Driving sustainable businesses through a strategic approach to responsible investment

Portfolio review

Our focus in 2023 was to establish a framework and a baseline to assess our progress towards attaining a sustainable portfolio by 2030. Our Investment Team engaged with our fund managers to execute this assessment and we are pleased with the outcome and the insights to date. This will help us to set the agenda for the years ahead.

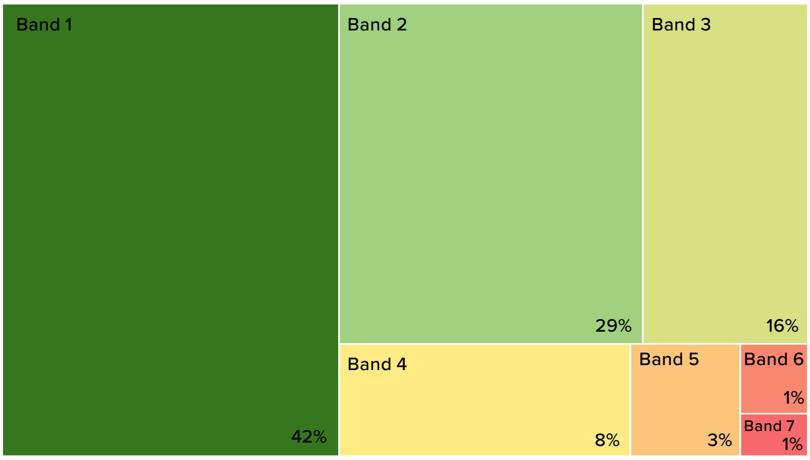
In 2023, we set decarbonisation targets (known as the Initial Target Disclosure) in line with the Net Zero Asset Managers initiative ('NZAM') guidelines. We also engaged with our third-party managers to learn from the 2022 baseline assessment of the portfolio using the responsible investment framework. Working with our managers, we identified areas for engagement and, where necessary, escalation. The exercise was repeated in 2023 when over 300 companies were assessed.

BUILDING ON OUR FOUNDATIONS

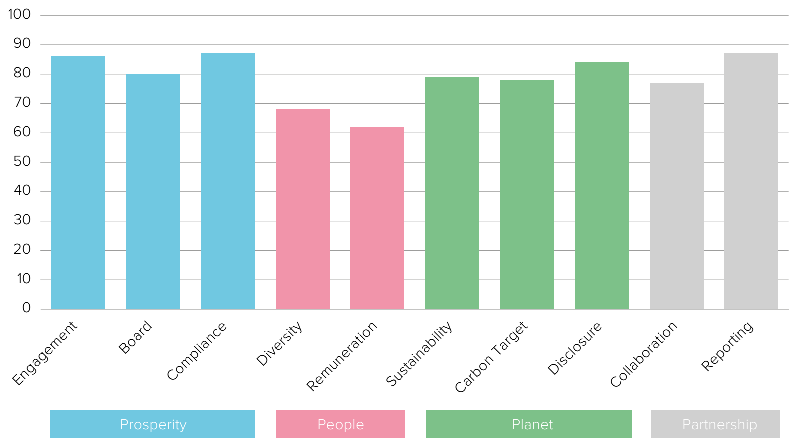
A key target of our responsible investment strategy is to ensure that by 2030 our listed equity portfolio consists entirely of sustainable businesses. Having set our baseline in 2022, we once again engaged with our managers to see what progress had been made by portfolio companies over the subsequent 12 months. The purpose was to assess where we were positioned relative to our sustainability objectives.

As before, the assessment involved Witan and every fund manager rating each of their portfolio holdings across the four pillars of prosperity, people, planet and partnership (see page 17) that we believe characterise a 'sustainable business'. Witan provided a detailed methodology, identifying ten individual issues (grouped under the four pillars), to assist fund managers in assessing each company. In short, over 90% of portfolio companies were judged to be either fully or partially aligned with eight out of the ten categories, while over 75% were similarly in compliance with the other two categories (namely Diversity and Remuneration).

WITAN SUSTAINABILITY ASSESSMENT[1]



AVERAGE SCORE PER ISSUE[2] ACROSS FOUR PILLARS



(1) Sustainability bands ranked 1 (highest) to 7 (lowest); see page 19.
(2) See explanation of each issue on page 117.

SCORING OUR PORTFOLIO

These assessments were converted into a numerical score with each company achieving a rating of 0-100. In total, over 300 companies across our core and specialist portfolios were assessed.

In 2023, the weighted average assessment of sustainability was 81 (2022: 80) out of a possible 100. As noted last year, our portfolio is on a journey towards greater sustainability, and we expect progress to be incremental and not necessarily linear. It is therefore pleasing to make positive progress this year. The results of the assessment are shown in the charts opposite and below.

