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# Sustainable Investing

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Neeta Madahar, Falling 1 (detail), 2005. Lightjet print mounted on aluminum, 48 x 48 inches (122 x 122 cm)

## Sustainable Investing

**Section one** ..... Sustainable investing overview

**Section two** ..... Climate Risk & Reporting

**Section three** ..... Sustainable Development Goals and Impact

**Section four** ..... Appendix

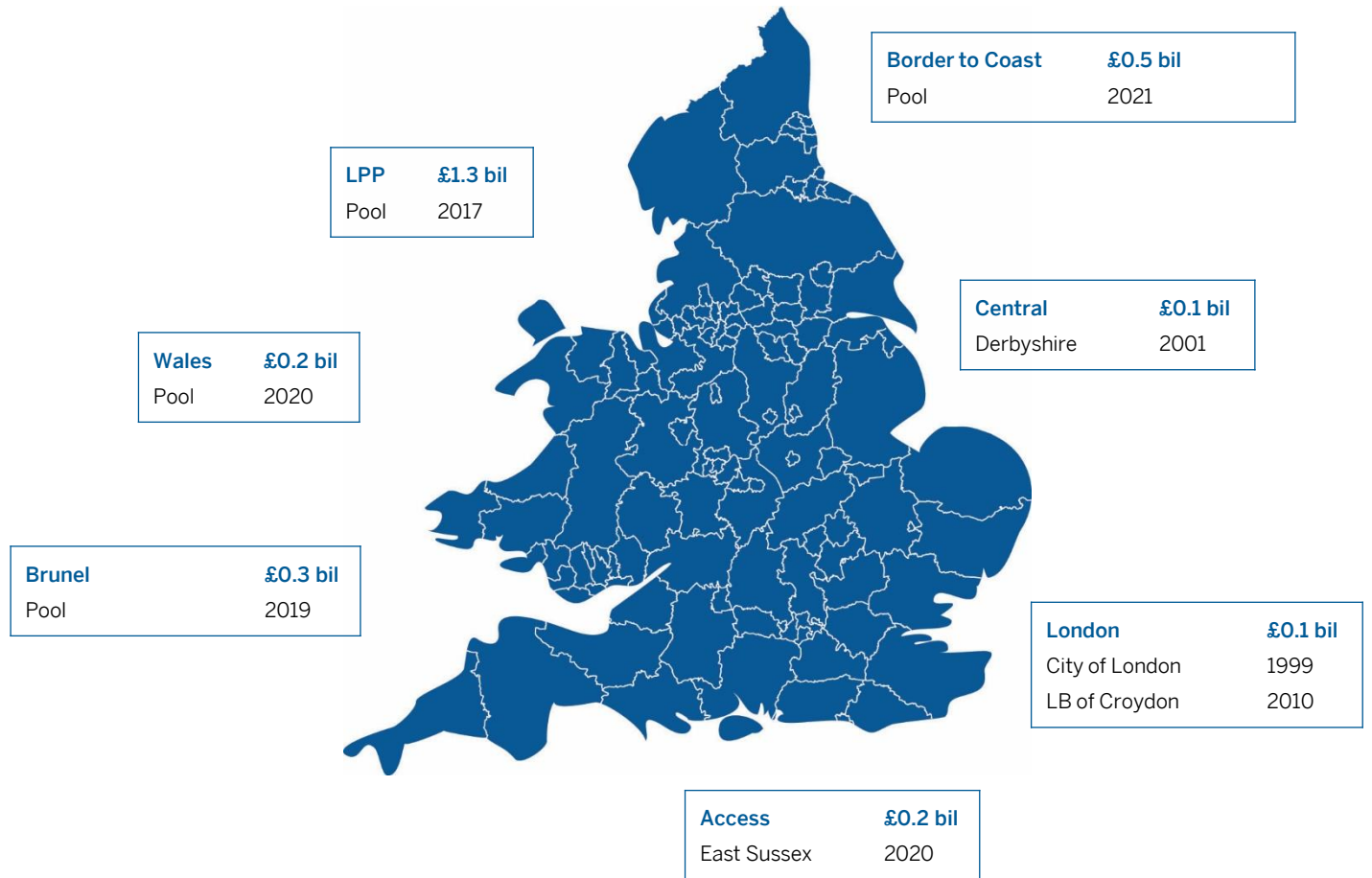
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## Our LGPS Client Partners

We manage £2.7 bil for 8 clients

One third of our LGPS relationships are over a decade long



Clients listed include all LGPS clients within each pool. This does not represent an endorsement of the firm or its services. Totals may not add due to rounding. | As of 30 September 2022

# Sustainable Investing

## Glossary of terms

### ESG

Environmental, social, and governance; refers to a collection of non-financial issues that have the potential to be material to a company's long-term financial performance

### ESG integration

The explicit consideration of ESG factors in the investment decision-making process

### Impact investing

Investments made into companies, organisations, and funds with the intention to generate a measurable, beneficial social or environmental impact alongside a financial return

### Active ownership

The responsibility of investors to monitor companies in which they invest, using the tools of voting and engagement to positively influence companies' policies, actions, and investment outcomes. Can also be referred to as "investment stewardship" or "responsible investment."

### Materiality

The concept of materiality underpins financial disclosure standards by recognising that certain information is important to investors when making investment decisions. When applied to either financial data or sustainability data, it refers to the idea that the information could have a substantial impact on the financial condition or operating performance of companies.

### Negative screening

Investment technique focused on exclusion of certain companies or sectors based on sustainability criteria. Can also be referred to as "socially responsible investing," or "SRI."

