pi ESG CLUB

Far from allowing polluters to continue polluting, carbon capture and storage technologies help to keep climate change in check. Yet, as this month's ESG Club explains, a lot of work is needed before it makes a real impact.

SEPTEMBER 2024

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PROXY VOTING 2024 – ASSET MANAGERS PULL BACK ON SOME RESOLUTIONS

Support for environmental and social issues fell in this shareholder voting year, but governance proposals received a boost. *Andrew Holt* investigates.

Proxy voting on environmental and social resolutions this year has proved a sticky issue, at least for some asset managers.

Firstly, looking at the broader voting trends, 2024 has been something of an interesting year for ESG-related votes.

Governance proposals gained greater support, but for the environmental and social segments, it is complicated, said Lindsey Stewart, director of stewardship research and policy at Morningstar Sustainalytics.

Stewart identified ESG shareholder resolutions are still growing in number, but for the first time, the growth is primarily driven by 'anti-ESG' proponents.

There has though been a rebound in support for governance-focused proposals, from 30% in 2023 proxy year to 35% this year. Resolutions seeking to bolster shareholder rights enjoyed particular success.

Highlighting the reason behind this approach, Blackrock revealed in its Global Voting Spotlight: "In the 2023-24 proxy year, investors – including Blackrock – supported more shareholder proposals addressing corporate governance issues than in previous years. Generally, these proposals focused on introducing provisions to further strengthen the rights of minority shareholders, such as Blackrock's clients."

Blackrock's support for all shareholder resolutions rose slightly to 11% in the 2023 proxy year, from 9% last year.

There has though, overall, been a decline in shareholder support for environmental and social resolutions, which continued in 2024.

Average support for E&S resolutions fell to 16% this year from 19% in the 2023 proxy year.

Underlying shareholder backing for key E&S resolutions, those supported by at least 40% of a company's independent shareholders, remained at 2023 levels despite the continuing broader decline.

Large asset managers appear to have continued their withdrawal of support for E&S proposals in 2024, according to Morningstar, driving growth in a cohort of 'near miss' resolutions with between 30% and 40% independent shareholder support.

Continued growth in the overall volume of resolutions with falling average support is likely to prompt questions about the quality of proposals being filed, as well as the future of the entire shareholder resolution process, from institutional investors and companies.

One way to look at what has happened is to suggest that the largest asset managers appear to have continued a trend to rein in their support for some ESG-related resolutions.

Overly prescriptive

Asset management behemoth Blackrock came in for some stick after its Global Voting Spotlight revealed that it only supported around 4% of the shareholder proposals it voted on in the proxy year to the end of June, compared with around 7% in 2023 and 22% in 2022.

In the spotlight, Blackrock highlighted its approach: "Like last year, investors found the majority of these proposals [focused on climate and natural capital risks] to be overly prescriptive, lacking economic merit, or asking companies to address material risks they are already managing. As a result, these proposals continued to receive low support from shareholders, including Blackrock."

But Felix Nagrawala, financial sector research manager at responsible investment campaign group Share Action, is not impressed. "Blackrock's voting record this year is disappointing but not unexpected. Our research has shown Blackrock has repeatedly been one of the worst performers in recent years and seen its support of resolutions plummet."

And he added: "While they say the resolutions are too prescriptive and lack merit, in reality, we found most resolutions – three quarters in 2023 – were just asking for more disclosure – hardly too much to ask for companies when it comes to systemic risks like climate change that is in the long-term interests of its clients."

No support

Another big asset manager, Vanguard, surprised many with its announcement that it supported no shareholder resolutions on E&S themes.

"Vanguard's announcement that it supported precisely zero shareholder resolutions on environmental and social themes in the 2024 proxy year is certainly striking, but it doesn't surprise those of us who have been watching asset managers' voting patterns closely," said Morningstar's Lindsey Stewart.

Stewart then tried to be put the proxy-voting trend, at least among the bigger assets managers, in a wider context.

