse background. The supervisory board consists of five directors, while the executive board has three directors including two co-CEOs and one CFO. The trust used Cornforth Consulting for the latest appointments.

The trust discount is c.13% at the time of the engagement which is considerably better than peers. Therefore, the board is not looking to make buybacks at this level, instead the focus on paying down the revolving credit facility with the aim of paying it down during the next year.

The chair indicated that the board is actively working on marketing, and we should expect changes soon.

Outcome: The board achieved a balance of diversity and experience. The chair was receptive to feedback. We look forward to changes in the marketing strategy of the trust.

BH Macro – Governance

Objective: As part of the overall investment trust thematic engagement, we wanted to develop our understanding of the trust's board composition and approach to responsible investment. We also wanted to discuss the current stock performance and the board's plan for managing the discount.

BH Macro invests solely in the master fund of the flagship hedge fund run by Brevan Howard. The fund focuses on fixed income, foreign exchange, and volatility strategies.

The trust traded at a premium to Net Asset Value earlier this year and the board took advantage of this to issue some shares. However, over the past few months, the trust's is now at a discount of approximately 10%. This is partly due to a large investor selling down a portion of its position. The board is setting up a conversation with the investor in question to ascertain its future intentions before it announces any buybacks.

As the trust is invested in a derivative trading fund where standard responsible investment disclosures requirements do not apply, due to the short holding periods and quantitative trading strategy. The chair said that when it comes to ESG factors, the most important for him is governance and ensuring compliance at the board level.

Outcome: We have no significant concerns with the trust. The trust asset class makes it harder to integrate traditional responsible investment approaches. However, the chair is focusing on the board's governance and oversight of the investment advisor.

Capital Gearing Trust – Governance

Objective: As part of our wider investment trust thematic engagement, we met to discuss responsible investment disclosures and broader governance, as well as the issues behind the failure of the discount control mechanism (DCM) and manager succession.

The chair highlighted certain limitations in the investment adviser's operations. Firstly, the team is relatively small, with only five active investors; hence, capacity is restricted. Additionally, there is no

independent stewardship team, and most of the fund is invested in bonds, with the remainder in funds and equities. The investment advisor does vote and engage with the close-ended trust it holds, and it reports this to the board. We suggested that including some examples of voting and engagement would be of value, as it would evidence how the managers' stewardship activity fits within the investment strategy.

The board has announced that the Senior Independent Director (SID), also the chair of the audit committee, will step down next year after serving for eight years. Ravi Anand, a qualified accountant who joined the board last August, will replace him as the chair of the audit committee. The incumbent chair is likely to exceed the recommended nine-year tenure limit as the search for a successor is ongoing. The successor is likely to be an external appointment, with a period where both the incumbent and successor are in post to ensure a smooth transition.

Peter Spiller has served as the fund manager since 1982. While there is no indication of retirement plans at present, the board is cognisant of the importance of having a succession plan in place. The manager has built a team around the main manager and recently restructured the team to include the CEO and CIO. We also inquired about the potential change in investment style if the manager were to step down. The board assured us that while the current PM has a conservative style, whoever inherits the trust would maintain the core of the approach.

The trust has a Discount Control Mechanism (DCM) in place. Typically, the trust will strive to maintain the discount/premium of the trust to no more than -2/+2% above or below Net Asset Value (NAV). To achieve this, the trust has the ability to issue shares up to 15%. However, due to an admitted administrative mistake, the trust is not able to buy sufficient shares to maintain the discount above -2% When we asked how this happened, we were referred to the company secretary. We believe that the manager should have been aware of this issue, but ultimately, the board is responsible. The buybacks will not resume at full level until January at the earliest.

Outcome: We are currently satisfied with the composition of the board. However, we will monitor the board succession. We have suggested that more information be provided regarding stewardship activities of the trust. Specifically, we would like to see examples of voting and engagement disclosed. We are concerned about the oversight of the DCM and how this issue was allowed to occur. We expect the board to disclose how it plans to avoid such issues in the future. In addition, we will be following up with the investment adviser regarding the DCM issue.

Foresight Solar Fund Limited – Governance

Objective: To discuss the board's oversight of responsible investment as well as the broader governance of the trust including board composition. This engagement was part of the wider investment trust thematic engagement and the first-time meeting the board of Foresight Solar Fund Limited (FSFL).

The fund does not have a sustainability mandate. The chair explained that they have, however, followed the market and regulatory requirements for ESG reporting and adhered to the Association of Investment Companies' recommendations on ESG considerations. The investment adviser reports on an annual reporting cycle, and the board's Risk Committee provides oversight of the ESG reporting, which is approved by the board. The social impact of the investments is discussed frequently in the board and is something that factors into the due diligence process.

Last year we had a meeting with the manager where we discussed FSFL's supply chain. The investment trust has enhanced due diligence for high-risk markets, such as China, and used third-party resources to assist with risk assessment. On the topic of the lifecycle of renewable energy assets (see our previous engagement with renewable funds), we considered FSFL's approach as one of the more mature amongst its peers.

The board has achieved gender parity; however, it fails to meet the Parker Review's targets of having at least one director from an ethnic minority.

The board believes that the discount will remain in place for some time; this is not specific to FSFL but reflective of the wider infrastructure sector.

Outcome: The board still needs to meet the Parker Review targets. We anticipate that the chair and the SID will announce their retirement from the board soon, considering their extended tenure. We will closely monitor any future changes in the board composition.

Foresight Solar Fund Limited (2) – Governance

Objective: We participated in the Foresight Solar key investor survey conducted by a third party. The objective was to provide our view as shareholders on a number of topics such as governance, quality of management and disclosures.

During our meeting, we emphasised our support for the Parker Review targets, which aim to include at least one non-executive director (NED) from an ethnic minority background. Moreover, we suggested the implementation of a board skills matrix, which would help in visualising the expertise and experience that each NED brings to the board.

We spoke about our view of the management and the access to the investment adviser team. We also discussed the quality of the ESG related disclosures. Finally, we stressed the importance of increasing the transparency and disclosure of capital allocation decisions.

Outcome: As a responsible investor and active owner, we aim to provide our views to the companies we invest in. Therefore, we welcome Foresight Solar's proactive outreach for our comments.

GCP Infrastructure Investments Limited – Governance

Objective: To discuss the board's oversight of responsible investment as well as the broader governance of the trust including board composition. This engagement was part of the wider investment trust thematic engagement and our first time meeting the recently appointed chair.

In 2022, the board established an ESG committee to oversee responsible investment activities within the trust. Last year, the trust hired a consultant to expand the scope of its data collection. The manager has also increased the collection of ESG data points from underlying investments and now RAG rates the investments based on their ESG factor performance. ESG data points include, water consumption, waste generated, gender diversity, green building certifications, quantity of fuel used and number of hospital beds amongst others. However, the board has not set any targets for these ratings. The trust has a positive screen to identify investments that promote sustainability or benefit society, including, but not limited to, climate change mitigation and adaptation, energy transition, critical infrastructure, affordable living, social housing, education, and healthcare. There is no indication that the board has any significant responsible investment experience.

The board has six non-executive directors (NEDs), four of which are based in Jersey. Two of the Jersey-based directors will be stepping down from the board shortly. According to last year's annual report, two of the longer-tenured NEDs did not own any shares. The chair confirmed that all directors now own shares. Unlike his predecessor, the current chair considers it important for NEDs to build up share ownership, until they hold positions equivalent to one year's fee.

During the year, the board underwent an external evaluation by Stephenson Executive Search. The evaluation highlighted several key outcomes. Firstly, it was recommended that all NEDs acquire share ownership. Secondly, the size of the board was deemed to be too large. Finally, there was positive feedback regarding the quality of the directors.

The board is responsible for making investment decisions, but it is reliant on the recommendations of the investment adviser. The adviser presents
a shortlist of ideas to the board for initial approval, and based on factors like risk tolerance, some ideas are chosen for further investigation. These proposals then go back to the board for final approval. Each investment proposal also includes
a section on sustainability.

Outcome: The board has established an ESG committee to supervise responsible investment activities in the trust. In addition, the manager has enhanced its collection of ESG-related data from the underlying investments. However, it is not obvious how ESG factors are integrated into the investments. There are two directors leaving the board in the next few years, we will closely monitor any further changes in board composition.