### Sustainable investing

Broad term to identify investment processes which include elements of ESG integration and engagement, screening based on sustainability criteria, or impact investing



# Spectrum of Capital

**Finance-only (traditional)**

**Socially Responsible investing (SRI)**

**ESG**

**Thematic impact investing**

**Impact first investing**

**Social-only (philanthropy)**

**Competitive returns**

**ESG risk management**

**ESG opportunities**

**Maximum-impact solutions**

Seek financial returns regardless of ESG factors

Screen out “sin” stocks

ESG integration

Targeted themes & financial returns drive investment selection

Social and environmental considerations take priority over financial returns

Financial returns disregarded

**Negative screens**

- Tobacco
- Alcohol
- Weapons
- Gambling
- Pornography
- Nuclear energy

**Factors considered**

- Carbon
- Resource use
- Waste reduction
- Compensation
- Product safety
- Gender equality

**Solutions for**

- Climate change
- Population growth
- Urbanization
- Water scarcity
- Food systems

**Support for**

- Innovation and Risk taking
- Proof of concept
- Enabling environments

Sources: Wellington Management, JPMorgan Chase | For illustrative purposes only



# ESG Integration

**Definition:** The explicit and systematic inclusion of ESG issues in investment analysis and investment decisions

## Environmental



- Water efficiency
- Resource management
- Climate change adaptation
- Pollution
- Conservation efforts

## Social



- Labour costs
- Corporate culture
- Employee diversity
- Community involvement
- Supply chain management

## Governance



- Executive compensation
- Board composition
- Board independence
- Accounting transparency
- Shareholder rights

## Climate risk

The spectrum can be applied across a framework that outlines an approach to the climate transition

### Situation

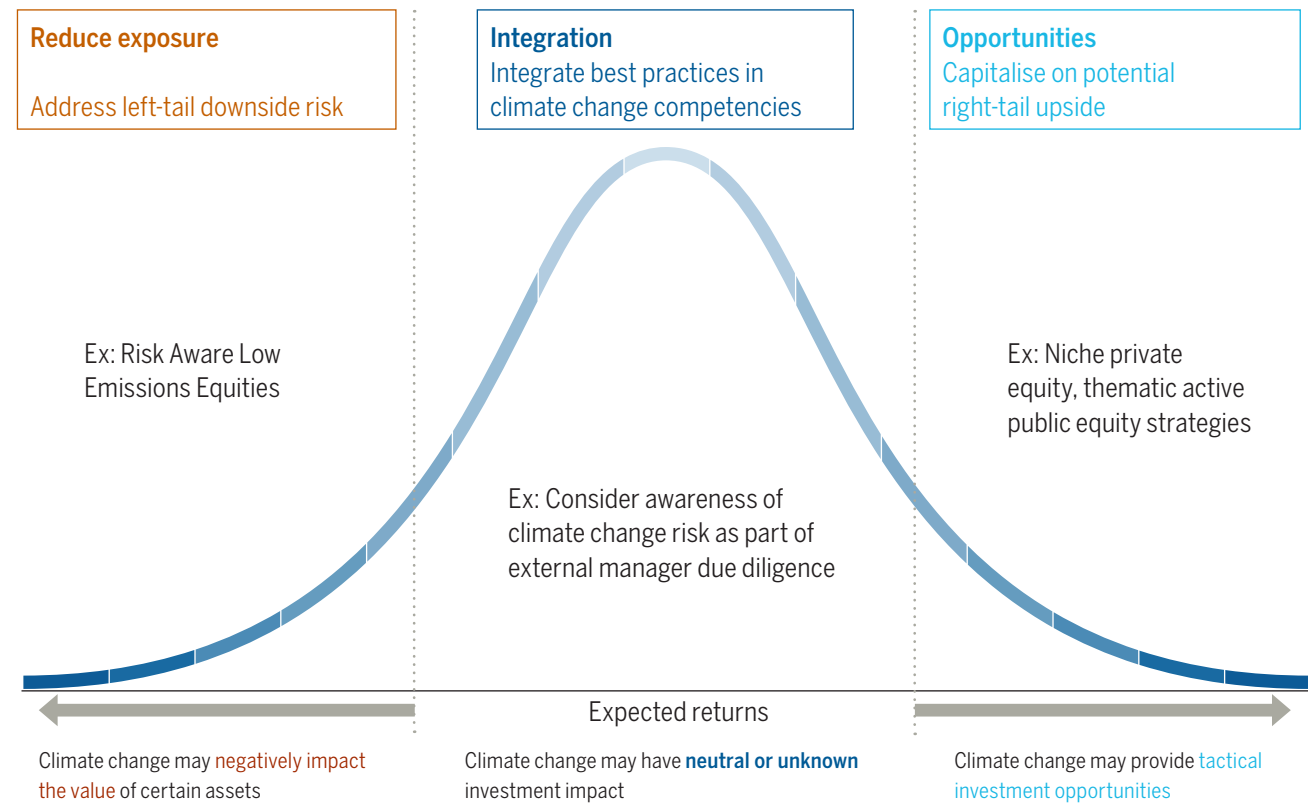
The climate transition will likely result in physical, market and policy changes

### Complication

It will be difficult to identify the timing, magnitude and precise outcomes of the climate transition

### Approach

Manage climate risk and reward through the distribution of investable assets

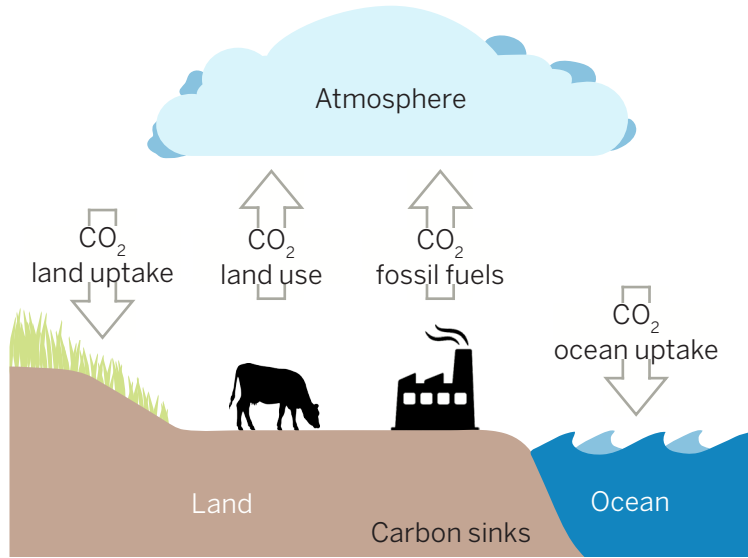




# Terminology

## Transition risks vs. physical risks

### Cause



Higher emissions in atmosphere exacerbates physical risks

### Effect

#### Chronic



Heat



Drought



Water access

#### Acute



Flooding



Hurricanes



Wildfire

### Transition risks...

Policy & regulation

- Carbon pricing to reduce future emissions
- Carbon sinks to remove existing emissions