"Amid ongoing pushback on all things ESG from more conservative elements of the political spectrum, Blackrock, Vanguard and other large asset management firms have increasingly emphasised a focus on financial materiality and traditional corporate governance," he said.

"This emphasis has manifested in recent proxy voting decisions that dissent from company boards' recommendations with increasing rarity, meaning much lower support for shareholder proposals," Stewart added.

ESG INTERVIEW – FAITH WARD

"Recognising that you cannot save the world is important."

The chief responsible investment officer at Brunel Pension Partnership tells *Andrew Holt* about looking at the big picture, being focused on real world change and dealing with everything, everywhere all at once.

Could you give me an insight into your approach to responsible investment?

Our thinking starts top down. We think about the systemic issues that are affecting the economy and society and what those implications might be for our investment portfolio and the associated financial risks. So we start with that big picture.

Addressing those risks can present investment opportunities. What we try to do is make sure we are aware of them, assess them and take action where possible.

Our strategy has three pillars: integration, collaboration and transparency.

The bulk of the detailed work is with the asset managers – we focus on setting expectations rather than being overly prescriptive. Being 100% outsourced, that is our primary business model.

It is then how we integrate responsible investment into the decisions we make, in terms of asset manager expectations and what we do on voting and engagement policies, bringing together the integration and collaboration approaches and then finally, communicate it, which is the transparency.

So those three lenses – how we integrate it, who we work with and how to report it – is a matrix of how we bring this approach to life.

Has there been any disconnect between your responsible investment policies and what asset managers are delivering?

Asset managers have timelines and mandates that are constructed in a way that are different to pension funds. We try to bridge that by setting our expectations when we have a mandate.

Sometimes it is co-created, where we work closely with the managers. This is essential when we are taking on the challenge to integrate climate into an asset class that hasn't traditionally had that. Our net-zero multi-asset credit portfolio is a good example of this, and the work is on-going. But yes, we do read about those who do not come up to the bar. And in terms of expectations, the bar is getting higher. But there is only so much time and energy we have to bring firms up and there comes a point where you may need a new manager.

For listed equity the bar is quite high and last year we led the work looking at voting on what the differences were on oil and gas companies, post the Paris Agreement. UK asset owners were driving that, but there was evidence that with asset managers, especially the larger ones, the alignment is limited and has diminished in some instances in recent years. From the other point of view, asset managers have also said they want asset owners to be more explicit about their expectations by setting parameters.

It is a difficult line to draw when you are trying to be clear about the outcome you are seeking and the expectations on risk management. We have done some work on bridging the gap by communicating

In short, we either progressed or achieved all of the targets we set ourselves. We have made our net-zero commitment by 2050, but we are looking for pretty material progress by 2030.

We were also able to report a reduction in our carbon intensity of over 50% from our baseline in 2019. Although this is not a fantastic measure, it is useful to give some reduction direction to our portfolios and the wider market. We have reduced that by 50%. We have also reduced our exposure to the fossil fuel sector by just shy of 90% since 2019.

Presumably meeting those targets is why you extended your reporting beyond the TCFD's requirements.

We have met many of them. The one area where we need to progress, particularly in the product area, is some of the forward-looking metrics in our scenario analysis. That is because we are still trying to navigate what is being used. We are transparent on all of the metrics.

what we expect any manager holding high-impact companies to provide. We need that level of granularity to provide us with evidential-based analysis of the risks around climate and any individual company and its actions to address them.

You have described Brunel as being focused on a 'real world' approach to responsible investment. What does that mean?

There are two tactics when approaching climate risk: one is to avoid the problem, the other is to change the situation by providing a solution to make progress. So what we mean by 'real world' impact is getting stuck into the difficult things is the more appropriate strategy and will deliver the impact in the real world we seek.

It means pivoting to transition finance, doing the complicated stuff, not just investing in deep green. We need to work with the trickier parts of the economy. It is picking out the more difficult sectors and companies to focus on.

