MHP Group

Capital Markets ESG *Insights*

July 2023

Welcome

In this latest iteration of the MHP Capital Markets' quarterly ESG Insights newsletter, we look at how industries are working collaboratively to tackle the climate crisis, and whether this is an effective vehicle for change or a risk to industry. We explore how ESG investors are looking to private capital for sustainable returns, and host a Q&A with the FAIRR Initiative, a collaborative investor network that raises awareness of ESG risks and opportunities in the global food sector, specifically focusing on the upcoming Taskforce on Nature-related Financial Disclosures (TNFD) recommendations. We also feature Next 15 Group PLC as our Client in Focus.

For any questions or feedback please contact us at *esg@mhpgroup.com*

Industry cooperation on decarbonisation: Vehicles for change or reputational hazards?

Taking action on climate change is often viewed through the lens of actions by individual companies to reduce emissions within their own operations. Industry-wide collaboration has been less common, despite it offering an opportunity for firms to come together to create significant structural change. Many businesses have been hesitant to work with rivals to share resources and establish common goals due to concerns over antitrust regulations.

Recently, however, there has been a shift in both UK and EU policies that address these concerns, providing clarity to businesses that want to take collective action on climate change and environmental sustainability.

Reassuring signals

In February, the UK's Competition and Markets Authority published practical examples companies can use to shape their decisions when working together with other businesses on sustainability initiatives.

Similarly, in June, the European Commission published guidelines to help companies assess their cooperation agreements' compatibility with EU competition rules.

There are stand out models of industries effectively working together and harnessing their collective strength to enact agreements and develop climate change solutions. Carbon capture projects, like SSE Thermal's landmark green hydrogen project in partnership with Equinor, seek to unite hydrogen production, storage and power generation in one location, and will significantly contribute to the UK's net zero journey. Similarly, the recently launched Peak Cluster initiative is an innovative collaboration between aggregates players including Breedon, Tarmac and Aggregate Industries, to capture, transport and permanently store CO2 emissions from the cement and lime industries across Derbyshire, Staffordshire and Cheshire.

These positive signals from the UK and EU in recent months should encourage more collaboration across various industries as businesses look to make headway on their climate plans.

A transatlantic divide

On the other side of the Atlantic, however, private sector coalitions on climate change have become the latest ESG minefield for firms to navigate.

The Net Zero Insurance Alliance (NZIA) was set up in late 2021 ahead of COP26 and, until recently, boasted some of the world's largest insurance and reinsurance groups as members. Participants committed to decarbonise their underwriting portfolios in line with science-based targets, while using their collective strength to advocate for a socially just transition to net zero.

That was until it received heavy criticism from Republican lawmakers, who raised concerns that the NZIA's targets could violate federal and state antitrust laws. This is set against the broader context of the ESG backlash in the US, which we discussed in our October 2022 edition of ESG Insights, and which has seen 99 anti-ESG legislative bills filed in the first four months of 2023 compared to 39 during the whole of 2022.

Under regulatory and reputational pressure, an exodus ensued, seeing some of the NZIA's most high-profile members pull out and raising questions over the initiative's future.

Navigating a polarising landscape

Businesses considering cooperating with competitors on a project will need to weigh up their desire to collaborate against a polarising landscape. While a clear transatlantic divide has emerged, regardless of location, industry communications should be stress-tested against how stakeholders are likely to respond. Businesses should be careful to craft clear and transparent messaging which lays out the merits of the joint endeavour, alongside being equipped to answer questions on the legal and regulatory status of agreements.

Ultimately, climate change is a challenge every industry faces. By working together, firms can create long-lasting, meaningful change that will have a greater impact than their efforts alone. But, as with their individual actions, they should be prepared to be challenged along the way.

A new partnership: ESG investors look to private capital for sustainable returns

Pension funds, charitable organisations and family offices are increasingly looking to private capital for revenue growth amid a sustained period of high inflation, tightened monetary policy and interest rate rises.

This shift presents private capital – including private equity, venture capitalists and large family offices – an opportunity to further integrate ESG into corporate strategies in order to attract additional investment.

