



WHEB

October 2016

## Responsible Investing: Engagement Report Q3 2016

*The Paris Agreement on Climate Change will now enter into force from the beginning of November. We believe that this is an historic moment.*

*We've been delighted at the speed with which the Paris Agreement has been ratified by the world's governments*

### Introduction

While preparing this edition of the quarterly Responsible Investing report, the news arrived that the European Union had successfully ratified the Paris Agreement on Climate Change. The Agreement will now enter into force from the beginning of November. We believe that this is an historic moment, but also recognise that in many respects the hard work is only now beginning. We've remained engaged in this process through the IIGCC and report below on their work as well as wider policy work that we are doing through other fora to support the development of a sustainable financial system.

This report also touches on a perennial challenge that we face, and that is the lack of corporate disclosure on environmental, social and governance (ESG) issues. We describe below a couple of recent examples where this has been the case and where our engagement has helped to uncover valuable additional information, while encouraging these businesses to report more comprehensive ESG information.

### Keeping the pressure on climate policy

Through the Institutional Investor Group on Climate Change (IIGCC) WHEB has been supporting efforts to ensure that the world's governments remain ambitious in their efforts to accelerate action to reduce greenhouse gas emissions and limit climate change.

In August, WHEB, along with other members of the IIGCC, wrote to the governments of the G20 nations calling on them to ratify the Paris Agreement, implement the recommendations of the 2015 Global Investor Statement on Climate Change and support the doubling of investment in clean energy by 2020.<sup>1</sup>

We've been delighted at the speed with which the Paris Agreement has been ratified by the world's governments and believe this sends a vital signal on the importance of this issue. The agreement will now enter into force in November 2016.



We were also pleased to see the emphasis put on green finance at the G20 meeting that took place in China in September. The final communique issued by the G20 clearly emphasised the need to scale up green financing as a route to delivering economic growth while addressing environmental and financial risks.<sup>2</sup> These points were then subsequently re-emphasised by the Governor of the Bank of England Mark Carney when he encouraged Germany, which holds the next presidency of the G20, to keep the focus on green finance.<sup>3</sup>

### Supporting sustainable finance

WHEB has also been a supporter of an initiative from the think-tank E3G to encourage the European Commission to ensure that their Capital Markets Union (CMU) strategy include an explicit commitment to sustainable finance. The Capital Markets Union is a European initiative to help mobilise capital for projects around Europe. The E3G initiative aims to encourage the Commission to ensure that sustainability is seen as an integral part of this objective by focusing on sustainable infrastructure and inclusive development that respects the Paris Agreement on Climate Change and that companies and financial institutions properly understand and report on their exposure to climate-related and other ESG risks.

The group supporting the initiative, which includes investment managers as well as NGOs such as Carbon Tracker, ShareAction and WWF and academics such as the Smith School at the University of Oxford hopes to meet with Commissioners involved in the CMU in the coming weeks.

<sup>1</sup> The full text of the letter is available at

<http://tinyurl.com/zdyk3nd>

<sup>2</sup> <http://tinyurl.com/gre5hpj>

<sup>3</sup> <http://tinyurl.com/zzubzko>

## Company Engagement

### ■ Using engagement to fill in the blanks

Although it is now nearly a quarter of a century since the first corporate environmental reports were first published, far too many companies still do not provide useful disclosures on how they manage key environmental and social issues. This is particularly true for US businesses, and even more so for small and mid-sized businesses of the type that WHEB routinely invests in.

This lack of disclosure represents a challenge for us because our investment process operates best when we are able to form a view on a company based on a wide range of data sets including ESG-related data. However, it is our experience that companies with strong disclosure are not necessarily the best at managing ESG issues, and conversely, poor disclosers are not necessarily bad at managing ESG issues<sup>5</sup>.

For example, two recent investments in our fund include Nautilus, a US manufacturer of fitness equipment, and STERIS another US business that provides cleaning and sterilisation services for the health care and research sectors. Both are mid-sized US businesses that provide rather rudimentary ESG disclosure. In both cases, however, we discussed their approach to critical ESG issues and were able to conclude that both companies have a strong approach to the most important ESG issues facing their businesses. For example, Nautilus sources components for their exercise equipment from China. They do not disclose how they audit their Chinese suppliers, but they told us that they conduct quarterly audits on health and safety and labour standards as well as wider aspects of quality.

STERIS discloses that it has both ISO14001 (environment) and OHSAS18001 (safety) certifications but clarified in conversation with us that they also have impressive programmes focused on minimising water, hazardous chemical and energy use in their business.

STERIS stated that we were the first investor that had ever asked them these questions and we encouraged both businesses to disclose more information to investors in-line with the emerging best practice in this area.

