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Many of the stories which caught our eye last quarter demonstrate how the term “ESG” means different things to different stakeholders. We saw a theme emerging as the wider industry questioned what it means “to be ESG.” In this update we pick up on some of the moves by regulators, legislators, ratings agencies and investors to draw brighter lines around ESG investing.

ESG at Epoch

Proxy season saw a record number of environmental and social (E&S) shareholder proposals on the ballot, but support levels are slipping: Midway through proxy season, ISS reported that E&S proposals were averaging 23% support from shareholders, down from 30% in 2021. The drop in support is thought to be driven by the increasingly prescriptive nature of E&S proposals, making some investors less willing to support them. Epoch takes a case-by-case approach to voting significant E&S proposals. We believe proxy voting is a powerful tool to influence management to act on significant issues such as climate change, but also observe there may be more effective channels for evaluating and influencing the specific details of a company’s approach, such as engagement.

Sexist remarks aimed at senior women at Aviva Plc’s AGM reminded us that there is still work to be done to tackle sexism in the workplace: Aviva’s CEO Amanda Blanc observed, “the more senior the role I have taken, the more overt the unacceptable behavior.” Meanwhile, diversity and inclusion (D&I) standards for board and management at large corporates are becoming more established. Major proxy voting advisors introduced updated voting guidelines for the 2022 proxy season, formalizing board-level D&I metrics and expectations. We continue to use engagement as a channel to encourage the development of thoughtful, impactful D&I initiatives, as well as follow best practices in this area closely as they evolve.

A provocative presentation on climate risk led to HSBC suspending their global head of responsible investing, Stuart Kirk: Kirk’s comments, including the line “who cares if Miami is six meters underwater in 100 years?”, did not go over well with HSBC leadership, who retorted that Kirk couldn’t be further from their position. The incident highlighted tensions in the industry. Many felt Kirk’s comments dangerously downplayed climate risks and were out of touch with science, whilst others appreciated Kirk’s willingness to prompt debate in an industry at risk of groupthink.

ESG professionals debated Tesla being dropped from the S&P 500 ESG Index: Despite Tesla’s impact on electrifying the automobile industry, S&P decided the company has fallen behind peers when examined through a wider ESG lens. Tesla’s score suffered on social factors including codes of business conduct and involvement in controversies. Elon Musk swiftly tweeted that “corporate ESG is the Devil Incarnate”. While we don’t agree with this hyperbole, we agree that with ESG ratings, the devil is in the detail. At Epoch, we are primarily interested in the ratings research as an input to our own ESG analysis. While we pay attention to the specific letter ratings, these are merely one factor we take into consideration as part of our research.

Idaho was the latest state to introduce an “anti-ESG” bill, fueling the debate on what it means to be ESG: The bill prevents public entities selecting investments which consider ESG characteristics in a manner that could override the prudent investor rule. Meanwhile, the West Virginia state treasurer implemented a bill authorizing the creation of a blacklist of financial institutions found to have boycotted energy companies. Our philosophy is to pursue ESG analysis as part of a sound investing process. Where ESG analysis involves subjective value claims, we aim to be transparent, nuanced and rigorous to meet our clients’ needs.

The Russia-Ukraine war continues with huge implications for global energy markets as prices soar:

While the European Union is not planning to relax its ambitious carbon reduction goals, the bloc has been forced to reinstate old coal plants to keep the lights on. The European Commission commented that the bloc would use 5 percent more coal than previously expected over the next 5-10 years. Going into engagement season, we are conscious that the energy landscape today is dramatically different from this time last year. Our research and engagements will explore how the immediate energy challenges could impact longer term transition plans and company climate commitments. We also aim for our approach to be robust to various commodity price scenarios. Earlier this quarter, we authored a three-part blog series exploring the complexities of ESG investing against the backdrop of Russia's invasion of Ukraine.

US Supreme Court's ruling on the case of West Virginia vs. the Environmental Protection Agency (EPA) shows the challenges of using federal regulatory power to stem climate change:

In a 6-3 ruling, the Supreme Court limited the EPA's power to regulate CO2 emissions from existing power plants. While some of the finer points of this ruling are still being debated – and will likely unfold over many years – it is clear that federal action on climate change is far from straightforward, forcing the power sector to operate under political uncertainty. In the meantime, the Obama-era Clean Power Plan, targeted by this ruling, has long been rendered obsolete by the remarkable decline in the price of renewable energy.

What we've been up to:

- **Annual report:** We published our 2021 Sustainable Investing Report, available on our website. Our report includes a message from Ravi, highlights from our 2021 engagement season, and for the first time, the portfolio carbon footprint results for various strategies.
- **Proxy season:** Q2 saw a flurry of activity as our analysts and Portfolio Managers reviewed and submitted their proxy voting decisions. As ever, various items sparked debate amongst the investment team. We weighed in on significant proposals including those focused on Executive Compensation, Shareholder Rights, Political Lobbying, Board Composition and Diversity and Inclusion.
- **Executive compensation education:** In tandem with proxy season, we invited Farient Advisors to present a session to our investment team on evaluating executive compensation. The session was well received, and we intend to host further educational seminars on ESG for the team.
- **Engagements:** We led or participated in 6 engagements on corporate governance matters, triggered by significant proxy items. Generally, the purpose of these engagements was to speak with management to deepen our understanding of the situation, evaluate the analysis produced by our proxy advisor (ISS), share our views, and ultimately inform our voting decision.
- **Engagement process:** We updated the structure of our engagement reporting template, to reflect the evolving expectations on reporting engagement activity. We hosted an internal refresher for the wider Epoch team on the details of our engagement process, including case studies.
- **ESG note review:** We commenced our review of analyst ESG notes. This process is designed to provide all analysts with bespoke feedback on their ESG analysis, sharpening their understanding of material ESG factors.
- **Quarterly ESG portfolio analysis:** We extended our quarterly carbon analysis to include additional portfolio-level ESG insights. The extension was trialed on a selection of strategies and was received very positively. We are working with our data provider to evaluate the feasibility of rolling this out for more strategies.
- **Product development work:** We continued to collaborate with the wider organization to introduce versions of Epoch strategies to meet clients' different ESG needs. This included taking a closer look at the EU's Sustainable Finance Disclosure Regulation (SFDR).

- **Net Zero research:** We undertook further research into net zero portfolio frameworks, evaluating a selection of carbon data provider tools and methodologies.
- **Blog series:** ESG and the War in Ukraine: Ravi Varghese, our Head of Sustainable Investing, authored a three-part blog series exploring the complexities of ESG investing against the backdrop of Russia's invasion of Ukraine. Available on our website.
- **Podcast analyzing the "S" in ESG:** Ravi Varghese joined Epoch's Actively Speaking Podcast to discuss how we analyze the "S" in ESG, often the most nebulous and subjective of the three ESG pillars. Available on our website.
- **Conference:** Ravi Varghese spoke on the "Equity and Shipping: The Investor Perspective" panel at Marine Money 2022, sharing how Epoch thinks about ESG and how those considerations might affect the shipping industry.

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