Greencoat UK Wind – Governance

Objective: We had our first meeting with the board of Greencoat UK Wind to discuss responsible investment oversight and governance, including board composition, as part of the investment trust thematic engagement.

The chair has indicated that the latest ESG report shows significant improvement over previous versions, while acknowledging there is still room for improvement. The board is actively discussing appropriate ESG ratings and accreditations for the trust.

The chair explained that the investment trust places a great deal of importance on health and safety. As an example, she mentioned that the investment adviser has recently undergone health and safety training, which was also attended by two of the non-executive directors. The board also discussed the topic of wind turbine recycling and has awarded a grant to research alternative recycling. The chair mentioned that this initiative arose from discussions held at the board level. Last year, we engaged with the manager regarding the life cycle of renewable assets as part of a thematic engagement involving a number of renewable investment trusts. During the conversation, we observed that the level of detail on the issue and overall ESG factors was lower than what we had seen among some of the trust's peers. We voiced our concerns to the board, and we are pleased that this is an issue that is being taken seriously and is actively discussed. For the next board hire, the chair confirmed that consideration will be given to candidates with ESG-related experience as it has become increasingly important and will help them challenge the manager on this issue.

Outcome: The board was receptive to our feedback. The board will be looking to recruit a non-executive director in the new year, considering ESG related skills and balancing this with the diversity requirements. We will monitor changes in the board composition in the future.

Gresham House Energy Storage Fund – Governance

Objective: To discuss the board's oversight of responsible investment, board composition and wider governance topics. This engagement was part of the wider investment trust thematic engagement and the first time meeting the board of Gresham House Energy Storage Fund (GRID).

The trust's investment strategy is to invest in utility scale operational energy storage systems, which utilise batteries, located in Great Britain and Ireland, although it has recently been exploring the possibility of expanding in the US.

The chair highlighted that every investment goes through a rigorous ESG related due diligence process before it is presented to the board. The chair explained, the integration of ESG factors into the investment process is about risk mitigation. For example, one of the risks that the board has discussed is the trust's dependency on China, as that is where most of its battery suppliers are located. The board considers questions such as how geopolitical escalations could affect the supply chain and as a result has allocated a small capital pool to invest in European battery producers to invest in the future and to diversify suppliers. Recycling of lithium-ion batteries and the sourcing of cobalt have also been points of discussion. Health and safety is a routine item on the board meeting agenda.

We talked about the trust's website which is currently integrated into the investment advisor's website. We asked the board if there would be any merit in moving it to a standalone website. Similarly, we discussed the sustainability report, which is currently handled at the asset manager level. The chair is very cognisant of cost, but the board has discussed moving the website in the past. The trust is considering moving to a premium listing and if it does so, then this would be a good time to refocus the website.

The trust is looking to expand in the US, starting with a site in California which would serve as a pilot scheme for the investment advisor. The board would consider hiring another advisor if the US deal goes ahead.

The board has identified a key person risk in relation to their long-term fund manager, Ben Guest. The chair talks about this regularly, making sure that the manager is growing in-house talent and ensuring that there are people in place to replace him if needed.

Outcome: This engagement was helpful to understand the current situation of the trust. We are content with the current board composition.

Hipgnosis Songs Fund – Governance

Objective: To discuss the recently announced sale of part of the song catalogue and the upcoming continuation vote.

On 14 September, Hipgnosis Songs Fund announced that it has agreed to sell 29 catalogues to its investment adviser (Hipgnosis Songs Capital) for $465 million. Blackstone is a majority owner of Hipgnosis Songs Capital, which is run and minority-owned by Merck Mercuriadis. During the engagement, the chair explained that the main objective of the sale deal was to reduce the discount and debt.
The planned sale is subject to shareholder approval; at the same time the trust has a continuation vote. A continuation vote is a periodical proposal to allow shareholders to vote on whether the company should continue or be wound up.

The board explained that Blackstone was the obvious buyer, as the market for music rights is limited, especially for large transactions such as this one. Therefore, the board started negotiations with Blackstone, which led to the agreed sale. Our concern is that no other investors were part of these initial negotiations, and the offer was only made public once Blackstone had agreed to the terms.

It is important to consider the potential conflict of interest to determine whether the fair value has been properly assessed. We asked the board if any independent pricing mechanisms are in place for oversight. The sale includes a “”Go-Shop”” provision, which allows the board to solicit alternative offers for forty days, which Hipgnosis Songs Capital has the option to match. The “”Go-Shop”” mechanism, according to the board and their advisors, serves as evidence of fair value. If no new offers are made, it indicates that the offered price is a fair estimation of the assets’ worth.

Outcome: After careful consideration, we have concluded that there are several conflicts of interest involved with the proposed sale arrangements. As such, we are not convinced by the rationale behind the preferential terms offered during the negotiations. We do not think the “”Go Shop”” provision is sufficient to ensure a competitive bidding process. Therefore, we voted against the transaction. Furthermore, our view is that the board has displayed a lack of independence in numerous instances, and therefore we have decided to vote against all directors standing for re-election. Finally, given our lack of confidence in the investment advisor and the current relationship with the trust and board, we will also be voting against continuation. We advised the board informing them of our voting intentions.

International Public Partnerships – Governance

Objective: The focus was on the board’s oversight of responsible investment and governance in particular the non-independent director’s position on the board. This was part of the overall investment trust thematic engagement.

The board has an ESG committee, which is usually convened before the board meetings. This is to ensure that any issues identified can be raised at the board meeting. The trust publishes a sustainability report every two years, which the board reviews before publishing.

The board is responsible for approving new investments and is involved in the early stages of new acquisitions. The board is presented with a shortlist of potential investments and provides rigorous oversight of the manager’s ESG due diligence process. The board has the power to turn down investments. For example, the Senior Independent Director (SID), mentioned a case where the board declined to invest in an infrastructure project because it was concerned about the government in the region. The board also mention safety as a key concern, and it is an item in every board meeting.

The board comprises of seven directors, four of whom are based in the Channel Islands. Although the board meeting meets gender diversity requirements, it lacks a director from an ethnic minority background, as required by the Parker Review. The board is aware of the lack of ethnic diversity, and it is working towards improving this in the future.

The board includes a non-independent director representing Amber Infrastructure, the investment adviser. The non-independent director, Giles Frost, is the chair of Amber Infrastructure and has been a member of INPP’s board for the past 16 years, making him the longest-serving member.

The board argued that having Giles Frost on the board provides corporate memory and that there are mechanisms in place to manage conflicts of interests. For example, when making investment decisions the board meets separately, additionally the non-independent director only sits on the ESG sub-committee.

Recently, the board underwent an external evaluation conducted by Fletcher Jones. The evaluation was interview-based, and a representative from Fletcher Jones interviewed each director individually and attended one of the board meetings. One of the key takeaways from the evaluation was the need for the board to have more time to meet independently of the manager, and to spend more time with the trust’s broker, Numis.

Outcome: We are primarily concerned about the manager representative on the board. We have shared our concerns with the board. Furthermore, the board is not currently meeting the diversity requirements outlined in the Parker Review recommendations, although it is actively working towards improving this in the future.

JLEN Environmental Assets Group – Governance

Objective: This engagement was part of the overall investment trust thematic engagement and the first-time meeting the newly appointed chair of the board.

JLEN is an investment trust that invests in environmental infrastructure assets The current investments are located across the United Kingdom, Norway, Germany, and Italy, and includes a range of sustainable solutions spanning wind turbines, waste & bioenergy, anaerobic digestion, solar, and hydro assets.

The board has six members and meets the FCA diversity requirements. The board has gone through a refreshment process, which has resulted in an extremely low average tenure. The most tenured director has served for just four years.

The board has recently created an ESG committee to oversee responsible investment matters within the trust. The ESG committee has agreed on several sustainability KPIs for the manager, which it reviews during the quarterly meetings. The board is considering creating targets in the future as the KPIs are used solely for monitoring purposes currently.

The board has retained Board Alpha for an external evaluation, which currently in progress. Part of the evaluation is to understand the board's skills and future succession planning. We would welcome any details on the outcome of this evaluation, including a board skills matrix. The chair is reconsidering whether the board requires six members for a
trust this size.