Each portfolio company scored between 0 (failing to meet any sustainability criteria) and 100 (meeting all criteria). The 0-100 assessment of sustainability was sub-divided into seven equal bands with Band 1 being the highest rating and Band 7 the lowest. 42% (2022: 40%) of companies in the portfolio sit within sustainability Band 1 (shown in dark green on the chart) while 87% (2022: 83%) sit within the top three bands. We consider this to be an encouraging result, especially as this year's assessment included an additional 50+ companies, many of which are smaller, often emerging market companies, where responsible investment practices are less well developed and a higher sustainability assessment may be harder to achieve.

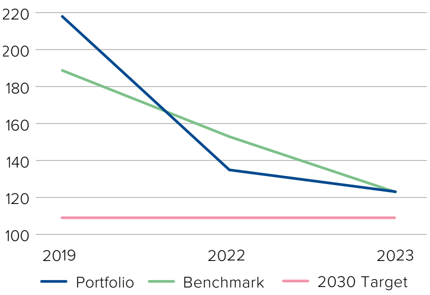
Just 18 companies (equal to less than 5% of the portfolio) sat in the lowest three bands (5 to 7) where a lack of disclosure, rather than poor practices per se, were the primary cause of a low rating. Of these, seven were Chinese companies (ironically, all seven provide products or services which contribute to improving environmental and / or social outcomes), two were Japanese and five were high-growth technology or biotechnology companies, with little or no direct carbon footprint. Subsequent to the year-end, both companies which were judged to be in Band 7 (the lowest band) were sold, albeit for investment reasons, by their respective managers.

Whilst our approach primarily involves an assessment of clearly defined policy and identifiable initiatives, there is also a degree of qualitative assessment involved. It is therefore encouraging to note that there continues to be a high degree of correlation between ratings applied to companies which were owned by more than one manager. This shows that our framework is being applied consistently across our whole portfolio, irrespective of which manager is carrying out the analysis.

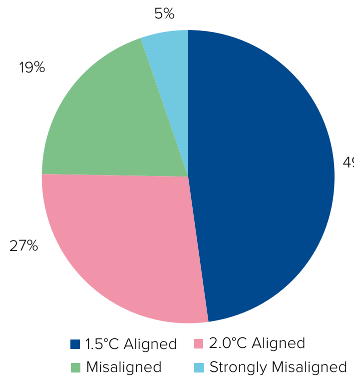
PROGRESSING TOWARDS NET ZERO

Following our commitment to NZAM, we were required to set decarbonisation targets (known as the Initial Target Disclosure) in line with the NZAM initiative. These involved identifying what proportion of the portfolio would be covered by our commitment and what our interim (2030) target for decarbonisation would be. In setting our initial targets we considered what could be measured as well as what could be achieved.

CORE PORTFOLIO WEIGHTED AVERAGE CARBON INTENSITY



CORE PORTFOLIO IMPLIED TEMPERATURE RISE DISTRIBUTION



Therefore, our NZAM commitment covers our core portfolio of primarily developed market, large and mid-cap companies, equating to 75% of our total assets under management. Our decarbonisation target for this part of the portfolio is a 50% reduction in Scope 1+2 WACI between 2019 (the baseline year) and 2030.

Witan subscribes to MSCI for ESG research to supplement our own responsible investment framework and we use their data to analyse the portfolio. We focus on two key measures when considering our progress towards net zero. The first is the WACI of our NZAM aligned assets (i.e. the core portfolio) which was 125.4 tCO2e/$M sales (2022: 134.9). This is already close to our 2030 target of 109.50 tCO2e/$M sales and is broadly in line with the benchmark's WACI of 122.9 tCO2e/$M sales. The second measure, which is forward looking, is the implied temperature rise of the core portfolio. To be aligned with net zero and therefore the aims of the Paris Agreement on Climate Change, the portfolio should achieve alignment with an implied temperature rise of no more than 2°C and preferably 1.5°C. Currently, 76% of the portfolio is aligned with 2.0°C, with 49% also being aligned with 1.5°C. Overall, the core portfolio is currently aligned with an implied temperature rise of 2.0°C. This is materially better than the 2.4°C for our equity benchmark. These, of course, are snapshots which could change due to company behaviour or portfolio turnover so it is important to continue to monitor progress over time. We expect that much, if not all, of this progress will be achieved by operating improvements within portfolio companies (via reduced energy consumption, better use of technology or a combination of both). We do not, at least for the foreseeable future, favour divestment to achieve portfolio decarbonisation.