Global Advisory ESG Newsletter

December 2023 – Edition 5

1 Global political themes – COP28 concluded with mitigation actions agreed, which should have a material impact on the energy transition:

- The **global stocktake** recognised that emissions need to be cut by 43% by 2030 vs. 2019 to fulfil the Paris Agreement 1.5°C goal and the need for **adaptation finance to be significantly scaled up**
- **"Transitioning away from fossil fuels"** - the long-negotiated wording in the Summit's final text referenced "transitioning away" vs. the more definite "phase out" - despite the battle and delays to get there, it does represent a historic agreement, key measures included;
- Pledge signed by 118 countries to **triple global renewable energy capacity** by 2030
- Pledge from major oil and gas companies accounting for 40 per cent of global oil output to reduce their carbon emissions from their operations to net zero by 2050 and to **eliminate methane emissions** by 2030
- Basic agreement on the key features of a **global loss and damage fund**, agreed during COP27, with several nations collectively pledging an initial total of $420m
- Announcement of plans for a joint "end-to-end integrity framework" aimed at ensuring the **integrity of voluntary carbon markets**, covering both demand side (SBTi, VCMI) and supply side (ICVCM) standards

2 Spotlight – lithium market overview

The R&Co GA Global Metals & Mining team have advised on key transactions and financings in the lithium sector in the last two years and can provide insights into this important commodity market.

Context: lithium extraction and processing – lithium is abundant but challenging to extract, comes from brine (e.g. saline water in Atacama desert) and hard rock (e.g. Western Australia), and is a key input for automotive batteries. Refined mainly in China, the supply chain, criticised for environmental impact, requires extensive transport and energy-intensive processes, relying significantly on thermal coal, the source of 50-60% of China's energy.

Price volatility – until late 2022, lithium prices soared, exceeding $50,000/tonne (compared to $10,000/tonne in 2020). However, 2023 witnessed an 80% drop, earning lithium the title of worst-performing commodity of the year.

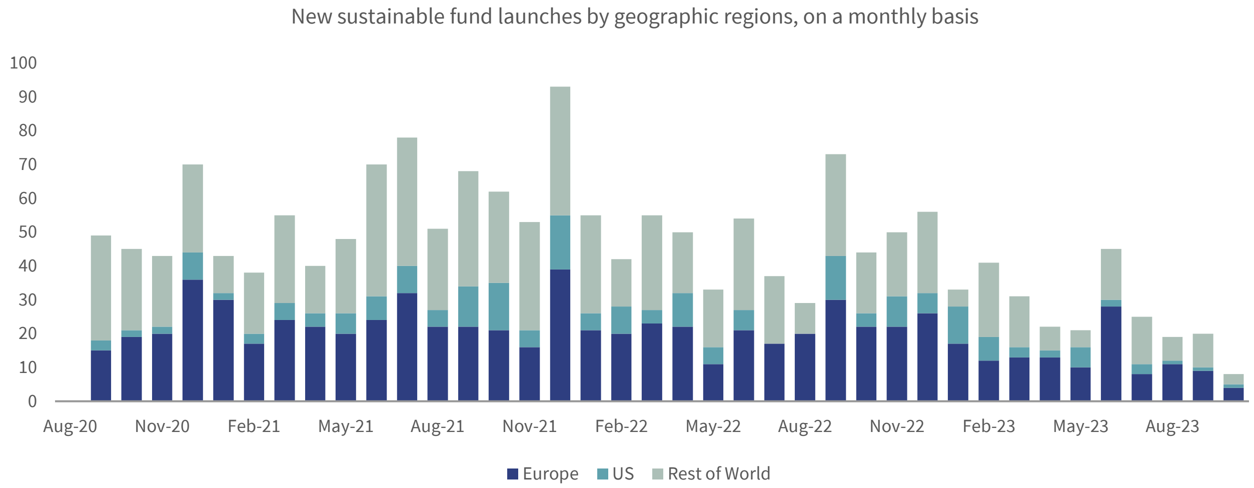
Supply and demand dynamics – as prices increased fivefold in a year, supply surged, with new projects gaining financing. On the demand side, China's economic slowdown, lower growth in western auto EV demand, and cost-related challenges for consumers contributed to a sharp repricing.

Resilience in the sector – Despite price declines, M&A activity in the lithium sector remains resilient, with over 40 transactions announced since 2021, and high profile large transactions in Australia and the US. Chinese outbound investments continue apace, alongside investments in direct lithium extraction (DLE) technology and exploration, supported by influential backers like Bill Gates, Jeff Bezos, and US oil majors, underscoring enduring confidence in the lithium market's potential.