The trust is currently trading at a discount. We ask the board to disclose further information on its decision on capital allocation, including a breakdown of the benefits of new investments, paying down debt, or undertaking buybacks. The chair explained that buybacks would reduce the trust's size and reduce liquidity. The chair is open for acquisitions if an opportunity arises. Reducing the discount by ensuring disposals are above the NAV level is preferable, as these strengthen the credibility of the valuations. The chair did not mention specific details, but that is something that he is considering.

Outcome: Overall the trust broadly meets our expectations regarding the focus of this engagement however improvements focused on additional disclosure regarding board experience and the process behind capital allocation decisions would be welcomed.

Octopus Renewables Infrastructure Trust – Governance

Objective: To discuss the board's oversight of responsible investment as well as the broader governance topics. This engagement was part of the wider investment trust thematic engagement.

The board meets once a quarter, during which the manager provides updates on future investment activities. Additionally, the chair has a call with the manager every Friday. The board is responsible for the determination of the company's investment policy and strategy, the board is also responsible for the final investment decisions.

The chair describes the relationship with the manager as collegial but stringent. The board has been very hands-on through the initial period since listing, meeting up to 20 times a year. The board is currently attempting to grant the manager a broader operational authority to reduce the need for the board to approve routine items.

The trust has chosen to be classified as Article 9 under SFDR (Sustainable Finance Disclosure Regulation) and self-certifies as being 100% aligned to the EU Taxonomy. Its core impact objective is to accelerate the transition to net zero through its investments. The fund invests in onshore wind farms, solar parks, and battery storage facilities. During board meetings, the board receives an assessment of the trust's ESG (Environmental, Social and Governance) issues and the aspects that could be improved. The chair mentioned a couple of issues that have been investigated during the meeting, such as supply chain management, particularly when it relates to workers' well-being. The board has also discussed issues like peat and how laying the foundation for some of the sites can affect this and other innovations such as having beehives among the solar panels to promote biodiversity. The chair has a call with the fund manager every Friday.

Capital allocation is top on the board's agenda. The board has engaged previously with the broker to examine the pros and cons of buybacks. Additionally, the manager plans to sell some assets but is waiting for competition clearance. The plan is to reinvest the capital and assets from the sale. We suggested more disclosure around capital allocation decisions, especially when it comes to deciding whether to make new investments, pay down debt, or buy back shares.

Outcome: The trust has successfully established a well-balanced board in terms of both composition and skills. However, while there is no immediate concern, the board should start considering succession planning to prevent potential issues, as most directors joined around the time of listing. We recommend that the board provides more comprehensive explanations for the capital allocation decisions, especially about buybacks versus other activities.

Pantheon Infrastructure – Governance

Objective: The aim of this engagement was to understand the trust's oversight of responsible investment, discount and capital allocation and gender parity. This engagement was part of the investment trust thematic engagement and the first-time meeting Pantheon Infrastructure's (PINT) board.

The board has a committee dedicated to environmental, social, and governance (ESG) matters and convene twice a year. The ESG committee chair conducts monthly meetings with Pantheon, the investment advisor. Pantheon's Head of ESG is also a committee member, although she is not a board member. The board does not approve the investments since Pantheon holds a discretionary mandate. A discretionary mandate refers to when an asset owner, in this case the board on behalf of investors delegates the investment decisions to the manager. However, the board ensures that the manager adheres to the investment mandate by reviewing the potential investment pipeline and examining the sector distribution.

The board comprises four non-executive directors (NEDs) and has achieved gender parity. However, it does not meet the Parker Review's target of appointing at least one director from an ethnic minority background. Due to the small size of the board and the current macroeconomic situation, the board is not actively searching for another director. Nevertheless, the board will consider diversity during its natural evolution and succession planning.

All directors have varying infrastructure experience. We would welcome additional information regarding their skill matrix and evaluation process.

Outcome: The trust has successfully established a well-balanced board in terms of both composition and skills. However, while there is no immediate concern, the board should start considering succession planning to prevent potential issues, as most directors joined around the time of listing. We recommend that the board provides more comprehensive explanations for the capital allocation decisions, especially about buybacks versus other activities.

Sequoia Economic Infrastructure – Governance

Objective: To discuss the board's oversight of responsible investment as well as the broader governance of the trust including board composition. This engagement was part of the wider investment trust thematic engagement.

The trust has classified itself as an Article 8 fund under the EU's Sustainable Finance Disclosure Regulation (SFDR). The trust has several exclusions, which include sectors such as coal, military infrastructure, alcohol, and gambling. The trust also has positive screens for renewable energy, financing the transition and infrastructure with social benefits.

The board is ultimately responsible for making investment decisions. The board has established specific investment parameters for the investment adviser. If new investments fall within those predefined parameters, the investment adviser can proceed without extensive board oversight. However, for the c.20% of investments that are outside of these parameters, the investment adviser must seek prior approval from the board. Such investments may fall outside of the parameters due to risks associated with credit or ESG factors.

The trust uses proprietary ESG ratings to measure the sustainability performance of the investments over time. The board has not yet set specific targets for the manager. However, the ESG score of the fund is expected to increase gradually.

As the trust does not invest in equities, it does not hold any voting rights. Therefore, it uses covenants in loans to influence the sustainability strategy of the borrowers. Loan covenants are agreements between the lender, who is the manager, and the borrower, which stipulate the activities that the borrower is permitted to undertake. These covenants can require the borrower to report ESG metrics such as carbon emissions, energy, water emissions, hazardous waste ratio, and diversity.

The board consists of five members with an additional member joining soon pending regulatory approvals. This new hire is part of the succession plan as the chair and the Senior Independent Director (SID) are due to retire next year. The board also has two independent advisors who attend every board meeting. These advisors have no relation to the investment advisor. The chair specifically mentioned Andrea Finegan, one of the advisors who previously served as COO at Greencoat, Climate Change Capital, and ING Infrastructures. She attends the ESG committee meetings but is not a member and does not have voting rights. Kate Thurman, the second advisor specialises in credit risk.

Outcome: The ESG committee provides robust oversight of the responsible investment activities within the trust's investments and benefits from an independent advisor with expertise in responsible investment who joins the ESG committee meetings. The current chair has announced his retirement in the upcoming year, and the SID is also reaching a nine-year tenure next year. We will closely monitor any changes in board composition.

VH Global Sustainable Energy Opportunities – Governance

Objective: This was part of the overall investment trust thematic engagement. The focus was on the board's oversight of responsible investment, board composition and the trust's discount strategy. This was the first time speaking to the board of VH Global Sustainable Energy Opportunities (GSEO).

The investment advisor invests in energy infrastructure investments that align with the United Nations' Sustainable Development Goals (SDGs). The trust classifies investments into four themes: addressing climate change, energy access, energy efficiency, and market liberalisation. The trust currently has solar fields, hydropower, and battery storage assets across Brazil, the US, the UK, and Australia.

The board meets formally six times a year. During these meetings, the investment advisor's head of ESG joins to update the board regarding responsible investment. Louise Kingman, a non-executive director (NED), leads the engagement on ESG-related issues, including diversity, and has frequent engagements with the manager's head of ESG. The board is in regular contact with the manager given the nature of the strategy as an example the chair has calls with the fund manager twice a week to discuss updates and the audit committee chair holds calls twice a week with the manager's Chief Financial Officer (CFO).

The chair was involved with the trust launch and proposed that the investment advisor use the SDGs framework. The board reviews the investment adviser's new investment pipeline to ensure that it fits within the mandate, but the board does not make investment decisions.

We suggested the addition of a skills board matrix to the trust's disclosures would be helpful for investors to understand the rationale behind future changes in board composition.

According to the Association of Investment Companies' (AIC) Corporate Governance Code, the board is required to nominate a Senior Independent Director (SID). However, currently, the board has not done so. In the chair's view the current board structure does not warrant one, however he would not rule it out in the future.

Outcome: The board has achieved a good balance of diversity and skills. We recommend the inclusion of a board skill matrix within the trust's disclosures The board does not have a nominated SID, which we consider a deviation from best practice. We have written to the board outlining our position on the issue. Shortly after our engagement, the firm appointed an existing NED to the role of SID.

Fund engagement

We invest in funds managed by other investment firms. Below are some of the third-party fund engagements we have carried out over the last year. We have anonymised this given the nature of the discussions. We track the developments and outcomes over time. The engagements are split into four areas:

1. The firmwide approach to responsible investment
2. Manager and strategy approach to responsible investment
3. Engagement on ESG risk and exposure
4. The firmwide approach to net zero

Over this quarter our focus has been on third party managers' approach to net zero.