We try to pivot towards the real world. That is why our approach to divestment is more nuanced. It is about thinking through the outcome we are trying to achieve and what are the best mechanisms to achieve it.

So divestment is the option of last resort?

That is how I have always categorised it. Divestment, or using investment exclusions, is an appropriate strategy where normal stewardship tools are unlikely to provide the desired outcome.

Although in the coming years, I think we will become more nuanced to when is the right time to move away from certain sectors and activities.

Could you summarise the key findings of your latest *Climate Progress* report?

It covered Task Force on Climate-Related Financial Disclosures (TCFD). It also covered our other climate and ESG-related challenges.

Could you tell me more about your net-zero ambitions?

It is to be net zero by 2050 and operationally everything we invest in needs to be aligned by 2040. In other words, we need a clear plan as to how these are going to be decarbonised by then. So plenty of progress by 2030, but by 2040 we should have a solid plan.

In your *Responsible Investment & Stewardship Outcomes* report you highlighted how Brunel wishes to raise the bar on impactful stewardship. Why has that become more important?

Within stewardship there has undoubtedly been a lot of progress. The big change is looking at how efficient and effective stewardship has been.

What we are trying to say is we need to be much more focused on the outcomes we are trying to achieve. There have to be consequences to stewardship, otherwise it is not going to make any difference. It is a recognition that we have not always been as effective as we would have liked to be in corporate engagements.

You have voted against companies that have not come up to scratch on ESG. Is that an important part of your armory?

It is, and it is an area we have stepped up on. Voting, as a signal, is part of our armory. It is a way of reinforcing those engagement conversations. It is a way of proving the changes we want to see.

We have stepped up our voting. It has been enabled by artificial intelligence, which has allowed us to process more information at a quicker rate and give us greater confidence to take action.

Do you see any scepticism among your partner funds in addressing responsible investment?

I wouldn't say scepticism. They get involved in setting our stewardship and voting policies. So there is a lot of engagement, although there is sometimes a difference of opinion.

Where some of the challenges come is on the question of: are we having enough impact? Are we seeing the changes? In some instances we are not. So that is a fair challenge.

So it is about doing more and being assertive. Where we have faced scepticism, that has helped us put our case better. The majority of partners support the work Brunel is doing.

What are the biggest challenges you face from a responsible investment perspective?

You feel like you have to deal with everything, everywhere, all at once. There are an awful lot of challenges. What we have achieved is a much higher awareness of the risk. The awareness is so much higher. The expectation from society is you then have to solve all of these problems.

Recognising that you cannot save the world is important. But going forward we need a concentrated effort in some areas where we can progress smartly. One example is Mining 2030, led by the Church of England Pension Fund, which comes at the problem in a different way. We need to solve this for a range of responsible investment reasons, not just for climate. That takes a lot of effort. But that is how to bring about real change.

Do you expect a different approach to ESG from the Labour government?

The Conservatives had good moments: they set the legally-binding net-zero target, Boris Johnson was good in the run up to COP26 and there was good momentum. So the Conservatives started strongly, but it was more the retrenching when things got a little bit tricky.

Equally, the Labour government has come out of the gate strongly. We have the National Wealth Fund, which we have been advising on. They also have commitments to net zero as part of the Transition Plan Taskforce. We are keen to go forward with that, and a commitment to the green taxonomy – initiatives that stalled under the previous administration.

But it is all about resolve and sticking with these strategies. Only time will tell if Labour has the courage of their convictions.

What we mean by 'real world' impact is getting stuck into the difficult things.

There has been a push back on ESG in some circles: is this an issue in your view?

It has been through a bit more of a rocky patch in the last couple of years. There has been a bit of a reality check.

The act of being challenged will make us, as a wider group of responsible investors, much better and stronger and help us improve through better communication and articulation on the issue.

