ESG INVESTMENTS

The Livery movement, through its Companies and Guilds, is the steward of substantial assets invested in stocks and shares via Company and charitable portfolios. The following guidance on prevailing ESG (Environmental, Social and Governance) investment practice is aimed at helping you to manage these assets wisely and appropriately, so that individual Companies and the Livery collectively can make their own contribution to tackling the climate crisis.

ESG investing – the basics

Livery Companies and their Charitable Trusts invest capital in order to deliver sustainable wealth creation over the long term. Sustainable, specifically in terms of wealth creation, implies avoiding stocks that rise sharply at first, only to collapse in value thereafter—a risk all investors run when businesses behave in unsustainable ways. Such problems can stem from reputational, governance or operational failure, or from more systemic challenges, such as regulatory action, political instability or climate change. Wealth creation entails sustainable investing in order to earn a share of the new wealth generated by the investment. This can enrich investors, employees and society. It requires long-term thinking, because investments can take time to pay off, and because the investor's needs can stretch well into the future.

Asset or investment managers, whether acting as professionals or individuals, have two vital stewardship roles. The first is to act as responsible stewards of clients' or beneficiaries' capital, making sensible allocation of the funds to different investments. The second is to be good stewards of the investments that have been made.

Rather than allowing purely financial factors to drive investment decisions, they must now take account of ESG issues: the E to address the climate crisis, the S to make sure that this is done in a just and fair way, and the G to ensure the right structure is in place to protect the investment - **E**nvironment, **S**ocial, **G**overnance.

These stewardship responsibilities towards the investments made broadly involve engaging with companies, or having our investment managers do so on our behalf, to fulfil our responsibilities as stakeholders (bondholders can engage too). We maximise our effectiveness by getting to know the companies listed in the portfolio and, alongside other asset managers where necessary, by lobbying and voting to require invested entities to act in ways that ensure wealth is created sustainably.

Such stewardship can also extend to dialogue with local communities as well as, where appropriate, governments and supranational institutions.

The capital element of ESG investing, like all investing, can be done either passively or actively. Engagement, however, by definition means taking an active stance. The simplest approaches tend to involve negative screening – removing companies deemed the worst offenders from the opportunity set. A more nuanced approach would be to be ready to invest in some companies that do face ESG challenges, but where pressure for the needed improvements can transform performance and bring societal benefit. Indeed, it is worth noting that ESG factors can have a direct material financial impact and should be considered as part of any investment decision.

The other side of this coin would be a best-in-class approach—in other words positive screening to include only those companies meeting certain ESG criteria. There are also "values-driven" approaches, which place direct emphasis on measurable societal benefits, or what is called the "social return on investment". Livery Companies that adopt this approach will likely focus their portfolios on world leaders in sustainable practice. Finally, there is impact investing, a mission-driven approach where investments are made in a way that directly aligns the purpose of a product, service or project with a measurable societal benefit. Positive change must be material and additive. Firms in this category may well be more disruptive to existing practices.

Writing or reviewing an investment-policy document

It is good practice for any investor to review their investment policy on a regular basis. The investment objectives need to flow from the aims and strategy of the organisation. These objectives will then inform the investment strategy and selection of investment managers and funds. All charities and charitable trusts should examine the latest guidance on investment strategy, including on responsible investment, issued by the Charity Commission.

All charities also need to consider how their investment decisions may impact their own reputation. For example, a cancer charity that held investments in tobacco companies would look at best foolish and at worst hypocritical. Environmental, social and governance issues need to be considered in the same light. Even if ESG concerns are not directly mentioned in an investment policy, a Livery Company's investments inevitably have an ESG profile. The question is, is that profile appropriate?

Concern over climate change can be seen as a value issue, where there is a moral imperative for the world to act. However, climate risks can also directly affect financial returns. Companies that do not transition sufficiently fast to a lower-carbon world risk future costs in terms of loss of business, tighter regulation and higher taxes.

