Rothschild & Co
Global Advisory

Global Advisory ESG Newsletter

October 2023 – Edition 4

1. Global political themes – ‘security and polarisation’

The **G20 summit** in India in September **focused on security concerns rather than setting new major climate goals** and provided **no new detail around how the estimated $4 trillion green transition bill can be funded.**

The US, India, Saudi Arabia and UEA announced a **new trade corridor intended to connect India to the Middle East and Europe**. The new route is seen as a potential counter to China’s Belt and Road initiative and Biden noted the ***“endless opportunities for clean energy, clean electricity, and laying cable to connect communities”*** created by the route.

Election cycles are creating political polarisation around ESG with 2024 elections in Taiwan, US, UK and India – a series of events that has the potential to cause uncertainty for transition related investment and impact transition progress.

Speculation around COP 28 in December continues - despite public debates about the credibility of the UAE venue and presidency, **expectations are high for a more concrete action plan to transition the global economy towards a low-carbon future**, with a focus on the role of business as well as developing nations. **Governments are expected to agree on commitments to double energy efficiency, triple renewable energy capacity, and double hydrogen production** to 180m tonnes a year by 2030.

The African nations are forming more demanding alliances – the inaugural African Climate Summit, held in Nairobi from the 4 - 6 September in the run-up to the COP 28, culminated in the signing of **The Nairobi Declaration**, which **calls for the imposition of global carbon pricing and for top polluters to pay a tax that will in turn enable poorer nations to roll out green energy systems**.

2. International, National and State pressures are seeking to drive change

The UN called on financial institutions to *"end fossil fuel lending, underwriting and investments in coal"* in order to avoid 'climate catastrophe' stressing at a press conference in June that, alongside Governmental support, the fossil fuel industry should utilise its *"massive resources to drive, not obstruct"* the global transition to renewable energy.

California filed a civil lawsuit against Big Oil companies including Shell, BP, Chevron and ExxonMobil, on the 15 September, **accusing the companies of covering up climate change risks**. The civil action is seeking damages to help mitigate costs of global warming caused by fossil fuels. Climate Disclosure Bills were passed in September, which require large public and private companies conducting business in the state to disclose their scope 1, 2 and 3 emissions, beginning in 2026.

Germany passed a bill on 8 September to **phase out oil and gas heating systems**. The bill is part of Germany's drive to become **climate neutral by 2045** but is a **watered-down version of the initial draft**, which would have imposed the green switch much earlier, and caused huge dispute amongst the ruling coalition. The conservative stance viewed the bill as too costly, while the environmentalists argued it was not strong enough.

Following the Supreme Court ruling against affirmative action, US companies have cut back on public discussions of workplace diversity: **reference to diversity, equity and inclusion on earnings calls and at conferences among Russell 3,000 Index companies fell by 54%** in the third quarter vs the year prior and to the lowest levels since 2018 according to Bloomberg data.

Increasing focus on defence and ESG - an opinion piece published by the UK Government, co-written by the Treasury Minister and Defence Minister, cited the ***"troubling misunderstanding within investor preferences and the defence sector"*** and challenged investors to review and think about the importance of defence investments for ***'long term democratic freedoms.'***

In France, **MPs voted in favour in July of mandatory Say on Climate plans for corporates** with a final vote in October. If passed, the amendment would make France the first country to propose a national requirement for listed companies to disclose their climate transitions plans and implementation, which shareholders can vote on.

