WHEB's investor contribution

Stewardship and engagement

We define stewardship as the responsible management of money on behalf of savers and pensioners, to create sustainable benefits for the economy, the environment and society.

As investors, at WHEB we believe we have a responsibility – and an opportunity – to advocate for progressive change at the companies in which we invest. Done well, we believe this will benefit the companies as well as society more generally. For WHEB, this is achieved through:

1) **Capital allocation decisions:**
We focus on investing in solutions to sustainability challenges.

2) **Proxy voting:**
We exercise our voting rights at company meetings.

3) **Company engagement:**
We enter into dialogue with investee companies bilaterally and/or collaboratively, escalating where necessary.

4) **Public policy and industry engagement:**
We urge a greater focus on sustainability in the wider financial system, indirectly supporting positive impact businesses.

5) **Reporting:**
We communicate efforts back to investors and other stakeholders.

Stewardship is firmly embedded in our investment process, which assesses investee companies' positive impact on social and environmental challenges, as defined by our nine sustainable investment themes. Engagement and voting activity with portfolio companies is undertaken directly by the Impact Investment Team and underpinned by our views on the materiality[1] of key sustainability issues for the investee business. Our focus is on engagement that underpins the long-term success of the businesses that we invest in.

1. Our views on the materiality of sustainability issues for different business activities are informed by guidance from the International Sustainability Standard Board (ISSB) and other relevant guidance.

2023 in review

The stewardship stampede

New developments such as the UK's Sustainable Disclosure Requirements (SDR)[2] helped to boost asset managers' attention on stewardship activities in 2023. This has been evident in the intensified engagement activities and related disclosures across the industry.[3] However, the quality of some of this work has, quite rightly, been called into question.[4,5,6]

We welcome the greater scrutiny on stewardship and agree with others that there has been an excessive focus on metrics that quantify asset manager stewardship activity levels. But, in addition to unintentionally fuelling the 'stewardship stampede', such datapoints do not adequately capture the depth or nuances of meaningful stewardship work that will influence real-world outcomes.

Moving from quantity to quality

It is critical, in our view, to explain *how* issues are selected, prioritised and then addressed in order to underpin a quality approach to exercising stewardship responsibilities. Though stewardship and engagement are well established within WHEB's investment process, last year we looked to further enhance the overall quality of what we do. We did this by becoming more:

1. Methodical

It is not possible, nor desirable, to engage every investee company on every topic. We have put more focus on how we select which engagements to pursue focusing on a) the most material and b) the most controversial and/or strategic issues.

We have also been clearer about our rationale for engagement. Embedding stewardship in our investment process means that our objectives and priorities are closely aligned with our fundamental interest in the long-term success of the companies in which we invest.[7]

2. Effective

As asset managers we believe we can show correlation but not causation between our stewardship and engagement efforts and real-world outcomes. We do not look to claim additionality in our engagement because outcomes are almost inevitably the result of the efforts of multiple stakeholders. Instead our aim is to look beyond activity levels and understand our effectiveness. Implemented in late 2022, our Objective Milestones Framework (Figure 1) helps this evaluation process.

3. Clear

Reporting is a vital part of our stewardship toolkit. Our focus has been on finding reporting methodologies that help readers and investors interpret our contributions without overwhelming them with voluminous data sets or providing case studies which may not be representative of our engagement activity and outcomes.

We have therefore developed complementary disclosures to evidence how our actions align with outcomes for core issues. Figure 2, for example, shows how the biggest emitters of GHG emissions in WHEB's portfolio have changed their emissions between 2022 (dots) and 2023 (triangles), and also, whether their approach to managing their emissions has become more or less aligned with the Paris Agreement. In the coming year we aim to develop this approach to reporting to cover other key issues such as gender diversity, biodiversity and hazardous chemicals.