Objective: In September 2023, we began engaging with third-party managers who were signatories of the Net Zero Asset Management Initiative (NZAM). During this engagement we will engage with 20 of the third-party managers with NZAM targets where we have our largest third-party fund holdings. During the first quarter of 2024, we will publish a report that outlines the conclusions drawn from this engagement program. These engagements aim to better understand how different managers are approaching their Net Zero targets, including their chosen methodologies and the process behind selecting the size of committed NZAM aligned assets.

Within these engagements we use the following acronyms:

AuM – Assets under Management

NZAM - **Net Zero Asset Managers initiative**

NZIF - **Net Zero Investment Framework**

SBTi - **Science Based Target initiative**

SBT – Science Based Targets

Third party manager – multi-asset - The firmwide approach to net zero

The firm is focusing on setting a narrow scope for its first targets, while cultivating support and embedding responsibility for targets with fund managers. The scope of its first targets was driven by control of assets, so consist exclusively of its parent company's assets. It has chosen to use carbon intensity to measure net zero alignment despite its awareness of the 'shortcut' limitations of this method, to encourage more managers to take an active role in the firm's net zero targets. The firm's immediate priority is to increase firm-wide support and upskill its fund managers in understanding climate metrics and gauging companies' climate performance. Fund manager involvement is critical its climate strategy

because the firm is measuring net zero alignment at fund-level, rather than asset class-level, expressly to convey ownership of net zero targets to fund managers.

The firm is working to increase the ambition and scope of its net zero committed assets by shifting its focus to forward-looking metrics, expanding included asset classes, and educating clients on climate risk. It has already set more ambitious internal targets, equating to 20% total AuM being aligned to net zero by 2030, and is actively moving some of its funds to a novel climate KPI-based alignment approach. Engagement does not appear to be the leading consideration regarding its NZAM targets. It currently lacks a dedicated climate engagement framework; however, it maintains a 'focus list' of c.150 companies identified as potential 'high impact' engagement targets, which would include climate among other topics for engagement (e.g., ESG factors, sector-relative underperformance). The firm is looking to improve its capacity for engagements by training its fund managers and setting engagement targets.

Outcome: Although the methodology chosen by the firm for its NZAM targets is not the most stringent, its measured approach entrusting fund managers with the responsibility for targets is markedly different from many of its peers. It remains to be seen whether the firm's fund managers will be sufficiently driven to progress the firm's climate targets; expanding the firm's net zero-committed AuM in the future may be challenging where fund managers remain disinterested. Similarly, given the engagement-centred approach promoted by NZAM, we would expect it to have a more explicit connection between its NZAM targets and its assets. The firm's exploration of increasingly ambitious and forward-looking climate targets is, however, encouraging. The fact it has already set higher-ambition internal net zero alignment targets since setting its first NZAM targets demonstrates greater progress in forward planning than has been evidenced by other firms. However, the issues the firm has with the format of NZAM commitments appears to be a superficial quibble; if the firm were to use this to delay a public, verified expansion of future targets, it would come across as mere pretext to deferring its climate strategy.

Third party manager – UK equity - The firmwide approach to net zero

Building support across the firm and thoroughly evaluating available methods for net zero alignment were critical pre-requisites to setting NZAM targets. The firm conducted extensive engagement with its investment teams to assuage any concerns fund managers may have around the firm making a net zero commitment, as it was important to its stewardship team that fund managers understand and ultimately support its targets. The firm chose to use an adapted 'house' version of NZIF (Net Zero Investment Framework) alignment for its NZAM targets because of its engagement-driven and adaptable structure. It is taking reasonable steps to assure the robustness of its adapted-NZIF methodology, which is currently undergoing stress-testing by an external third-party.

Engagements are broadly owned and led by the firm's investment teams, including the firm's high emitters engagement. The stewardship team brings additional support and insight to these engagements, providing training to fund managers and undertaking analysis on more complex elements of company's climate credentials (e.g. transition plans). The firm is structuring its climate engagement framework around its top emitters: 15 companies make up c.75% of the firm's financed emissions. It is working through this list to focus its resources where best deployed for maximum impact and is having 'baseline' engagements to develop bespoke milestones for each company.

Outcome: Although the targets and methodology the firm has taken are not overly innovative, it distinguishes itself from competitors with clear, articulated strategy and evidenced support for its net zero ambitions from fund managers. This fund-level integration has been notably lacking from many larger, better-resourced peers. It is possible that the firm's smaller size makes embedding climate into its investment processes more straight-forward; nonetheless, it has obtained firm-wide buy-in and support for its climate targets where other firms have been unable to evidence beyond corporate-level commitments. The firm's engagement approach seems thorough, suitably ambitious, and ownership is well-balanced between fund managers and its central stewardship team. It is taking the optional additional steps which reflect thorough evaluation of and commitment to its net zero ambitions, including involvement with industry initiatives to increase net zero alignment asset class coverage. It appears to be taking a longer, more considered view of its climate commitments; it delayed joining NZAM explicitly to ensure that any commitments made were appropriate to the firm and has similarly been deliberate in related initiatives (e.g., the firm's upcoming coal policy included careful peer comparison of many industry-leading firms' policies).

Third party manager – global equities - The firmwide approach to net zero

The firm's process for setting net zero targets is thoroughly bottom-up, requiring explicit approval from both fund managers and the firm's clients before any of its funds are committed to alignment targets. The firm measures fund alignment based on the sum of all companies' net zero alignment in a fund, meaning each fund within the firm is either entirely included or entirely excluded from its NZAM commitment. Its process for scoping funds for inclusion evaluated three factors – fund philosophy alignment to net zero, fund manager agreement, and client permission. Overall, the firm has 25% AuM committed to net zero alignment.

The firm designed its own proprietary methodology, the Climate Audit, which comprises of two parts: an emissions assessment and a business strategy evaluation. The emissions assessment evaluates a company's disclosures, targets, and implementation of its decarbonisation plan, resulting in a score along a seven-point scale and a resulting category (Lagging, Preparing, or Leading). The business strategic component focuses on how the company is positioned relative to peers in preparing for the economic transition, organising companies into one of four categories (Materially Challenged, Potential Evolver, Potential Influencer, Solutions Innovator). The resulting assessment maps companies across these two components to highlight the companies to target for engagement.

The firm has made its NZAM targets an essential part of each aligned fund's philosophy, which requires its IMs to be thoroughly engaged with the targets. The fundamental view of the firm is that if climate is a material issue, IMs and analysts need to take responsibility for evaluating how well companies are managing these risks. As the firm has effectively devolved responsibility for its NZAM targets to its IMs, there is no central climate engagement framework. However, the firm has set clear expectations for its companies at different climate 'levels,' with more basic requirements graduating to the more challenging for companies at the higher end of the scale (e.g. estimates of avoided emissions).

Outcome: The firm has demonstrated a particularly thorough 'bottom-up' approach to its NZAM targets and in doing so distinguishes itself from peers on two counts: the high degree of IM involvement / fund alignment to NZAM targets, and explicitly seeking client permission for incorporating net zero targets into each fund. This devolved responsibility approach has meant the firm's initial proportion of AuM committed is not as sizeable as other firms,' but it places the ownership of its net zero targets firmly with IMs (with the support of the climate stewardship team). This embeds a level of accountability and future proofing that is missing from many other firms' targets. The firm's communication with its clients about its net zero targets also deserves particular attention, as this direct approach protects both clients and the firm from future recrimination over these targets. It unambiguously addresses the amorphous spectre of client approval of a firm's climate strategy. The process the firm has designed (with external input) is thorough, comprehensive, and nuanced, adopting the simplified NZIF structure while providing truly clear accompanying KPIs. Overall, it has set a strong standard for net zero target integration at product-level. Whether the firm is able to grow these targets in future remains to be seen.

Third party manager – index funds - The firmwide approach to net zero

The engagement began with the firm expressing scepticism about the reliability and limitations of current climate data. It also emphasised that most of its assets are invested in index funds, limiting its influence over the assets. The remaining 10% is invested in active strategies.

