How we approached our investment portfolio review to assess ESG compliance

The Finance Committee of the Worshipful Company of International Bankers (WCIB) invests about £1m of the Company's trust fund. We follow a model portfolio which includes various reputable funds and diversifies our investments across all markets and sectors globally. Our objective is to gain the returns available from each market over the medium to long term in an "ESG compliant" way … So, let's examine what that really means.

By way of reminder, Environmental, Social and Governance (ESG) criteria are the measures used to evaluate non-financial performance; that is the sustainability and critical impact of an organisation and its social value to the community. They commonly include considering the organisation's policies, practices and activities in relation to the three themes:

1. Environmental Factors. Examine how a business performs as a steward of our natural environment and include: waste and pollution; resource depletion; greenhouse emissions; deforestation; and climate change.
2. Social Matters. Look at how a business treats people namely: employee relations and diversity; working conditions; local communities; health and safety; and conflict.
3. Governance Considerations. Evaluate how a business polices itself and how it is governed. Consider: strategy; executive remuneration; donations and political lobbying; corruption and bribery; and board diversity and structure.

Leading fund managers now accept the need for ESG transparency, reporting and engagement at Board level with the companies which they invest in and therefore to whom we as the ultimate investor, are exposed. The larger managers focus on engagement rather than exclusion. They seek to reach an accord with the companies to work together for a common interest in meeting ESG targets.

As the Finance committee at WCIB, we have a duty to review and question the funds with whom we invest. We start by reviewing the ESG policies of the fund managers – below are some examples of what matters to them and therefore us, through the ESG lens. The WCIB ESG Policy published in March 2022, sets out our founding principles for the Livery Company.

Fund 1
As mentioned above, the policy for most diversified funds is to remain invested in companies and encourage them to take positive action on material ESG risks. Most believe they can deliver long-term sustainable value for investors and society at large without having to divest from specific companies. This stewardship approach encourages all companies and their boards to oversee and mitigate all material risks including ESG risks. They aim to be a key voice on governance matters such as board diversity, independence and structures as well as on an increased oversight of specific ESG related risk, disclosures and mitigation. For climate change, they believe it is better to own, engage and encourage boards to manage risks They expect a plan for a transition to a low carbon economy.

Fund 2

Investment stewardship to them means the responsible oversight of capital that they allocate on behalf of their clients. This should give sustainable benefits for the economy, the environment and society. They engage with the companies to address risks and opportunities – both company-specific and market-wide. Their engagement with regards to Modern Slavery and Fast Fashion brings this to life. They have challenged FTSE 350 companies that had failed to meet the reporting requirements of Section 54 of the Modern Slavery Act, 2015. Not only did they want to highlight the importance of eradicating modern slavery throughout the supply chains of FTSE 350 companies, they also sought to raise the importance of eradicating modern slavery across global business. Separately, they had numerous engagements with X Group in the second half of 2020 to discuss its response to criticisms of poor practices in its supply chain. X has since announced its Agenda for Change programme.

Fund 3

Has a set of investment principles to meet ESG objectives. They also do not screen out companies from their investment universe purely on the grounds of poor ESG performance, rather they adopt a positive engagement approach whereby they discuss these issues with the management of the companies. They use the information gathered during these meetings both to encourage company management to improve procedures and policies. A second principle is that as Institutional investors, they should have a clear policy on voting and disclosure of voting activity. Where their views differ from those of the investee Board they will engage with that Board at an early stage to try and resolve differences. Their guiding principle is that voting rights should always be exercised in the best interest of investors. They disclose their voting record for the preceding 12 months on their website and update this information on a quarterly basis.

Fund 4

They too actively engage with the companies they invest in to encourage them to transition towards more sustainable business models that support long-term future growth and resilience. In 2020, there was much focus on the E in ESG and particularly on climate change. They have taken three major steps on this front that show how they are taking decisive action. The first is that they have joined the Net Zero Asset Manager initiative, the goal of which is to attain net zero greenhouse gas emissions by 2050 or sooner. It is part of a shared aim to limit global warming to 1.5 degrees above pre-industrial levels. Secondly, they have pledged to set robust emissions reduction targets under the Science-Based Targets initiative. The third is their appeal to the largest FTSE 350 UK listed companies to publish detailed plans describing how they intend to transition, beyond simply showing long-term ambition. They want to go beyond reported profits. In time, they aim to examine ‘impact-adjusted profits’. Profit, after all, is only half the story. It’s essential that how that profit is generated is part of the evaluation equation.

In conclusion, ESG Investing is about aligning the values of the Investor (us) with how our investment managers and the ultimate investees treat the planet, people and how it is run. It is clear we cannot simply leave it to others to self-regulate what matters to us. We need to ensure the funds and their investments align standards and definitions, are robustly transparent and ensure their investees actually deliver improved outcomes. We, as Investors, have to do a bit of digging and ask some challenging questions. We must put our money where our mouth is! ESG matters.

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WCIB Finance Committee
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Further Reading:

The Livery Climate Action Group Guidance Note on ESG Investments