Technological disruption

- Renewable energy
- Electric vehicles

Litigation

Societal pressure & behavior

...drive need for mitigation

### Physical risks...

Chronic risks are long-term shifts in climate patterns

Acute risks are event-driven and increasing in severity

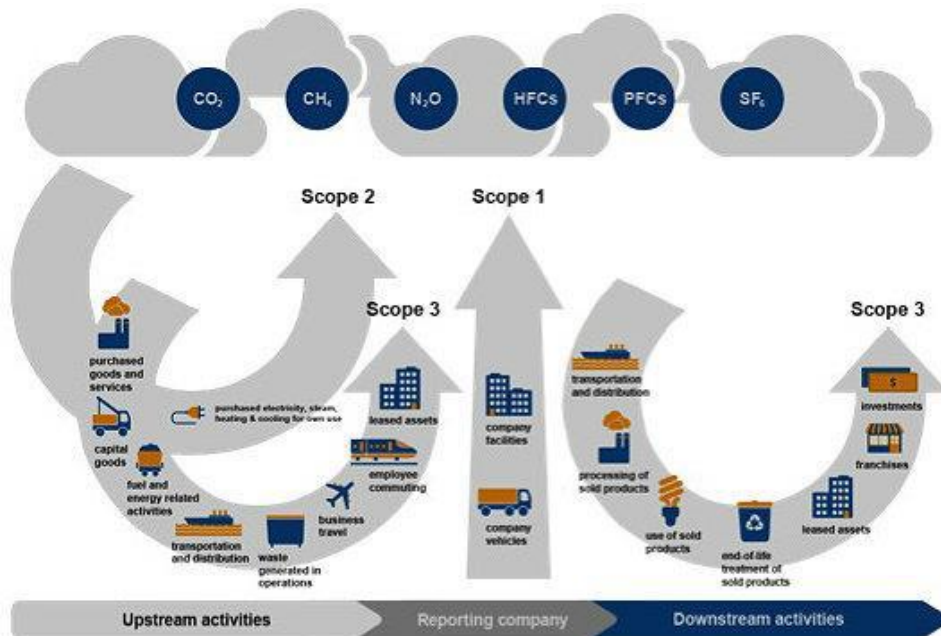
Changing climate will impact regions at different paces and magnitudes

Impacts to: societies, economies, private & public spending, infrastructure

...drive need for adaptation

# Terminology

## Emissions scopes



### Scope 1

Direct emissions occurring from sources such as factories or vehicles that are owned or directly controlled by the institution

- Examples: factories, company vehicles

### Scope 2

Indirect emissions generated by the production of electricity consumed

- Examples: purchased power, heating and cooling systems

### Scope 3

All the other indirect emissions that are a consequence of the activities of the institution, but occur from sources not owned or controlled by the institution

- Examples of upstream: purchased goods and services, business travel
- Examples of downstream: use of sold products, investments

## Carbon footprinting

### Portfolio-level metrics

Metric	Description
Total 'Apportioned' Carbon Emissions	Absolute contribution to climate change (emissions owned or financed), typically with an environmental or social motivation to reduce this over time
Carbon Emissions Per USD 1 million invested	Compare contribution to climate change (emissions owned or financed) across mandates of different sizes
Carbon Footprint	Compare carbon efficiency of portfolio's security selection relative to benchmark/opportunity set
Weighted Average Carbon Intensity	Compare carbon efficiency of portfolio's security selection relative to benchmark/opportunity set

## TCFD/LGPS Consultation

**Scope and timing:** The proposed regulations will apply to all LGPS AAs. The first reporting year will be the financial year 2023/24, and the regulations are expected to be in force by April 2023. The first reports will be required by December 2024.

**Strategy:** AAs will be expected to identify climate-related risks and opportunities on an ongoing basis and assess their impact on their funding and investment strategies.

**Scenario Analysis:** AAs will be required to carry out two sets of scenario analysis. This must involve an assessment of their investment and funding strategies. One scenario must be Paris-aligned (meaning it assumes a 1.5 to 2 degree temperature rise above pre-industrial levels) and one scenario will be at the choice of the AA. Scenario analysis must be conducted at least once in each valuation period.

**Risk Mgt:** AAs will be expected to establish and maintain a process to identify and manage climate-related risks and opportunities related to their assets. They will have to integrate this process into their overall risk management process.

**Metrics:** AAs will be expected to report on metrics as defined in supporting guidance. The proposed metrics are set out below and must be measured and disclosed annually;

\* Metric 1 will be an absolute emissions metric. Under this metric, AAs must, as far as able, report Scope 1, 2 and 3 greenhouse gas (GHG) emissions.

\* Metric 2 will be an emissions intensity metric. We propose that all AAs should report the Carbon Footprint of their assets as far as they are able to. Selecting an alternative emissions intensity metric such as Weighted Average Carbon Intensity (WACI) will be permitted, but AAs will be asked to explain their reasoning for doing so in their Climate Risk Report.

\* Metric 3 will be the Data Quality metric. Under the Data Quality metric, AAs will report the proportion the value of its assets for which its total reported emissions were Verified, Reported, Estimated or Unavailable.

\* Metric 4 will be the Paris Alignment Metric. Under the Paris Alignment Metric, AAs will report the percentage of the value of their assets for which there is a public net zero commitment by 2050 or sooner.

**Targets:** AAs will be expected to set a target in relation to one metric, chosen by the AA. The target will not be binding. Progress against the target must be assessed once a year, and the target revised if appropriate. The chosen metric may be one of the four mandatory metrics listed above, or any other climate related metric recommended by the TCFD.

**Disclosure:** AAs will be expected to publish an annual Climate Risk Report. This may be a standalone report, or a section in the AA's annual report. The deadline for publishing the Climate Risk Report will be 1 December, as for the AA's Annual Report, with the first Climate Risk Report due in December 2024.