The firm's initial NZAM commitment includes 77% of its AuM. The firm's commitment included its equity, fixed income, and sovereign assets, which were included as it considers there to be more climate data available for these. The 23% of AuM excluded represents assets like cash and private equity.

The firm's first target aims for 75% of its committed assets to be covered by SBTi or equivalent targets by 2030 (its baseline for this was 25%, as of 2021). The firm considers issuers aligned if they follow another "equivalent" science-based framework, particularly for sectors for which methods are not available from SBTi. The firm opted for using decarbonisation targets to measure net zero alignment because it considered this approach the most applicable to its business model, as control over index-linked AuM is limited. It also favoured the engagement-led approach of SBTi, which suits the firm's strengths, having one of the largest engagement teams in asset management.

We asked about the climate engagement strategy. The stewardship team has a Climate Focus Universe list composed of the largest polluters in its investment universe, encompassing more than 1,000 carbon-intensive public companies that represent 90% of the firm's financed emissions in public equity holdings. Fund managers might participate on those engagements, but the engagement is directed by the stewardship team.

Interestingly, the only climate metric it routinely tracks is carbon intensity (Weighted Average Carbon Intensity) as it believes this to be the most relevant metric. It does not track science-based target (SBT) alignment across or within its funds, despite this being the metric it has selected for its NZAM target. This suggests a separation between the firm's NZAM target and its fund managers, as fund managers will not have visibility of the metric the firm is meant to be actively tracking its net zero alignment with. When directly asked how involved fund managers were in climate-specific engagements, the firm was non-committal, stating that its stewardship team tries to invite relevant fund managers to significant climate engagements, but that ultimately stewardship team members cultivate their own relationships with companies.

The firm acknowledged that further clarity is needed for the disclosure of its NZAM approach, this extends to the way in which it completes Requests for Information from other investors such as Quilter Cheviot.

Outcome: The firm has set ambitious targets for 2030 which are particularly challenging as most of its assets under management are invested in index funds. Unlike other managers, this firm's NZAM commitment is driven by assets instead of fund or strategies. The firm is using SBTs as an alignment metric, which is a simple and clear system for equities, but it can be more challenging for government bonds. It acknowledges that it needs to provide further clarity on how it communicates its NZAM ambitions.

Third party manager – fixed income - The firmwide approach to net zero

The firm has set ambitious net zero targets, committing over 80% of its AuM across various asset classes, including equity, fixed income, real estate, and infrastructure. It is using a proprietary methodology to align investments with temperature goals. Notably, the firm's targets include Scope 3 emissions across all these asset classes, which is a marked departure from its peers' targets. The firm developed its own proprietary temperature-alignment methodology to evaluate net zero alignment of assets, which was reviewed and validated by multiple third parties. The firm is progressing its equity, fixed income, and real estate holdings towards the 2025 and 2030 interim targets, although it has found its infrastructure target is more challenging.

The firm's climate engagement approach is clearly structured and comprehensive, including formal company-specific climate objective plans, and defined climate-specific objectives for each sector. It is unique among its peer asset managers in that it has a dedicated stewardship and engagement service which undertakes engagement activity on behalf of other managers' assets. Responsibility for in-house engagements appears to be shared between the stewardship service team and investment teams in a constructive way, with engagement activities firmly integrated into investment teams' operations.

Outcome: The firm presented a cohesive, reasonably ambitious, and comprehensive set of NZAM targets, with the resource in place to implement. The firm has undertaken several measures going beyond the bare minimum including having its bespoke methodology validated by multiple third parties, including Scope 3 emissions in its targets, and committing a sizeable portion of its AuM. Its climate-linked engagements appear to be more advanced than peers, evaluating companies' climate alignment at fund-level where many other firms' engagements are only now seeking climate data disclosure. It has also chosen a more challenging methodology for its net zero target: temperature alignment, which appears to be a common approach for firms with more progressive climate strategies. The firm has clearly integrated its climate targets into the day-to-day operation of its products to a degree not seen in peer managers. The fund manager demonstrated familiarity with the net zero targets which apply to the fund, and highlighted the processes in place which ensure the fund is aligned with these targets in both short- and long-term. Given how transparent the firm was in both its progress and challenges, it appears to be genuinely ahead of its peers in achieving robust climate targets.

Third party manager – global equities - The firmwide approach to net zero

The firm has a largely undefined, flexible approach to its NZAM targets at this stage. The firm is using its own net zero alignment methods (rather than industry standard) and is offering the choice of multiple metrics fund managers can use to measure alignment at a fund level. These are accommodating measures in keeping with the firm's deliberately cautious approach to its net zero commitment. The firm is trying to influence or 'nudge' its fund managers towards adopting climate targets, rather than imposing requirements as part of a firm-wide commitment.

Although it considers this flexibility key to its strategy, its current cautious approach does not lend well to planning. It does not have plans in place on how it will increase the proportion of its investments committed under NZAM in the future, nor clarity on how it will achieve net zero alignment of those funds it has already committed. The firm is planning to hold discussions with its fund managers to identify their preferred metric for measuring net zero alignment before 2025, which can be selected from a 'menu' the firm considers appropriate (to include temperature alignment, SBTi, and unspecified others).

The firm has initiated a targeted climate engagement focusing on the companies comprising 70% of the firm's top emitters. It emphasised that its approach to these engagements is to avoid being prescriptive when communicating its climate expectations, with the aim that its 'asks' will be better received when they are sector-relevant and tailored to the challenges faced by different industries. This engagement is very much in the beginning stages but is indicative that the firm is beginning to issue clear expectations to heavy emitters.

Outcome: Overall, the firm's stance on its NZAM targets can be aptly summarised as 'commit now, plan later.' It was a founding member of NZAM, disclosing its targets in late 2021. However, its targets do not appear to have been integrated into its overall strategy since then, at either firm- or fund-level. The targets themselves are not entirely substantive either – although the firm-level target is in line with peers, it is unclear whether it is implementing a cohesive strategy to achieve this. Given the number of undefined details in both the targets and the methodologies, it is difficult to gauge how much thought has been invested in the firm's net zero strategy, let alone determine whether progress has been made. That said, the firm's preliminary climate engagements indicate it is undertaking some work towards defining these targets by 2025. The firm's approach will require close monitoring in the lead-up to 2025, particularly with fund managers' selection of climate metrics to measure progress against firm targets.

Third party manager – Passive funds -The firmwide approach to net zero

The firm has a NZAM target of 58% reduction in emissions intensity of its investment holdings (tCO2e/m$ invested) by 2030 with a baseline year of 2019. It has committed 38% of AuM and has an additional target of engaging with companies that have revenues of more than 10% from Thermal coal.

Sustainability-focused strategies measure carbon and other environmental factors and consider ESG factors in all investment decisions. It follows an ""engage versus divest"" policy and uses third-party sources to obtain emission data. It has built investment teams to assess company transition plans and defines sector guidelines and focuses on the largest emitters and aims to launch more green products. The firm is building a system to set the NZIF category for each product and considering the double-counting of emissions when evaluating national emissions.

The firm is actively engaging in discussions regarding climate as part of its ongoing stewardship approach. However, the NZAM engagement strategy has not been well-defined yet. Regarding collaborative engagements, the firm is part of Climate Action 100+. The firm has a team of seven focused on engagement and lead the firm's top engagement priorities, including discussions focused on net zero. The stewardship team manages the large emitters engagement and leads the baselining exercise. Engagement is preferred over divestment.

Outcome: We held two meetings with this firm, focusing on the NZAM targets. However, the firm struggled to explain how its strategy was integrated throughout the firm. Although it appears that it has some elements of climate engagement and analysis, the extent of this is not very clear. Additionally, the NZAM plan seems to be in the initial stages, which leads us to believe that it made commitments before having a clear view of how the execution will roll out. Overall, compared to the other meetings in the engagement, this firm was not capable of articulating its NZAM plan.

Third party manager – fixed income - The firmwide approach to net zero

Objective: Evaluate the evolution of firm's Net Zero Asset Management initiative NZAM strategy, including the approach for interim targets and the engagement strategy.

Overall, the firm's attitude towards its net zero targets could be described as cautious but engaged. It is evident that considerable thought has gone into understanding and appraising the challenges inherent to a net zero target, and the firm is tracking developments in topics around climate commitments (e.g., net zero alignment of indexes, climate metric data refinement). Climate engagement at the firm is currently limited by the organisational structure, in which fund managers' views drive engagement. The firm does appear to be making positive changes, notably by formalising its engagement approach and enhancing its resources.

