Environmental, Social & Governance Policy

1. Introduction

Asset owners, asset managers, politicians and the general public have all grown increasingly aware of Environmental, Social and Governance (ESG) issues, and how these can, and perhaps should, be incorporated into investment management processes to promote best practice. There are a variety of different acronyms that are used in this discussion: Corporate and Social Responsibility (CSR), Socially Responsible Investing (SRI) and Environmental, Social and Governance (ESG), the latter being the most common. For the purpose of this policy, we use the terms ESG and ESGI, the 'I' in the latter standing for 'integration'.

The question of how asset owners and asset managers approach ESG has grown in importance over recent years. ESG as a concept appears unlikely to diminish, indeed all signs indicate it will likely be of increasing relevance to a growing percentage of the global population. Much has been written on the subject of ESG yet there remains significant disagreement within the industry as to how best asset managers should implement an ESG programme, or if indeed they should at all. There is an argument that ESGI may just be the latest investment trend, and like other investment fashions will have its moment before retreating once again into obscurity.

Origin (the Firm) does not believe that ESG is an investment fad. The incorporation of ESGI factors is not comparable with other investment caprices, and is more of a fundamental shift towards creating a cultural norm. It is also important to note that Origin fundamentally believes in and supports the principles guiding the movement towards the adoption of ESG.

Even were that not the case, the regulatory umbrellas governing the global investment community have been slowly tilting in favour of socially responsible investors. Several countries in Europe (including the UK and the Netherlands) have passed laws requiring pension funds to disclose ESG related policy information, in addition to which there are legislative requirements in certain jurisdictions (ie banning the ownership of cluster bomb munitions manufacturers) that investment managers must acknowledge.

All that said, Origin's view is that the Firm's primary responsibility is to fulfil its fiduciary duty to its clients, and if the Firm either does not believe in the fundamental premise of ESGI, or that there is a legitimate or sensible way of implementing it in a way that benefits the Firm's clients, then it is of paramount importance that we do not fall into the trap of implementing an ESG programme simply because it offers the path of least resistance.

As immediately attractive as ESGI appears, there are arguments against implementation. Very briefly, from the viewpoint of exercising the Firm's fiduciary duty, it could be argued that there could be a conflict of interest for companies between maximizing shareholder value and ESG prudence. It could be argued that the sole objective of a public company is to grow shareholder value rather than dedicate resources to combatting externalities irrespective of its potential impact. It might be argued that the costs allocated to ESG based process improvements outweigh any benefits. Alternatively, limiting an investment universe to ESG compliant companies will clearly limit an investor's breadth of investment choices and alpha opportunities.

An opposing viewpoint might suggest that companies demonstrating ESG prudence can reduce their overall risk exposure and thereby increase shareholder value by mitigating large drawdowns. Furthermore, ESG investors can directly impact company specific behaviour towards ESG awareness and accountability thereby improving long-term economic conditions. It has also been argued that companies that demonstrate a strong awareness and adherence to best practice with regard to ESG experience enjoy a lower cost of capital than their less aware counterparts.

Whatever the conclusions regarding integration, this policy outlines Origin's position with regard to ESGI on the basis of the evidence as it stands today, and reviews some of the broader discussions, arguments and issues both for and against ESGI. Origin will continue to monitor the question of ESGI carefully, and should there be any change in the evidence, then the Firm will re-examine this policy accordingly.

2. Origin's current approach to ESGI

As a boutique investment manager, Origin focuses solely on the management of Global Equities (and subsets thereof).

As noted above, the Firm's overriding focus is its fiduciary responsibility towards its clients, and as such will only ever incorporate ESG considerations into its investment process should it be felt to be in the direct fiduciary interest of the client.

Origin currently incorporates governance in the due diligence process in the form of the accounting score which forms an element of capital management or quality factors that are used in the investment process. Moreover, Origin's portfolios are skewed towards companies with strong governance and sustainability as the investment process focuses on companies with history of high profitability and growth. Origin will hold stocks for as long as they clearly continue to embody the target characteristics in order to retain objectivity and to ensure that stocks are judged using a uniform data set.

While it is currently our opinion that most ESG metrics under consideration by the fund management industry do not meet our criteria of having a direct fiduciary impact on the shareholder, the Origin investment team have identified the potential for contingent liability driven by the emissions of carbon to be a significant risk factor for the sustainability of a companies returns going forward. So within our Capital Management component we consider the extent to which a companies future returns and indeed its cost of capital today could be adversely impacted by the levying of a tax on its carbon emitted. Other things being equal, we will express a preference for businesses without that risk. The team have created a bespoke carbon risk measure and are able to decile rank all companies based on this particular measure of risk and by so doing reduce the relative attractiveness of the heaviest carbon emitters.

Of course this particular metric is only one of many under consideration and so will not be the dominant source of portfolio risk, but nonetheless, it does deliver a measurable effect on portfolio construction.

Whilst direct company contact is intentionally not part of the Firm's systematic investment approach, Origin is aware of the increasing importance of corporate governance and active engagement to clients, and the Firm wishes to provide an active governance and voting solution on the stocks held in clients' portfolios.

In order to do this, Origin has established the following approach:

- Use of the international governance research and voting specialist Glass Lewis, via the Broadridge ProxyEdge voting platform.
- Whilst Origin's engagement policy does not typically involve communication with management of companies, the Firm will adhere to specific client IMA guideline mandates and regulatory obligations around engagement.

For those clients that have specified a desire to actively engage with companies the objective of the Firm will be to encourage the lowest-ranked companies on the carbon sensitivity metric to reduce their carbon emissions over a span of 24 to 60 months, with the aim to rank up and out of the bottom decile or significantly improve their carbon leverage profile.