Figure 1: Objective Milestones Framework

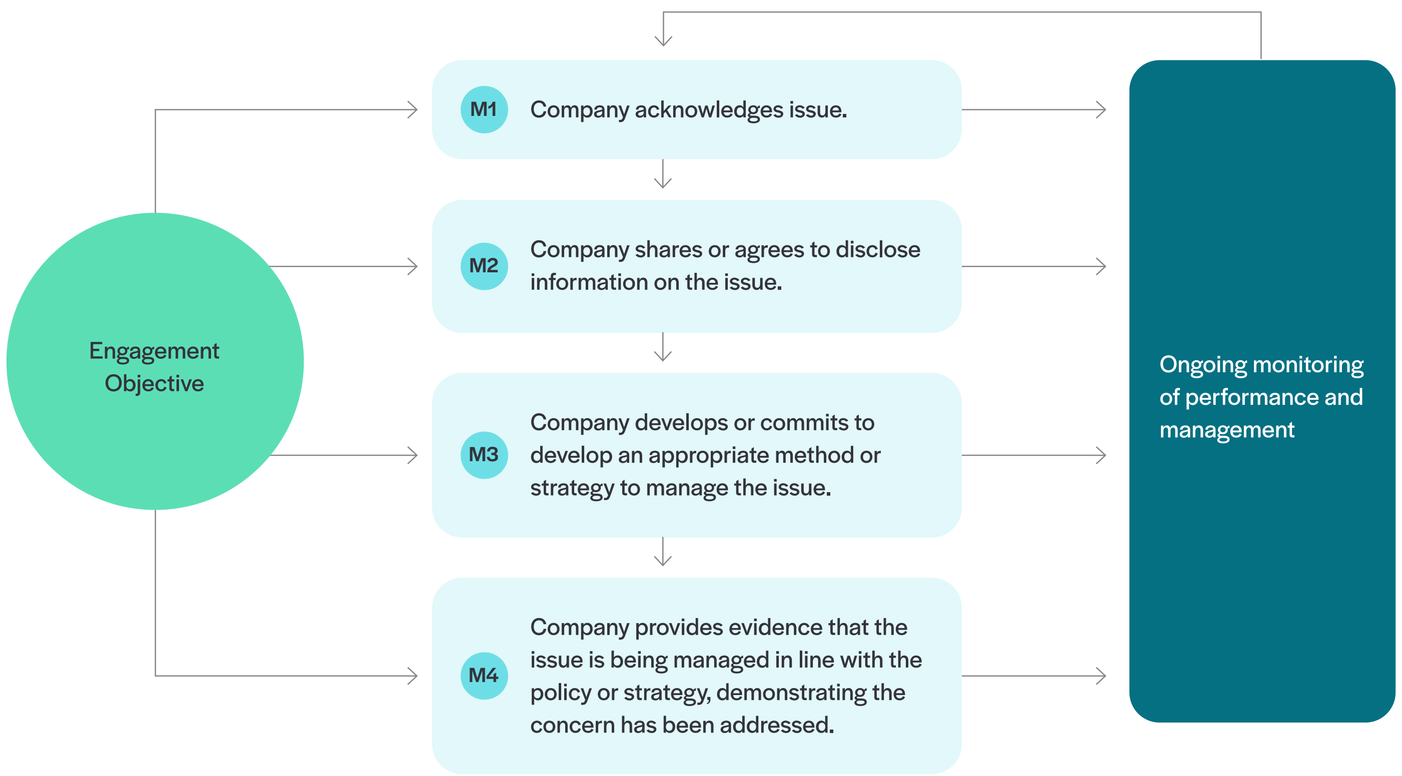