## Carbon footprinting

### Limitations

#### Based on disclosure & supplemented by estimation

Time lag for disclosure

#### “Gross” emissions, no netting

Current portfolio aggregation ignores avoided emissions (e.g., renewables)

#### Point-in time snapshot

Does not account for improvements/targets set by companies

#### Fixed income challenges

Subsidiary mapping: balancing coverage and accuracy

#### Intensity is sensitive to its denominator, revenue

Carbon intensity for cyclical companies will fluctuate dramatically with no change to business processes

# Carbon intensity

## What's measurable today

### Agreed measurement

- Listed equities
- Corporate investment grade credit
- Corporate high yield credit

### Not yet agreed

- Sovereigns
- Securitized
- Derivatives
- Privates
- Short exposure

### Emissions disclosure at corporate level

	% By number of companies				% of market value				% Contribution to scope 1+2 ACWI			
	Reported	Adjusted	Estimated	No data	Reported	Adjusted	Estimated	No data	Reported	Adjusted	Estimated	No data
MSCI ACWI	61.6	4.9	32.2	1.2	85.4	3.0	11.3	0.3	89.9	1.7	8.4	0.0
Russell 2000	8.3	2.1	61.6	28.0	15.7	4.2	74.0	6.1	33.1	5.8	60.5	0.6
MSCI Europe	88.0	4.8	6.7	0.2	95.0	2.6	2.2	0.3	98.9	0.3	0.8	0.0
MSCI EM	43.1	6.2	48.4	2.2	72.3	4.3	22.1	1.3	79.8	4.8	15.4	0.0

### Measurement standards

#### Carbon accounting methods

- Greenhouse Gas Protocol Corporate Standard: guidance for scopes 1, 2, and 3
- Partnership for Carbon Accounting Financials (PCAF): guidance for scope 3, emissions associated with lending and investing

#### Carbon reduction target setting

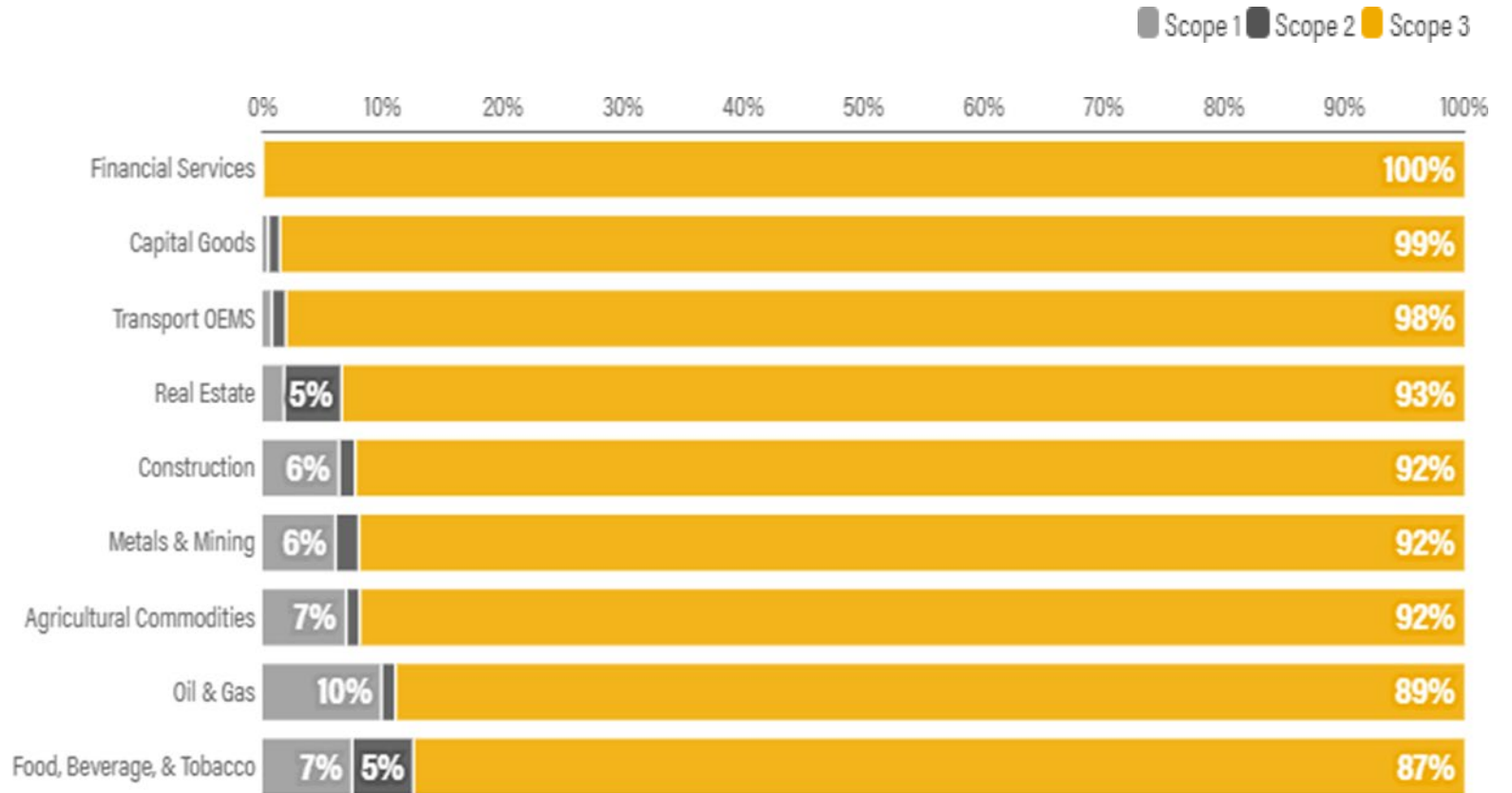
- Science Based Targets Initiative (SBTi) for companies including financial institutions
- Institutional Investors Group on Climate Change (IIGCC) Net Zero Investment

#### Framework for asset owners

For illustrative purposes only. Source: MSCI, Wellington Management.

# Climate Transition

## Scope 3 - Materiality



For illustrative purposes only. Share of Scope 3 emissions to Total emissions, by sector. | Source: WRI. Data is from CDP. Research and analysis of the data was conducted by Concordia University.