Growing pains

When it comes to public markets, capital has flowed out of ESG-aligned investments at a rapid rate. ESG funds saw approximately £304m of redemptions in May, a record outflow and only the second time in five years that investors were net sellers, according to data from Calastone. Much of this was due to underperformance, with Calastone finding that ESG funds did not deliver positive returns in 2022, and Bloomberg noting that the ten largest US ESG funds by AUM reported double digit losses through the year, with eight of them underperforming the S&P 500's -14.8% decline.

Despite the challenges, ESG funds as an investment should not be written off: asset managers are expected to increase ESG-related assets under management to US$33.9tn by 2026, from US$18.4tn in 2021 — an increase of 84% – according to a report released by PwC in October last year.

However, with volatility in the public markets and a high inflationary, high interest rate environment expected to be the new norm for some time, ESG investors are turning to private capital to find sustainable returns.

A decisive moment

Led by the US Inflation Reduction Act and its European equivalent, private equity funds are increasingly offering investors opportunities to invest in clean energy projects, launching funds targeted at financing the expansion of renewables as companies target subsidies on offer. Indeed, Quantum Energy Partners has raised more than $2.5 billion so far for its latest flagship private-equity fund, which will invest in both fossil fuel and clean energy companies – demonstrating appetite for investment in the energy sector.

There are many signs that private equity investors are beginning to embed best practices into their investment processes, according to the UN's Principles for Responsible Investment (PRI), but funds need to go further if they are to attract more purist ESG investors. Recently published analysis by Pitchbook shows that funds managed by private investment firms that have committed to a specific set of ESG principles have performed equally as well as those of their non-ESG-aligned peers, a clear sign that managers can integrate ESG metrics into investment strategies without sacrificing returns, countering a longstanding belief of ESG critics.

"The most activity around sustainable investing is really happening in the private markets"

Jonathan Hirschtritt, a managing director of sustainability at GCM Grosvenor, told an ESG conference in New York earlier this year.

Strong performance, backed up by data and alignment to a credible ESG framework, as well as being communicated well, can deliver a premium valuation and attract further investment. As investors look to private equity for both attractive and sustainable returns, integrating ESG into investment practices can provide a competitive advantage over other assets where this focus is lacking.

Q&A with FAIRR on the upcoming TNFD recommendations

The FAIRR Initiative is a collaborative investor network that raises awareness of the ESG risks and opportunities in the global food sector. Its mission is to build a global network of investors who are aware of the issues linked to intensive animal production and seek to minimise the risks within the broader food system. We spoke with Sajeev Mohankumar PhD, Senior Technical & Engagement Specialist at the FAIRR Initiative, about the upcoming TNFD recommendations.

***01:* What should companies and investors expect from the upcoming TNFD recommendations in September?** FAIRR welcomes the release of the TNFD V1.0 guidance in September 2024. The general guidance will provide organisations with a risk management and disclosure framework to report and act on evolving nature-related risks and opportunities.

In addition to this, TNFD is building frameworks for specific sectors, ecosystems (forests, cultivated land and water bodies) and value chains. For instance, V1.0 will include additional guidance for financial institutions, agriculture and food, energy, and mining and metals. These additional frameworks will provide much-needed sector specificity and allow for more representative and meaningful disclosures.

The TNFD acknowledges the interconnectedness between climate and nature. To achieve integrated climate-nature disclosures, TNFD is closely aligned with the Taskforce on Climate-related Financial Disclosures (TCFD). TNFD is also working closely with other corporate disclosures, national standards and target-setting bodies to ensure compatibility and to prevent variable asks from a proliferation of guidance on nature and biodiversity.

Organisations can expect a comprehensive and structured framework driven by TNFD's unique LEAP approach (Locate, Evaluate, Assess and Prepare). They also have an extensive catalogue of tools and resources linked to each step in the LEAP approach, allowing organisations to implement the framework requirements.