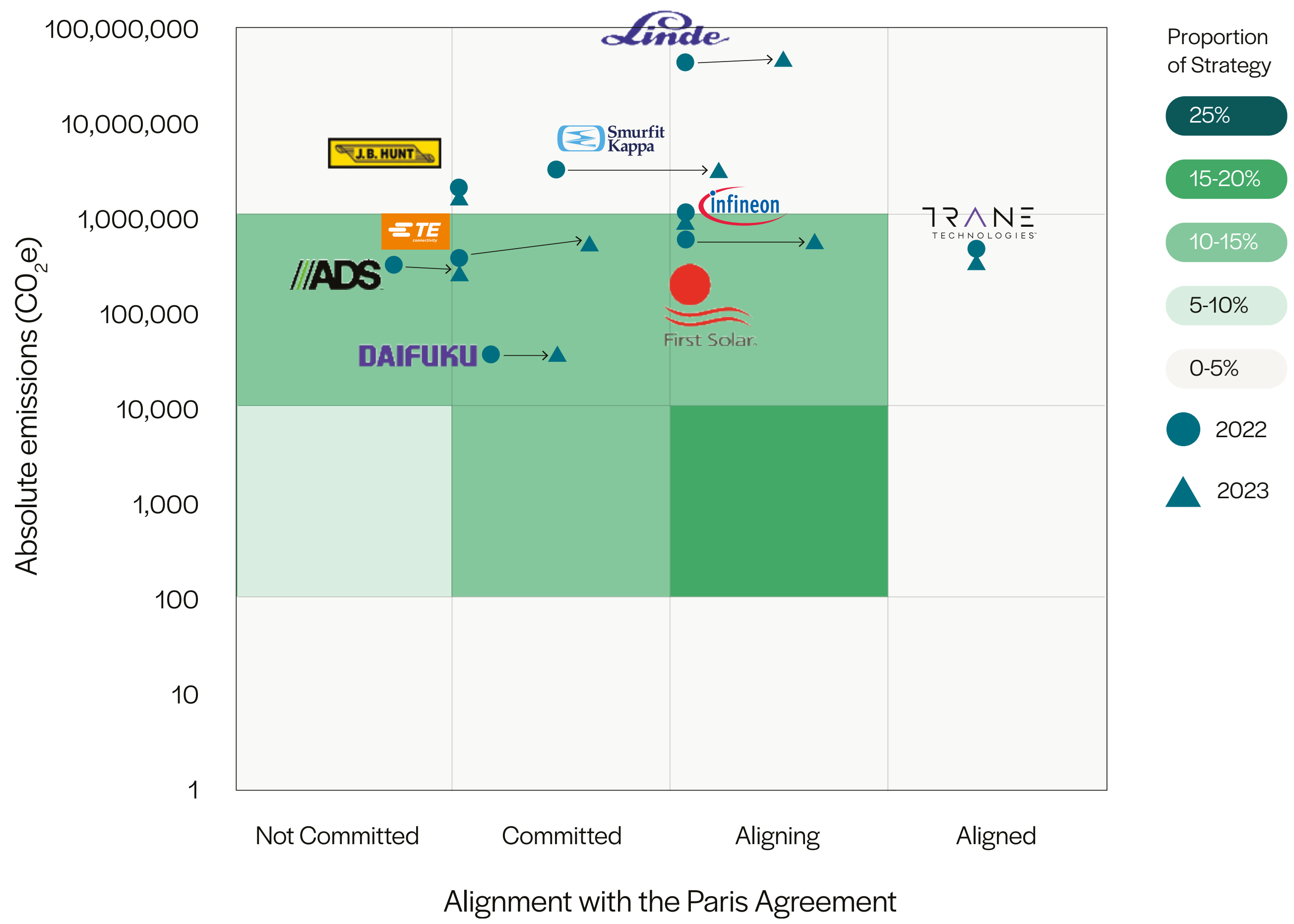