We need to keep pushing though. The rollback on the FCA's listing rules is disturbing. If it leads to a race to the bottom, it will be counterproductive.

We need to keep fighting and articulate our case.

But if you look at the momentum going into COP26 in 2021, it was positive. Overall, we are in a much more positive place than we were many years ago, when many didn't see responsible investment as a relevant financial issue.

What about the role of supranational bodies and government in addressing climate change and ESG issues?

We do need that ambition from such organisations. We have seen some positive changes. And we need that as a great deal of harmonisation is needed, in carbon markets and the like, in order to make change happen on a wider scale.

We need to bring about change as a global community. There is still a lot of fiscal adaptation and resilience that needs to be baked in and this is massively under actioned.

What are your responsible investment ambitions for Brunel?

It is having that impact. It is about seeing the desired outcomes actually delivered.

What has been the biggest lesson you have learnt from your career?

I am continually learning. Therefore, I have learnt that it is important to build a strong network of people who know what they are talking about and to regularly tap into that.

INVESTING WITH CARE: THE KEY TO RESILIENT RETURNS IN THE UK CARE SECTOR

Over the coming decades, the UK care sector will become all the more critical. Demographic trends are placing ever-greater demands on an already ageing care system. Investment is needed now to meet the needs of the future.

Institutional investors and managers can work together to help transform care infrastructure in the UK. But it is important that this happens in the right way to deliver good outcomes.

How can investors build care home portfolios with resilient returns?

The answer is a quality-first approach.

The needs of the care system and investors are aligned

The UK needs more quality care homes.

"Over the next century, we're set to see almost 300% growth in the over 85 cohort of the population," said Mike Toft, who is head of care homes at Octopus Real Estate.

It's not just the number of care homes, but the quality of care that can be provided.

"While there is a balance of care beds now, over the long term, we're going to see a reduction in quality care beds being provided in the UK. There's a big obsolescence issue underlying the provision of stock.

"Around 50% of care homes in the UK were registered more than 20 years ago. These are often Victorian conversions, which lack ensuite wet rooms, suffer from inefficient design, and have poor ESG credentials.

"Because of the age of the infrastructure, the ability for operators to provide the highest quality of care is becoming increasingly difficult. And we're seeing some operators deciding to close care homes."

There is a clear opportunity for private capital to build and operate care homes that are fit for the future. And focusing on quality is aligned with the needs of investors as well as customers.

Targeting resilient income

"It's ultimately about the quality of care being provided to the elderly cohorts. That's fundamental to what we're doing.

"Because we believe that focusing on quality of care from an investment

strategy perspective leads to a more resilient income profile."

A state-of-the-art home with the highest quality of care should ensure demand is strong and beds are full. That obviously translates into a more robust and predictable return. What's good for residents – the best care possible – is also good for investors.

Mike's view on the link between the quality of care homes and the quality of investment performance was only reinforced during the global pandemic. As a whole, the care sector performed well during a challenging period. However, it did draw attention to the clear advantages of fit-for-purpose homes.

"Covid-19 highlighted the difficulty some operators had to overcome in providing quality care in ageing homes compared to the homes we are investing in. Having those ensuite wet rooms, wider corridors, and the ease of segregation made an enormous difference."

Looking ahead to the future, as newly developed care homes become more energy efficient, we'll see the resilience of returns only strengthen.

"We've seen a multiplication in the energy costs operators are bearing. In some cases, there is as much as a 300% increase in utility costs. Modern care homes are more able to mitigate that cost pressure, whether that's the introduction of PV panels or heat pumps over time."