European parliament agreed to raise the **renewable energy share from 30% to 42.5% by 2030 and loosen permitting procedures following last minute concessions to the nuclear power industry** in France and Eastern Europe. The EU energy commissioner said the upgraded target was *"the right signal to attract the massive investment required…a game-changer for renewable deployment."*

EU continues to push the energy transition and circular economy agenda: with a new Battery Regulation coming into force on 17 August. The regulation entails more sustainable, circular and safer battery usage by ensuring that *"batteries have a low carbon footprint, use minimal harmful substances, need less raw materials from non-EU countries, and are collected, reused and recycled to a high degree in Europe."*

The **EU carbon border adjustment mechanism (CBAM),** which requires firms in the blocs to pay tariffs on carbon-intensive imports, entered into transitional application on 1 October. Imports of materials such as cement, iron and steel, aluminium, fertilizes, electricity and hydrogen are required to report on the value of their imports and embedded greenhouse gas emissions, which has the potential to place an administrative burden on both importing and exporting companies.

3. Complex changing regulatory & reporting requirements

Key regulatory developments in the last quarter, mainly from the EU, include:

European Council issuing the final set of sector-agnostic European Sustainability Reporting Standards (ESRS) on 31 July – a set of reporting rules underpinning the Corporate Sustainability Disclosure Regulation **(CSRD)** which will come into force for the largest companies from 2024. This latest update has **watered down disclosure requirements for some indicators for companies on materiality grounds** but is still extensive.

The watered down ESRS is creating gaps between proposed corporate disclosures and investment related sustainability disclosures under SFDR regulation. The **approach to SFDR is now under review** and out for public consultation.

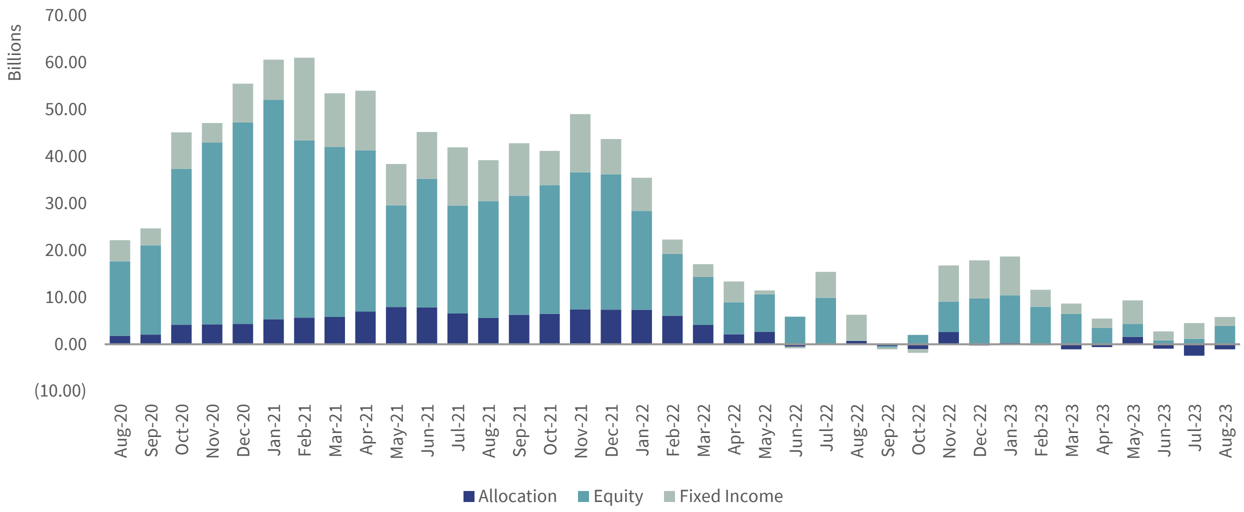
Whilst **uniformity amongst the global reporting landscape appears unlikely,** a **'building block approach' to reporting** is expected to emerge. Where the IFRS Sustainability Disclosure Standards (ISSB) are likely to form the baseline for other countries without disclosure standards, focusing on the concept of 'financial materiality', ESRS build on this and apply an additional lens of 'impact materiality.'