Figure 2: Mapping outcomes on WHEB's portfolio GHG emissions



2. https://www.fca.org.uk/publication/policy/ps23-16.pdf
3. https://redington.co.uk/wp-content/uploads/2022/12/Redington-Stewardship-Code-reporting-FINAL.pdf
4. Hoepner, Andreas G. F., UK Asset Owner Stewardship Review 2023: Understanding the Degree & Distribution of Asset Manager Voting Alignment (November 17, 2023). Available at http://dx.doi.org/10.2139/ssrn.4643377
5. https://www.responsible-investor.com/manager-inconsistency-on-stewardship-drives-growing-frustration-among-uk-asset-owners/
6. https://www.responsible-investor.com/under-resourced-and-ineffective-industry-leaders-deliver-gloomy-verdict-on-stewardship/
7. This is especially important as the power of investor stewardship is increasingly recognised by a variety of stakeholders that may pressure investors to adopt their own agendas.

Engagement activity in 2023

We define a company interaction as an engagement activity where there is a:

- Purposeful dialogue with a company, either bilaterally or collaboratively;
- with a clear objective to address a material sustainability or governance risk or opportunity;
- an identifiable outcome, as gauged by our objective milestones.

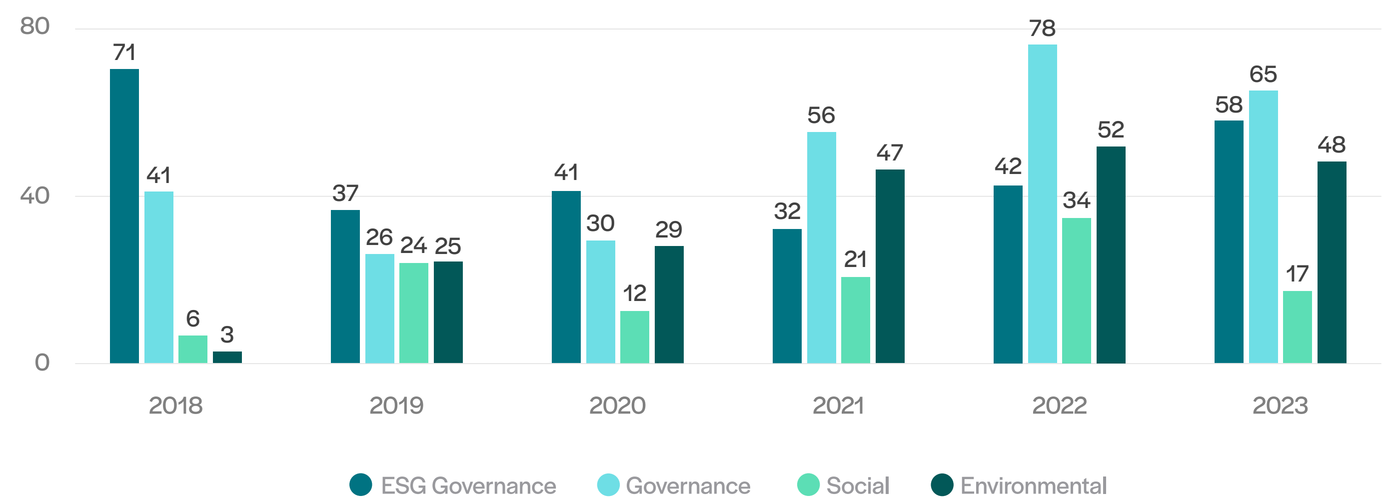
In 2023, we recorded 188 engagement activities approximately in line with increased activity levels from 2020.[8] We continue to engage roughly three quarters of investee companies annually with engagement activities having occurred across 46 companies in 2023 representing 72% of all holdings.[9]

In terms of the topics addressed, (Figure 3) Governance represented the largest proportion, mostly due to persistently low auditor independence. ESG Governance issues constituted a larger portion of our engagement activity compared to the previous year and focused mostly on problematic executive compensation practices. Efforts to advance Environmental objectives remained significant once again including activities on NZC commitments, biodiversity and nature loss and WHEB's involvement with investor initiatives on hazardous chemicals.

Conversely, Social issues comprised the smallest proportion of our engagement activity last year though this work was once again primarily focused on promoting gender diversity.

While this data may indicate our engagement priorities, it reveals little about a) the depth of engagements and b) the progress made which we consider further below.

Figure 3: Engagement topics



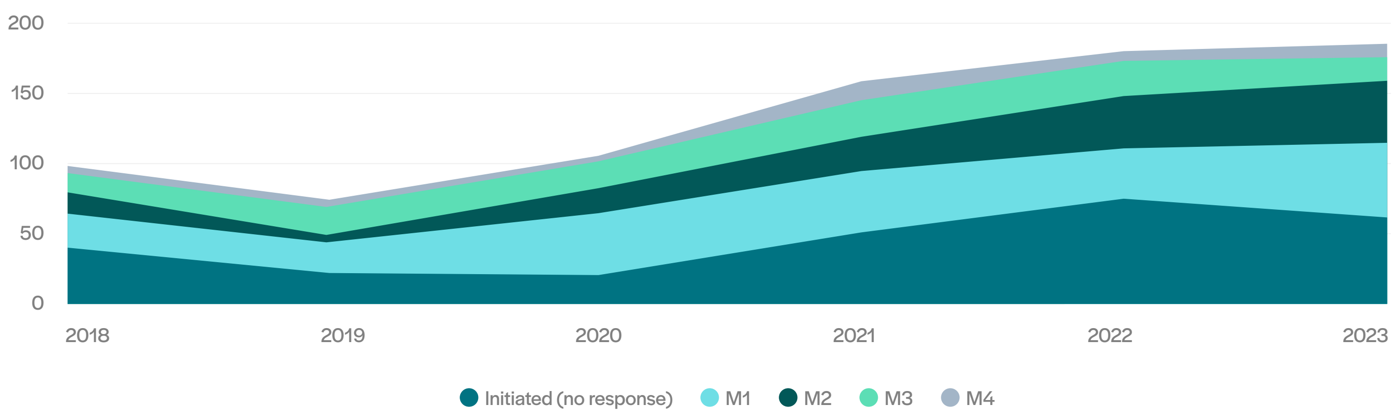
Effectiveness, objectives and milestones

During 2023 we reviewed our engagement activities from 2018 to identify the milestones that have been achieved over this period. Figure 4 shows how the overall amount of engagement has increased during this period, with a greater number of engagements initiated from 2020 to 2022. In turn, this has fed into a proportionally larger number of Milestone 1 (M1) and Milestone 2 (M2) outcomes. With WHEB's engagement objectives often targeting ambitious, long-term changes to strategy and policy, we expect a longer analysis period to demonstrate a similar increase in Milestone 3 and 4 (M3 and M4).

