

CAPITAL MARKETS ESG INSIGHTS

APRIL 2022

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WELCOME

to our second quarterly ESG insights newsletter of 2022.

ESG insights is a quarterly report, which aims to examine some of the most pressing themes from the ESG landscape in the last few months. We also look to include some practical recommendations, as well as featuring a Client in Focus, highlighting some of the good work being done in this area by our clients.

In this edition of our ESG Insights report, we are looking at some of the key ESG-related themes arising from Russia's invasion of Ukraine.

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

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WHAT THE
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POWER CUT: WHAT THE INVASION MEANS FOR THE ENERGY TRANSITION

The invasion has pushed European nations (and the West more broadly) to consider the extent to which they are reliant on Russian hydrocarbons, and the risk this poses to energy security.

Economic sanctions on Moscow and reducing the flow of Russian oil and gas play a critical role in curtailing the invasion. However, recent events could prove to be the impetus that Western economies need to accelerate the transition to clean energy, shifting the balance away from hydrocarbons towards a clean, independent and cost-efficient energy mix.

CUTTING OFF SUPPLIES

In response to the invasion, several major economies have communicated their plans to reduce reliance on Russian hydrocarbons, with the European Union

currently importing 45% of its gas, 27% of its oil and 46% of its coal from the country. The European Commission created REPowerEU, which will seek to diversify gas supply, speed up the roll-out of renewable gases and replace gas in heating and power generation with the aim of reducing reliance on Russian gas by two thirds before the end of the year. It also includes the British Energy Security Strategy, which was launched at the beginning of April.

In March, the International Energy Agency (IEA) published its 10-Point Plan to Reduce the European Union's Reliance on Russian Natural Gas, including accelerating the replacement of gas boilers with heat pumps, stepping up energy efficiency improvements in buildings and industry and further promoting behavioural changes such as encouraging consumers to temporarily turn down thermostats to reduce gas demand.

“Several major economies have communicated their plans to reduce reliance on Russian hydrocarbons, with the European Union currently importing 45% of its gas, 27% of its oil and 46% of its coal from the country.”

SECTION 01

POWER CUT: WHAT THE INVASION MEANS FOR THE ENERGY TRANSITION

Despite the challenges, the invasion has evidently shaken up the global pace of the energy transition. Renewables, such as offshore wind, solar energy and green hydrogen development, are now not only seen as a response to climate change, but also a way in which Western economies can strengthen energy security and independence whilst simultaneously benefitting their local economies.

SHIFTING THE BALANCE OF POWER

Renewable energy produced more of the world's electricity than coal in 2021, as wind and solar combined to make up more than 10% of global generation for the first time, according to think tank Ember. However, challenges remain for a wholesale shift away from hydrocarbon-based energy.

For the West to reduce its reliance on Russian oil and gas, a multi-sector, policy-led approach will be required. As conventional energy prices spike higher, the relative

economic attractiveness of renewables continues to grow; according to [Schroders](#), this continues to be the case even after accounting for higher equipment costs as a result of supply chain constraints.

The argument for accelerating the transition of our energy system to one based on cheap, clean, and reliable power is made all the clearer and more necessary by recent events. Corporates would do well to reassess the pace at which their own sustainability strategies and net zero ambitions are progressing; communicating these actions clearly would not only show stakeholders that they are taking their role in the climate crisis seriously, but would also signal an awareness of the part they play in reducing the West's reliance on Russian energy.

In 2021 wind and solar combined made up more than 10% of the world's global electricity for the first time.



HAS THE INVASION CHANGED THE WAY WE CONSIDER DEFENCE STOCKS?

Following the invasion, one of the most prominent stories in the ESG space has been the renewed debate around defence stocks.

While there is nothing new about investors' qualms over defence companies, with the rapid growth of ESG investing, proliferation of ESG funds and the increased use of ESG screening tools, defence stocks have largely been shunned by ESG investors in the same manner as those exposed to tobacco and fossil fuels.

Executives of defence companies have long spoken about the "pariah" status defence stocks have assumed due to a broad brush approach from investors, and ESG investment metrics which disqualify them from essential investor support. They cite the imperatives of national security as a key social good which involves the necessary development of sovereign capabilities used to protect the basic needs and security of a society.

The invasion has indeed led to some introspection amongst investors and debate about the positive role of defence in ensuring safety, security and stability, and its place within ethical investment portfolios, challenging the view that defence stocks which produce offensive capabilities should automatically be regarded as untouchable.