Setting ESG and climate objectives

With the popularity and proliferation of ESG funds, making choices can seem daunting. The first step is to be clear what you want your investments to achieve. Some basic steps can help to set ESG and climate objectives:

1. Reflect on the Livery Company's aims and review its investment objectives

What are the values of the Livery Company? What does it stand for, and against? What is its position on climate change and is this likely to change? What does the Livery Company or Charitable Trust need to achieve with its investments and what is its fiduciary duty?

2. Determine why ESG concerns are important for investment policy

For example, to what extent does the Livery Company or Charity want to exclude investments that are contrary to its values and objectives, or conversely to represent those values and objectives more positively?

3. Determine which ESG concerns should be considered in investment policy

Different Livery Companies will have different priorities. Some will be most concerned about particular social issues, while others may want to focus on specific environmental themes.

4. Determine how ESG factors should be included in the investment policy

A balance needs to be struck between the ESG concerns and what is achievable and also consistent with the attainment of overall investment objectives. There is no such thing as a perfect company in which to invest.

One example might be Diageo, a drinks company. Those wishing to exclude shares in alcohol-related companies would presumably want to avoid such an investment. Yet Diageo also embraces and reports widely on its progress towards the United Nations Sustainable Development Goals. Another example might be Pfizer, which in the past has been rated poorly on some indices for its wage practices, yet has also saved millions of lives with its Covid-19 vaccine.

Just to add to the confusion, it is worth noting, too, that different ESG rating agencies, which investment managers use to assess the ESG footprint of companies, themselves adhere to different criteria. A high score from one agency may be matched by a low or middling score from another.

It is important to consider whether your Company or Charity wants its asset or investment managers to engage with companies in which it invests and what it wants that engagement to achieve? Does it simply want to be part of a general effort to lobby for companies to change, or does it want to push for specific positive impacts?

The Livery Company or Charity might also need to decide what type of investments, if any, it wants to exclude on ESG grounds. On a reassuring note, there is research which shows that exclusion strategies are unlikely to hinder portfolio performance. Companies and Charities may also want to vary their exposure according to ESG factors.

If the Livery Company has taken upon itself a commitment to reduce carbon emissions over a given period, perhaps with a net-zero emissions target, it would make sense for its investments to reflect this. An investment professional, such as an investment manager, should be able to help here.

But how to assess investment performance? It may be appropriate to choose a benchmark which most closely reflects the Livery Company or Charity's ESG policy; or investment managers may be required to specify to what extent ESG policy has led to variance from a mainstream benchmark.

5. Compare investment managers and funds against the new ESG investment policy

Your Livery Company will be looking for investment solutions which meet its objectives, including its policy on ESG issues.

If the investment fund is sufficiently large it may be able to operate as a segregated fund, which means there is only one investor and that investor can then determine the fund's overall investment policy. Where Companies and Charities need to invest in pooled funds, the investment objectives of those funds will need to be compared with the Livery Company's approach to ESG, identifying those which have the closest match while also achieving the overall investment objectives.

Cost should also be a consideration.

A Livery Company may want its investment managers to report against mainstream ESG standards, such as those produced by Principles for Responsible Investment (PRI) and the Taskforce on Climate-related Financial Disclosures (TCFD).

Monitoring existing investment managers

Monitoring investment managers for ESG performance is not much different from monitoring them with regard to other investment objectives. Is the investment manager doing what he/she said they would do?

ESG reviews should be conducted regularly, alongside performance reviews.

Relevant ESG questions include:

- Is the agreed ESG investment approach being applied consistently or has there been a change?
- If positive exposure to ESG factors is the aim, is the manager maintaining investment discipline, for example by not overpaying?
- To what extent are the manager's ESG activities relevant to the fund's objectives?

Further clicks

CDP

The **CDP** (formerly the Carbon Disclosure Project) is an international not-for-profit organisation based in the United Kingdom, Germany and the USA that helps companies and cities disclose their environmental impact. It aims to make environmental reporting and risk management a business norm. This represents the richest and most comprehensive data set on corporate and city action.