The pace of client adoption of climate preferences is the most important factor influencing the achievability of the firm's net zero targets. Returning to the firm's client-driven business model, if clients do not wish to incorporate climate into their investments, the firm considers it inappropriate and unjustifiable to impose any measures relating to climate to these managed assets. Other risks highlighted by the firm included the inconsistent global climate policy context, and the ongoing politicisation of ESG.

Outcome: The firm's approach to its net zero targets appears to be pragmatic, if slightly hedged by its client-driven philosophy and conservative view of fiduciary duty. The firm clearly considers climate to be a relevant investment risk, and its ESG team demonstrated a thorough understanding of relevant factors to climate target setting (e.g., inconsistent data quality, limitations in asset class net zero alignment). However, its net zero commitment is heavily caveated by two primary limitations in its view: 1) critical need for government intervention to drive market realignment, and 2) client demand for climate integration in investment products. Overall, its net zero targets accurately reflect the firm's measured, prudent approach to incorporating climate into its investment processes. Arguably the targets lack ambition, however the firm provided thorough reasoning to support its strategy – with the notable exception of its engagement practices.

Third party manager – global equities - The firmwide approach to net zero

The firm decided to join NZAM after conducting due diligence on the implications and process; the firm believes climate risk is a material financial risk; thus, integrating climate risk and assessing net zero strategies of businesses is critical to managing returns.

The official stance of the corporation seems hesitant and non-committal. In a recent declaration regarding NZAM the firm made it clear that "net zero commitments" will not affect current investment strategies or limit clients' investment options. It also stated that it may continue to invest in companies with high carbon footprints if it aligns with its duty to its clients. It has absolved itself of any significant responsibility by saying that its net zero target is dependent on government policies, technological advances, and changes in corporate practices. In short, it will encourage the adoption of SBTs, but that is the extent of involvement.

The firm explained that climate risk has become a significant financial concern. Therefore, it needs to work more closely with its legal team to ensure consistent disclosures, whilst also managing the potentially conflicting demands of different clients. It explained that to achieve the NZAM target, it will use a central engagement framework, but it will not impose it on fund managers. It highlighted that this framework is one of the strategies that the firm can use, but it will not be forced on any investment strategies.

To select targets for engagement, the focus is on high-emitting companies that do not have SBTs. In the first year of the engagement framework pilot, the priority list consists of 80 such companies. The escalation period varies from 18 months to three years, depending on the nature of the engagement. A 0-4 score system is used to evaluate the progress, where 0 means unsuccessful, recommend divestment; 1 means the firm has raised an issue with the company; 2 means the company has acknowledged the issue; 3 means the company has started to set policies in line with the request, and 4 means the company has completed the request. The quality of the transition plans is a factor that feeds into this framework.

The firm is facing challenges from clients around its commitment to NZAM. It has defended its climate strategy by presenting evidence from industry analysts to cite 'on the ground' examples of climate risk impacting company value, demonstrating the importance of incorporating climate risk into its investment decisions.

Outcome: The firm's approach to NZAM seems to be one of caution, due to the influence of the US, which has an impact on its ambition of achieving set targets. The preferred alignment metric is SBTi or equivalent. However, there are indications that the firm is exploring the possibility of increasing its level of commitment to other assets.

Third party manager – fixed income - The firmwide approach to net zero

The firm's relatively new Head of Climate Investment indicated the firm is revisiting the details of its NZAM target and climate strategy and is likely to make significant structural changes to its approach in the next half year. The firm set out a clear approach for assessing net zero alignment of its holdings, requiring three elements: a net zero commitment, long-term and short-term decarbonisation targets, and a sector-relevant transition plan. Like other firms, the third-party fund manager is building expertise and developing in-house tools to interrogate companies' transition plans and integrate these assessments directly into the valuation and ranking of a company.

The firm has a clearly structured NZIF-aligned climate engagement framework based on an internal engagement target (70% financed emissions engaged, called the 'Hot 100'). The firm also engages on its coal policy, which requires its thermal coal holdings to have transition plans in place and commit to phasing out thermal coal in both OECD (by 2030) and non-OECD (by 2040) markets. Its coal engagement has already resulted in the firm instructing its fund managers to divest from coal holdings which failed the requirements of its thermal coal policy.

Stewardship is relatively well integrated into fund investment teams, with regular 'engagement review' meetings held between the stewardship team and each investment team where fund climate metrics are discussed, and engagement priorities identified. Fund managers have climate metrics available to them at fund level, including company climate targets and decarbonisation scenarios, as well as a dedicated fund alignment tool to measure transition alignment at company and fund level.

The firm expressed similar concerns to peers in achieving its climate targets – data quality and availability, shifting political momentum – while emphasising the growing importance of asset managers progressing beyond bilateral, company-level engagement into direct engagement with policymakers.

Outcome: The firm articulated its climate strategy well, given how much it suggested it will be changing in the near future. The firm suggested it is implementing a more coordinated and thorough approach to climate, including potential SBTi-validated firm targets, bespoke engagement roadmaps for its top emitting companies, upgraded climate-linked voting and thermal coal policies, and revised net zero alignment targets using recognised frameworks. If it indeed achieves these ambitions over the next year, it will certainly place itself among the better climate-prepared asset managers. At the moment, the firm is solidly in the 'middle of the pack' with its current targets and policies. That said, it is encouraging to see the firm implement its thermal coal policy through to divestment where applicable, and it evidenced a reasonably integrated stewardship strategy with its funds. We would expect to see an engagement-linked target in the firm's revised NZAM targets, as it remains unclear why this was excluded from its existing submission. The firm will need to overcome the key limitation faced by similar insurance-linked asset managers on revision of NZAM targets, of finding a way it can comfortably expand its net zero-committed AuM beyond its parent's assets.

Third party manager – fixed Income - The firmwide approach to net zero

The decision to join NZAM was made by the parent company of the firm, which has been actively involved in the Paris Aligned Investment Initiative (PAII). It decided to join NZAM to convey its intention to work towards achieving net zero. However, no comprehensive analysis was conducted before making these commitments. The firm has committed 71% of its Assets Under Management (AuM), including the assets managed by the parent company and direct mandates.

The firm has set a target of reducing its emissions intensity by 50% by the year 2030 (baseline year 2020). The firm decided to use emissions intensity as a measure because the firm considered it customary practice at the time it published targets. They adopted the methodology of Partnership for Carbon Accounting Financials (PCAF), which had just been published that time. Although the target is based on intensity for tracking purposes, the firm takes into account both intensity and absolute scope 1 and 2 emissions, and for engagements, it considers scope 3 as well.

There is a desire to increase the assets under management (AuM) included in the targets, but challenges include asset-class relevant methodology, fluid risk appetites, and complicating factors such as the Just Transition concept. The firm has included all asset classes deemed feasible – including sovereign fixed income, an asset class many peers have excluded. Multi-asset funds are being evaluated for net zero alignment, but it is still challenging to align tricky asset classes like derivatives. The limitation with passive funds is more to do with a reduced risk appetite for potential losses – the firm experienced this in 2022, when the surge in demand for energy and the subsequent impact on the share price of related companies adversely impacted funds which had newly introduced net zero-linked benchmarks (e.g., Paris Aligned Benchmark [PAB]). The firm also emphasised its consideration of social justice implications of its net zero-aligned asset allocation, to ensure that funding is not being kept from countries that require it for transitioning.

The firm's primary climate engagement plan is the Net Zero Stewardship Programme, which the firm reports on biannually. This engagement specifically targets 50% of the firm's financed emissions. The scope of this engagement is defined primarily by emissions profiles of companies – the firm tracks total emissions annually, adding new companies while retaining those with whom the firm is in ongoing discussions with. The objective of this engagement is to evaluate and/or influence issuers representing 70% (currently at 50%) of their financed emissions by pushing them to adopt emissions reduction targets linked to science-based sector-specific alignment methodologies. These methodologies include measures like setting science-based targets (SBTs), using SBTi (Science-Based Targets Initiative) or similar frameworks, and publishing industry-appropriate climate transition plans.