# Implementing a Paris-aligned or net-zero target

## Terminology: Net zero and Paris alignment

### Net zero emissions

Emissions produced = emissions removed from atmosphere

### Net zero targets

Target defines a date by which emissions become neutral, but does not specify the pathway

- Theoretically, high net emissions could exist until shortly before the target date, when steep decarbonisation occurs

### Open questions about treatment of mitigation options

Carbon dioxide removal

Avoided emissions

Offsetting with carbon credits

### Paris Agreement

To limit warming to 1.5°C (and prevent worst physical climate impacts), global emissions must reach net zero by 2050

### SBTs ensures Paris alignment

Targets that are in line with what is necessary to meet the goals of the Paris Agreement, using 2°C scenarios to characterize pathways for different sectors

### Sources of “negative emissions” are currently out of scope

CCS

Avoided emissions

Offsets

Net zero by 2050 is specific to carbon emissions. Total GHG emissions, comprehensive of the six major greenhouse gases of which carbon is one, must reach net zero in the 2060s.





# UN Sustainable Development Goals

What are they?



## Impact investing

Impact investing ecosystem

*“Impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.”*

– Global Impact Investment Network (GIIN)

Supporting the success of social impact companies



# Impact Investing

Investible themes in public markets

## Life essentials

Affordable housing



Clean water and sanitation



Sustainable agriculture and nutrition



Health



## Human empowerment

Safety and security



Education and job training



Digital divide



Financial inclusion



## Environment

Alternative energy



Resource efficiency

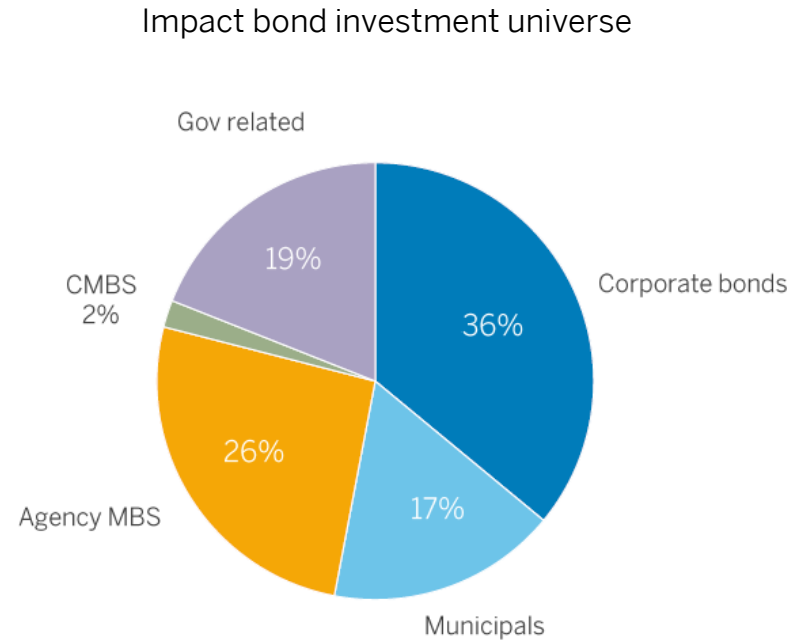
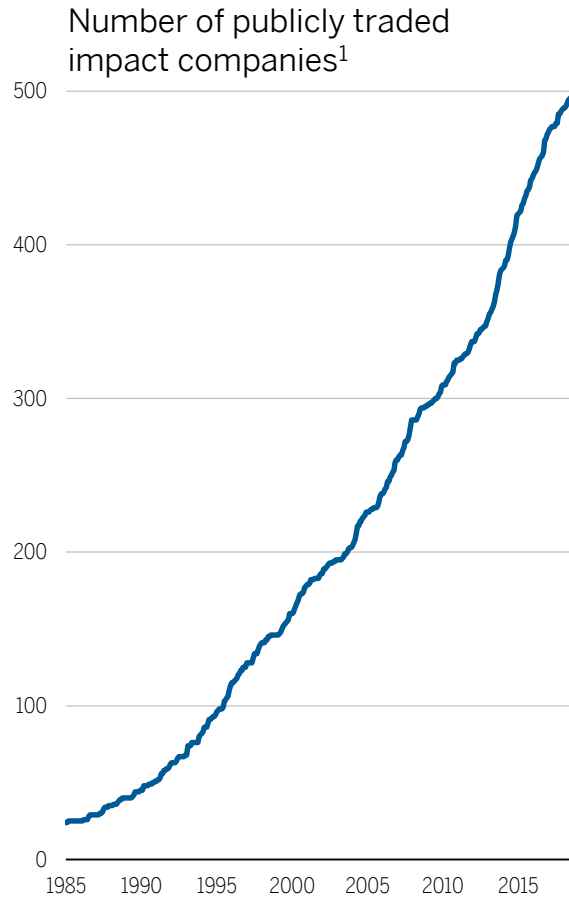


Resource stewardship



# Market Inefficiency

## Impact universe is growing, but is not well defined



Impact investment universe is greater than \$1 trillion and 350 issuers

<sup>1</sup>Updated semi-annually. As of 31 December 2019. The proprietary opportunity set reflects Wellington Management's fundamental research on individual companies. | Sources: Wellington Management, FactSet | Chart data: January 1985 – December 2018  
Bond Impact universe size is estimated as of November 2019 based on Wellington Management's Global Impact Bond Team's assessment framework and definition of impact investments in fixed income

## Role in Overall Portfolio

### Impact Equity and Impact Bond

#### Potential return enhancement

Potential exposure to disruptive, innovative companies/issuers targeting large, under-served markets

#### Values alignment

Seeking companies/issuers whose core business addresses critical social and environmental issues

#### Diversification/completion

Equity: Exposure to companies and secular themes that tend to be under-represented in traditional strategies

Fixed Income: Provide core fixed income exposure, investing globally across fixed income sectors

#### Liquid impact complement

Seeking public-markets security component of an overall impact investing strategy

<sup>1</sup>The characteristics presented are sought during the portfolio management process. Actual experience may not reflect all of these characteristics, or may be outside of stated ranges.

## Impact investing

### Fixed income investment example: South American water sanitation



#### Problem

Water treatment needs exist in parts of South America, where portions of the population lack adequate wastewater collection services

#### Potential solution

Improve access to clean water by lending to a water sanitation company to expand its operational footprint

#### Impact measurement

- ✓ 8,900,000 people provided clean drinking water representing 4.3% of the total population of the country

For illustrative purposes only. The example shown was selected because it was deemed representative of the investment process. It is not representative of all of the securities purchased, sold, or recommended for clients. It should not be assumed that an investment in the example shown has or will be profitable. Actual holdings will vary for each client and there is no guarantee that a particular client's account will hold any or all of the securities listed. Actual occurrences may differ from any forward looking statements made.