***02:* Which companies are ahead of the curve with regards to TNFD disclosures?**
Since the final guidance is not out yet, TNFD is encouraging organisations to pilot-test the framework until its release. So far, 130 organisations have been involved in the piloting process, and several have presented their approach and preliminary results to the TNFD. This included insights from corporates, financial organisations, technology and service providers.

Notable investors piloting the guidance include AXA, Kirin Group, Phoenix Group, ABRDN, and Climate Asset Management. Investors such as Norges Bank, Aviva and Blackrock are also calling on businesses to align with TNFD to integrate nature and biodiversity into their sustainability strategies. When it comes to corporates, AB InBev, Bayer, GSK, and Grieg Seafood are early adopters of the approach. The FAIRR Protein Producer Index is a useful resource to assess the performance of animal protein companies for ESG risks, including metrics on biodiversity and nature. Organisations involved in pilot testing and already considering TNFD principles in their annual disclosures can get ahead of the curve by identifying key gaps in data, capability and knowledge required to align with the guidance and start integrating the TNFD principles early in their sustainability strategies.

03: What are the common questions FAIRR recieves regarding the TNFD recommendations?

As FAIRR engages with stakeholders in the animal protein sector, the key concern raised so far has been on the usability and representativeness of the Food and Agriculture guidance.

There is great appreciation towards the TNFD for producing such a comprehensive framework. However, understanding the guidance and disclosing nature-related metrics will pose a significant knowledge and resource allocation challenge for many organisations.

Some concerns have also been raised over the sheer volume and diversity of approaches which will lead to a myriad of disclosures on metrics, scenarios and targets. Organisations were concerned that this might not be representative across organisations and sectors for benchmarking and comparison purposes. There were also calls for a phased implementation of disclosures allowing for flexibility in the rigour and timelines to report on nature-related risks, especially for organisations starting their nature journey.

04: What work has FAIRR been doing for clients in anticipation of the TNFD recommendations?

FAIRR continues to monitor this space and has been actively involved in the consultation phases of the TNFD and other nature-related standards, such as the Science Based Targets Network (SBTN).

All consultation responses are available to its investor members. In addition, it has worked collaboratively with investors on biodiversity. FAIRR recently released the findings of its Waste and Pollution Engagement, which focuses on addressing biodiversity risks from animal waste management. It also has a workstream on Regenerative Agriculture, which aims to provide investors with the confidence to support companies and farmers in adopting regenerative practices at scale.

05: What other initiatives are in the pipeline which companies and investors should be aware of?

The Corporate Sustainability Reporting Directive (CSRD) is expected to enter into force in 2024, with the first submissions due in 2025, replacing the Non-Financial Reporting Directive (NFRD). This regulation acts to broaden the scope of sustainability disclosure, requiring all listed companies in the EU (including listed SMEs, but not micro-enterprises), as well as other large companies and certain non-EU companies, to report against specific sustainability standards which are currently under development.

The EU has also approved the [deforestation-free regulation](), which aims to tackle deforestation stemming from the consumption of key agricultural commodities. Within two years after the law comes into force, the financial sector will be required to conduct due diligence checks and stop investments that cause deforestation, potentially disrupting both corporates and investors that do not meet the required level of traceability and responsible sourcing.

The Land Sector and Removals Guidance is to be published in the summer of 2023. It will explain how companies should account for and report greenhouse gas (GHG) emissions and removals from land management, land use change, biogenic products, carbon dioxide removal technologies, and related activities in the Agriculture, Forestry and Other Land Use Sectors (AFOLU).

The Science Based Targets Network (SBTN) has also released guidance for companies who wish to set science-based targets for nature. This initiative aims to equip companies to assess their environmental impacts and set targets, beginning with freshwater and land, enabling companies to both reduce their negative impacts and increase positive outcomes for nature and people. The target validation process is expected to begin in early 2024.

Sajeev Mohankumar PhD
Senior Technical & Engagement Specialist at the FAIRR Initiative

Client in Focus: *Next 15*

Next 15 is an AIM-listed tech and data-driven growth consultancy with operations in Europe, North America and across Asia Pacific.

