

Our Approach to Responsible Investment: Delegated Portfolios

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1. Purpose

This document articulates our approach to responsible investment (RI). We have developed it in line with industry best practice guidance, including the Principles for Responsible Investment (PRI) framework, the 2020 UK Stewardship Code, and the latest regulations issued by the Department for Work and Pensions at the time of writing.

2. Definition and approaches

The PRI defines RI as “an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to **better manage risk and generate sustainable, long-term returns**”, which can be implemented through a range of approaches.

Aon identifies four broad approaches to RI, outlined below (*exhibit 1*).

Please see *table 1* in the appendix for examples of ESG factors.

Exhibit 1



Socially responsible investing

Selection process:
Negative

SRI investing involves the avoidance of or divestment from an investment or group of investments, usually based on an investor’s or organisation’s value system.

(Anti-pornography, carbon, coal, Iran, Sudan, fossil fuel)



Impact investing

Selection process:
Positive

Looks for investments that have a positive investment return as well as desired social, economic or environmental outcome, aligned with an individual’s or organisation’s values.

(Renewable energy, clean tech, public health facilities)



Mission related investing

Selection process:
Positive or negative

Place investments with companies or funds that complement the investor’s mission. Uses a combination of responsible investment strategies.

(Healthcare, education, religious)



ESG integration

Selection process:
Positive or negative

Integrates environmental, social and governance criteria into fundamental investment analysis to the extent they are material to investment performance.

(Investing in companies with good ESG fundamentals to reduce risk or enhance returns)

For SRI, Impact and Mission investing, ethics or values are typically the primary driver of investment decisions

For ESG investing, the fundamentals of an investment are the first priority

3. RI approach: delegated portfolios

Our primary goal is to help clients achieve their investment goals and objectives, allowing for any constraints or preferences they express. Our aim is to secure optimal investment outcomes for clients, while allowing them to define their values and beliefs if they wish. We believe that having a well-defined and robustly implemented approach to RI is important as it:

- may improve investment outcomes for clients;
- allows clients to reflect their beliefs and values in their investment approach if they wish;
- provides quality information to clients, to ensure transparency and accountability, and;
- helps clients to comply with their regulatory obligations.

Out of the approaches outlined in *exhibit 1*, we believe ESG integration is generally the best approach for clients investing in our pooled funds for several reasons, including:

- Enhancing the robustness with which ESG factors are being incorporated into portfolios, which may improve investment outcomes for clients;
- It allows for effective collective stewardship;
- It does not impose a certain set of ethical or moral values on a wide range of clients.

There are cases where we may adopt a different approach. There are two situations where this will typically occur:

- **Reactively:** we recognise that some clients have specific values that they wish to invest in line with. Where this is the case we can develop socially responsible, impact or mission related investment funds to meet this demand, provided there is sufficient capital to make the solution operationally viable. An example is the Global Equity ex-Tobacco fund which incorporates SRI into its investment process.
- **Proactively:** when we identify an opportunity to implement socially responsible, impact, or mission related approaches without compromising the return and risk characteristics of the investment product in question. An example is the Global Multi-Factor Equity fund, which has a low carbon tilt and range of exclusions on sectors widely considered controversial. Because of the unique investment approach (factor exposure used to generate alpha rather than traditional bottom up stock selection) these screens can be applied without compromising the investment characteristics of the fund.

We have developed an RI policy and framework for ESG integration. This framework comprises three-parts – **assessment, monitoring and engagement** – and ensures our underlying managers are incorporating ESG factors into their investment processes, and in turn ensures robust integration of ESG factors into client portfolios. Each step of this process is set out below.

Please refer to *table 3* in the Appendix to see how these steps relate to the principles of the 2020 UK Stewardship Code.

Whilst our fund of funds structure does not permit us to directly undertake voting and engagement activities, our ESG integration process ensures that these actions are carried out in alignment with our clients’ best interests.

Exhibit 2



Assess

Initial **ESG rating** issued by investment manager research when manager are ‘Buy’ rated

Only invest in managers rated a **2 or above** on ESG

Annual review of ESG rating



Monitor

Annual detailed report on ESG matters from managers

Bi-annual ESG deep-dive meetings with underlying **DCS** managers

Use of **third party data providers** to analyse portfolio ESG exposures



Engage

Focused discussion with **DCS** managers

Highlight areas that can be **improved**

Collaborate with other Aon teams to **influence change**

Note: ESG manager ratings are explained in table 2 in the Appendix.