### Measurable KPI

- ✓ 10 million metric tons CO<sub>2</sub>e GHG emissions avoided through use of renewable diesel



## Impact Investing

Equity investment example - Resource stewardship  
Collection and re-purposing of food waste



### Problem

Transportation accounts for 20% of global GHG emissions<sup>1</sup>

The world is expected to use 50% more energy by 2050<sup>2</sup>

### Impact solution

Renewable diesel feedstock supplier and producer offering fuels that can reduce emissions from transportation. The company develops & produces renewable energy by repurposing food waste, which contributes to the shift in the world's long-term energy balance initiative.

### Investment case

Favorable economics of renewable diesel, which results from more favorable sourcing, vertical integration and better access to pre-treatment facilities. Attractive valuation for entry point.

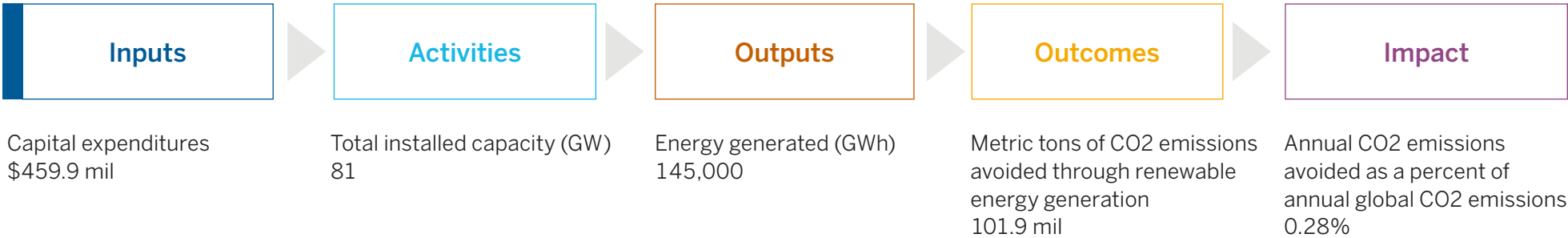
<sup>1</sup>Our World in Data | <sup>2</sup>International Energy Outlook 2019, US Energy Information Administration| The example shown is presented for illustrative purposes only and is not to be viewed as representative of actual holdings. It should not be assumed that any client is invested in the (or similar) example, nor should it be assumed that an investment in the example has been or will be profitable. Actual holdings will vary for each client and there is no guarantee that a particular client's account will hold the example presented. | Wellington determines the goals and targets that, in our view, each portfolio company aligns with. | Wellington supports the United Nations Sustainable Development goals. A decision to invest should take account of all the characteristics and objectives described in the offering documents.





# Impact investing

KPI's: measuring, monitoring and reporting impact



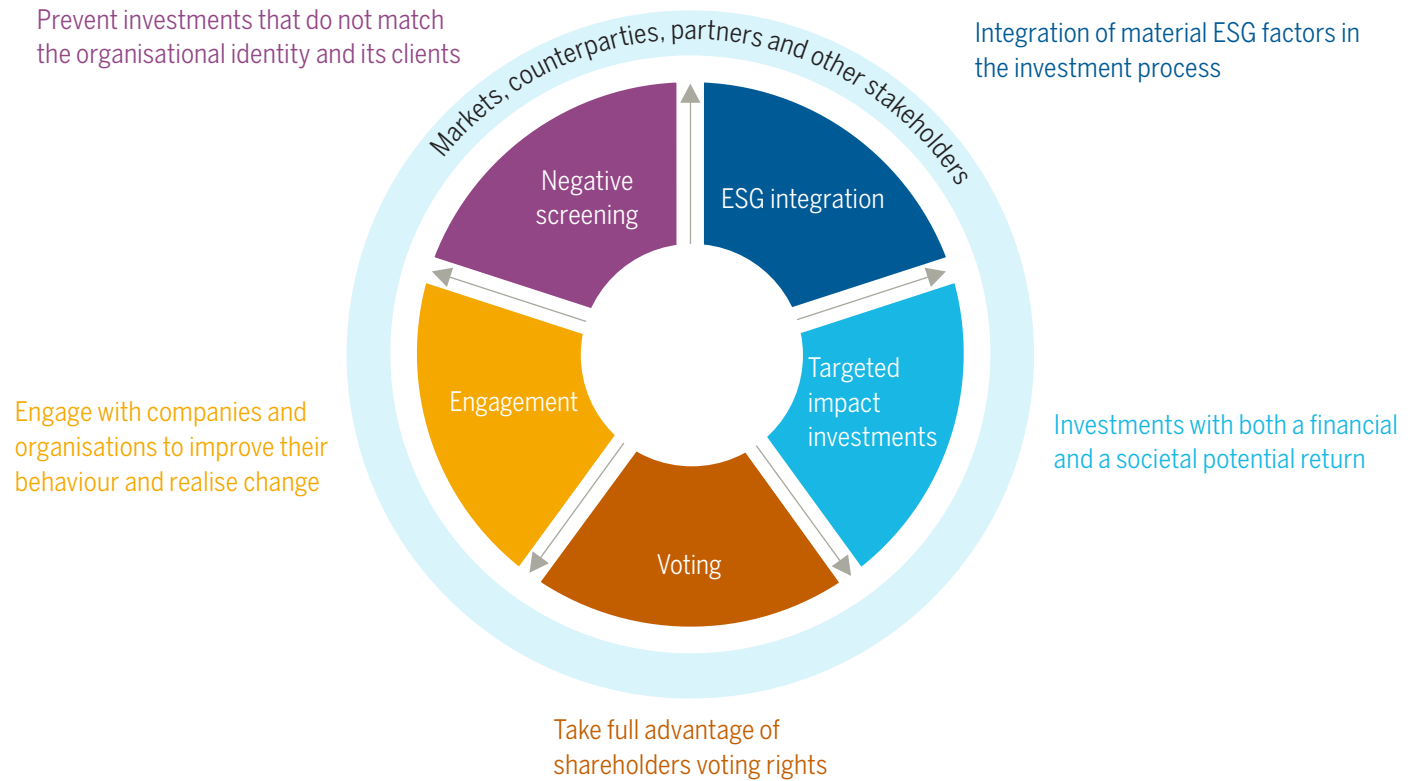
## Wind turbine company



Developed on a company-by-company basis, based on IRIS taxonomy, leveraging direct engagements, company reports, publications, and databases. IRIS is the catalogue of generally-accepted taxonomy and performance metrics managed by the Global Impact Investing Network (GIIN), a nonprofit organization dedicated to increasing the scale and effectiveness of impact investing. The example described is presented for illustrative purposes only and is not to be viewed as representative of actual holdings. It should not be assumed that any client is invested in the (or similar) example, nor should it be assumed that an investment in the example has been or will be profitable. Actual holdings will vary for each client and there is no guarantee that a particular client's account will hold the example presented.

