Rothschild & Co
Wealth Management

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Annual ESG Report 2021

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Foreword

Since we began reporting our environmental, social and governance (ESG) activities in 2016, the world has been getting warmer. That inaugural year had the highest average global temperatures on record and, unfortunately, it was not an outlier. The seven warmest years ever recorded have all occurred since 2015.

Global warming appears to be reaching a tipping point. The IPCC[1], the world's leading authority on climate change, has warned that net carbon emissions must peak by 2025 and then reach net zero by the early 2050s if we want to limit global warming in accordance with the Paris Agreement.[2]

Throughout 2020, the unprecedented social impact of COVID-19 on businesses, families and communities worldwide meant the 'S' in ESG was, understandably, the immediate priority. COVID-19 has not disappeared of course, and we must stay vigilant to the threat posed by the disease and any new variants. However, the rollout of vaccine programmes has enabled many economies to start recovering from the pandemic, with international efforts towards climate change and the transition to a net-zero economy regaining much-needed momentum in 2021.

The COP26 global climate summit epitomised this resetting of the focus. Initially postponed in 2020 due to COVID-19, diplomats from nearly 200 countries converged on Glasgow between October and November 2021 to discuss progress towards the Paris Agreement pledges. While the summit fell short of many of its stated ambitions, it emphasised that not enough is being done to prevent climate change and avert the very worst outcomes for our planet.

At Rothschild & Co, we continue to support efforts to prevent climate change and took a number of steps in 2021 to reaffirm our commitment. For example, we pledged to become net zero across our operations by 2030 in order to offset the impact of our carbon emissions.

In Rothschild & Co Wealth Management specifically, the way in which we invest our clients' wealth forms a key part of our strategy, and the way in which we do that is the foundation of this report. We want to explain how our approach to sustainability has evolved, as well as the important climate initiatives we've joined and the key engagements we've had with the companies and managers we invest in.

We hope you enjoy this year's report and – as ever – we welcome your feedback.

Thank you for reading.

[1] The IPCC: The Intergovernmental Panel on Climate Change

[2] The Paris 2015 Agreement (agreed by 196 countries in Paris in December 2015) is a legally binding international treaty on climate change. It aims to strengthen the global response to climate change by keeping the global temperature rise this century well below 2°C, and preferably 1.5°C, above preindustrial levels.

Although the pandemic has dominated international focus over the past two years, the challenge of tackling climate change has remained high on the global agenda.

As many parts of the world began to emerge from the pandemic in 2021, there was a concerted effort to refocus international attention on the 'E' in ESG.

From 31 October to 12 November last year, the UK hosted COP26 – or the 26th Conference of the Parties – in Glasgow. The objective was to agree far-reaching action on climate change in order to keep the goals of the 2015 Paris Agreement alive.

The final deal – the Glasgow Climate Pact, which was adopted by all 197 participating countries – is viewed by some as a compromise, but it made abundantly clear that urgent action is needed to save the planet.

Ahead of COP26, a report released by the IPCC had already delivered a stark assessment of the climate emergency, warning that our opportunities to limit global warming to below 1.5°C are diminishing. According to the report, even a sub-2.0°C future 'will be beyond reach' without 'immediate, rapid and large-scale reductions in greenhouse gas emissions'.[3]

And while countries representing 90% of global GDP have now pledged to be net zero by 2050, current national climate plans – NDCs or nationally determined contributions – fall considerably short of what is required.

If human-induced global warming continues at its current pace, we will surpass 1.5°C warming by 2040 and 2.0°C by 2050[4] – key tipping points beyond which the extreme effects of climate change are considered irreversible. Alarmingly, global temperatures were already 1.1°C above pre-industrial levels in 2021.[5]

Against this backdrop, we welcome a resetting of the focus towards the environmental challenges that lie ahead.

Investing for generations

As a family-owned business, we have been investing for over 200 years. Our purpose is to protect and grow the real value of your wealth for multiple generations in a sustainable way.

Investing responsibly – by which we mean fully integrating sustainability factors into our approach – underpins the way we manage all client portfolios. We believe this approach both mitigates risk and enhances the prospects for strong long-term investment returns. This is borne out by our strong long-term performance record.

One of our core beliefs is that sustainability is a fundamental investment issue. ESG factors cannot be separated from economic factors; they are an inherent part of the long-term risks and opportunities for any company. That is why sustainability analysis is explicitly integrated into our investment process.

As long-term investors, we want to own high-quality businesses that have resilient business models and sustainable business practices. The impact of climate-related risks and opportunities on long-term investment outcomes cannot – and should not – be ignored.

We therefore expect our investee companies and managers to have a clear understanding of the climate risks they face and to have – or be developing ¬– a clear plan on how they will mitigate these risks.

[3] Climate change widespread, rapid, and intensifying – IPCC

[4] https://www.ipcc.ch/sr15/faq/faq-chapter-1/

[5] World Meteorological Organization's State of the Global Climate 2021 report

Over the past year, we have stepped up our engagement on climate risk with the companies and managers we invest in. With regard to measuring and monitoring activities, we have set a clear agenda of our expectations from companies on their climate-related disclosure. Companies must:

1. Report emissions and climate risks.
2. Have a clear and credible plan to get to net zero.
3. Monitor and set milestones.