About us - CDP

Climate Bond Initiative

An international, investor-focused not-for-profit organisation working to mobilise the $100 trillion bond market for climate-change solutions. The aim is to develop a large and liquid Green and Climate Bonds Market that will help drive down the cost of capital for climate projects in developed and emerging markets.

Climate Bonds Initiative | Mobilizing debt capital markets for climate change solutions

Climate Change Committee

The Climate Change Committee (CCC) is a UK-based independent, statutory body established under the Climate Change Act 2008. Its purpose is to advise the UK and devolved governments on emissions targets and to report to Parliament on progress made in reducing greenhouse-gas emissions and preparing for and adapting to the impacts of climate change.

Climate Change Committee (theccc.org.uk)

COP26

The Conference of the Parties 26 is the UN Climate Change Conference UK 2021, scheduled for 1-12 November in Glasgow.

HOME - UN Climate Change Conference (COP26) at the SEC – Glasgow 2021 (ukcop26.org)

ESG Rating Agencies

There are currently over 6,000 ESG indices, measuring ESG performance and risk and providing ESG scores and ratings. Ratings scores may differ substantially between agencies.

EU Taxonomy

The EU taxonomy is a classification system, establishing a list of environmentally sustainable economic activities.

EU taxonomy for sustainable activities | European Commission (europa.eu)

Global Sustainability Standards Board (GSSB)

Responsible for setting globally accepted standards for sustainability reporting.
Global Sustainability Standards Board (globalreporting.org)

Global Green Finance Index (GGFI)

GGFI 6 (6th edition: 27/10/2020) provides evaluations of the depth and quality of the green finance offerings of 74 major financial centres around the world.
The Global Green Finance Index - Long Finance

Green Finance Institute

The UK-based Green Finance Institute brings together global experts and practitioners to co-design sector-specific solutions that channel capital towards an inclusive, net-zero-carbon and resilient economy.
Green Finance Institute

GSG

The Global Steering Group for Impact Investment (GSG) aims to drive impact that improves lives and the planet. It continues the work of the Social Impact Investment Taskforce established under the UK's presidency of the G8. It currently covers 33 countries and brings together impact leaders from the worlds of finance, business, government and philanthropy.
GSG – Making Impact Count (gsgii.org)

ICMA

The International Capital Markets Association's Green Bonds Principles are a voluntary set of standards. The transition to a sustainable global economy requires scaling up the financing of investments that provide environmental and social benefits. The capital market through green, social and sustainability bonds as well as sustainability-linked bonds can help attract capital to finance these requirements.
Sustainable finance (icmagroup.org)

IIGCC

The Institutional Investors Group on Climate Change (IIGCC) is the European membership body for investor collaboration on climate change. Their mission is help drive progress by 2030 towards a net-zero and resilient future, through capital allocation decisions, stewardship and engagement with companies, policy makers and fellow investors. The IIGCC established the PAII (Paris Aligned Investment Initiative) in May 2019. (See PAII below)
IIGCC – The Institutional Investors Group on Climate Change

IPCC

The Intergovernmental Panel on Climate Change (IPCC) is the United Nations body for assessing the science related to climate change. The IPCC was created to provide policymakers with regular scientific assessments on climate change, its implications and potential future risks, as well as to put forward adaptation and mitigation options.

IPCC — Intergovernmental Panel on Climate Change

IPSF

Founded in 2019 in the margins of the International Monetary Fund (IMF)/World Bank annual meetings in Washington DC by the European Union together with relevant authorities of Argentina, Canada, Chile, China, India, Kenya and Morocco. The International Platform on Sustainable Finance (IPSF) aims to scale up the mobilization of private capital towards environmentally sustainable investments. The UK joined in February 2021.

International platform on sustainable finance | European Commission (europa.eu)

Net Zero

Net zero refers to the achievement of a balance between the amount of greenhouse gas emissions produced and the amount removed from the atmosphere. There are two different routes to achieving net zero, which work in tandem: reducing existing emissions and actively removing greenhouse gases from the atmosphere.