It operates across four segments, each of which helps its customers grow in different ways: Customer Insight helps them understand their opportunities and challenges; Customer Engagement optimises their reputation and digital assets; Customer Delivery helps them connect with customers to drive sales; and Business Transformation helps maximize long-term value through corporate positioning, business design and the development of new ventures.

The Group aims to use business as a force for good by delivering sustainable growth for its stakeholders, placing diversity, community, well-being, and the low-carbon transition at the heart of its work.

A purpose-driven, people-led business

Next 15's success is underpinned by a people-led approach. Its purpose is to make its customers and people the best versions of themselves, and it defines its culture as empowering and respectful. It believes that by demonstrating that it is truly committed to delivering on an ESG agenda, it is embedding best practice that will deliver immense long-term value, for the benefit of all stakeholders.

Defining ESG priorities

To define its ESG priorities, the Group recently carried out a comprehensive materiality assessment, developing an inventory of topics relevant for its business over the next five to ten years. Working with stakeholders from across Next 15 and its brands, the Group then refined this list to the most relevant ESG topics, mapping these onto a draft materiality matrix.

Finally, it engaged with stakeholders - representing senior leaders, employees, brands, customers, and suppliers – to challenge its thinking and fully understand the impact of these areas.

Next 15’s core impact areas

Customers
Next 15 seeks to work with clients who share its values and are committed to making a positive impact on the world. It is selective about who it works with.

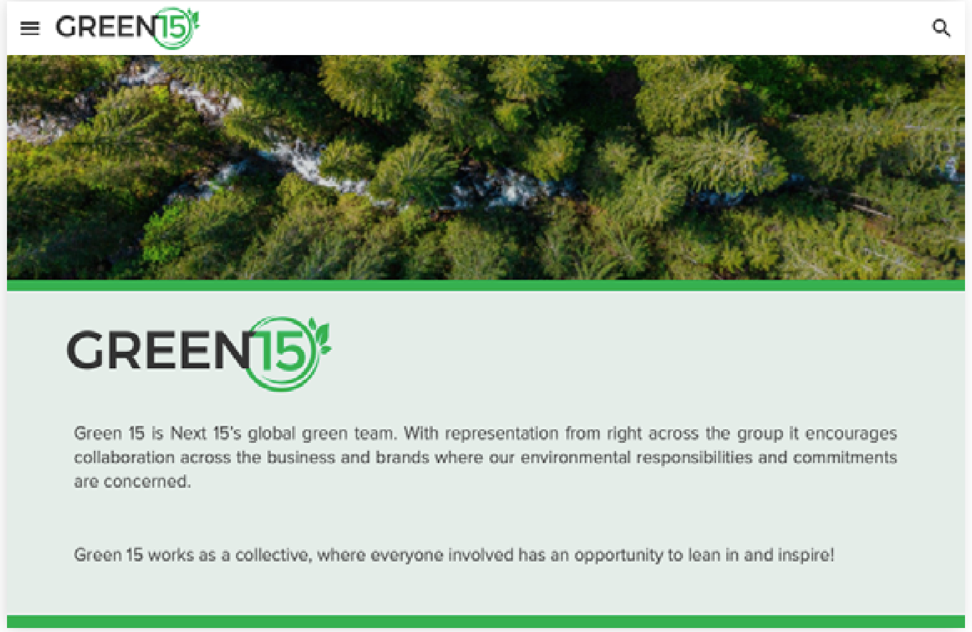
In December 2020, the Group established the **Next 15 Ethics Group** to support its brands in making values-based choices about which clients and projects to pursue, placing sustainable growth at the heart of client conversations.

People
The Group has long believed that a diverse and inclusive workforce is not just a social good, but a commercial advantage when it comes to attracting and retaining the best people. Fair practices in hiring and talent development, as well as maintaining safe, inclusive and supportive company cultures, are key to the Group’s success.

Environment
Climate change is a key priority for Next 15 stakeholders, and the Group is committed to playing its part. It does this in two ways – through contributing to sustainable growth through client project selection and execution, and through its own operations. The Group began measuring Scope 1 and 2 emissions and elements of Scope 3 emissions in February 2021, and has this year extended its Scope 3 boundary and included EMEA and APAC alongside the UK and North America.