These are now standing agenda items in our discussions with company management and inform our decision-making on climate-related proxy voting.

In 2020, we also started mapping the carbon footprint of our portfolios. Throughout 2021, we continued to expand the scope of our analysis given increased data disclosure by companies and our investment in new tools provided by our ESG research provider MSCI. Joining two respected industry initiatives – Climate Action 100+ and Say on Climate – in 2021 has also enabled us to further strengthen our engagement on climate risk (see boxout).

While we have considered the potential impact of climate change on our portfolio holdings for some time, our process continues to evolve as the world around us changes and companies get better at reporting relevant data.

Climate initiatives

Say on Climate, an initiative founded by activist fund manager Chris Hohn in association with the Children's Investment Fund Foundation, calls for companies to publish a 'Climate Transition Action Plan' and to submit these to a shareholder vote annually at their AGMs. It puts climate risk firmly on the agenda for both companies and investors.

One aspect we particularly like about Say on Climate is the requirement to report annually. Many companies have made bold statements and commitments about reaching net zero by 2050, but the scale of the challenge and the pace needed to achieve the transition require action now. Requiring companies to present their transition plans annually will, we believe, make companies take this more seriously and help us to support companies in turn. We have already referred a portfolio company that is at an earlier stage of developing a climate strategy to the initiative.

Climate Action 100+ is an investor-led initiative to engage the world's largest companies on curbing emissions and strengthening climate-related financial disclosures. We became a signatory to be able to participate in collective shareholder action. Through our membership of Climate Action 100+, we have joined their Berkshire Hathaway working group. We've had initial discussions with those leading the engagement about avenues for increasing the pressure on Berkshire and we discuss some of this progress later in the report.

Sustainability Factors: the ‘E’, ‘S’ and ‘G’

E – Environmental factors

When evaluating a company’s environmental credentials, we assess how they contribute to and perform on environmental challenges, including pollution, greenhouse gas emissions, climate change, deforestation and plastic use. We aim to understand their current impact on the environment, as well as their potential future impact.

There is no doubt that climate-related risks and opportunities are increasingly important to investment outcomes over the long term. We believe all companies need to understand their environmental impact and be committed to reducing their footprint.

S – Social factors

Social factors relate to how a company behaves towards its workforce, customers, suppliers and other stakeholders.

Assessing social factors for a company is very different to assessing its environmental impact. However, despite their differences, social and environmental factors share a common characteristic: they can affect a company’s sustainability and financial performance if managed poorly. Therefore, we are only interested in investing in companies that take a long-term perspective and behave sustainably and fairly, creating ‘win-win’ outcomes for all stakeholders.

G – Governance

Ensuring high standards of corporate governance helps align the interests of company management teams with the interests of long-term shareholders. We believe that good corporate governance improves the quality of a business, which in turn leads to higher and more sustainable long-term returns.

More specifically, we want to make sure the companies in which we invest consider our interests as minority shareholders fairly. When assessing the corporate governance of potential investments, we consider a number of key areas:

- Board composition
- Company culture
- Shareholder rights
- Executive compensation
- Capital allocation
- Company reporting

Integrating ESG analysis into our approach

As mentioned earlier, we embed sustainability factors into the investment process as a matter of course, rather than it being 'added on' as a separate exercise. This applies across asset classes and to all our client portfolios.[6]

For clients familiar with our approach, you will know that we believe in doing our own deep, fundamental investment research. The depth and breadth of our research is one of our distinguishing features and we have a highly experienced investment team who have worked together for many years. We believe our rigorous research gives us an in-depth understanding of the assets in which we invest, enabling us to act with conviction and make investments for the long term.

Responsibility for incorporating ESG analysis sits with each member of our investment team, rather than a standalone 'ESG team' that operates in a silo. The investment team assess and debate relevant ESG issues as a normal part of their investment analysis, in the same way they consider a company's (or fund's) competitive position, the sustainability of its business model, the quality of its management, and so on.

In recent years, we have increased our focus on this area, putting more structure around the way we do things. Now, our investment team has two dedicated Responsible Investment Specialists, one of whom we recruited in 2021. They provide additional direction and support to our sustainability work; co-ordinate voting decisions; and collect all relevant ESG data on our portfolio holdings.

We have also established a Sustainability Forum – a working group of 'ESG champions' that consists of three members of the investment team (including one of the Co-Heads of Portfolio Management and the Responsible Investment Specialists) and two members of our client adviser team. This group meets every week to discuss various sustainability topics: investment activities; research pipeline; responsible investment processes; industry initiatives; engagements; and non-standard proxy votes. The group also ensures client requirements are being addressed.