The **Final Task Force for Nature related Financial Disclosures (TNFD) recommendations on nature related have been published in September** with 14 recommended nature-based disclosures and implementation guidance. Corporates and investors can now begin the process of adopting the voluntary guidance after two years of design and pilot testing by 200 companies and investors – some companies, including GSK, have already announced their intention to adopt TNFD and work towards nature positive outcomes through business decisions and support the goals of the Kunming-Montreal Global Biodiversity Framework, others will indirectly be disclosing in line with key elements of the framework as part of ESRS implementation.

4. Public market themes

Sustainable Flows in Europe continue to be positive, but the US and Rest of the World are seeing net outflows; fixed income continues to dominate new flows

New sustainable fund launches by geographic regions, on a monthly basis



Greenhushing' - refers to the trend of some corporates and/or institutional investors to **be less vocal about their Net-Zero commitment due to the potential reputational risk** as a result of taking a stance on sustainability issues.

Whilst some investors are becoming less vocal, other **investors are taking more radical or vocal action:**

In response to the **UK announcement of changes to carbon trading** – a move that has been criticised as reducing the cost of polluting. Nicolai Tangen, CEO of **Norway's sovereign wealth fund, which owns c2.5% of every listed European company, expressed concern** *"to me, climate is about as political as gravity. It's just not political. I don't understand how you can turn this into politics."*

The Church of England Pensions Board announced on 22 June that it had divested from Shell and remaining oil and gas holdings before exiting the Net Zero Asset Owner Alliance in July, evidencing internal dissension amongst Net Zero Alliance coalitions. UKSIF issued an open letter to Prime Minister, Rishi Sunak, which highlighted **recent public statements** (such as the boost to North Sea oil and gas production and electric vehicle target changes) and **policy signals, risk undermining the UK's leadership in its commitment to net zero**. The letter, publicised on 28 August, is signed by 36 investors responsible for £1.5tn in AUM.

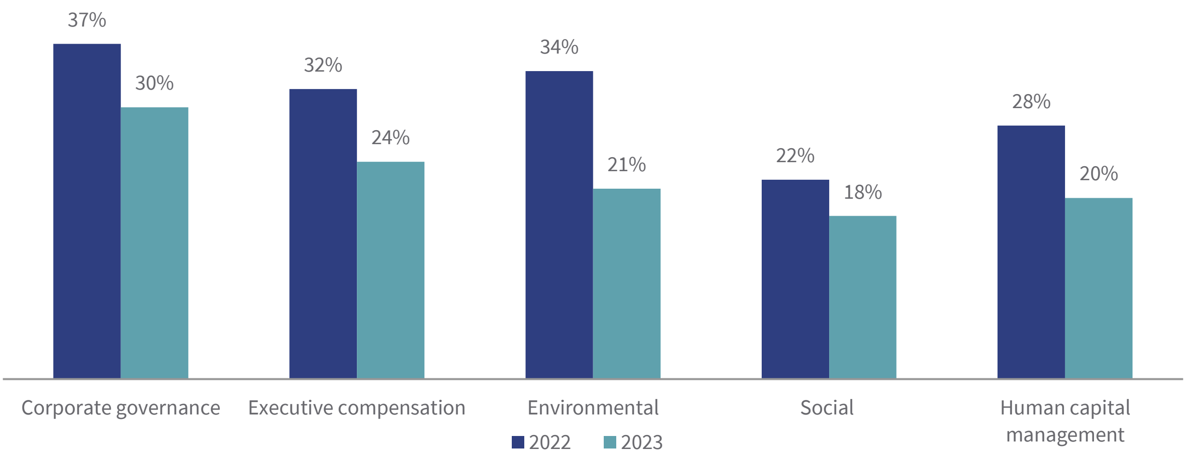
Blackrock balancing act continues – Blackrock avoided ESG references in Q2 results to focus on marketing the energy transition as "*one of the greatest investment opportunities.*" Aligning with comments made by CEO Larry Fink in June "***I'm not going to use the word ESG because it's been misused by the far left and the far right.***" The launch of the **Brown to Green Materials Fund (Article 8) is a recent example and targets undervalued carbon intensive companies**, looking for the valuation discount to close as production processes transition over time. In July, **Amin Nasser, the Saudi Aramco CEO was appointed as an Independent Board Director with Fink** highlighting Nasser's "**understanding of the global energy industry and the drivers of the shift towards a low carbon economy.**"