As part of that, there is also significant focus around supply chain and transitioning to renewable energy in as many offices as possible. The Next 15 ISO 14001 Environmental Management System expansion programme is also helping to progress those ambitions.

In September 2022, Next 15 set up **Green 15,** designed to be a unifying, collaborative force that supports the Group’s environmental targets by encouraging more sustainable behaviour and thinking. Members are drawn from across Next 15 and its brands globally.



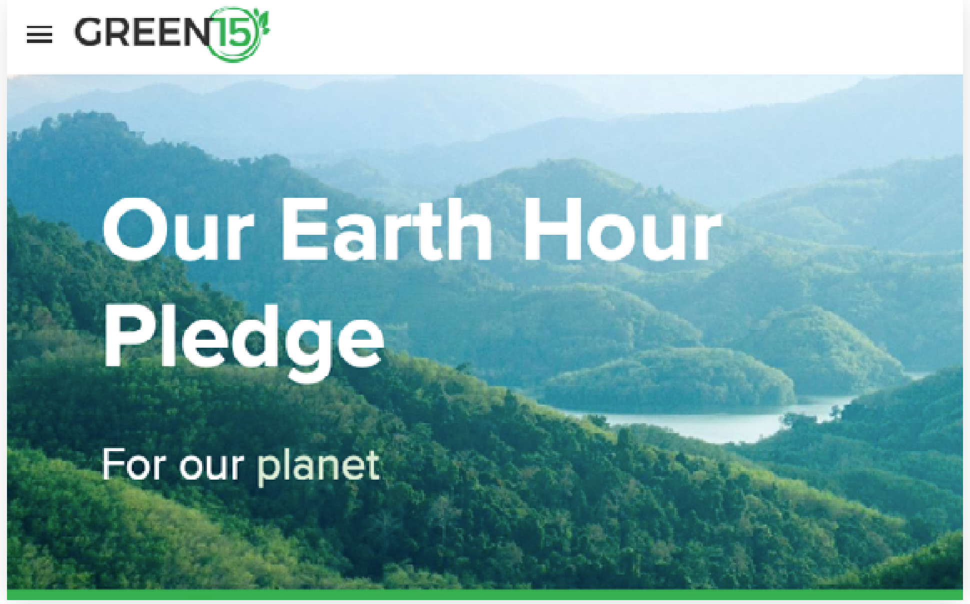
Community
No organisation exists in isolation. Next 15 defines Community as the communities in which it operates, and the suppliers and distributors within its supply chain. The Group promotes positive action across both, and its brands give time or money to local, national, and international causes that are aligned to their values.

In FY23, the Group set a KPI to measure the percentage of net revenue donated to charity during the last fiscal year. It also seeks to drive sustainability throughout its supply chain.

In August 2021, Next 15 began its partnership with onHand, a London-based tech for good organisation that matches volunteers with community projects. Next 15 UK employees completed 674 missions during the past year, with feedback from volunteers overwhelmingly positive.

Governance
Robust governance is critical to the long-term success of the Group, and Next 15 is determined to run its business as a force for good. Next 15's ESG Committee is chaired by Next 15 Non-Executive Director, Dianna Jones.

Its purpose is to assist the Board in fulfilling its oversight responsibilities of all ESG matters, and to ensure that the Company has a guiding vision and clear long-term commitments, KPIs and targets.



ESG progress in FY23

Next 15 recently engaged environmental specialists to capture carbon data, established an internal Ethics Group, and undertook EDI audits. During the year, the Group also extended its Scope 3 reporting and attained ISO 14001 certification at its Head Office.

To help the Board define what sustainable growth looks like in practice, the Group also established its ESG committee, responsible for approving Next 15's emerging overarching ESG strategy.

In cooperation with B Labs, Next 15 decided its brands would seek B Corp certification individually, with the first, elvis, becoming accredited during FY23. Internally, Next 15 adheres to internationally recognised B Corp standards.

What’s next?

This year, Next 15’s ESG team will be working with external advisers and representatives from its brands, to further refine what sustainable growth looks like in practice.