[6] Our framework for integrating sustainability factors into our investment research applies to all investments for which it is relevant. Excluded from this are money market instruments, cash held on account, developed market sovereign bonds and derivatives

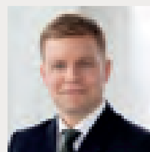
Sustainability Forum

Michel Van Der Spek (23)

Co-Head of Portfolio Management
Managing Director

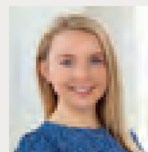
Tracy Collins (24)

Client Adviser
Director



Dan Drain (13)

Responsible Investment Specialist
Assistant Director



Poppy Mather (7)

Client Adviser
Assistant Director

Nana Baffour (3)

Responsible Investment Specialist
Associate

*numbers in brackets indicate years of experience

Materiality matters

Investing responsibly is not a box-ticking exercise or a matter of adhering to a list of rigid criteria. It involves considering all the issues that affect a company's financial performance over the long term, including relevant sustainability factors. A one-size-fits-all approach that uses ESG screens and checklists is, in our view, too simplistic because not all sustainability factors are relevant to all investments.

We recognise that each industry and company faces its own specific sustainability risks. Environmental impact and fuel efficiency, for example, matter more to an airline than a software company. Therefore, we concentrate on the most material issues for each company and use this analysis to make more informed decisions.

Highlighting our process: An example of our materiality analysis

For each company we invest in (or are considering investing in) we perform a materiality analysis, which involves a three-stage process. To demonstrate this process, we take Linde — a global industrial gases company — as an example.

1. Thematic materiality assessment:

The first stage entails a materiality assessment of a broad range of relevant ESG themes. Which themes are relevant is determined by the economic activity of each company. The table below provides examples of the type of broad ESG themes we consider at this stage (please note this list is illustrative and by no means exhaustive).

ENVIRONMENTAL THEMES	SOCIAL THEMES	GOVERNANCE THEMES
▪ Climate management and strategy ▪ Physical impacts of climate change ▪ Environmental stewardship ▪ Resource efficiency	▪ Human capital ▪ Supply chain ▪ Data stewardship ▪ Consumer welfare	▪ Board composition ▪ Executive compensation ▪ Capital allocation in relation to ESG targets ▪ Risk management

We assess each theme as being of 'Low', 'Medium', or 'Critical' materiality to the prospects of the company and therefore our investment case.

Linde: ESG materiality overview	
CRITICAL	Climate management and strategy
CRITICAL	Physical impacts of climate change
CRITICAL	Environmental stewardship
CRITICAL	Resource efficiency
LOW	Human capital
MEDIUM	Supply chain
LOW	Data stewardship
LOW	Consumer welfare
MEDIUM	Board composition
MEDIUM	Executive compensation
CRITICAL	Capital allocation – ESG targets
MEDIUM	Risk management

Our assessment of Linde shows that we consider the management of carbon emissions, having a carbon reduction plan in place, and energy consumption to be material sustainability factors for companies operating in this sector.

2. Company level data and insights

The next stage involves gathering quantitative and qualitative data on how a company is performing on each theme. In addition to our own proprietary analysis, we use data provided by an external ESG research provider, MSCI ESG Research. We currently utilise around 80 discrete data points from the MSCI ESG database, including historical performance where possible, to complement our own analysis.

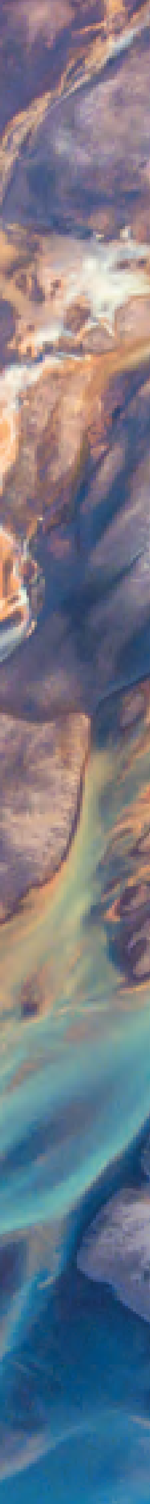
For an industrial gases company like Linde, as noted in the materiality map above, carbon emissions are critical. We therefore focus on the ESG Key Performance Indicators (KPIs) that relate to this. For instance, when evaluating Linde's carbon footprint, we consider the company's:

- Absolute emissions across Scopes 1, 2 and 3[7]
- Carbon intensity[8]
- Estimates of the emissions they enable their end customers to avoid

In total, for Linde we monitor 36 data points relating to the themes we have assessed as being 'Critical'. We also track these metrics over time as data becomes available and evaluate whether Linde is performing in line with their own roadmap and our expectations. The table below is a snapshot of some of the data points we monitor for Linde.

[7] These scopes are a way of categorising the different kinds of carbon emissions a company creates in its own operations, and in its wider value chain. Scope 1 emissions are a direct result of a company's own operations. Scope 2 emissions come from the generation of purchased energy, and Scope 3 emissions capture all the indirect emissions that occur along a company's value chain, including both upstream and downstream activities. These are not yet widely reported, but often represent a significant portion of a company's emissions. While measuring Scope 3 emissions is clearly more challenging – given that they are outside a company's direct control – they are obviously crucially important when it comes to evaluating a company's overall environmental impact and the associated business risks and opportunities for mitigation.

[8] Carbon intensity measures a company's efficiency of resource usage and is calculated as: total carbon emissions divided by revenue, market capitalisation or enterprise value.



3. ESG assessment

Finally, we draw our conclusions about how these material ESG factors are being managed. Below we show our summary assessment of how Linde is managing its climate risks.