Material fines for greenwashing –DWS, German asset manager (AUM €859bn), agreed to **pay the US securities regulation (SEC) $19mn in July to settle greenwashing charges**. This is the SEC's highest penalty against an investment advisor and is likely to become more of a focus with a recent **SEC amendment** which **requires 80% of holdings in US public investment funds to match their names**.

AGM season in 2023 – polarisation and agreements between activists and corporates

Both 'pro and anti ESG' resolutions increased but the underlying picture also complicated lower support and withdrawals: +12% ESG-related shareholder proposals in 2023, in the US the number of proposals dubbed 'anti-ESG' also increased from 21 in 2021 to 88 in 2023. The lower levels of support seen for ESG shareholder resolutions from 34% to 21% in 2023 **obscures a trend of some proposals being withdrawn ahead of AGMs in return for corporate commitments**.

Average support for shareholder proposals - Russell 3000 index, 2023 AGM



2022: filed and voted Jan through June; 2023: filed Jan through May 30, voted Jan through May 24

A report published in August by think-tank, InfluenceMap, suggests **US managers appeared to have lessened their support of climate goals, in the wake of *"anti-ESG"* rhetoric**. The think-tank evaluated actively held assets of the world's 45 largest firms, managing $72tn in assets. *"Stewardship efforts appear to have stagnated":* average asset manager **support of climate resolutions** presented to corporate boards was at 35% in 2019, which grew to 61% in 2021, before **falling to 50% in 2022**.

ESG Financing Market - strong momentum for the sustainable bond market and a couple of ESG inaugural issuances in the equity linked market:

- Eni, the integrated oil & gas company, **placed the first Sustainability-linked convertible bond issuance in the sector**. The €1bn seven year bond will be convertible into Eni existing ordinary shares under the share buyback programme. The issuance is linked to reducing Net Carbon Footprint Upstream (Scope 1 & 2) and the increase of Renewable Installed Capacity.
- On 22 September, Snam, the gas pipeline company and one of the main issuers of transition bonds in the debt market, **placed a €500m five year EU Taxonomy aligned transition bond**. exchangeable for existing ordinary shares of Italgas.

Other products have attracted attention as well, such as the **first debt-for-nature swap in Continental Africa** which closed on 15 August: Gabon finalised the deal, worth $500mn, which funnels cash to conservation in return for lower interest rate on the nation's debt and longer repayment time. The **deal is a sign that more developing countries are turning to new ways to address high debt financing, whilst aiding conservation**.

In the **credit ratings space, the S&P dropped ESG scores from credit ratings with immediate effect** in August: the agency will no longer rank companies' ESG risk from one to five.

5. Private market themes

- **Main themes – large decarbonisation and AI related capital raises**
  - **Largest private placement in Europe this year** - H2 Green Steel Raises **Over $1.5 Billion** to Build First-Ever Large-Scale Green Steel Plant, capable of producing steel with 95% lower emissions.
  - KKR Invests **$750 Million in London based Transport and Grid Decarbonization Solutions** Company Zenobē.
  - Lyten, a pioneer **in 3D graphene decarbonizing super-materials, raised $200M** in series B equity round led by Prime Movers Lab, with significant participation from Fortune 500 leaders including Stellantis, FedEx and Honeywell.
  - Water management and leak-prevention solutions provider Wint Water Intelligence announced that it has raised $35 million, with proceeds from the financing aimed at supporting its growth and innovation in its AI- and IoT-based solutions.
- **Sustainability integration is diverging in capital allocation** - Pitchbook Sustainable Investment Survey in July, showed that between 2021 to 2023, **more private investors have integrated sustainable investment principles**, growing from 30% in 2021 to 37% in 2023. However, there has also been an **increase in private investors with no plans to incorporate sustainability into their investment work,** going from 9% in 2021 to 17% in 2023.