A source from the UK defence industry was quoted as saying:

"Interestingly, the defence industry has traditionally been outside ESG but we're seeing it being brought into the fold a little bit. Everyone is recognising that defence, which might not be the most popular industry, can actually play a significant part in safety, stability and economic recovery."



"Liberal democracies lead the way on environment, society and governance and you can't maintain a liberal democracy without robust defence."

David Lockwood
CEO of Babcock International

SECTION 02

HAS THE INVASION CHANGED THE WAY WE CONSIDER DEFENCE STOCKS?

The markets have responded accordingly, with defence names having their moment in the sun in recent weeks.

Of course, we cannot assume that all of those investing in defence stocks are now doing so because they believe they are ESG-sound investments. Rather, investors have simply responded to multiple governments pledging to boost defence spending. That being said, Sweden's SEB

Bank notably reversed its sustainability policy – which had previously prohibited any investment in defence companies – following the Russian invasion.

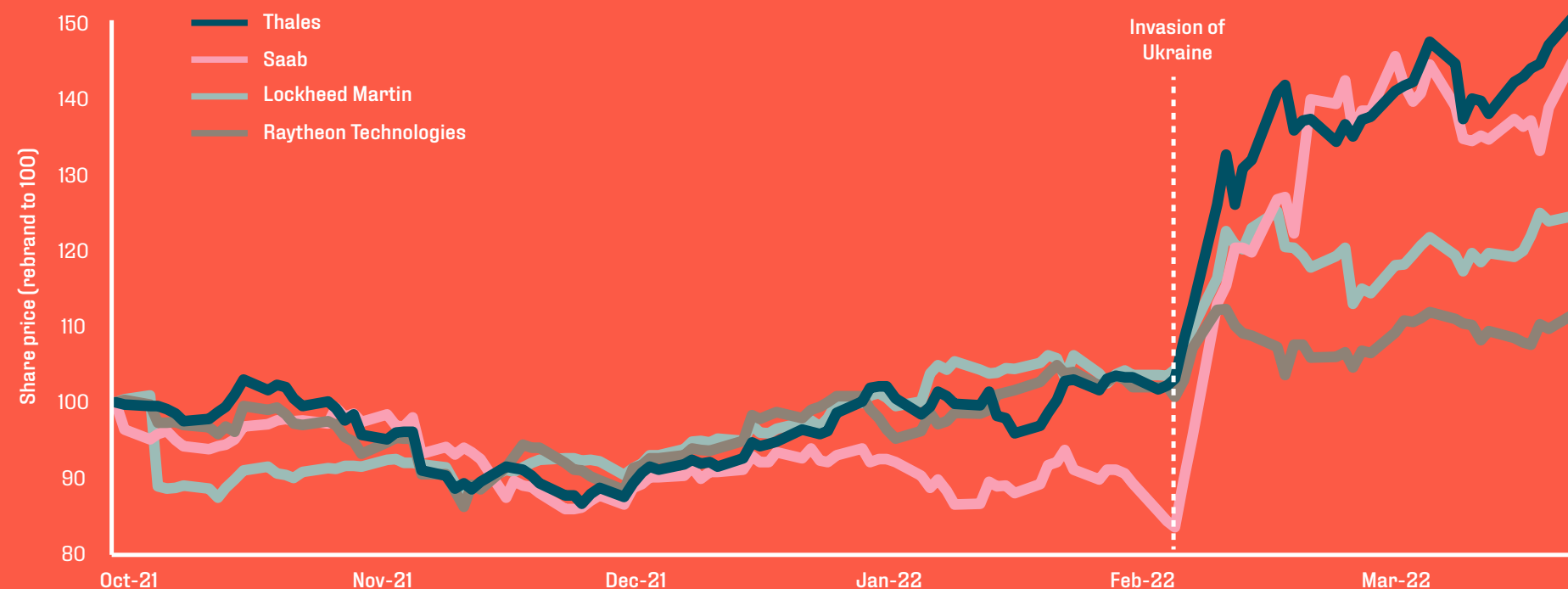
The discussion regarding whether defence stocks are ESG-worthy or not is likely to persist, and a debate has thus begun regarding the appropriate metrics, criteria and broader considerations used to evaluate what “ESG” really means.