Linde – climate management and strategy theme

- Linde has a large absolute carbon footprint of around 37 million metric tonnes of CO_2 equivalent ($MTCO_2e$) in 2020
- However, the company's products and services enable its customers to avoid more than twice its own level of emissions – 85 million $MTCO_2e$ – in the same period
- We have therefore concluded that Linde is enabling the transition to a net zero global economy
- The company's positive trajectory has been reinforced by its recent shift from a carbon intensity target to an absolute emissions target – aiming for a 35% reduction from 2021 levels by 2035, and climate neutrality by 2050. This is based on utilising 100% renewable power and the development of carbon capture and storage projects.

ESG theme	Why it matters?	Data points monitored	Metric	Thematic materiality
Environmental				
Climate management and strategy	Ability to compete in carbon budget constrained market	Scope 1 emissions ($MTCO_2e$)[9]	16,247,000	Critical
		Scope 2 emissions ($MTCO_2e$)[9]	20,063,000	Critical
		Scope 3 emissions ($MTCO_2e$)[9]	20,422,562	Critical
		Total GHG emissions (Scope 1+2)	36,310,000	Critical
		Carbon intensity (Scope 1+2 emissions/USD million sales)	1,333	Critical

Our thoughts on portfolio metrics and reporting

For several years now, investors, including us, have been encouraging the companies we invest in to provide more information on key ESG issues, such as carbon emissions and workforce diversity. This can benefit both the companies themselves – enabling them to identify and manage risks and opportunities – as well as investors, helping them to do the same across their portfolios. This process is ongoing, but now the expectations are shifting back on to us and fellow investors.

Growing client interest is a key driver of this, but so is regulation. This includes the Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy in Europe, as well as the FCA's upcoming requirement for managers in the UK to disclose key climate metrics, following TCFD (Task Force on Financial Disclosures) recommendations.

We have been stepping up our own efforts accordingly and are sharing more data of this nature with our clients. There are two important conclusions from the work we have done to date.

The first is that the sustainability of a company cannot be deduced from a single number or rating. Any analyst needs to 'look behind the numbers'. The second is the difference between changes in portfolio level metrics and 'real-world' change.

For example, reducing the level of emissions associated with a portfolio can be easily achieved by simply selling companies with the highest emissions and switching into those with the lowest emissions. This might involve swapping industrial and manufacturing companies for asset-light technology companies. But simply selling your shares to another investor has no impact on the company's emissions.

This prompts the question: faced with these issues, what should we do? A credible way of reducing the myriad of important ESG data points, both existing and yet to exist, into a single metric may remain forever illusive. However, these data points can form part of a wider mosaic that informs the analysis or portfolio manager. It can help us deepen our understanding of the risks and opportunities companies face regarding the transition to a more sustainable global economy and, in turn, help the companies make better decisions for the future.

[9] Metric tonnes of CO_2 equivalent

Is there an 'ESG bubble'?

Increasing interest in sustainable investing and a surge in investor demand for 'sustainable' or 'ESG' investments over the past few years have pushed valuations of some areas of the market – such as electric vehicles and renewable energy – to extreme levels. In some cases, these are well beyond their future earnings potential, leading to some market commentators talking about an 'ESG bubble'. There has certainly been a proliferation of ESG-labelled funds launched in recent years. According to Morningstar Inc.,[10] net flows into sustainable mutual funds and ESG-focused exchange-traded funds were $596 billion last year, with total assets rising by 53% globally to $2.7 trillion.

COVID-19 has likely accelerated this trend, but awareness of climate change, social inequality and other sustainability issues were already gaining momentum pre-pandemic. Governments around the world are increasingly focused on the sustainability agenda, and the corporate world is now also stepping up and aligning itself with the transition to a sustainable global economy.

As we state earlier in this report, for us ESG is not a 'product' or an 'asset class' – as some investment managers seem to view it – but rather an integral part of our process. It's an approach to investing that is in our DNA and is about identifying intrinsic risks and opportunities for the assets we invest in.

We believe that investor demand for companies with strong sustainability credentials will only continue to grow. This could continue to push the valuations of certain companies and sectors at the forefront of sustainability innovation still higher.

Our approach, however, is very focused on the price we pay for investments. We won't make investments at any price, so our clients don't need to worry about us chasing investment performance. We are genuinely long-term investors and prepared to be patient and wait for the right entry point. As it happens, current market volatility is making the valuations of some very interesting companies – which we have researched in the past few years but have eschewed due to price – start to look more attractive.

Another positive year for the Exbury strategy

In terms of continued strong investment performance and growing traction with clients, 2021 saw another positive year for the Exbury strategy. From one client and assets of less than £20 million when it was launched at the end of 2018, assets under management grew to £935 million across more than 50 client groups as at 31 December 2021.

We created the Exbury strategy for clients who want to actively target positive ESG outcomes, in addition to preserving and growing the real value of their assets. Specifically, the Exbury strategy seeks to invest in assets that enable the goals of the Paris Agreement, and which support the transition to a low-carbon economy.

At the end of 2021, 41% of the portfolio[11] was invested in these 'Enablers', and we aim to increase this allocation by 5% every year (from a baseline of 30% in 2020).