3 Sustainable investment themes – changes and more regulation

Tightening of French ESG requirements - France tightened criteria for ESG fund labelling under its SRI label in November. **SRI funds** need strict exclusion criteria for coal companies, non-conventional O&G companies as well new O&G projects. Companies need to demonstrate a transition plan in line with the Paris agreement. Morningstar estimated the new rule could lead to €7 billion of Oil & Gas divestments.

Sustained decline in the number of sustainable equity funds launched throughout 2023 across all geographies.



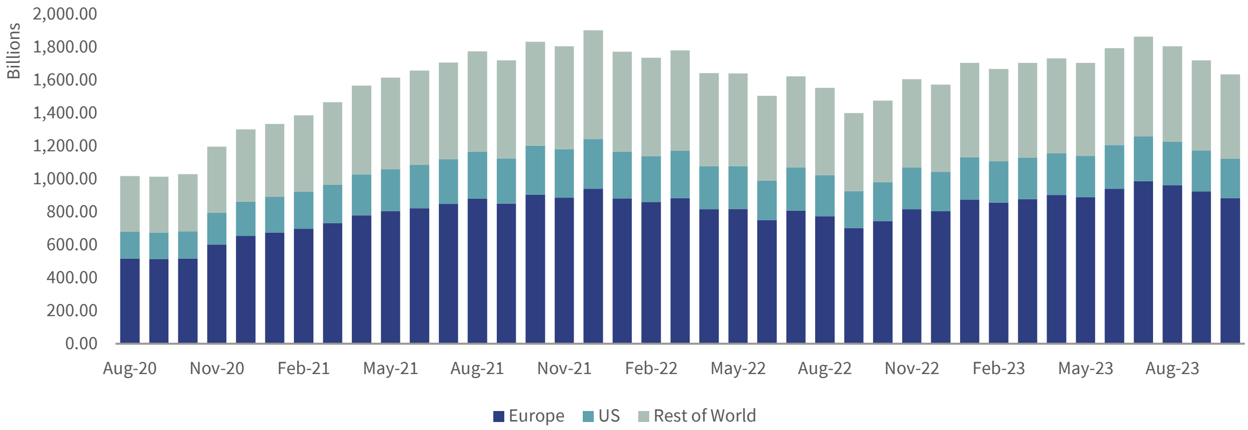
FCA greenwashing measures – FCA confirmed a 'substantial package of measures to improve the trust and transparency of sustainable investment products and minimise greenwashing' on 29 November and an anti-greenwashing rule will be combined with product labels, naming, and marketing requirements.

Greenwashing scrutiny in the consumer sector – UK Competition regulator announced in December it is investigating whether Unilever overstated claims on how 'green' some of its products are, including and whether images and logos make products appear cosmetically greener. Recycling claims are also in focus – European Consumer Rights organisations, in November, announced legal complaints against Coca Cola, Nestle and Danone for 100% recycled/recyclable claims on plastic water bottles.

European Commission closed a consultation on the **Sustainable Finance Disclosure Regulation (SFDR)** in December, seeking to capture views on the usefulness and compatibility of the current rules, and changes to disclosure requirements. It may result in the adoption of a new 'labelling' approach and a reclassification of sustainable products (Article 8 & 9 funds), through legislation, impacting ESG fund flows.

Steady decline in net assets held by sustainable equity funds during Q3 2023, impacted from net outflows in October 2023 and capital depreciation.

Total net assets held by sustainable funds by geographic region, on a monthly basis



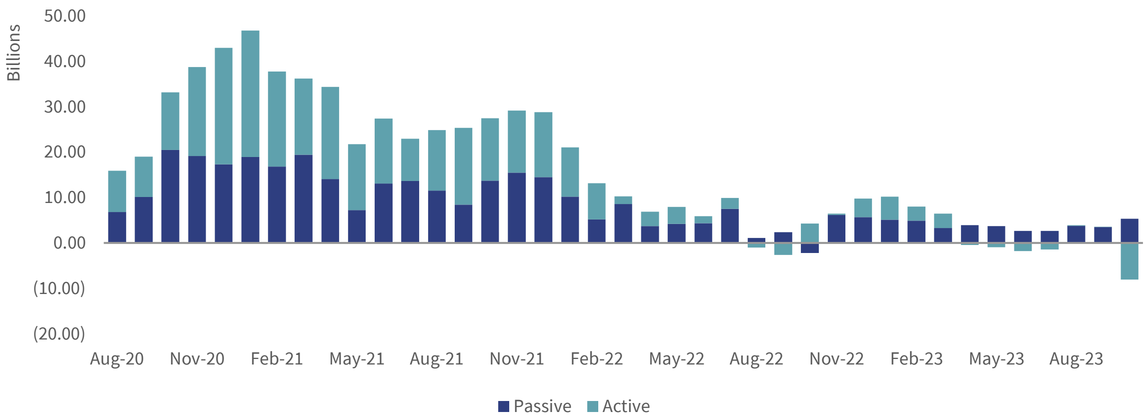
UK seeking to regulate the ESG ratings industry as early as January 2024 – this aligns with the EU Commission and against a backdrop of global focus. The Treasury is examining whether regulating ESG agencies will require fresh legislation or could be achieved through measures implemented under existing laws, the remit of the FCA.