# Sustainable Investing in practice: Putting the pieces together

## Implementation strategy example

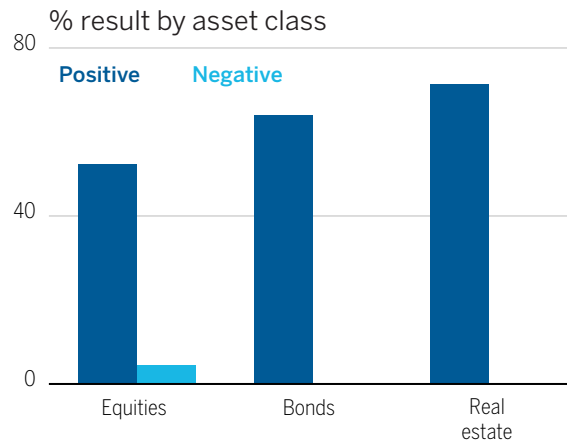




# ESG Integration

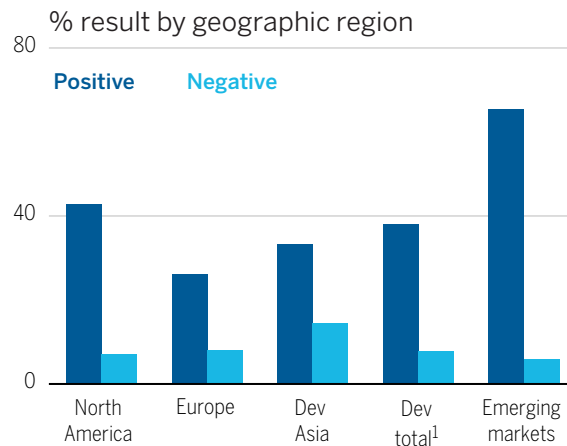
## Does it add value?

### Studies of ESG and corporate financial performance link



Available empirical research from 2,200+ studies supports the general conclusion that

- Proper ESG integration can benefit performance
- ESG integration works across asset classes
- Negative results from ESG integration tend to be rare



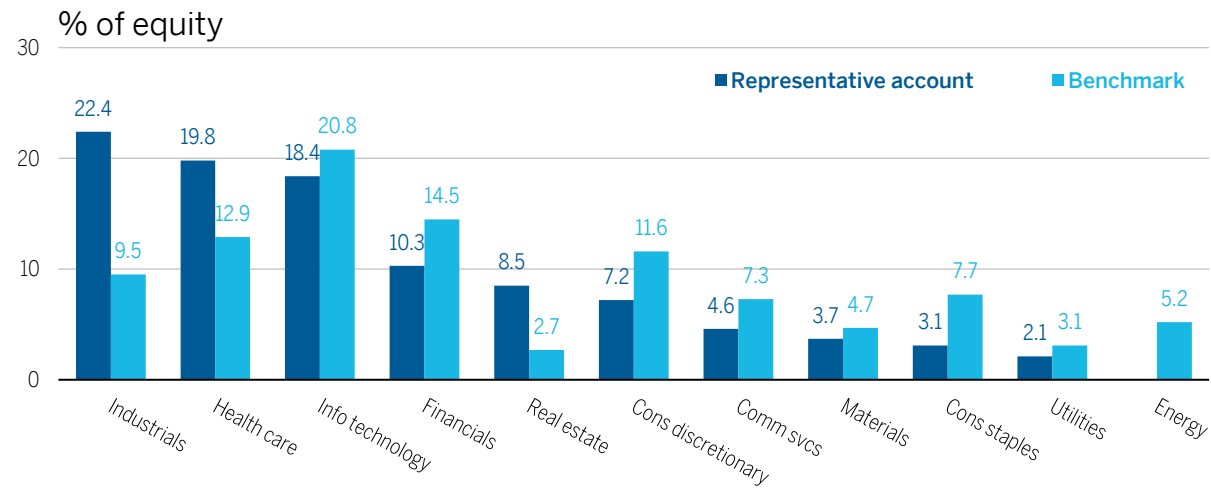
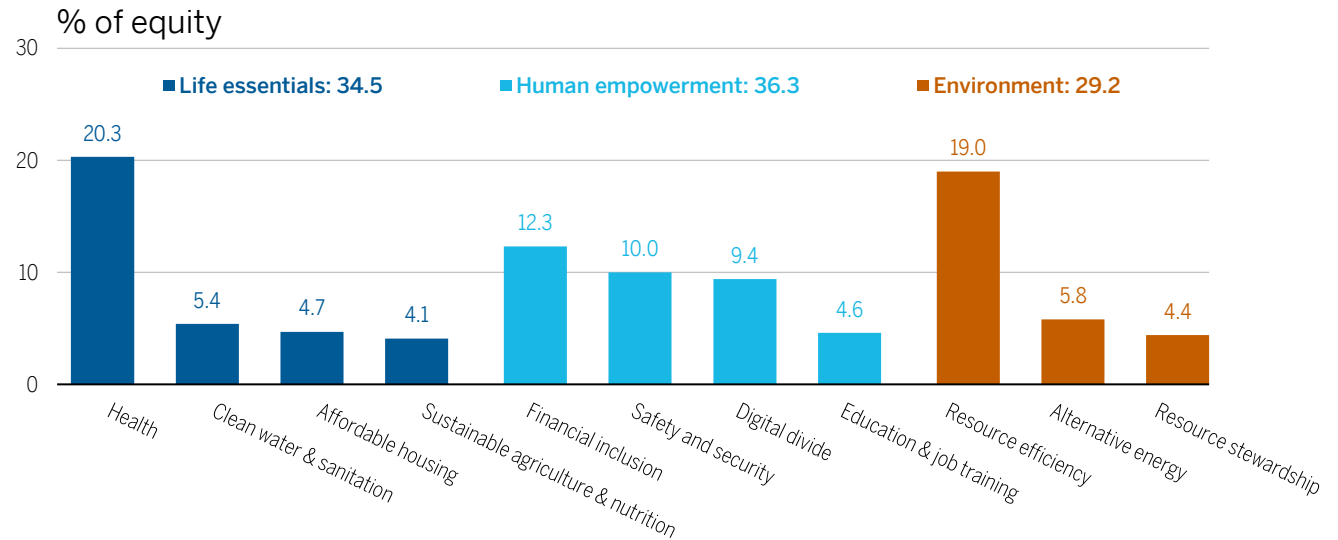
More focused studies suggest