We look for companies, securities and funds that are making a meaningful impact on one of the following key areas:

- Powering our world – renewable energy generation, energy distribution and storage
- Sustainable transport and infrastructure
- Responsible production and consumption
- Financing the transition

Enablers can sit in either the 'return' or 'diversifying' asset side of the portfolio depending on their risk and return characteristics.

In the last two years, we have further developed the Exbury strategy, allowing us to identify very interesting investment opportunities for our clients. This has included seeding some early-stage managers that are actively contributing to – or even accelerating – the Paris goals.

[10] Morningstar is a global investment research and financial services company that provides a wide range of services to help educate and inform investors and finance professionals.

[11] 41% of assets relates to our Balanced GBP portfolios; percentage weightings in other strategies may vary.

Engagement highlights in 2021

For clients familiar with our approach, you will know that in our view, engagement is one of the most powerful tools we have as investors to influence positive change. If we can encourage companies to operate more sustainably, this will not only lead to better investment outcomes, but will also create more positive results for society and the environment.

For us engagement is an ongoing conversation; we listen to the challenges companies face and provide honest feedback as shareholders. This collaborative approach allows us to build rapport and develop mutual respect.

Through this direct dialogue, we believe we can exert influence and make a difference, and on the following pages we have included some examples of our climate-related engagements with companies and managers in 2021.

Initiating a new investment: seeding WHEB Environmental Impact Fund

We have a great deal of investment expertise in-house, but we do not have a monopoly on investment talent. We also work collaboratively with external managers, particularly where they bring specialist knowledge to our clients' portfolios and believe we can partner with them over the long term. Our belief is that this flexible approach creates more opportunities for our clients and gives them the best of Rothschild & Co, complemented by some truly first-class managers where the track record and potential for excess returns justify the fees.

WHEB Asset Management is an established impact and sustainable manager. The company invests in global equity markets, focusing on sustainable investment themes and companies providing solutions to major social and environmental challenges.

Towards the end of 2021, we seeded a new fund focused on the opportunities created by the transition to a low-carbon and sustainable global economy. The new fund is a 'carve-out' of its existing WHEB Sustainability Fund (launched in June 2009). We intentionally did not create a fund for Rothschild & Co clients only, but welcome other investors in this commingled fund.

We have spent the last two years getting to know the team at WHEB, observing their philosophy and behaviour in action to determine whether they are genuinely aligned with our own investment philosophy and Exbury's environmental objectives. We believe the strategy we are investing in fulfils our criteria in both respects and are confident that the manager will be a good long-term partner for us and our clients. The Environmental Impact Fund is a relatively concentrated global equity fund (20-30 holdings) and will invest in companies that fall into their five environmental themes:

- Cleaner energy
- Environmental services
- Resource efficiency
- Sustainable transport
- Water management

Engagement type: Direct with company

Topics: Environmental disclosure and strategy

Summary: Deere is a global agricultural equipment manufacturer. We had a video call with Deere at its request to provide feedback on its sustainability reporting. We informed it that while its overall reporting was high quality, there were a few areas for improvement. In addition, we wanted to understand what role Deere sees the company having in aiding the transition to a net-zero economy, as well as what it believes needs to happen and the technology required in global agriculture.

What we discussed

- Carbon emissions reporting
- Amount of carbon avoided
- Regenerative farming and carbon sequestration
- The role of technology in emissions reductions and inputs required

What we learned

- Deere understands the importance of further developing its reporting and has a dedicated team working on the framework for disclosures and targets.
- The scale of the challenge of collating Scope 3 emissions data: Deere has around 350,000 machines in circulation, covering 230 million acres. Electric and hydrogen power is not currently viable for many machines. It considers 'carbon avoided' as a more useful metric than Scope 3 emissions.
- The portion of the carbon footprint attributable to corn production due to the machinery involved is only 10% compared to 75% for the fertiliser. Applying technology to decrease the use of fertiliser can be more impactful than improving fuel efficiency.
- Information about Deere's educational initiatives encouraging farmers to adopt more sustainable practices.

Next steps

We will continue to monitor ongoing progress across its operations, reporting and target setting.

Our contribution

We informed the company of the information that is, or would be, useful for us as investors. In particular, it is important that the company highlights the contribution it can make towards a net-zero economy in light of the large contribution agriculture makes to global carbon emissions.

Boutique fund manager investing in UK businesses

Engagement type: Direct with the manager

Topics: Clarifying the philosophy around sustainability and improving reporting

Summary: We have been invested with the manager since 2013 and consider ourselves long-term partners. The manager's investment philosophy is closely aligned with ours, and our clients have benefited from a concentrated portfolio of UK stocks over the investment period.

Historically, the manager has been extremely focused on governance issues and has at times been a very active shareholder to effect change for the benefit of all stakeholders. However, the articulation around social and environmental factors had been less developed.

What we discussed

- Better articulation of the manager's philosophy on sustainability, how this feeds into the research process and, ultimately, the resulting impact on decision making.
- Consistent reporting of key performance indicators for ESG factors, as well as engagements with companies and the proxy voting record.