What many defence company executives have called for is greater clarity in ESG investment criteria. They want more nuance in investment decisions rather than blanket restrictions, and greater emphasis placed on individual companies and the role they play, in isolation from the wider industry. As ESG funds and investment criteria increasingly dominate the direction of asset flows, Charles Woodburn, CEO of BAE told the FT that the industry was:

“Suffering from a lack of consensus in defining ESG compliance, which is causing some investment funds to exclude all defence stocks, rather than taking a more considered approach to assess individual company strategies and portfolios.”

At the very least, the invasion has provoked debate about how the markets should think about investment in defence companies. Moving forward, akin to the US Armed Forces' inaugural 2022 Climate Strategy, industry participants may look to communicate more pertinently how they are making efforts to improve their own ESG performance and reporting.

DEFENCE STOCKS SHARE PRICE PERFORMANCE



LONGER TERM IMPACTS – THE LEGACY EFFECTS OF THE INVASION ON ESG BEST PRACTICE

The invasion has created a number of immediate impacts on the ESG landscape globally. Governments are being measured on the substance and rapidity of their response, the question of energy security has risen to the fore, supply chains are being stretched even further and global businesses have abandoned Russia en masse. All of this happened in days and weeks, but what are the longer-term implications for ESG?

ESG FAILINGS

Sceptics would argue that the invasion has highlighted some significant ESG failings by the wider market:

- Russia invaded Ukraine and seized the Crimea in 2014, leading to an eight-year war in the Donbas region with minimal corporate consequences or condemnation
- ESG ratings agencies inaccurately measured Russia's risk; MSCI rated Russia BBB prior to the invasion, one mark shy of an A grade, whilst Sustainalytics gave Russia a higher ESG rating than Ukraine
- An over-reliance on these ratings agencies meant that \$9.5bn of ESG funds were deployed in Russia as at February 2022

Simon MacMahon, Global Head of ESG at Sustainalytics, said:

“We recognize that ESG ratings firms, and I think analysts of all types, really, could have been more forward-looking and perhaps quicker to raise a significant flag prior to Russia’s invasion [of Ukraine].”

It would be easy for asset managers to lay the blame at the feet of the ratings agencies, but what about those who pride themselves on leading the way on ESG matters? BlackRock, which has its own ESG screening methodologies, has reportedly taken \$17bn in losses associated with its holdings in Russia.

SECTION 03

LONGER TERM IMPACTS - THE LEGACY EFFECTS OF THE INVASION ON ESG BEST PRACTICE

SO, WHAT'S NEXT?

In addition to changed thinking we have discussed regarding energy security and defence, what other changes are we likely to see in the ESG landscape?

1

Ratings agencies will likely have to reflect on their previous position, particularly with regards to how they interpret and communicate geopolitical risk, and we may also see an increased level of consistency in how these ratings are applied.

2

Fund managers and other financial institutions are likely to face increased scrutiny regarding how they integrate ESG policies into their overall risk analysis frameworks when investing.

3

Supply chain risk will continue to increase in importance. With Ukraine and Russia amongst the world's **largest exporters of cereal crops and oils**, the impending global food shortage will make businesses rethink supply chains, with a focus on shortening and diversifying exposure.

PLANNING AHEAD

Business leaders will have to tread even more carefully on the ESG path ahead, with a number of new considerations to factor into decisions:

1

Carefully consider geopolitical risk factors not only within your own operations, but also in your supply chain. Is your business agile enough to cope with any major disruption?

2

Understand and prepare for commodity inflation and shortages; work to limit exposure to the shockwaves this conflict will create, identifying risk areas and limiting impacts where possible.

3

Assess your approach to net zero and the transition away from hydrocarbons. Stay abreast of government initiatives regarding renewable energy.

4

Communicate effectively to the market on how these risks are being assessed and managed; don't let ESG ratings agencies define your story for you.

CLIENT IN FOCUS – IDOX PLC

Idox provides specialist software solutions that power government and industry, driving productivity and a better experience. Its public sector software solutions deliver innovative on-premise and cloud-based solutions, and its specialist facilities management and engineering information management software solutions bring the power of digital to engineering and construction.

A RESPONSIBLE IDOX

Idox has been building its approach to ESG over several years. Its vision in building and enabling a responsible business is to focus its efforts on grassroots approaches, that create value for all stakeholders.

In 2021, Idox reinforced its approach, forming an ESG steering committee with the core responsibility of understanding and monitoring how its business practices are sustainable in environmental and social terms, as well as being well governed.

By setting out four areas of commitment, that support the UN Sustainable Development Goals, Idox found an engaging way to communicate its efforts to its people, shareholders and other stakeholders.