More detailed case studies of our engagement are provided quarterly. Typically, these updates include three case studies that represent the range of issues we engage on and the outcomes we achieve. These are available from our website.[10]

8. Explained by the growth of the Impact Investment Team and WHEB being appointed as subadvisor and fund manager of the iMGP Sustainable Europe Fund in Jully 2022, which includes additional European stocks to the main strategy.
9. This number decreased slightly to 62% in 2022 after onboarding the iMGP Sustainable Europe Fund.
10. https://www.whebgroup.com/investing-for-impact/stewardship/engagement-case-studies

Figure 4: Engagement effectiveness



Collaboration and escalation

Collaborative engagement is an important tool to influence portfolio companies and the financial system as a whole. In 2023, 10% of our activity was conducted in this way, mostly as a means of escalation.

We prefer escalating in this way for several reasons. First, dialogue most easily allows us to ensure that objectives and priorities are positioned within the context of our interest in the company's long-term success. Second, collaboration also avoids certain technical and temporal hurdles linked with escalating through proxy voting and AGM attendance. Finally, given WHEB's longstanding advocacy for sustainable investing, it is not difficult for us to connect with like-minded investors to collectively engage companies.

At the same time, the power of investor stewardship is increasingly being recognised as a key catalyst for effecting change and delivering tangible real-world outcomes. Consequently, more opportunities to join investor initiatives are becoming available each year.

In 2023, for example, we addressed net-zero carbon targets at TE Connectivity via the Institutional Investors Group on Climate Change (IIGCC)'s Net Zero engagement Initiative (NZEI).[11] We have also worked with other investors as part of ChemSec's Investor Initiative on Hazardous Chemicals (IIHC).[12] We joined this initiative in 2021, which aims to phase out hazardous chemicals (Figure 5). WHEB also became a member of Nature Action 100 on its launch in the second half of 2023. We hope this will support the work we have been doing to engage companies on biodiversity and nature loss since 2020.[13]

Collaboration alone is not always effective, though, and occasionally it is necessary to escalate further using other tools such as AGM attendance, as was recently the case in our efforts to engage TE Connectivity via the NZEI.

Figure 5: WHEB's industry networks and associations

11. https://www.whebgroup.com/te-connectivity-nzc-case-study
12. https://www.whebgroup.com/ecolab-engagement-case-study-chemicals
13. https://www.whebgroup.com/our-thoughts/stewardship-in-the-spotlight-nature-calls-from-assessment-to-action

WHEB also aims to shape the wider financial systems to incentivise businesses to deliver more positive social and environmental outcomes. This work is often done through industry initiatives. In the past year, for example, we have collaborated with other investors to promote regulations at International, European and UK level to encourage, among other things, the phase-out of hazardous chemicals, the elimination of plastic waste in the world's oceans, the mandatory publication of climate transition plans and faster action to tackle climate change.

We also participate in industry initiatives promoting high standards in sustainable investing. In 2023 a major focus was on the UK's Sustainability Disclosure Requirements (SDR). WHEB is a member of the Financial Conduct Authority (FCA)'s Disclosure and Labels Advisory Group (DLAG) and has been deeply involved in inputting into this regulation. Further discussion of asset managers' role in shaping financial systems is included below.

WHEB's view on voting

We endeavour to vote all our shares as per our voting policy, and we use voting to complement our other stewardship strategies to achieve effective outcomes.[14] For example, it is our policy to write to company management when we vote against their recommendations, which often leads to further dialogue.

WHEB's voting policy leads us to proactively use routine proposals, such as the election of the chair, as a way of asserting our views on key governance and sustainability issues. For example, our policy states that if a company does not have a NZC target, we will vote against the election of the chair. This approach differs from most fund managers and proxy advisers, who typically vote on sustainability issues only where they are specifically raised in a shareholder resolution.