What we learned

- The framework of embedding sustainability into the research process is much more developed than we had thought and goes beyond just governance.
- Its philosophy on sustainability is very much aligned with our framework of materiality.
- What was missing was the articulation of its thinking on paper.
- A lot of work has been done on evaluating emissions of companies, measuring and reporting it in the right way and developing a framework around net zero.

Next steps

- Encouraging manager to reach 'best-in-class'.
- Manager to appoint a dedicated resource to focus on sustainability topics.
- Manager to publish a detailed articulation of the sustainability framework.
- Consistent reporting on sustainability factors.

Our contribution

While we don't claim to be able to drive the direction of travel of an independent investment boutique, through our long-term partnerships we are able to influence managers and point out weaknesses in their processes. We are also able to leverage our own experience on these topics, as well as share best-in-class practices. We believe this can make a difference.

Berkshire Hathaway Inc.

Engagement type: Collective, via the Climate Action 100+ initiative

Topics: Environmental disclosure and strategy

Summary: Berkshire Hathaway is a diversified holding company headquartered in the US whose subsidiaries operate in a diverse range of industries, including insurance, freight rail transportation, energy generation and distribution, services, manufacturing and retailing.

The company's scale and its underlying activities in energy and railroads make Berkshire Hathaway the single largest emitter of our directly held positions. Despite some disclosure by the emissions-intensive energy and railroad businesses, Berkshire was on our radar for engagement due to the lack of information on sustainability issues at the holding company level. This includes carbon emissions data and reporting on its climate-related risks at the group level.

At the company's 2021 AGM, we supported a shareholder resolution requesting an annual assessment of climate-related risks and opportunities at the holding company level. The resolution was not successful and we concluded that this was a clear example where collaborating with other investors would likely have a greater chance of encouraging change, and more quickly.

What we discussed

Since joining Climate Action 100+, we have discussed the work[12] they have done with Berkshire Hathaway and the avenues explored. This gave us ideas for practical next steps we could take.

What we learned

- The working group's engagement lead had been in contact with Berkshire prior to filing and presenting the climate-related resolution at the 2021 AGM. This provided useful context and re-affirmed that the working group's ambitions were aligned with our own, and with the interests of all our shareholders.
- More information about the AGM process for US companies, which will be useful in the event we want to file our own resolution or a solicitation in the future.
- Relevant contacts at the company, with whom we can consider engaging directly.

Next steps

- We plan to discuss a climate proposal for the company's 2022 AGM with Federated Hermes ahead of the meeting.
- We will also write to Warren Buffett, Berkshire Hathaway's CEO, to outline our views on this matter.

Our contribution

The most tangible aspects of our contribution were directing our votes in favour of the climate-related resolutions at the AGM, as well as adding our voice to the narrative by contacting the company directly, in parallel to others. More generally, we hope that the detailed knowledge we have built up on the business over more than a decade of share ownership can bring useful insights to the engagement, helping us find common ground with the company from which to build a dialogue.

[12] This work was led by the Ceres Investor Network and Federated Hermes.

Collective engagement

Our preference is to engage with companies directly and in private. As long-term investors, we aim to maintain strong direct relationships with the companies in which we invest, and our collaborative approach facilitates direct engagement in most instances. However, we will instigate or join collective initiatives if we believe it's in our clients' best interests to do so and constructive engagement with an investee company has failed.

For this reason, we are a signatory of the UN PRI – which offers opportunities for collaborative engagement – and have been members of the UK Investor Forum since 2017. The Forum was set up to promote stewardship and facilitate collective engagement with UK companies.

Over the last two years, we have identified and conducted due diligence on a number of industry initiatives that we believe are aligned with our philosophy and our clients' interests. As previously mentioned, we joined the Say on Climate campaign and Climate Action 100+ in 2021. Part of the rationale for joining these initiatives is to broaden our network and facilitate opportunities to join specific collaborative engagement activities.