Our strategy

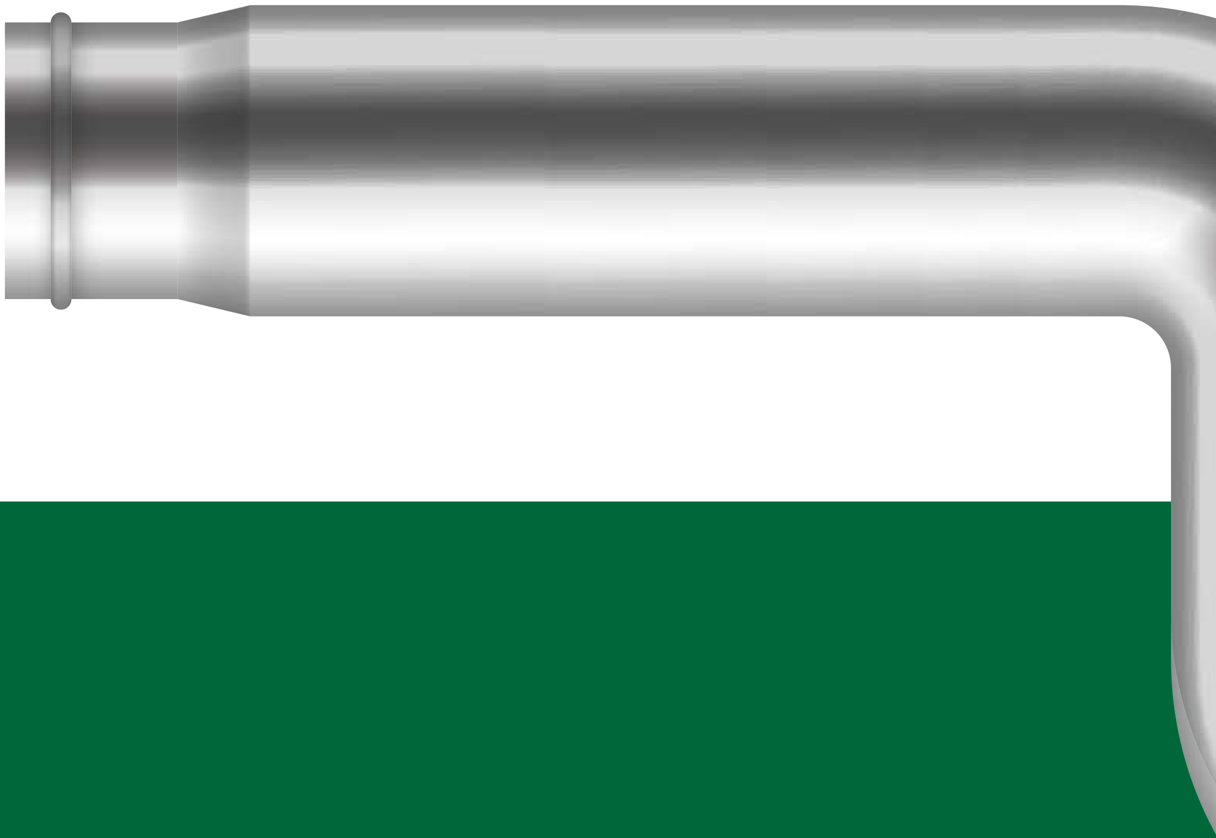
"What we're doing with our current strategy is targeting long-term, countercyclical returns for our investors and meeting the growing demand for quality care homes.

"Investing in the right locations, with operators capable of providing the highest quality of care, should lead to a resilient investment and allows us to build a more sustainable care sector.

"We have a clinical assurance team, which is the cornerstone of the underwriting process. With highly experienced nurses in the team, we have eyes and ears on the ground. They're liaising with the operators, liaising with their clinical leads, underwriting the clinical frameworks which operators have in place, and liaising with the regulator. That sets us up for success."

"Fundamentally, what we're doing is investing in care homes that we would be happy for our own loved ones to live in. Having homes that are fit for the future will ensure the right quality of care is provided."

CLIMATE CHANGE:



There's more to fighting global warming than building wind farms, but, just like renewable energy, carbon capture technology needs work. *Mark Dunne* reports.