OUR PEOPLE

OUR COMMUNITY

THE AIM

To build a diverse and inclusive workforce who feel supported and encouraged to excel in their career and life at Idox.

To support and enable our local communities to achieve more through the use of our products and using Idox’s knowledge base to educate and support individuals.

THE UNSDGS WE SUPPORT



OUR ENVIRONMENT

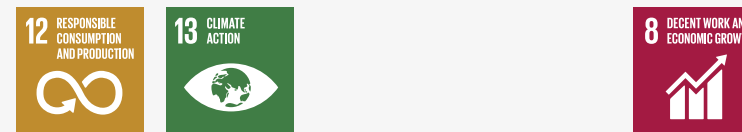
OUR ORGANISATIONAL RESPONSIBILITY

THE AIM

As a naturally low emission business, Idox is committed to improving our environmental performance and enabling its customers to do so.

To be a responsible employer, supplier, and overall business.

THE UNSDGS WE SUPPORT



SECTION 04

CLIENT IN FOCUS - IDOX PLC

DEVELOPING IDOX'S COMMITMENT TO THE ENVIRONMENT

While Idox's business model of software development and deployment is lower consumption than most other industries, the business is dedicated to reducing carbon emissions in all the communities it affects.

Idox has adopted the recommendations and model of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). In early 2022, Idox introduced a quarterly reporting cycle, which will allow the business to track its environmental impact and highlights areas where improvement is needed.

IDOX COLLEAGUES ARE VITAL IN THEIR JOURNEY

Idox's initiatives are driven by the people within the organisation, giving them the space and time to give back to their colleagues, communities, and their passions. By providing paid volunteering leave, payroll giving and employee resource groups, Idox has engaged its people in building a better society for all.

The positive impact of its products, from providing information on grants to supporting sexual health clinics, is something Idox is proud of. The expertise of Idox colleagues has allowed the business to build and innovate products that do good for their customers and the communities they serve.

In 2021, Idox launched **My Funding Central**, a service connecting charity and voluntary organisations with funding streams following the cessation of the National Council for Voluntary Organisations (NCVO). As part of Idox's commitment to supporting communities, the service is free to use for charitable and voluntary organisations with incomes of less than £30,000.

WHAT'S NEXT FOR IDOX

This year, Idox has plans in place to accelerate its commitment to **Diversity, Equality and Inclusion (DEI)**. Idox is currently completing a 'Dare to be different' survey, aimed at understanding who its people are and empowering colleagues to step forward as leaders of employee resource groups, demonstrating Idox is a committed inclusive employer. Idox Elevate, an example of the success of Idox's employee-led networks, has led positive campaigns to create more **gender equality** within the organisation.

As Idox continues to build on its ESG framework and provide more data for its stakeholders, the business is excited to continue to create value for the communities it serves. As Idox further develops its digital communication strategies and continues to build reporting structures, its aim is to continue to celebrate the good work of its people in helping create a responsible business.

Find out more: [Idox ESG](#)

Read their: [Annual Report](#)



UPCOMING KEY EVENTS

Event	Date
Climate & Energy Investment Forum	18 April 2022
Wall Street Journal Pro Sustainable Business Forum	20 April 2022
International Earth Day	22 April 2022
The Chartered Governance Institute 'ESG Summit'	22 April 2022
UN Biodiversity Conference (COP 15) Part Two	25 April - 08 May 2022
Bloomberg Green Summit	27 April 2022
OECD Forum on Responsible Mineral Supply Chains Meeting	02 May - 06 May 2022
Investment Week's Sustainable Funds to Watch Conference	10 May - 11 May 2022
Business in the Community and The Times Top 50 Employers for Women Celebration Event	17 May 2022
FT's Moral Money: Europe Summit	18 May - 19 May 2022
World Economic Forum Annual Meeting, Davos	22 May - 26 May 2022
International Biodiversity Day	22 May 2022
EU Green Week	30 May - 05 June 2022
World Environment Day	05 June 2022
CBI Achieving Net Zero Conference	07 June - 08 June 2022
ESG Data and Disclosure Summit	07 June 2022
Reuters Responsible Business Summit Europe	08 June 2022 - 09 June 2022
Reuters Global Energy Transition Summit	14 June - 15 June 2022



MHP CAPITAL MARKETS

MHP Capital Markets provides strategic financial communications advice to private and public companies across a range of sectors. We advise companies on all aspects of their engagement with the capital markets, from financial reporting, M&A, IPOs and fundraisings to corporate profile-raising activity, ESG communications and reputation management.



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