Escalation

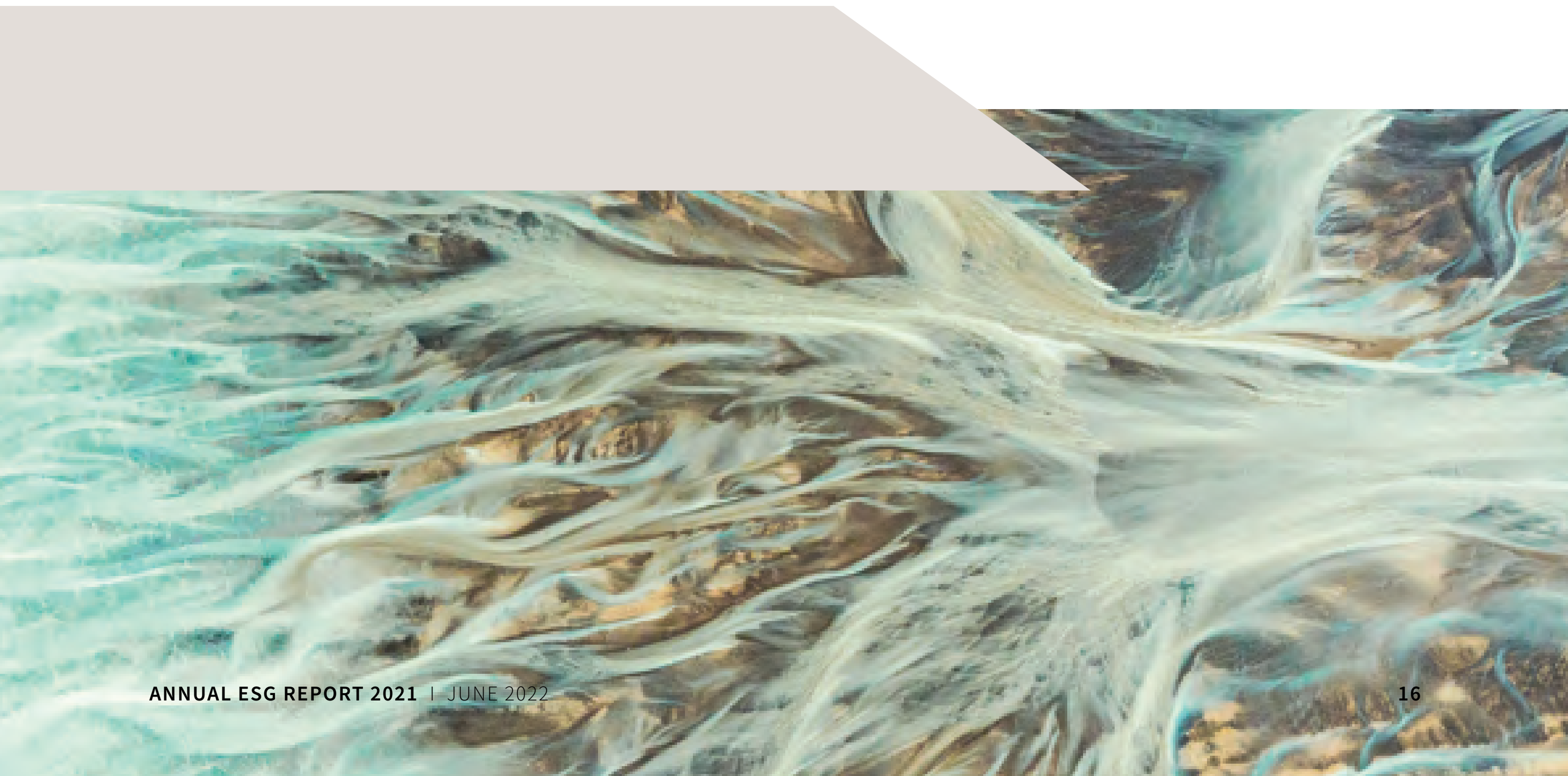
Given our approach to investment selection and monitoring, we do not expect to need to escalate our concerns on a regular basis.

In our frequent meetings and discussions with investee companies and managers, we seek open and constructive dialogue and are not afraid to address difficult topics. We believe this approach allows us to resolve most issues.

Where a resolution is not possible, we will consider the following escalation options:

- Contacting a company's investor relations team for explanation or clarification
- Holding additional meetings with management
- Escalating to board members
- Utilising our voting rights
- Engaging in collective action

If these escalation options do not resolve our concerns, we may ultimately sell a company's shares if we determine it is in our clients' best interests to do so. In 2021, we escalated our engagement with Berkshire Hathaway.



Our 2021 annual voting record

An important aspect of our active ownership, and one of the key tools we have to influence companies, is exercising our rights as shareholders through proxy voting at company shareholder meetings.

The following voting principles frame our proxy voting activity:

- We vote on all resolutions where we have voting rights
- We base voting decisions on our own analysis
- We see voting as one form of engagement among others

In 2021, we voted on 322 resolutions across 21 company meetings, representing 100% of our equity holdings.

We saw several shareholder proposals last year relating to topics that are important to us and our clients' interests. Our views on these matters resulted in more of our votes being counter to the recommendations of the board than in any previous year.

Specifically, we voted on four resolutions regarding climate-related disclosures and strategy. We supported all of these in accordance with our belief that climate change is one of the most significant challenges facing society and our expectations of investee companies in light of this.

Three resolutions used the Say on Climate framework discussed earlier in this report. These were at the annual general meetings of Moody's and S&P Global – where the boards recommended that shareholders vote in favour of the proposal – and Charter Communications, where the board did not.

Although disappointed by the latter, we were pleased to see the company announce an ambition of net-zero operations by 2035 later in the year. The company also offered more transparency by publishing its response to a climate change questionnaire by CDP.[13]

Furthermore, we voted on a resolution requesting that Berkshire Hathaway publish an annual assessment of climate-related risks and opportunities. The board highlighted the decentralised nature of the various operating entities in their recommendation to vote against the resolution. While we recognise both the idiosyncratic nature of the holding company and the array of businesses that make it, as well as the reporting provided by several of these, we voted in favour of the resolution. We believe having relevant information aggregated at holding company level would be beneficial to both the company and its stakeholders. Unfortunately, the resolution was not passed, so we made the decision to join the collective actions under the Climate Action 100+ initiative as described earlier in this report.

Supporting two resolutions relating to diversity and inclusion also saw us voting against the board. Both were proposals at Charter Communications' AGM, where we concluded the current disclosures were insufficient and the proposals were reasonable. Three other companies (American Express, Berkshire Hathaway and Wells Fargo) had resolutions on this topic at their AGMs. After further analysis and deliberation, we decided to vote against these on account of the specifics of the resolution not working in the specific context of the company in question or the company taking action that meets our expectations.