PIPE DREAM

It sounds like the Saudi oil minister's wet dream: burning oil and gas to power parts of the economy, while still being on a path to limit global temperature rises to 1.5-degrees.
Science is making this a reality. Indeed, carbon capture and storage (CCS) technologies are designed to complement the natural carbon sinks that remove the climate-harming gas from our atmosphere.
The idea is that carbon dioxide (CO_2) is sucked out of the atmosphere and is then imprisoned underground instead of hanging in the air and stopping heat from escaping into space.
Such innovations are needed given the abundance of climate-harming gases in the skies above us. Indeed, 27 CO_2 appraisal and storage licences have been approved in the UK so far.
However, such approaches to help the world reduce the level of climate-harming CO_2 in the atmosphere are proving to be controversial.
For some, it could be seen as an excuse to not invest in renewable forms of energy and therefore to continue using fossil fuels, which could save oil companies from extinction. For others, the efficacy of such technology is unproven.
Yet such innovations are needed to clean up the world's energy system. In the UK, for example, an average of almost 20 million tons of carbon dioxide needs to be cut each year until 2030 to meet its carbon commitments.
With the country so reliant on fossil fuels, it is not going to be easy to make such a drastic reduction each year. And there are always going to be some areas of the economy that you cannot decarbonise.
"We call it net zero for a reason," says Nick Stansbury, head of climate solutions at Legal & General Investment Management (LGIM), acknowledging that completely removing carbon from our economies will be difficult.
Steel, cement, chemicals and aviation are industries that will be hard to entirely decarbonise. The food on our plate is another problem.
"However much we work at dietary change, we are going to struggle to remove all emissions from the agricultural system," Stansbury says.

We must never hold up CCS as a reason not to decarbonise.

Nick Stansbury, Legal & General Investment Management

Then there are what Stansbury describes as "fugitive emissions" from municipal waste and landfill sites. "There are always going to be some quantum of harmful emissions in the system," he adds.
Yet there are scenarios which could see the world completely abate all harmful emissions, Stansbury believes. But they involve "incredibly aggressive" policy action. "Our view is that those are relatively unlikely scenarios, so there is an important role for the 'net' in net zero," he says.

Burying the problem

It is clear that developing more reliable cleaner sources of energy, changing how we produce food and dispose of waste in a way that is kinder to the climate will not be enough to help us achieve net zero in the next 25 years.
We have to deal with the emissions which cannot be prevented. Then there is the carbon that is already in the atmosphere, which could, scientists say, remain in the skies above our heads for up to a thousand years.
So there is a need for carbon sequestration, storage and removal. There are three approaches here, which are either natural or technical.
First, there is nature-based carbon removal. This means trees, peat bogs, seagrass, fungi, soil and the oceans, which are all carbon sinks. As trees grow, for example, they capture carbon from the atmosphere and store it.
But the issue is that trees are not a permanent store of Co_2, in that carbon is released when they are cut down and burnt for fuel or warmth.
So this is a matter of preserving existing carbon sinks and creating new ones, such as through planting new forests.
Category two is geotechnical carbon storage, which is sucking carbon dioxide out of the atmosphere, also known as DAC. The captured carbon is then pressurised until it turns to liquid and is injected into permanent geological storage. This typically means porous rocks or depleted oil and gas reservoirs.
Confidence in the permanence of this method has been borne from a long track record of success. "If hydrocarbons formed over millions of years in a reservoir, we can be confident that any CO_2 we put in do not leak out. If it could, it is highly unlikely that the hydrocarbons would have formed there in the first place," Stansbury says.
The third method is carbon capture and storage (CCS). Rather than sucking CO_2 from the air, gases are captured at the point of emission – a dream come true for the Saudi oil minister.
"It is stopping emissions at the source," Stansbury says. "It is not about undoing the harm of emissions which previously took place."
The emissions are then liquefied and injected into the ground and capped off to keep them there. "We still produce CO_2, but

> **CCS has an important role to play, but it isn't a golden bullet.**
>
> Nick Stansbury, Legal & General Investment Management

rather than allowing it to enter the atmosphere, we store it," Stansbury says.