FIG sector criticism of UN backed net zero science-based targets (SBTi) – (validation scheme for defined pathways for companies and financial institutions to reduce greenhouse gas emissions): HSBC and Standard Chartered have left the scheme in November while Societe Generale and ABN Amro Bank have raised concerns that the targets are too stringent. SBTi is anticipated to launch a new standard to assess financial institutions' net zero goals, with criteria including strict limitations on fossil fuel financing.

PCAF launched a new Accounting and Reporting Standard for Capital Markets in December, providing a framework for financial institutions to measure and disclose the GHG emissions associated with capital market business activities, complimenting prior guidance to measure and disclose emissions related to lending and investment activities.

Significant outflows from sustainable active equity funds in October 2023, despite sustained positive inflows into passively managed funds. Passive funds represent a growing share of sustainable capital under management, increasing from 11.6% of EuM in June 2023 to 12.5% of EuM in September 2023 for article 9 funds.

Estimated net flows across sustainable funds by management type, on a monthly basis



4 Public market themes – bond and equity markets

No evidence of pricing benefit for ESG-labelled debt – in research published in October, the European Securities & Markets Authority noted that it could not confirm a systematic pricing benefit for any ESG-labelled debt type as of March 2023. ESG bonds did benefit from a statistically significant pricing in the past driven by their credentials.

New green bond regulation – adopted in October, allows issuers to use European Green Bond labels (EGB), helping demonstrate legitimacy when raising finance for environmentally sustainable projects. The regulation requires at least 85% of bond funds to align with the EU Taxonomy, which will be fully implemented at the end of 2024.

Bpifrance received strong interest from investors for its €1.25bn inaugural social bond in October, maturing in 2027 with a fixed interest rate of 3.50% and a final orderbook over €2.9bn. Bpifrance now expects ESG bond issuance to make up 50% of its funding requirements in 2024.

Republic of Colombia raised $2.5bn in November from its first ever social bonds issued in the international market, in a five-times oversubscribed deal, aiming to utilise public debt to reform the labour, pension, and health sectors. It included two separate Global bonds: *$1.25bn 8.0% due 2035* and *$1.25bn 8.75% due 2053*.

5 Private equity activity

Investment in start-ups has declined for a second year – total VC and PE investment is down 50.2% YoY. However, funding in Climate Tech start-ups has not fallen as far, down 40.5% and in Q323, Climate Tech's share of private market investment grew to 11.4% vs 9.2% in 2022, increasing share in a muted market.

Sustainable aviation and automotive sector financing continued: hydrogen-electric aviation startup, ZeroAvia, raised $116m. Macquarie invested €175m in sustainable aviation fuel platform SkyNRG. Energy-saving motor startup, Infinitum, raised $185m, to drive industrial decarbonization in November.

Renewable energy and impact focused funds find investment:

- BlackRock raised c.$1 billion in client commitments at initial close of energy transition and energy security-focused Evergreen Infrastructure Fund.
- KKR raised $2.8 Billion for an SDG-Focused Global Impact Fund - KKR Global Impact Fund II. The new fund more than doubled the size of its predecessor fund and focuses on Climate Action, Sustainable Living, Lifelong Learning, and Inclusive Growth.
- CIP raised $2 Billion for Bioenergy Renewable Infrastructure Fund. The advanced Bioenergy Fund focuses on decarbonization of sectors via advanced biofuels and biogas.

6 2023 AGM review – and looking ahead in 2024

UK material remuneration changes and higher dissent in Europe– over 60% of companies with a policy vote made a material change to their remuneration policy in 2023, including increasing shareholding requirements, reducing and aligning pension contributions. 35% increased quantum, citing benchmarking (45%), recruitment (32%) and US competition (16%) as rationale. In Europe, the share of remuneration report votes contested increased from 39.4% in 2022 to 42.9%.

Remuneration ESG KPI's now mainstream in UK– 88% of FTSE350 companies are now linking remuneration to environmental and social measures vs. 75% in 2022, 60% in 2021. Proxy advisor guidance is for specific, measurable KPI's, clearly linked to strategy.

Say on Climate Proposals dropping in 2023 in UK with only 7 companies seeking approval for climate transition plans vs. 17 in 2022.

US - AI related AGM shareholder resolutions emerging – Apple and Microsoft were amongst six US companies targeted as investors seek clarity on the ethical governance of AI. The PwC 2023 Investor Survey in November, of 345 global investors and analysts, reported that 72% had concerns around bias and discrimination issues from AI.