4. Helping clients adhere to UK regulations

UK regulations require the trustees of pension schemes to disclose publicly on an annual basis:

- An explanation of how and to what extent, the trustees' policy in relation to exercising shareholder rights including voting rights and undertaking engagement activities in respect of the investments has been followed during the year, in the opinion of the trustees; and
- A description of the voting behaviour by, or on behalf of, the trustees (including the most significant votes cast by the trustees or on their behalf) during the year and state any use of the services of a proxy voted during that year.

In response to the above, Aon has advised clients that delegate the management of their assets to us to articulate their stewardship policy in a way that acknowledges us as their asset manager. This means that our clients can demonstrate compliance with their stewardship policy through the monitoring of and engagement with ourselves.

By monitoring and engaging with us, clients will be able to ensure that we are conducting our monitoring and engagement activities with underlying managers on their behalf. To support clients in their disclosure requirements, we will provide suitable data on the voting and engagement activities of underlying managers and of engagements that we have had with managers.

5. Responsibility and accountability

Ultimate accountability for adhering to the ESG integration approach set out in this document rests with us. We have responsibility for the day-to-day integration and management of ESG risks and opportunities across the investment management services provided.

We will work in conjunction with and be reliant on input from other teams within Aon to carry out the day-to-day integration and management of ESG risks and opportunities. For example, ESG ratings for managers are produced by Aon's investment manager research team and are a key input into the framework for ESG integration. We are also reliant on underlying managers to complete our data requests and agree to the regular ESG deep-dive meetings. Due our importance as a client to underlying managers we have not to date had any issues with this and are unlikely to in future. Though, we are subject to the operational constraints underlying managers may have in delivering the transparency we require.

6. Policy statement review

This ESG Integration approach is reviewed annually, or more frequently as required, to ensure that it remains in-line with industry developments.

Appendix

Table 1: Environmental, Social and Governance (ESG) factors

Environmental factors	Social factors	Governance Factors
Carbon / greenhouse gas emissions	Diversity	Transparency
Ecosystem change	Consumer protection	Reporting and disclosure
Fossil fuel dependence	Fair trade	Executive compensation
Climate change	Animal testing	Shareholder rights
Water issues (use, access, impact on local supply)	Human rights	Board accountability and makeup
Clean tech	Health care	Director independence
Toxic chemical usage	Working conditions (living wage, harassment, physical risks)	Accounting practices and policies
Renewable energy	Child labour	Voting practices

Table 2

Rating	Comments
4	The Fund Management Team demonstrates high awareness of all known and potentially financially material ESG risks in the investment strategy and, at present, has incorporated appropriate processes to identify, evaluate and potentially mitigate these risks across the entire portfolio .
3	The Fund Management Team demonstrates an above average awareness of potential ESG risks in the investment strategy and has taken essential steps to identify, evaluate and potentially mitigate these risks.
2	The Fund Management Team is aware of potential ESG risks in the investment strategy and has taken some steps to identify, evaluate and potentially mitigate these risks.
1	The Fund Management Team appears unaware of unconcerned with ESG risks in the investment strategy and has not taken any material steps to address ESG considerations in the the portfolio.

Table 3

UK Stewardship Code Principles	Is this principle met at an Aon organisation level?	How do we adhere to this in delegated portfolios?	Which area of our ESG integration framework meets this principle?		
			Assess	Monitor	Engage
P1 Signatories should disclose: <ul style="list-style-type: none"> • how their purpose and investment beliefs have guided their stewardship, investment strategy and decision-making; and • an assessment of how effective they have been in servicing the best interests of clients and beneficiaries. 	✓	Section 2 and 3 explain how Aon’s investment beliefs have led to the development of our ESG Integration approach. Section 4 provides one example of the benefit to clients that this ESG Integration approach gives. Through the review process in section 6 we will assess the effectiveness of our policy.	n/a	n/a	n/a
P2 Signatories should disclose: <ul style="list-style-type: none"> • how effective their chosen governance structures and processes have been in supporting stewardship; and • how they may be improved. 	✓	Through the annual policy review outlined in section 6, we will be able to assess the effectiveness of the stewardship processes we have put into place through the ESG Integration framework.	n/a	n/a	n/a