### ■ Linking executive compensation with environmental and social issues

We are strongly of the view that environmental, social and governance issues can have a material impact upon a company's financial performance, particularly over the long-term. As long-term investors, we are keen to see management teams incentivised to generate performance over a multi-year time horizon and believe that one way to do this is to link a part of the long-term incentive plan with strong performance on critical ESG issues.

This was also one element of the red lines voting initiative that we have been pilot testing in the UK this year. We analysed six UK businesses and found that none had clearly linked executive remuneration with social or environmental performance and as a result we voted against the remuneration report and/or the Chairman of the remuneration committee at each company's AGM. In some cases, including with Oxford Instruments and Renishaw, companies reported to the CDP that they link monetary incentives for management with the achievement of

emission reduction targets. However, these references could not be found in the remuneration report or policy. We are writing to the companies in question to seek further clarification on these issues and will report on their responses in future editions of this report.



## Industry initiatives:

### ■ UN-PRI assessments



The UN Principles for Responsible Investment is the world's leading industry initiative aimed at promoting responsible investment. As a member of the UN-PRI, WHEB is assessed annually on its commitment to responsible investment and the quality of our approach in integrating ESG into our investment process. Our annual submission is available online as well as the UN-PRI's assessment of our performance. In 2016 we were delighted to receive the top grade of A+ for all sections of the assessment.<sup>4</sup>

*STERIS stated that we were the first investor that had ever asked them ESG questions.*

*We analysed six UK businesses and found that none had clearly linked executive remuneration with social or environmental performance.*

*In 2016 we were delighted to receive the top grade of A+ for all sections of the UN-PRI assessment.*

<sup>4</sup> To download the full assessment see <http://tinyurl.com/hs4ga4c>

<sup>5</sup> Incidentally this also represents a challenge to ESG research agencies which primarily rely on published information from companies.

*WHEB has been critical of the Morningstar methodology which tends to reward investors for investing in large businesses in mainstream sectors rather than smaller businesses with a positive impact.*

#### ■ The Portfolio Decarbonisation Declaration

In September, WHEB joined the Portfolio Decarbonisation Coalition which is a UN-supported initiative aimed at mobilising a critical mass of institutional investors committed to gradually decarbonising their portfolios. For more information please see <http://tinyurl.com/zbbtcbv>

#### ■ Morningstar Sustainability ratings

The rating agency Morningstar has published 'sustainability' ratings on a wide variety of funds on the market. For many investors, these ratings represent a first step in helping them take account of sustainability in their investments. However, WHEB and several other investors have been critical of the methodology underpinning the ratings used. Their methodology tends to reward investors for investing in large businesses in mainstream sectors rather than small or medium sized businesses offering products and services with a positive impact. It also relies heavily on publically disclosed information which, as we noted previously, does not always give an accurate picture of actual performance. For more on WHEB's concerns with this approach see <http://tinyurl.com/huqo87d>

### Voting record: Q3 2016

The table below summarises the voting record for the FP WHEB Sustainability Fund from 1 July–30 September 2016. Full details of how we voted on each of the individual votes are detailed in Appendix 1 (<http://www.whegroup.com/investment-strategies/listed-equity/fund-governance/engagement-and-voting-records/>) including with rationales for votes against management and abstentions and where we supported shareholder resolutions.

Meetings	# of meetings	%
# votable meetings	6	100%
# meetings at which votes were cast	6	100%
# meetings at which we voted against mgmt. or abstained	5	83%

Resolutions	# of resolutions	%
# votes cast with management	54	84%
# resolutions where votes cast were against mgmt. or abstained (see list in appendix)	10	16%
# resolutions where votes were withheld	0	0%

Company	Topic	Comment	Outcome
Cerner	Auditor independence / CDP	Letter from company	Company response sets out their process for ensuring independence which they believe is robust
Dassault Systemes	CEO compensation / Shareholder resolutions on transparency / Director independence	AGM letter / Meeting	CEO compensation is variable and incl. HR criteria but is not disclosed for competitive reasons. Several shareholder resolutions asked for levels of transparency that were not legal and company argues that the most recent Board directors are independent of management
Ecolab	Shareholder proxy access / Auditor independence / CEO remuneration	Letter from company	Company acknowledged issues but believes its approach is robust.