OUTLOOK FOR 2024: UK code updates and climate, diversity and cyber requirements strengthened

New UK corporate governance code expected in January 2024 with the stewardship code is under review – in November, FRC announced it was scaling back proposed revisions with over half of original proposals withdrawn. Enhanced risk management and internal controls reporting proposed will be retained.

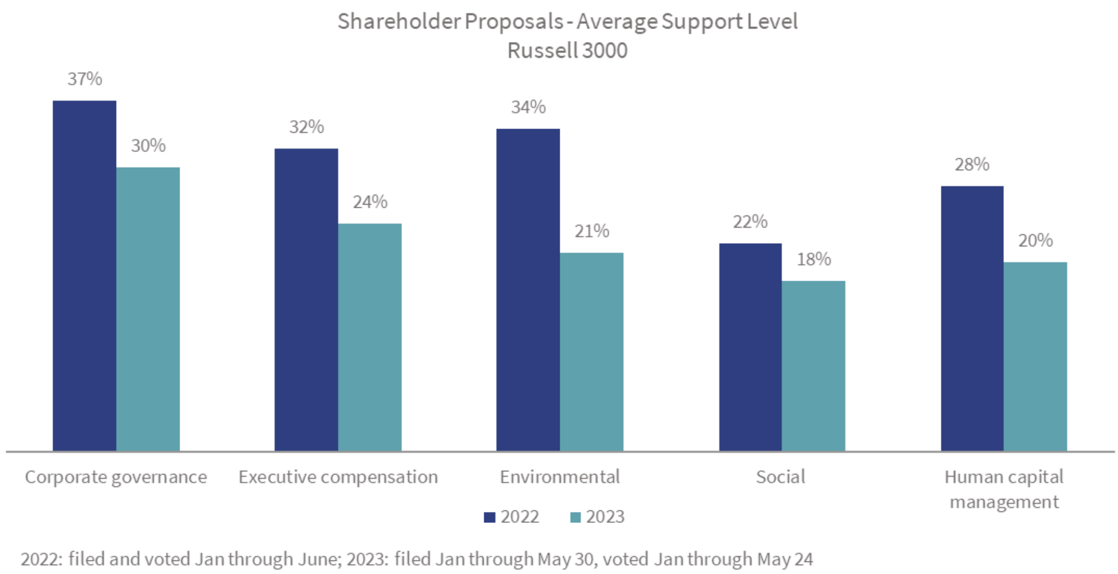
In Switzerland, the first reporting on non-financial matters is required for the first full business year as of 1 January 2023, published and submitted for approval in 2024.

Diversity target reporting mandated for UK corporates in 2024 – "comply or explain" statement required describing whether specified targets for women and ethnic minority representation on boards is met alongside a standardised numeral disclosure on ethnic background and gender identity.

Glass Lewis policy for **director accountability for climate related issues** to increase scope – policy will apply to all FTSE100 companies operating in industries where SASB has determined that companies' GHG emission represent a financially material risk.

Cyber risk oversight policy similarly expanded – where a company has been materially impacted by a cyber-attack, shareholders can expect periodic updates communicating company process towards resolving and remediating impact.

US saw a sharp decline in support for shareholder proposals across resolutions since 2022, notably environmental, possibly resulting from an increase in the number of shareholder proposals, corporates taking action on key issues, and institutional investors assessing proposals on a case-by-case basis.



7 Rothschild & Co ESG related Q4 transactions and projects

- Adviser to Banks Group and Banks Renewables on the 100% sale of Banks Renewables to Brookfield Asset Management
- Adviser to Banks Group on the sale of the 1.45GW Thorpe Marsh Green Energy Hub to West Burton Energy

- Severn Trent £1bn equity issue to fund growth and green initiatives
- Debt advice to ESP Utilities Group on a £120m financing
- Financial adviser to Mitsubishi in relation to the divestment of its 50% interest in Blackwater and Daunia coal mine
- Adviser to Aéroports de Lyon on its sustainability-linked €274m refinancing and potential change in regulatory regime
- Adviser to Inspired Villages Group on £150m green development facility
- Adviser to Komatsu on the acquisition of American Battery Solutions

Other highlights from Rothschild & Co's sustainability events and strategy:

- Rothschild & Co hosted the CDP's 'Future of environmental reporting' pre-COP event in October in London
- Rothschild & Co and Redburn Atlantic hosted an Energy Transition Conference in London (September) and New York (October), providing a platform for dialogue between transition investors and interesting companies working on solutions to support the low-carbon transition
- The GA Energy Transition Committee was formed to harness the significant expertise across GA to support clients spanning all sectors as they decarbonise their businesses and find new technologies and solutions
- Rothschild & Co 2022 Sustainability report published in April 2023, view here

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