UK Stewardship Code Principles	Is this principle met at an Aon organisation level?	How do we adhere to this in a fiduciary management context?	Which area of our ESG Integration framework meets this principle?		
			Assess	Monitor	Engage
<p>P3 Signatories should disclose examples of how they have addressed actual or potential conflicts of interest.</p>	✓	The Assess stage of the ESG Integration framework (section 3) allows us to filter out any managers where we have a conflict of interest, this forms a standard part of our Investment Manager Research and Operational Due Diligence process.	✓		
<p>P4 Signatories should disclose an assessment of their effectiveness in identifying and responding to market-wide and systemic risks and promoting well-functioning financial markets.</p>	✓	This principle is beyond the scope of this document as it requires discussion of a broader field of investment work that Aon does. Please contact us if you would like information on our adherence to this principle.	n/a	n/a	n/a
<p>P5 Signatories should explain how their review and assurance has led to the continuous improvement of stewardship policies and processes.</p>	✓	Our recent development of the ESG Integration process is a p step forward from our previous stewardship policies. Whilst we have always monitored underlying managers, this framework provides a much more robust process for gaining deeper insights and understanding of managers' stewardship activities and provides us with a greater platform for more active and targeted engagement. Section 6 outlines how we will continue to make improvements here.	n/a	n/a	n/a
<p>P6 How they have evaluated the effectiveness of their chosen methods to understand the needs of clients and/or beneficiaries</p> <ul style="list-style-type: none"> • how they have taken account of the views of clients and what actions they have taken as a result; • where they have not managed assets in alignment with their clients' stewardship and investment policies, and the reason for this. 	✓	<p>Sections 2 and 3 outline how we have taken into account the needs of all clients with our ESG Integration approach and explains the possibility of adapting this on a client specific basis where there is demand.</p> <p>Aon also offers clients a service called Viewpoints which is way for clients to define beliefs. Where the client defines a specific set of values that they wish to invest in line with, we can develop socially responsible, impact or mission related investment funds to meet this demand, provided there is sufficient capital to make the solution operationally viable.</p>	n/a	n/a	n/a
<p>P7 Signatories should disclose the issues they have prioritised for assessing investments, prior to holding, monitoring through holding and exiting. This should include the ESG issues of importance to them.</p>	✓	The ESG Integration framework detailed in section 3 explains how we assess and monitor investments. We can provide more detail here where necessary.	✓	✓	✓
<p>P8 Explain the action they have taken where signatories' expectations of their managers and/or service providers have not been met</p>	✓	The ESG Integration framework detailed in section 3 explains how we respond to managers not meeting our expectations. Our initial response would be to engage with the manager but could eventually result in divestment.	✓		✓
<p>P9 Signatories should describe the outcomes of engagement that is ongoing or has concluded in the preceding 12 months, undertaken directly or by others on their behalf.</p>	✓	From data and case studies collected through the monitoring and engagement steps of the ESG Integration framework, we are able to describe the outcomes of our engagements.		✓	✓

UK Stewardship Code Principles	Is this principle met at an Aon organisation level?	How do we adhere to this in a fiduciary management context?	Which area of our ESG Integration framework meets this principle?		
			Assess	Monitor	Engage
<p>P10 Signatories should describe the outcomes of collaborative engagement.</p>	✓	From data and case studies collected through the monitoring and engagement steps of the ESG Integration framework, we are able to describe the outcomes of collaborative engagements.		✓	✓
<p>P11 Signatories should describe the outcomes of escalation either undertaken directly or by others on their behalf.</p>	✓	From data and case studies collected through the monitoring and engagement steps of the ESG Integration framework, we are able to describe escalation activities of underlying managers and our own escalations.		✓	✓
<p>P12 Equity Disclose the proportion of shares that were voted in the past year and why;</p> <ul style="list-style-type: none"> provide a link to their voting records, including votes withheld if applicable; explain their rationale for some or all voting decisions, particularly where: <ul style="list-style-type: none"> there was a vote against the board; there were votes against shareholder resolutions; a vote was withheld; the vote was not in line with voting policy. explain the extent to which voting decisions were executed by another entity, and how they have monitored any voting on their behalf; and explain how they have monitored what shares and voting rights they have. <p>Fixed income Seeking amendments to terms and conditions in indentures or contracts;</p> <ul style="list-style-type: none"> seeking access to information provided in trust deeds; impairment rights; and reviewing prospectus and transaction documents. 	n/a (only applicable at asset management level)	<p>The questionnaire outlined in the monitoring stage has been designed to capture all of this information. We will be able to provide an aggregated version of this data for clients, dependent on responses from underlying managers.</p> <p>Upon request we are able to organise for an RI specialist to attend RI deep dive meetings with clients in order for them to develop a greater understanding of our processes and those of our underlying managers.</p>		✓	

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