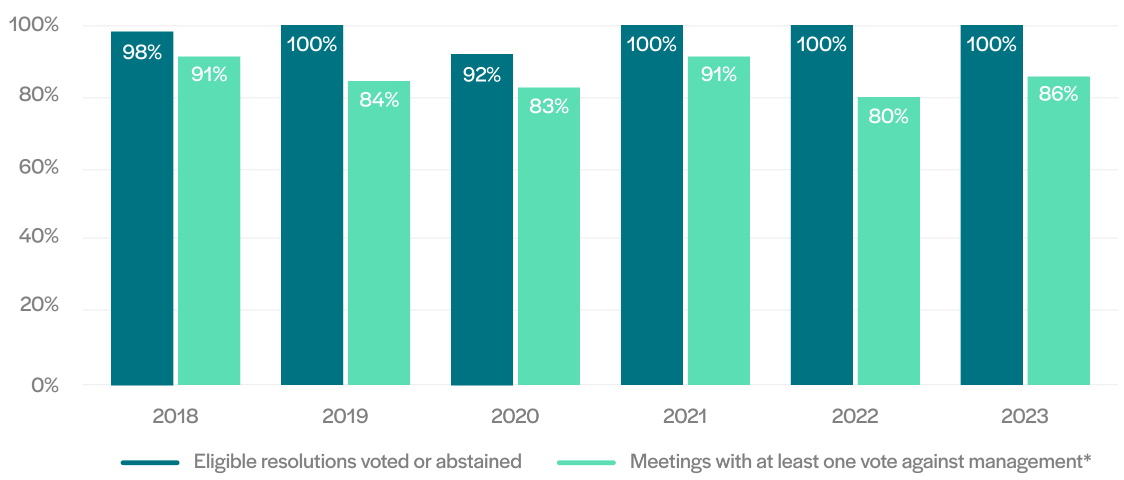
Voting activity in 2023

In 2023 WHEB cast votes on 100% of the resolutions on which we were entitled to vote in that year (Figure 6). We also voted against at least one resolution at 86% of these meetings.

We voted against management on 201 occasions, representing 21% of our votes cast and, in a pattern consistent with the previous six years (Figure 7).

WHEB currently uses Institutional Shareholder Services (ISS) as a third-party research provider to help inform our voting decisions and to deliver the votes to company meetings. However, we actively consider each vote ourselves to confirm whether it is line with our own, typically stricter, voting policies. We report the proportion of votes that go against ISS's policy in Figure 8. The vast majority of these votes are to vote against management when ISS's policy is to vote for management.

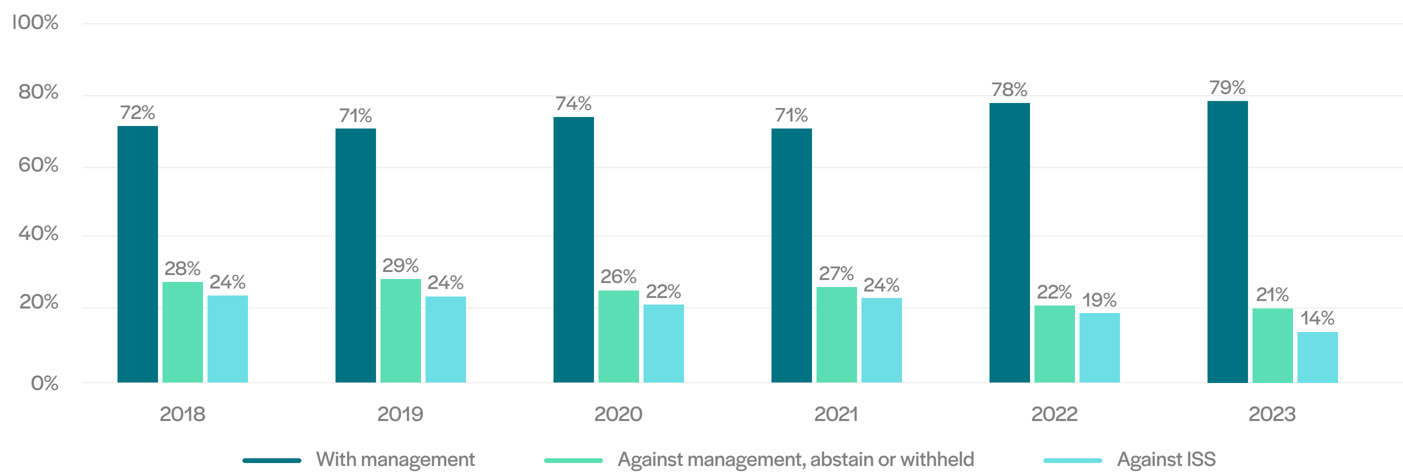
Figure 6: Exercising WHEB's voting rights[15]



* Votes against management included votes where we abstained or withheld our vote because voting against was not an option.

14. https://www.whebgroup.com/assets/files/uploads/20221201-wheb-voting-policy.pdf
15. The proportion of company meetings that included at least one vote against management also includes meeting where votes were withheld.