Company	Topic	Comment	Outcome
Henry Schein	CEO Remuneration / Auditor independence	Letter from company	Company explained approach to CEO remuneration and will consider making length of auditor tenure public
HMS Holdings	Auditor independence	Letter from company / Meeting	Company response sets out their process for ensuring independence which they believe is robust
Kansas City Southern	Fuel efficiency standards	Quarterly update	Co. has increased investment in fuel efficiency programmes
Nautilus	Supply-chain standards and disclosure	Conference call	Company has strong supply-chain audit process but this is not currently disclosed. We've encouraged them to improve disclosure in this area.
Orpea	Excessive scale of equity issuance authorisations / Board independence	Letter from company	Company stated that they do not plan to use authorisations. They also plan to appoint new independent Board Directors in 2017
STERIS	ESG standards	Conference call	Company has strong ESG performance but this is not disclosed. We've encouraged them to improve ESG disclosure.
Xylem	Auditor independence	Letter from company	Company has launched a retender process for the 2017 audit
China Longyuan Power	Lack of pre-emptive rights	AGM letter	No response as of 7 October 2016
Fresenius SE	Low pay-out ratio / Manufacturing safety	AGM voting letter	Teleconference scheduled for October 2016
Halma	Auditor independence / Executive remuneration	AGM voting letter	No response as of 7 October 2016
Intertek	Board responsibility for sustainability	AGM voting letter	No response as of 7 October 2016
Wabco	ESG disclosure	Email	Not response as of 7 October 2016

**Disclaimer:**

This document, its contents and any related communication (altogether, the “Document”) is provided by WHEB Asset Management LLP (“WHEB Asset Management”) and: (1) does not constitute or form part of any offer or invitation to buy or sell any security including any shares in the FP WHEB Sustainability Fund (“Shares” and “Fund” respectively), or any offer to perform investment management or other investment business; (2) should not be relied upon and should not form the basis of any investment decision in relation to Shares or otherwise; any such investment decision should be made only on the basis of authorised material provided to you, legal documents and the advice of your professional advisers; (3) is not and should not be treated as advice of any kind, investment research or a research recommendation; (4) is subject to the copyright of WHEB Asset Management and may not be reproduced without the prior written consent of WHEB Asset Management; (5) any opinions expressed in this Document should not be relied upon as an indication of future performance of the Fund, Shares or any stock market, or of any guarantee of any return from the Fund or Shares; (6) is in summary form and may refer to and may be materially affected by future events, and may contain statements, estimates and projections of anticipated future performance which reflect various assumptions which may or may not be within the control of WHEB Asset Management or be correct; (7) although this Report complies with the obligations set out in the FCA rules, and WHEB Asset Management considers it to be clear, fair and not misleading and has exercised all reasonable care in preparing this Document and it includes information from sources that we consider to be reliable, however no representation or warranty, express or implied, is made as to the accuracy, reliability or completeness of the Document or as to whether any future event may occur, by WHEB Asset Management, its group companies and its or their directors, officers, employees, associates and agents (“WHEB Persons”); (8) is subject to change at any time and no WHEB Person is under any obligation to inform any person of any such change; (9) is only made available to recipients who may lawfully receive it in accordance with applicable laws, regulations and rules and binding guidance of regulatory bodies; (10) in the UK, is only directed at and available to persons who are Professional Clients or Eligible Counterparties; and (11) does not constitute an offer to sell or a solicitation of an offer to buy securities in the United States. To the fullest extent permitted by applicable law, regulation and rule of regulatory body, WHEB Persons shall have no liability for any loss in relation to the Document, however arising including without limitation direct, indirect, consequential or loss of profit.

The prices of Shares and the income from them can fall as well as rise and you may not get back the amount originally invested. This can be as a result of market movements and also of variations in the exchange rates between currencies. Past performance is not a guide to future returns and may not be repeated.

By opening, reading and not returning this Document you agree to and acknowledge the above.

“WHEB Asset Management” is a trading name of WHEB Asset Management LLP, whose registered office is at 23 Hanover Square, London W1S 1JB and which is registered in England and Wales with number OC 341489. WHEB Asset Management LLP is authorised and regulated by the Financial Conduct Authority with Firm Reference Number 496413. Fund Partners Limited (formerly IFDS Managers Limited) is the Authorised Corporate Director of the Fund and is authorised and regulated by the Financial Conduct Authority with Firm Reference Number 469278 and has its registered office at Cedar House, 3 Cedar Park, Cobham Road, Wimborne, Dorset, BH21 7SB.

The state of the origin of the Fund is England and Wales. This document may only be distributed in or from Switzerland to qualified investors within the meaning of Art. 10 Para. 3, 3bis and 3ter CISA. The Representative in Switzerland is ACOLIN Fund Services AG, Affolternstrasse 56, CH-8050 Zurich, whilst the Paying Agent is Bank Vontobel Ltd, Gotthardstrasse 43, CH-8022 Zurich. The basic documents of the fund as well as the annual and semi-annual report may be obtained free of charge at the registered office of the Swiss Representative.

FP WHEB Sustainability Fund is listed on ImpactBase, the online directory of impact investment funds and products.