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ESG Update Q3 2021

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As always, a wide array of ESG-related stories caught our eye this quarter. We cover some of the most consequential and/or intriguing here.

The IPCC releases another troubling report on the state of the climate: The United Nations' Intergovernmental Panel on Climate Change (IPCC) released the first part of its sixth assessment report. Building on previous reports, the typically conservative IPCC pointed with even more certainty to the role of mankind in altering the Earth's climate to a degree that is "unprecedented over many centuries to many thousands of years." Many of these changes are irreversible. The IPCC also drew a stronger link between climate change and a spate of extreme weather events. In better news, the IPCC highlighted the importance of net zero carbon goals, which Epoch supports at many of our holdings, in staving off the worst effects of climate change. China's pledge to stop building coal-fired power plants overseas is another step in the right direction towards combating runaway climate change.

Activision Blizzard case throws spotlight on toxic workplace cultures: In July, the video game developer was revealed to be the subject of a lawsuit over sexual harassment and discrimination. This was swiftly followed by news of an SEC investigation into disclosures to investors about these claims. While Epoch does not hold a position in the company, we see the outcome of the investigation as another reminder that building inclusive workplaces has real business implications, beyond being the right thing to do.

ESG concerns become explicit for OnlyFans: The social media platform, OnlyFans, raised eyebrows with a proposed pivot away from its booming business as a platform for explicit content. This move reportedly came after pressure from its banking and payment service providers. While the company eventually changed its plans, we see this as another example of ESG concerns percolating through different stakeholders. While we're used to seeing consumers or investors nudging companies, critical suppliers are now emerging as an agent of change. Perhaps it's time for us to rework our understanding of Porter's Five Forces – assessing the power of various stakeholders on corporate action—with an ESG lens.

The SEC is pursuing greenwashing more aggressively: The SEC is beginning to investigate major asset managers more seriously over claims of greenwashing. We have no desire to throw rocks at competitors, particularly in an ongoing investigation. We do, however, view this as a welcome sign that the asset management industry's ESG claims are under intense scrutiny. Inflated claims, which ultimately harm investors, will no longer be tolerated.

An energy crisis may be brewing: The spike in energy prices has caught many market participants by surprise. Javier Blas, chief energy correspondent at Bloomberg News, notes the following price moves:

While the deployment of renewable energy needs to accelerate significantly, maintaining the stability of energy markets for heating, mobility and many other uses is a hugely important Social consideration. Fossil fuel producers and users must contend with their contribution to climate change, but these incumbents will likely remain a crucial part of our energy landscape for a long time to come. Ensuring they act in line with socially optimal outcomes – and assessing the implications for the value of these companies – continues to be a big part of our work at Epoch.

Is Chinese policy upheaval pro-ESG? A series of policy pronouncements from China was undoubtedly one of the biggest financial stories in the third quarter. The ESG implications of this episode are profound. Some ESG advocates may actually find positive nuggets in President Xi's push for a "common prosperity." After all, excessive income inequality and corporate influence are often criticized in Western capitalist economies. Furthermore, those in the West who decry the addictive nature of technology probably had some sympathy for the Chinese crackdown on tech use by youth (one state-run media outlet floridly described online gaming as "spiritual opium"). That said, extreme policy moves make it incredibly difficult for analysts – ESG or otherwise – to evaluate the long-term effects for companies. Furthermore, the strong corporate governance standards we advocate can lose relevance when state intervention supersedes investor interests. Like other market participants, we are keenly awaiting the next phase of policy change from China as we grapple with assessing the implications of these changes.

ESG at Epoch

We completed eight engagements in the quarter: The third quarter is typically a busy time for our team as we launch engagements with our holdings. In this quarter, we spoke with the following companies:

Utilities: American Electric Power, Enel, Entergy, Evergy, NextEra Energy

Materials: Berry Global, Linde, Phillips 66

We have four more engagements scheduled and expect to engage with roughly 20 companies this year. These interactions continue to be a crucial component of our ESG program. We will cover our engagements in more detail in our Annual Report, but we can safely say that the level of disclosure and ESG capabilities continues to increase at our holdings. We don't always agree with every aspect of our companies' strategies with regards to ESG, and we have no problems advocating in a reasoned manner when we have concerns. On the whole, however, we are pleased with the progress companies are making, particularly on emissions reductions.

We created a feedback form for analysts to spur engagement effectiveness: We never lose sight of one of the primary goals of Epoch's ESG efforts, which is to complement the work our fundamental analysts do. We have sought to increase the effectiveness of our engagements by ensuring our analysts find them useful and insightful. We created a feedback form for analysts to fill in after each engagement, which will hopefully guide our future engagement work.

We joined Climate Action 100+: We strengthened our engagement options this quarter by joining Climate Action 100+, a highly influential investor group that works with some of the world's largest corporate emitters. We look forward to participating in collaborative engagements through CA100+ in the next few months.

We invited a corporate governance expert to address our team: Lawrence Cunningham is a noted author and corporate governance expert, as well as being a professor at George Washington University. Larry's latest book, *Quality Shareholders*, has a high amount of overlap with how we think about the potential for ESG investing to positively shape corporate behavior. We were delighted to have Larry speak to a group of our PMs on his ideas.