Figure 7: A proactive voting policy in action

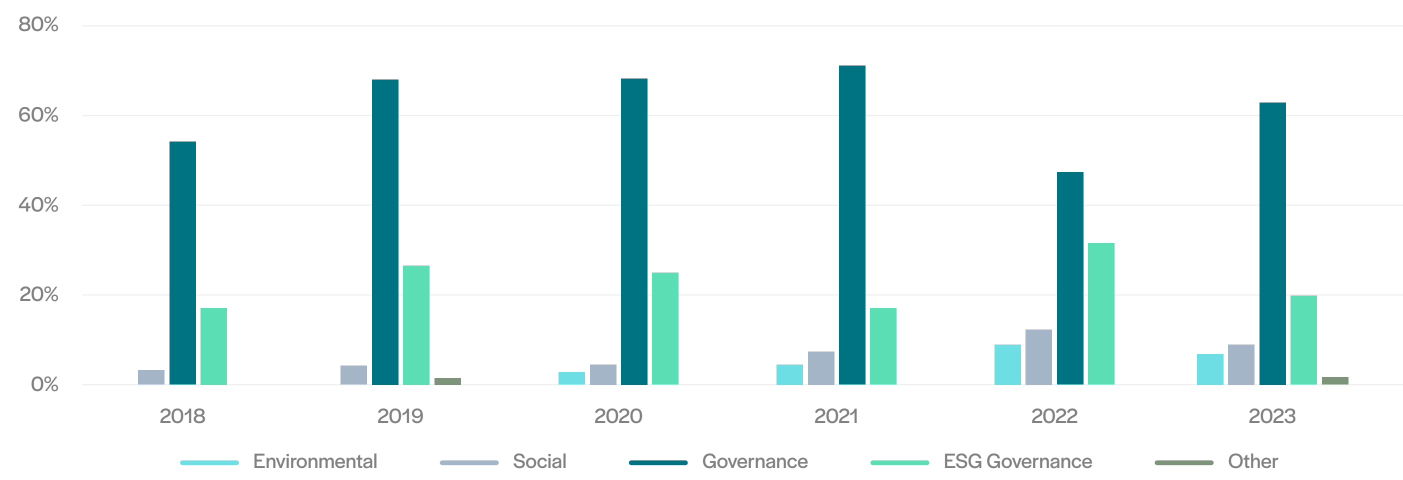


Of the votes where we voted against management:

- 63% of these votes were on Governance issues (especially auditor independence, director independence and executive remuneration).
- 7% of these vote were on Environmental issues, mostly carbon reduction targets.
- 9% of these votes were on Social issues, the majority aimed at improving board-level gender diversity (Figure 8).

Our escalation process of writing to company management provides an opportunity to widen the scope of engagement to cover Environmental and Social issues as well.

Figure 8: Votes against management by topic



Guest interview: systemic change and the role of asset managers

In responding to requests from new and existing clients, we have noticed an increased level of interest in the work we do to shape the rules and norms governing the financial sector's contribution to sustainability. We interviewed representatives from three leading institutions to understand why there is growing interest in this area and what is expected of asset managers.

Charlotte O'Leary
CEO, Pensions for Purpose

Emma Hunt
Head of Responsible Investment HSBC Bank Pensions Trust (UK) Limited

Sean Gilbert
Chief Investor Officer, Global Impact Investing Network (GIIN)

What is 'systemic change' and why is it important?

'Systemic change is really about how you fix a problem by trying to understand root causes rather than symptoms'. This view, expressed by Sean Gilbert at the Global Impact Investing Network (GIIN), was also endorsed by our other interviewees. There was also consensus that the 'economic system has not kept up with social and environmental change' as Emma Hunt from the HSBC Pension Fund put it. This is fuelling interest in what asset managers and other financial actors can contribute to systemic change. The current economic system does not fully capture wider social and environmental risk. Nor arguably does it prioritise the best long-term investments from an opportunity perspective. Risks that are not captured adequately in the financial system ultimately reappear when they reach breaking point, creating shocks that can undermine the system. As Charlotte O'Leary from Pensions for Purpose (P4P) argued: 'The fact that insurers no longer cover flood risk for certain parts of Florida (for example), does not mean that this risk has disappeared. It is just being borne by other parts of society.'

Systemic change is often interpreted as being about changing the 'rules of the game'. How important is public policy and are there other areas that are important?

All the interviewees agreed that influencing public policy is a key element in systemic change, but they saw its role quite differently. For some, regulation is important in 'raising the floor by forcing change among laggards'. For others, public policy is the starting point for driving change. It may also be that regulation is appropriate for some issues and other types of changes are better for others. For example, one interviewee suggested that regulation is an unhelpful tool in changing cultural norms (for example in attitudes to diversity) but that it has proved to be critical in incentivising action on climate change. Emma (HSBC) quoted Roger Urwin, the co-founder of the Thinking Ahead Institute, in arguing that 'while measurement gives a subject respect, it is narrative that gives it meaning'. To really change a system, you need to change the culture of the people that populate it.