PAII

The Paris Aligned Investment Initiative (PAII) looks at how investors can align their portfolios to the goals of the legally-binding 2015 Paris Agreement (aiming to limit global warming to below 2 degrees Celsius over pre-industrial levels) and work towards net-zero emissions by 2050 at the latest.

Paris Aligned Investment Initiative – IIGCC

PRI

The six Principles of Responsible Investing (PRI) are a voluntary set of investment principles that offer a menu of ways to incorporate ESG thinking into investment practice. These involve: incorporating ESG issues into investment analysis and decision-making; being active owners; seeking appropriate disclosure of ESG issues by investees; promoting wider acceptance of the principles within the investment industry; effective implementation of the principles; and reporting on progress.

PRI | Home (unpri.org)

Scope 1, 2 and 3 emissions

Businesses must monitor and report their CO2 emissions, a first step towards reducing them. To do so, companies must classify their carbon footprint in three scopes:

1. **Direct emissions**: Company processes causing emissions, including manufacturing and transport.
2. **Purchased energy**: Emissions associated with the production of energy consumed by a company.
3. **Indirect emissions**: Associated with company activities from sources not owned or controlled by a company: travel, waste, purchased goods, suppliers, capital goods (facilities). Also investments.

What are Scopes 1, 2 and 3 of Carbon Emissions? - Plan A Academy

SASB (Sustainable Accounting Standards Board)

SASB is a non-profit organization, whose stated mission "is to establish industry-specific disclosure standards across ESG topics that facilitate communication between companies and investors about financially material, decision-useful information. Such information should be relevant, reliable, and comparable across companies on a global basis."

SASB Materiality Map

SFDR

The EU's Sustainable Finance Disclosure Regulation (SFDR) introduces disclosure-related requirements for financial-market participants and financial advisors. The disclosure regime is intended to increase transparency and give investors the ability to compare products and sustainability outcomes.

Sustainable finance | European Commission (europa.eu)

Sustainability

Sustainability can be considered a form of intergenerational ethics in which the environmental and economic actions taken by present persons do not diminish the opportunities of future persons to enjoy similar levels of economic security.

Stakeholder Capitalism

A movement led by Professor Klaus Schwab, the Chair of the World Economic Forum, which formed the basis of their Davos Manifesto 2020. The point is to measure a company's success not by profit but well-being.

Measuring Stakeholder Capitalism: World's Largest Companies Support Developing Core Set of Universal ESG Disclosures > Press releases | World Economic Forum (weforum.org)

TCFD (Task Force on Climate-related Financial Disclosures)

Established by the international Financial Stability Board, its four recommendations are:

- Governance: Disclosure of the board's oversight on, and management's role in, assessing and managing climate-related risks and opportunities.
- Strategy: Disclosure of the short- and long-term climate-related risks and opportunities, their impact on the organisation, and the resilience of the strategy in place to manage those risks and opportunities.
- Risk Management: Disclosure of the organisation's process for identifying, assessing, and managing risks, and how this is integrated into the organisation's overall risk management.
- Metrics and Targets: Disclosure of the metrics used to assess risks – Scope 1, Scope 2, and Scope 3 greenhouse gas emissions, the risks they pose, and the targets in place to manage risks and opportunities.

The UK Government plans to make TCFD-aligned disclosures mandatory across the economy by 2025, with a significant portion of mandatory requirements in place by 2023.

FINAL_TCFD_REPORT.pdf (publishing.service.gov.uk)

Task Force on Climate-Related Financial Disclosures (fsb-tcfd.org)

UK NAB

The UK National Advisory Board on Impact Investing (UK NAB).

The-Rise-of-Impact_UK-NAB_low-res.pdf (good-with-money.com)

UKSIF

The UK Sustainable Investment and Finance Association (UKSIF). Represents UK Fund Managers.

UKSIF's 30th Anniversary - UKSIF

UN SDGs

The UN's 17 Sustainable Development Goals were published in 2015 with a call to action to end poverty and protect the planet to advance peace and prosperity for all by 2030.

THE 17 GOALS | Sustainable Development (un.org)