The final resolution that saw us vote against the recommendations of a board was the separation of the Chair and CEO roles at Charter Communications. We had voted in favour of similar resolutions at previous meetings and would still view an independent Chair as beneficial in this instance.

Regarding our external managers, we have received the majority of their voting activity for 2021. Encouragingly, we have already seen a multitude of cases where the managers have voted against resolutions in situations where they believe companies can improve. These covered issues of governance, such as executive pay and capital structure, as well as the environment.

[13] CDP is a charity that operates the global environmental disclosure system for investors, companies, cities, states and regions.

Summary of our voting activity in 2021

		Voted for	Abstained	Voted against	Total	Votes against the board recommendation
Board of directors	Director compensation	2	–	–	2	–
	Director Compensation Policy	1	–	–	1	–
	Election of directors	195	–	–	195	–
	Proxy access	–	–	1	1	–
	Separation of Chair and CEO Roles	1	–	–	1	–
Compensation	Advisory vote on executive compensation	12	–	–	12	–
	Advisory vote on frequency of compensation votes	–	–	–	–	–
	Compensation Plan	6	–	–	6	–
	Compensation Policy	4	–	–	4	–
	Compensation Report	5	–	–	5	–
Capital structure	Allotment of securities	8	–	–	8	–
	Cancellation of shares	–	–	–	–	–
	Disapplication of pre-emption rights	8	–	–	8	–
	Increase in share capital	1	–	–	1	–
	Payment of dividend	4	–	–	4	–
	Repurchase of shares	8	–	–	8	–
Financial reporting	Receipt of financial statement	11	–	–	11	–
Audit-related	Ratification of auditor	18	–	–	18	–
	Remuneration of auditor	6	–	–	6	–
Strategic	Political donations	2	–	–	2	–
	Reporting on lobbying activities	1	–	–	1	1
Environmental	Say on Climate	3	–	–	3	1
	Reporting on climate-related risks and opportunities	1	–	–	1	1
Social	Transition to public benefit corporation	–	–	2	2	–
	Reporting on diversity and inclusion	2	–	3	5	–
	Report on risks posed by failing to prevent sexual harassment	–	–	1	1	–
Governance	Action by written consent	–	–	1	1	–
	Removal of supermajority voting requirements	1	–	–	1	–
Administrative	Amendments to articles	3	–	–	3	–
	General meetings	3	–	–	3	–
	Powers to carry out legal formalities	2	–	–	2	–
Ad hoc	Issuance of shares for merger	1	–	–	1	–
	Deeds of release regarding relevant distributions and related party transaction	1	–	–	1	–
	Related-party transaction	2	–	–	2	–
	New Investment Policy	1	–	–	1	–
	Total	313	–	9	322	6

Our focus for 2022

We hope this report has given you an insight into how we are managing your portfolios in a responsible way and proactively engaging with the companies and managers we invest in on your behalf.

Our aim is to continually improve by making more informed investment decisions that deliver better outcomes for our clients, the communities in which we operate, and the environment.

But there is always room for improvement. The industry is constantly evolving and best practice moves in lockstep with this. We must therefore continue to develop our approach to systemic risks such as climate change and identify better tools to measure and communicate the impact of our portfolios.

In terms of tangible objectives for 2022, our goals include:

- Joining industry initiatives: we are considering other collaborative initiatives that align with our investment philosophy and our clients' objectives.
- Better data: requiring more and better data from our companies, so that we can compile appropriate and actionable portfolio analytics and metrics to help us and our clients understand the impact of portfolios (intentional or otherwise) and the direction of travel.
- Better client communication: improving how we report and communicate our responsible investment activities. The goal is to report the most relevant ESG performance indicators at the portfolio level to our clients.
- Review of our processes: our thinking around ESG integration and sustainability continues to evolve. As does the world around us. We review our processes on a regular basis to make sure we continue to integrate best-in-class practices. In 2022 we are conducting a review of our ESG integration process for equities, funds and fixed income. There will be a particular focus on including more quantitative analysis as more data is becoming available to us.
- Regulatory changes: in Europe we have seen the implementation of the Sustainable Finance Disclosure Regulation (SFDR). The UK will follow closely behind in 2023. We are preparing the ground to be ready for the new regulatory frameworks.

We recognise the path to sustainability will not always run smooth. Recent crises continue to have a significant impact worldwide, including the pandemic and ongoing geopolitical tensions in Europe.

The war in Ukraine – which is first and foremost a tragic humanitarian crisis – has resulted in severe volatility for energy and food security. This has further underscored the urgent need to not only phase out fossil fuels but to develop more sustainable agriculture.

Our thoughts continue to be with everyone affected by the conflict. The whole firm is engaged in a fundraising campaign to support the humanitarian efforts directed at helping people who were forced to leave their homes and lives behind. We also support the globally orchestrated sanctions to isolate Russia from access to capital markets.

These developments only strengthen our view that we all have an important role to play in nurturing and protecting a more sustainable economy, environment and society for future generations.

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