- ESG may work best as a signal in Emerging Markets
- This may be attributable to ESG factors' tendency to correlate with
  - Quality
  - Low volatility

<sup>1</sup>Refers to total developed countries, including North America, Europe, Developed Asia, Australia and New Zealand. | Sources: Deutsche Bank – Friede, Busche, Basseen (December 2015), Wellington Management

## Global Impact

Representative account impact sectors and themes as of 30 September 2022



Benchmark: MSCI All Country World Index | Sums may not total due to rounding. | The data shown is of a representative account, is for informational purposes only, is subject to change, and is not indicative of future portfolio characteristics or returns. Please refer to the Important Disclosures page for additional information.

# Engagement on Impact and ESG issues in 2021

## 2021 ESG and Impact engagement activity by company

Environment	E	S	G	I	Human empowerment	E	S	G	I	Life essentials	E	S	G	I
<b>Alternative energy</b>					<b>Digital divide</b>					<b>Affordable housing</b>				
Acciona	●	●	●		GoDaddy	●	●	●	●	Katitas	●	●	●	
First Solar	●	●	●		MediaTek	●	●	●	●	Nexity	●		●	●
Vestas Wind Systems <sup>1</sup>	●	●	●		Vodacom			●	●	Sun Communities		●		●
<b>Resource efficiency</b>				●	<b>Education and job training</b>					Vonovia			●	
Advanced Drainage Systems	●	●	●		Duolingo <sup>1</sup>		●		●	<b>Clean water and sanitation</b>				
Alexandria	●		●	●	Laureate		●	●	●	Evoqua Water Technologies	●			●
Boston Properties	●		●	●	Seek		●			Tetra Technologies	●	●	●	●
Hubbell	●		●	●	Udemy <sup>1</sup>				●	Watts Water Technologies	●	●	●	
Itron		●	●	●	Upwork	●	●	●	●	Xylem	●		●	●
Landis+Gyr	●	●		●	YDUQS		●	●	●	<b>Health</b>				
Niu Technologies	●	●	●	●	<b>Financial inclusion</b>					Agilent Technologies		●	●	●
Rivian Auto			●	●	Bank Rakyat Indonesia	●	●	●		Agilon Health		●	●	●
Samsung SDI			●	●	Block	●	●	●	●	Amedisys	●	●	●	●
Schneider Electric	●	●	●	●	Etsy	●	●	●	●	Baxter International	●	●	●	
Signify		●	●	●	Globe Life		●	●	●	Boston Scientific		●	●	
SK Innovation <sup>1</sup>		●	●		Old Mutual			●	●	Danaher	●	●	●	●
Trane Technologies	●	●	●	●	OneMain		●	●	●	Eisai	●	●	●	
Wabtec	●		●	●	Pagseguro <sup>1</sup>		●	●	●	Hapvida Participacao <sup>1</sup>		●	●	●
<b>Resource stewardship</b>					Popular		●	●	●	Health Catalyst		●	●	●
Ball Corp	●	●	●	●	Safaricom			●		Hikma Pharmaceutical		●	●	
Covanta <sup>1</sup>	●		●	●	Shriram Transport			●		Illumina	●	●	●	●
Darling Ingredients	●	●	●	●	StoneCo <sup>1</sup>	●	●	●	●	Insulet		●	●	●
					<b>Safety and security</b>					Invitae <sup>1</sup>			●	
					Chroma		●	●		National Vision			●	●
					Cyber-Ark Software		●	●	●	Philips <sup>1</sup>	●	●	●	
					Mimecast	●	●	●	●	Shenzhen Mindray	●	●	●	
					MIPS		●	●	●	Tigermed <sup>1</sup>		●	●	
					PGT	●	●	●		<b>Sustainable agriculture &amp; nutrition</b>				
					Rapid7	●	●	●	●	Genus	●		●	●
					Sentinelone <sup>1</sup>				●	Koninklijke DSM	●	●	●	●
					Stantech	●	●	●	●	Nomad Foods			●	●
										Zoetis <sup>1</sup>			●	

<sup>1</sup>Sold during 2021 | E = Environment, S = Social, G = Corporate governance discussions, and I = Impact. The companies shown comprise a complete list of all engagement meetings in which Wellington Management's ESG team and Impact participated in 2021. The specific securities identified are not representative of all of the securities purchased, sold, or recommended for clients. It should not be assumed that an investment in the securities identified has been or will be profitable. Actual holdings will vary for each client and there is no guarantee that a particular client's account will hold any or all of the securities listed. This is not to be construed as investment advice or a recommendation to buy or sell any specific security. A decision to invest should take account of all the characteristics and objectives described in the offering documents.

## Sustainable investing

### Resources

#### Reading list

ESG Made Simple (PLSA, 2019)

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ESG and Stewardship: A practical guide to trustee duties (PLSA, 2019)

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Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD, 2017)

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The ABC of ESG (Mercer, 2018)

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Stewardship Guide and Voting Guidelines (PLSA, 2020)

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ESG and climate change for pension funds (Sackers, 2020)

#### Training

PRI Academy – Getting Started in RI (3 hours)

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PRI Academy – RI for Trustees (2 hours)

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Certificate in ESG Investing – CFA (130 hours)

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