Its priorities include further developing an exciting and compelling ESG strategy that its brands and people feel part of, progressing its toolkit for measuring the impact of client work on the world, and to continue to embed EDI at the heart of the Group.

In FY24, it will reset the role of its EDI Council, a strategic advisory group for Next 15 that will provide guidance, make recommendations, and advocate for EDI across the Group.

Next 15 will also support its brands in setting science-based carbon reduction targets and deliver against them. While reducing carbon emissions is a priority, the Group also budgets for offsetting residual emissions and is developing a longer-term offsetting strategy, where it will invest any funds in early stage carbon removal technologies.

Next 15 remains committed to building ESG considerations into every area of its work with customers across all segments of the business.

More information can be found in Next 15’s recently published Annual Report 2023.

In case you *missed it…*

On 13 June, the European Commission proposed a package of measures to strengthen the EU sustainable finance framework. It enlarged the 'EU taxonomy', expanding the remit of the EU's sustainable finance criteria.

The classification system, which directs investment to economic activities aligned with net zero goals, will be extended to encompass pollution prevention, protection of water and marine resources, and the transition to a circular economy.

Secondly, the EU proposed regulation intended to improve the transparency and reliability of ESG rating providers, requiring issuers to be supervised by the European Securities and Markets Authority (ESMA). The Commission will continue to work with stakeholders as they aim to steer investments towards European Green Deal objectives.

Allegations against Crispin Odey shone a light on the hedge fund industry after the Financial Times published an investigation into the abusive workplace culture at Odey Asset Management. The allegations highlighted the importance of corporate governance, a lesser considered element of ESG, which the government has pledged to give greater weight, having asked the Financial Reporting Council (FRC) to bolster the UK Corporate Governance Code in May.

The FRC has consequently launched a consultation on the proposed revisions, which is open until 13 September.

On 26 June the International Sustainability Standards Board (ISSB) issued its inaugural standards – IFRS S1 and IFRS S2 – ushering in a new era of sustainability-related disclosures in capital markets worldwide.

The Standards will help to improve trust and confidence in company disclosures about sustainability to inform investment decisions, creating a common language for the disclosure of climate-related risks and opportunities for the first time.

The Standards have been developed to be used in conjunction with any accounting requirements and are built on the concepts that underpin the IFRS Accounting Standards.

In other regulatory news, the FCA launched the 'Greenwashing Techsprint' on 5 June. The international operational forum is aimed at developing tools to tackle greenwashing in financial services. The event brings together international regulators, firms, and innovators, pursuing collaborative goals laid out by the Global Financial Innovation network (GFIN).

The event runs for three months. Participants will aim to develop a 'tool or solution' that could help regulators, or the market, more effectively combat exaggerated, misleading, or unsubstantiated claims about ESG.

The UK's House of Lords has agreed to an amendment to the Financial Services and Markets Bill that adds nature to the new regulatory principle on net-zero emissions.

Back in March, the Lords came out in favour of an amendment that would make sure financial institutions carry out due diligence when investing in, or lending to, businesses producing "forest risk" commodities such as beef, palm oil and soy.

Baroness Boycott, who introduced the amendment, this week said:

"The government lists halting deforestation as a 'top priority' in its net-zero strategy, but the scale of finance continuing to flow from British banks and investors to the companies actively destroying the world's tropical forests shows that, in practice, the government does not prioritise this issue."

Upcoming *key events*

Event	Date
Environmental, Social and Governance (ESG) for FinTech SMEs (London)	26 July 2023
Reuters ESG Investment Europe (London)	6-7 September 2023
AIMA Putting ESG into Practice 2023 (London)	7 September 2023
IMN’s Inaugural Conference on ESG in Capital Markets (London)	12 September 2023
Sustainable Investment Awards (London)	21 September 2023
BlueEarth Summit (Bristol)	11-13 October 2023
ACT ESG Conference (London)	21 November 2023
ESG Integration Forum (London)	23 November 2023

Previous MHP Capital Markets ESG content

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MHP Capital Markets

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