The firm employs various methods to escalate issues, using both 'carrot and stick.' These techniques can vary, including voting for shareholder resolutions, abstaining, or even voting against the chair. The aim is to strategically use the vote to achieve the desired outcome. The ESG team leads engagements, while fund managers and analysts are also involved to some extent, but not to the same degree.

Outcome: The firm has set a top-down emissions reduction target without first understanding the logistics at the strategy level. The firm compared this to a country setting its defined national contributions budgets before having a plan for emissions reduction. As a result, the firm is still evaluating how this target will affect the overall strategy. It seems like there is a long way to go before the target is integrated into the underlying investment strategies – similar to its peers with insurance parent companies. So far, the strategy is mostly driven by the engagement approach, modelled on NZIF, it is remarkable in the simplified data analysis (focus only on emissions) and direct simple 'asks' for its holdings. Although nothing in its climate approach is especially novel, it is taking appropriate steps to integrate its NZAM targets into its investment process. It is certainly leading its peers when it comes to analysing the impact of its fixed income assets, as the firm has a dedicated fixed income ESG team actively developing its own climate engagement strategy.

Third party manager – Emerging markets - The firmwide approach to net zero

The manager considers its NZAM net zero ambitions a natural extension of the firm's broader investment thesis of responsible and environmentally sustainable businesses. The decision to join NZAM was driven by both customers' expectations and growing confidence in target setting methodologies and data. In its investment thesis, company selection is driven by proven positive impact, which the firm believes is a critical indicator of longer-term profitability; this means that it also excludes many heavy emitting companies, including oil and gas and industrials, due to risk exposure and its focus on long-term value. Setting NZAM targets within this context seemed a logical formality for the firm, which committed its entire holdings (100% AuM) in July 2023.

The firm's targets reflect the staged approach it views as most conducive to aligning its assets to net zero, with a near-term target to obtain emissions disclosure for 100% of its companies by 2025 and a mid-term target for 80% of its financed emissions to include a decarbonisation target. The first target focuses on enhancing disclosure as inaccurate disclosures directly affect the firm's ability to set informed and achievable targets. Its second target focuses on material alignment of companies using emissions reduction commitments (e.g., SBTi). It has purposefully kept target types open to persuade more companies to start working towards emissions reductions; the firm's view is that even if companies' first targets are relatively unambitious, these can be stepped-up in time.

The manager's climate engagements consist of two threads – one focuses on companies with no climate targets, in keeping with the firm's NZAM target, while the other encompasses tailored engagements on climate-linked challenges facing individual companies. Its NZAM-based engagements focus on the c.105 companies in their holdings which do not have targets in place. The firm explained its engagement style is to be patient and encouraging towards its companies, ultimately building constructive relationships which aim to enhance the companies' value in the longer term.

Outcome: The third-party fund manager's NZAM targets and strategy came across as straightforward and well-planned, if perhaps slightly unambitious (having already exceeded its disclosure target set only in July this year). The goals of NZAM clearly match the firm's investment style and thesis very well, and it appears to be well-positioned to achieve its targets. Although its alignment target for its financed emissions is open to various target types, it was reassuring to see the firm has outlined a clear hierarchy for these and is clearly communicating its expectation for higher 'grades' of targets over time. Overall, the firm's target is decent, particularly given it committed 100% of its assets and included its assets in emerging markets – an area that many peers have expressly excluded from its NZAM-committed AuM. Its NZAM-linked engagement could be a bit more robust (i.e., beyond letter-writing), but it is expected that this will ramp up as the firm's targets mature.

In the spotlight

Pulling the thread: Labour Standards in the apparel industry

Employing over 300 million people across its value chain, the scale and reach of the apparel industry presents a number of human rights risks. These risks include low wages, precarious working conditions, harassment, health & safety breaches, the inability to form unions and the absence of adequate grievance mechanisms. The potential of adverse events is often more acute in the supply chains of companies that utilise a 'fast fashion' sales model. This model relies on companies catering to ever-changing consumer tastes as quickly as possible.

In addition to labour concerns, the fast-fashion business model often follows the 'take-make-dispose' linear trajectory which can result in a cycle of unsustainable resource exploitation and extensive waste production. The lack of transparency throughout the complex supply chains for both materials and labour coupled with the price-driven culture can result in an increased risk of modern-day slavery. Another challenge faced by the apparel industry is the reliance on self-regulation and self-auditing which compounds the above risks further.

Greg Kearney
Senior Responsible
Investment Analyst

Kirsty Ward
Responsible
Investment Analyst

Click here for the full insight

In the spotlight

Water - Investment Opportunities

Water scarcity has long been thought of as an issue facing the developing world. Yet with the increasing impact of climate change coupled with a huge rise in the global population, water shortages are becoming a crisis near and far.

UK water demand is far outstripping supply, with the Environment Agency predicting that London and the Southeast could run out of water in 25 years. Water shortages bring an array of negative impacts and Thames Water estimate the cost of severe drought to London's economy to be £330m per day.

Caroline Langley
Investment Director

Tom Gilbey
Equity Research Analyst

Click here for the full insight

In the spotlight

A clean bill of health?: Product safety and litigation risk in the pharmaceutical and healthcare industries

Managing product safety is key for companies as it can impact financial prospects, as well as trust amongst consumers, suppliers, and investors. Product safety breaches are described by the US Consumer Product Safety Commission (CPSC)[2] as the unreasonable risk of injuries and deaths associated with consumer products. Healthcare and pharmaceuticals companies are especially vulnerable to product safety issues. Failure to undertake adequate testing for drugs and medical equipment can lead to recalls, which not only have an economic impact but also reputational ramifications. In the most extreme cases, the products can lead to the injury and death of customers – which may result in litigation.

Litigation can be hugely expensive. For perspective, the largest ever corporate fines in US history have been awarded against pharmaceutical companies. The litigation process may take years, and until the case is resolved there is a degree of uncertainty that in some instances may have implications for the company's valuation. Additionally, the reputational damage of these high-profile cases may become embedded in the customer's vision of the brand. Finally, there is the human cost when drugs or medical equipment fail the patient.

Greg Kearney
Senior Responsible Investment Analyst

Ramon Secades
Responsible Investment Analyst

Click here for the full insight

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RI reels

Insights into Quilter Cheviot's approach to responsible investment, as well as topical issues.

The next generation

Kirsty Ward, Responsible Investment Analyst
Adelaide Claydon, Intern at Quilter Cheviot

Adelaide discusses her placement year and learnings at Quilter Cheviot

Watch vlog

Thematic Engagement: Investment Trusts

Kirsty Ward, Responsible Investment Analyst
Ramón Secades, Responsible Investment Analyst

Kirsty and Ramón discuss our latest thematic engagement and our expectations for Investment Trust boards.

Watch vlog

Climate - responsible investment

Kirsty Ward, Responsible Investment Analyst
Margaret Schmitt, Responsible Investment Analyst

Margaret, who's recently joined the responsible investment team as a climate specialist talks about her role and her main focus.

Watch vlog

Source of images: iStock

Overview

Overview of our activity across our discretionary holdings at Quilter Cheviot:

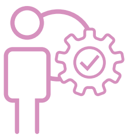
Activity	Universe
Voting	Discretionary holdings within the global equity monitored lists where we have voting rights including: MPS (Managed Portfolio Service) Building Blocks Climate Assets Balanced Fund and Climate Assets Growth Fund Quilter Cheviot Global Income and Growth Fund for Charities Quilter Investors Ethical Fund AIM Portfolio Service This includes our global equity and investment trust monitored lists; UK holdings where we own more than 0.2% or £2 million of the market cap. Additionally, clients are able to instruct voting on their behalf.
Engagement	Global equities within the monitored list Funds held on the centrally monitored list AIM Portfolio Service holdings UK holdings where we own more than 0.2% or £2 million of the market cap.
ESG integration	All holdings within the centrally monitored universe of equities, funds and fixed income.

We use the ISS proxy voting service in order to inform our decision making, however we do not automatically implement its recommendations. When we meet a company to discuss governance issues, the research analyst usually does so alongside the responsible investment team as we are committed to ensuring that responsible investment is integrated within our investment process rather than apart from it. As Quilter, we are a signatory to the Stewardship Code. In order to maintain our signatory status, we submit a Stewardship Code report to the Financial Reporting Council (FRC) every April. We have successfully maintained our signatory status in 2023.