But there are other important influences shaping the financial system. Accounting frameworks that ultimately determine what gets valued was one. Ensuring clearer accountability was another. 'Lawyers are now saying that delivering against the TCFD framework is a director responsibility and creates contingent liabilities on companies', said Charlotte (P4P). 'It is a rather laborious route to take because the measurement is driving the accountability [rather than the other way around].'

'Another powerful driver of change is FOMO (fear of missing out) – in fact the most powerful thing in human behaviour', argued Charlotte. If you can build a successful business and develop best practice, then other people will want to emulate that.

But is there a legitimacy question in financial actors seeking to change behaviour in this way?

The term 'systemic change' was seen as unhelpful – even politicised – particularly in the US. But 'if you step away from the labels', as Sean (GIIN) put it, all rational actors have a legitimate interest in the long-term health of society and the planet. 'Nobody wants lead in their drinking water or to be locked into a job with no protections', he said. But our interviewees did see different roles for different actors. Sean pointed out that private market impact investors have typically focused on the significance of new capital in creating impact. 'With public market actors now thinking about impact, there is much more of a focus on other levers you can influence', he said.

Asset owners have a clear interest, not least as 'universal owners' of the market as a whole, 'but still need to bring their own stakeholders with them', argued Emma (HSBC). For asset managers the picture is more complex. Some interviewees wondered 'whose views do [asset managers] represent?' as they are 'just intermediaries'. Others considered their legitimacy to stem from their knowledge of the companies that they own, combined with their role as agents for asset owners.

What are the other barriers preventing asset managers and others from engaging in efforts to change the financial system?

There is often a lack of a clear business case for work on systemic change. ‘Most asset managers do not have the bandwidth to undertake work on systemic change’, said Emma at HSBC. ‘WHEB is one of the first managers to reach out to us on this question’, she said. There is often a view at asset managers that there are just two jobs: managing assets and gathering assets. Anything else gets squeezed out. ‘Clients are often unwilling to pay for this activity. It is seen as a cost and is harder to sustain with pricing pressure’, said one of the interviewees.

The language also gets in the way as do concerns about intellectual property. This was a particular concern of Charlotte’s. ‘We need to make ways to share data and insights more freely [such as on new tools for measuring and reporting on biodiversity impact] in order to accelerate learning across the system,’ she said.

The biggest barrier, mentioned by all three interviewees is short-term investment horizons. Short termism is seen as a key element in divorcing the economic system from the social and environmental systems on which it is based. It is also seen as a barrier preventing financial actors from addressing systemic change. ‘You can’t deal with systemic issues within the context of a short-term mind-set’, argued Emma. Sean suggested that short-term attitudes at asset managers are a significant problem. Asset owners tend to think long-term because their liabilities stretch out over the long-term. ‘Companies are also much more inclined to long-termism because they are wedded to products, brands and infrastructure that is not liquid.’

So what are the solutions and what is the role for asset managers like WHEB?

While the lack of a business case may be seen as a barrier, both Charlotte and Emma agreed that work on systemic change should be seen as an investment. Charlotte argued that ‘asset managers need to devote resources to thinking longer-term and mapping out where the opportunity will be. You can create change that leads to opportunity’, she said.

All three interviewees also stressed the importance of purpose and identity. ‘If you don’t know who you are as an organisation, or you are just a marketing company, you will be pulled around at the whim of politics’, said Emma. ‘But if you have a clear purpose, you will attract high-quality clients that stay with you for a long time because they buy into your identity and what you offer.’

There was also a strongly held view that asset managers (and indeed all businesses) should listen to and focus more on addressing the needs of all of their stakeholders and not just their shareholders. ‘Asset managers have not been in ‘receive-mode’ nearly enough’, was one view.

It was also thought that asset managers should also look to get involved in collaborative initiatives aimed at addressing systemic issues.[16] Because while some of these issues are difficult to address as an individual asset manager, collaborations can help amplify asset managers’ voice and are an efficient way of channelling influence.

But it was clearly recognised that other financial actors have critical roles to play. ‘We are seeing asset owners recognise that they have to project their voice more’, was one view. Investment consultants too were seen as a key ‘pinch point’ in the investment value chain who could play an important amplification role for asset owners, for example by assessing asset managers on their engagement with systemic issues.

16. For example groups like the Institutional Investors Group on Climate Change, Pensions for Purpose and the Asset Owner Council were all mentioned.

‘Systemic change is really about how you fix a problem by trying to understand root causes rather than symptoms.’

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