6. R&Co recent ESG related transactions and projects

- The second **Rothschild & Co & Redburn Atlantic Renewables Conference** brought together 15 energy transition Companies presenting on carbon mitigation, decarbonisation solutions for industry, transportation, hydrogen and renewables (September 2023)
- **Nucera IPO:** sole financial advisor to thyssenkrupp AG on the €605m carve-out IPO of thyssenkrupp nucera AG & Co. KGaA, a leading global electrolysis technology provider for green hydrogen plant solutions (July 2023)
- **Costain:** sole debt adviser to Costain on its refinancing with a new 3-year £85m sustainability linked revolving credit facility, and £270m of surety and bank bonding facilities (August 2023)

- **Renewi**: debt advice to Renewi plc on the refinancing of their green and sustainability linked €400m RCF (August 2023)
- **Banks Group Ltd:** sole financial advisor on the 100% sale of its renewables business to Brookfield Asset Management (October 2023)

7. Recent ESG related Investor Feedback – focus on ratings agencies, disclosure and engagement

RATING AGENCIES – experiencing increased criticism by Companies and Investors

"All of our analysis is done in-house. We don't use any of the rating agencies because they are too focused on risk mitigation vs actual impact. Broadly we assess companies along the lines of a more refined version of the UN STGs." **– Long-only manager, UK**

"We don't like MSCI due to industry adjustments and the fact it can be gamed" **– Long-only manager, London**

"On ESG ratings, we look at more raw data from companies now as some of the ratings agencies are getting criticised."' **– Long-only manager, Frankfurt**

"In terms of ESG ratings agencies, we use Sustainalytics, but we will also talk to the company, so we don't rely on one method to assess a company's ESG credentials." **– Long-only manager, UK**

DISCLOSURE & ENGAGEMENT – investors are seeking increased amounts of engagement and specific disclosure

We try and engage with a company as much as possible, so when it comes to AGM voting season, a voting platform may recommend voting against a policy, we will not follow this blindly. We will try an engage with the company to understand why these things are popping up." **– Long-only manager, UK**

"Currently, we are trying to engage with companies who make up a larger part of our portfolios, as we are taking a bigger role to be responsible investors. For important holding[s] we are trying to really understand the business in greater depth via discussions … this will give us a base and we then aim to see how companies compare on some key metrics such as product control, safety control, manufacturing, and off-label use. It has been very interesting for us because companies can be doing wonderfully well from a data point of view but when the internal processes and cost to control isn't up to scratch then they can clearly have issues. – **Long-only manager, UK**

"In today's world, you need a dedicated resource, you need to have ESG sustainability reports. From our side of the fence, increasingly we are having to show those credentials to our investors about how we look at it, what we consider, what we will not invest in, and we see where we get to. We have to have that." **– Long-only manager, UK**

"Five or ten years ago, ESG was the kind of thing that might have been mentioned at the end of a meeting with management, almost a page in the appendix which the FD would say, 'oh, by the way, we did this,' or 'we just appointed a new person to the board who offers this set of qualities.' These days most management teams get the fact that it should be something that they are proud to speak about throughout the meetings, from the beginning of the meetings, and almost use it as a virtuous pillar to stand on top of and shout about. It is definitely a good thing to hear about and almost you cannot overemphasise your ESG credentials if you have got good credentials to talk about." **– Long-only manager, UK**

Additional resources related to Rothschild & Co's sustainability strategy and performance can be found below:

- Rothschild & Co 2022 Sustainability report published in April 2023, view here
- Rothschild & Co 2022 Climate Impact Report is available to view here

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