Where clients wish to vote their holdings in a specific way, we will do so on a reasonable endeavours basis; this applies whether the investment is in the core universe or not, and also to overseas holdings. We have ensured that two clients were able to instruct their votes over the last quarter.

For information regarding our approach to responsible investment, including our response to the UK Stewardship Code and our voting principles, as well as more granular detail on how we voted at each meeting please visit our website **Responsible Investment | Quilter Cheviot.**

Responsible Investment at Quilter Cheviot



Active ownership and ESG integration – for discretionary clients
We vote and engage with companies and fund managers on environmental, social and governance (ESG) matters. Integrating ESG considerations into our investment process can have direct and indirect positive outcomes on the investments we make on behalf of our clients.

We take a more targeted approach for clients that want their portfolios to reflect their specific interests or preferences.

A Direct Equity Approach* - DPS Focused

The strategies harness Quilter Cheviot's research and responsible investment process, as well as data from external providers, to implement ESG factor screening on a positive and negative basis. To ensure more emphasis is placed on ESG risks beyond the firm-wide approach to active ownership and ESG integration which forms the basis of the Aware categorisation.

A funds based approach – Positive Change
A pragmatic approach that combines funds that invest with a sustainability focus or for impact, with funds managed by leading responsible investment practitioners. Meaningful engagement by fund houses with company management is prioritised over formal exclusions on the basis that engagement can encourage change where it is needed most.

Sustainable Investment – The Climate Assets Funds and Strategy**
Investing in the growth markets of sustainability and environmental technologies, with a strong underpinning of ethical values. The strategy is fossil fuel free and invests in global equities, fixed interest and alternative investments. Five positive investment themes are at the heart of the stock selection: low carbon energy, food, health, resource management and water.

Ethical And Values Oriented Investment – Client Specific

This is incorporated on an individual client basis, informed by their specific ethical preferences and values. These will vary from client to client and will focus on industry groups, industries or individual companies.

* For UK, North American and European equity holdings

** Climate Assets Balanced Fund and Climate Assets Growth Fund.

Glossary

Active ownership: This is where investors actively use voting and engagement to influence the management of companies with respect to environmental, social or governance factors. Similar principles are also used by investors in other asset classes such as fixed income, private equity or property. This will also involve active participation in industry and peer group collaborative initiatives.

Clawback (and malus): Incentive plans should include provisions that allow the company, in specified circumstances, to ensure that a recipient:

- forfeits all or part of a bonus or long-term incentive award before it has vested and been paid – this is called 'malus' and/or
- pays back sums already paid – this is called 'clawback'.

Disapplication of pre-emption rights: Existing shareholders do not have first refusal on new shares and therefore their holdings will be diluted.

Engagement: Investors enter into purposeful dialogue with companies, funds, industry bodies, and governments to discuss environmental, social, and governance related issues in order to gain more information or to encourage and achieve change. This may be in collaboration with other investors.

ESG (Environmental, Social, and Governance): The risks and opportunities related to ESG issues. **Environmental** - relating to the environment such as resource, water and land use, biodiversity, pollution, atmospheric emissions, climate change, and waste. **Social** - relating to the relationship between companies and people, such as their employees, suppliers, customers, and communities. Examples of social issues of interest to investors include health and safety, labour standards, supply-chain management, and consumer protection. **Governance** - relating to the governance of an organisation, also referred to as corporate governance. Examples include board composition, executive remuneration, internal controls, and balancing the interests of all stakeholders.

Long-term incentive plan (LTIP): A type of executive compensation that pays out usually in the form of shares company. The reward is linked to performance metrics and the pay-out will be calibrated in line with the achievement of these. The quantum of the pay-out is linked to multiples of salary.

Net zero: Achieved when anthropogenic emissions of greenhouse gases to the atmosphere are balanced by anthropogenic removals over a specified period. Where multiple greenhouse gases are involved, the quantification of net zero emissions depends on the climate metric chosen to compare emissions of different gases (such as global warming potential, global temperature change potential, and others, as well as the chosen time horizon). Definition sourced from the IPCC.

NEDs (Non-Executive Directors): These are directors who act in advisory capacity only, however they should hold the executive directors to account. They are not employees of the company, however they are paid a fee for their services.

Over-boarded: Where non-executive directors are deemed to have a potentially excessive number of non-executive positions and the concern is whether they have sufficient time to contribute to the board of the company.

Pre-emption right: These give shareholders first refusal when a company is issuing shares. Premium listing: This was previously known as a primary listing for the London Stock Exchange. A company with a premium listing is expected to meet the UK's highest standards of regulation and corporate governance.

Principles of Responsible Investment (PRI): The world's leading voluntary initiative on responsible investment. Launched in 2006 it now has thousands of investor signatories globally who commit to adopt six principles for responsible investment and report against these annually. Although voluntary and investor-led the PRI is supported by the United Nations.

Proxy voting: Where a shareholder delegates their voting rights to be exercised on their behalf. Often voting rights are delegated to investment managers who exercise votes on investors' behalf. Votes are used to express shareholder opinions to company management.

Responsible investment: A strategy and practice to incorporate ESG factors in investment decisions and active ownership. Definition sourced from the PRI.

Restricted share plan: Some companies (and indeed investors) prefer the use of these plans as opposed to LTIPs (see above). The idea is that this type of plan encourages long-term behaviours and does not have the same use of targets that you would see within an LTIP. Therefore, it is expected that companies which adopt such an approach award a lower amount than would be seen under an LTIP which has a variable structure dependent on performance outcomes.

SID (Senior Independent Director): The SID position is taken by an independent NED. The SID often plays a critical role in ensuring communication channels are open between the board and shareholders.

Stewardship: The responsible allocation, management, and oversight of capital to create long-term value for investors and beneficiaries leading to sustainable benefits for the economy, the environment, and society. Definition sourced from the Financial Reporting Council (FRC).

TCFD: Acronym that stands for the Task Force on Climate-related Financial Disclosures. The Financial Stability Board created the TCFD to improve and increase reporting of climate-related financial information. Regulators are adopting TCFD and, in particular, the UK regulator (FCA) is requiring firms to apply these disclosure rules.

Tender – bid waiver: This is the right to waive the requirement to make a general offer under Rule 9 of the Takeover Code.

Total shareholder return (TSR): Is a measure of the performance of a company's shares; it combines share price appreciation and dividends paid to show the total return to the shareholder expressed as an annualised percentage.

UN Sustainable Development Goals (SDGs): The 2030 Agenda for Sustainable Development adopted by all United Nations Member States in 2015, provides a shared blueprint for peace and prosperity for people and the planet, now and into the future. At its heart are the 17 UN Sustainable Development Goals (SDGs), which are an urgent call for action by all countries - developed and developing - in a global partnership. They recognise that ending poverty and other deprivations must go hand-in-hand with strategies that improve health and education, reduce inequality, and spur economic growth - all while tackling climate change and working to preserve our oceans and forests. Definition sourced from the UN.

Voting Rights: Shares in listed companies typically come with specific voting rights which can be exercised at the company's annual general meeting or extraordinary meetings. They can be used as a means of expressing the opinion of the shareholder about how the company is being managed. This is also referred to as proxy voting when voting rights are delegated, for example to investment managers who exercise voting rights on an investor's behalf.

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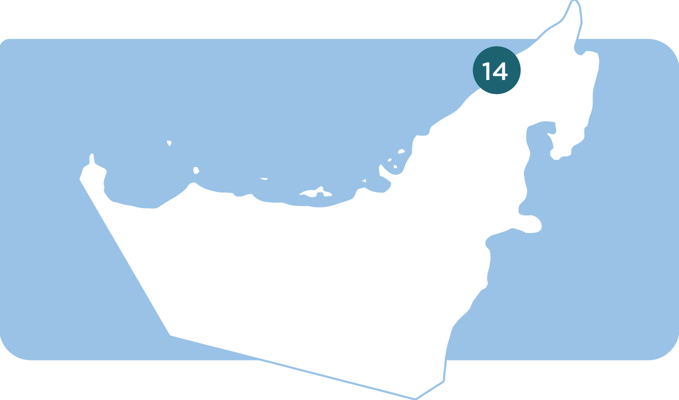
Our experts are here to help you



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Approver Quilter Cheviot Limited 1 January 17th 2024

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