Part of CCS is bioenergy carbon capture and storage, which is known as BECCS. Stansbury describes this as key if we are to reach net zero. "In many scenarios, it is thought to have the potential to play quite an important role," he adds.

But the process is controversial. As a route to generating net-negative emissions "BECCS is a provocative subject that will raise heated opinions from different people", Stansbury says.

Indeed, a study by Imperial College has highlighted the problems with such technologies.

The study labelled the goal to scale up carbon capture and storage technology to remove up to 30 gigatonnes of CO_2 each year by 2050 as "overly ambitious".

It said that storing up to 6 gigatonnes of carbon underground each year by the halfway point of the century is more feasible. It could even rise to 16 gigatonnes if storage capacity increases, which will need much more investment into the sector.

If such an option is to make a positive impact on decarbonising our economies it needs to up its game.

To achieve net zero, the International Energy Agency estimates that around 1 billion tonnes of carbon dioxide will need to be captured and stored globally each year.

Globally, about 51 million tonnes of carbon dioxide was removed from the atmosphere last year, according to BloombergNEF, which was only 0.14% of such emissions.

No golden bullet

So will CCS have a dominant role to play in meeting net zero?

"No, we don't think so," Stansbury says.

"It has an important role to play, but we don't see a world in which we continue to burn the same quantity of fossil fuels as we do today and then simply capture the CO_2 and store it in the ground," he adds.

Economics is one reason. The cost of generating power from renewable sources, such as wind and solar, in most parts of the world has fallen to a level that makes it cost efficient to replace large parts of our fossil-fuel infrastructure with low-carbon alternatives. "That would be cheaper than relying substantially on CCS in the power system," Stansbury says.

So is CCS not the game changer it appears to be on paper?

"CCS has an important role to play, but it isn't a golden bullet," Stansbury says. "It isn't as though if we get CCS right then nothing else has to change."

In fact, one of LGIM's catchphrases here is "and not or". "The challenge of reaching net zero requires us to say "and" an awful lot, and it doesn't require us using "or" very much.

"It isn't a case of using CCS or renewables or afforestation or hydrogen or nuclear," Stansbury says. "It is a case of utilising all of the renewables, CCS, nuclear and hydrogen that we can.

"We need every one of these tools, and we need to use as many of them as we can manage if we want to stand a good chance of getting anywhere close to net zero by 2050," Stansbury says. "We just need to keep saying, 'and', 'and', 'and', 'and'.

"We need all of these tools. It is not a case of if you support CCS, you are not supportive of renewables. They are both important," he adds.

That is not to say LGIM is being unrealistic about the problems and uncertainties that come with CCS. "We must never hold up CCS as a reason not to decarbonise," Stansbury says. "It should never be looked at as something that we use instead of abating emissions.

"It is something we use alongside doing as much abatement as we can possibly get our hands on. That is why we find this 'and not or' framing helpful.

"None of these technologies allows us not to use the other one," Stansbury says.

Here to stay

Time is running out as we march towards 2050, a year where most companies have set their net-zero deadline. "The only way of getting there is to use every tool that we have in the toolkit, and to use as much of them as we can possibly get our hands on as quickly as possible. And even then, it's going to be incredibly challenging."

Sir John Armitt, chair of the National Infrastructure Commission, was quoted by *The Financial Times* as saying: "We don't live in a perfect world and there is always going to be some carbon to be captured from different processes to enable particularly heavy industry to do what it needs to do."

So it is clear that renewable energy alone cannot fully decarbonise the economy.

Companies should focus all their energy on abating their emissions, but also developing CCS systems.

It's not quite a strategy that will put a smile on the face of the Saudi oil minister or allow polluters to ignore their greenhouse gas emissions, but it is an acknowledgment that fossil fuels are unlikely to be eradicated for generations to come.