Further details on the Firms metholody regarding engagement can be found in the Engagement Policy, which is available on the website.

Origin automatically votes stock on all portfolios (whether pooled or segregated), in line with the policy agreed and set out annually by the Origin Proxy Voting Committee. Presently the Origin position is to follow the principles set out in Glass Lewis' Proxy Paper Guidelines. The Glass Lewis policy specifically addresses key governance issues such as board composition, remuneration, the appointment of auditors, dividend distributions and Long Term Incentive Plans.

The Firm has worked closely with clients in the UK, Netherlands, Canada and Australia for nearly ten years to address specific requirements in implementing bespoke solutions for ESG integration, and naturally the Firm remains open to discussing any proposed approach a client may have in this regard We currently have more than $1bn of client monies invested in bespoke portfolios where clients have asked us to "turn the dial" or upweight the importance of our carbon risk measure relative to other data sets under consideration. This has allowed us to further reduce exposure to heavy carbon emitters where our clients demand it.

3. <u>The Fundamentals of ESGI</u>

There appear to be four underlying fundamentals driving the integration of ESG into an asset manager's investment process:

1. **Business** - Given the rising demand by clients for ESG incorporation, is it necessary for asset managers to incorporate ESG into their process in order to prosper?

2. **Ethics** - is incorporating ESG into an investment process the *right* thing for an asset manager to do from an ethical standpoint and should asset managers and asset owners alike recognize that there may be a cost that needs to be borne in this respect?

3. **Risk Management** - Should ESG be treated as a formal risk in the same way as volatility, liquidity or any other risk consideration?

4. **Alpha** - Does incorporating ESG add alpha to the investment process (in whatever format, whether as a naïve score based inclusion, ESG momentum or other), or at the underlying level add to a company's corporate financial performance (CFP)?

3.1 Business

It is undeniable that there is an increasing demand from institutional clients around the globe for some sort of ESG incorporation. Nevertheless, as a standalone reason for any ESG consideration, business development or asset gathering can be dismissed immediately. While some asset managers may adopt this approach, Origin feels that without substance behind ESGI, any entity stands to lose its credibility, should any cynicism or hypocrisy on this part be exposed.

Certain jurisdictions, particularly northern Europe and the UK are demanding not only greater transparency with regard to adherence to ESG principles (on a look-through basis), but also in some case have legal and regulatory requirements preventing investing in certain industries/companies. In the UK, the Parliamentary Pension Fund recently divested from all investments (on a look-through basis) in fossil fuels in a move towards investing in renewables. In this regard, as noted in section 2 of this policy, Origin already works with a number of clients to implement specific requirements, and the Firm will continue to retain an awareness of the broader legal and compliance requirements in this arena and implement them in collaboration with clients wherever required.

3.2 Ethics

While ethical considerations are arguably the most important concept underpinning the entire question of how asset owners and managers should use their influence in order to attempt to improve the world, Origin believes this is beyond the scope of its remit as an investment manager.

Origin does not stand as, nor claim to be, a moral or ethical arbiter. While there is likely a majority who would agree that the manufacture of cluster munitions is something that it may be preferable not exist, equally there are others who view their manufacture as an unpleasant necessity. More contentiously, should gambling companies or alcohol distilleries and distributors be viewed as ethically questionable? The line is a blurred one and it is clear that one size does not fit all when it comes to applying an ethical framework to an investment process.

Furthermore, the data that is available is, from an ethical perspective, very suspect. The majority of data providers to whom Origin has spoken score a company solely on the basis of its exposure to *financial* risk as a result of ESG related behaviours rather than on the basis of their *ethical* leanings. This is not a particularly strong argument from an ethical standpoint as companies are very capable of exploiting regulatory arbitrage to improve their ESG score/diminish their financial risk.

Most fundamentally, as stated previously, as an asset manager Origin believes its fiduciary duty is to its clients, and in that respect consists of constructing portfolios of stocks that the Firm believes stand the greatest chance of outperformance. As noted previously, this does not mean the Firm will actively seek out stocks with negative ESG characteristics, merely that it may impede our ability to fulfil our fiduciary duty should *the* Firm either reduce the size of its investable universe on these grounds, or incorporate data that does not add value. As noted previously, Origin is very happy to work with clients and prospective clients to determine parameters which can govern the Firm's ability to invest in particular stocks, but this is not a decision that Origin believes it should be making on behalf of its clients.

3.3 Risk Management

In an era of increasing awareness of ESG and in which companies find themselves under increasing scrutiny to demonstrate an adherence not only to environmental laws, but also laws around corporate governance and sustainability, and in which companies may find themselves the subject of increasing litigation, does Origin's investment process 'price' this risk into the decision-making framework effectively?

It would be simple to incorporate ESG further as a formal risk flag, in a way similar to that of liquidity, beta, days above/below moving average etc. In keeping with Origin's approach of outsourcing non-core investment management functions, such an approach would require incorporating data from an external vendor. Currently Origin access the full suite of MSCI ESG data and as such could use the overall MSCI ESG risk rating should we choose to. As stated above though, while we have identified the particular financial risk around carbon emissions to be a significant risk factor that requires attention, we do not at present feel that other ESG metrics have significant impact either on the path of future returns or on the cost of capital enjoyed by the company today. This may change of course and it is certainly the case that five years ago, the emission of carbon was not the financial risk factor that we consider it to be today.

While the absolute ESG 'rating' of a company might not then potentially be useful, it has been suggested there may be more efficacy in incorporating an ESG-momentum criterion. Introducing an explicit ESG momentum risk signal would again be a very simple matter given the process driven nature of our approach, however such a risk signal is arguably already embedded in Origin's Earnings Revisions characteristic. Looking at the evidence, any ESG-momentum input is by definition ex-post. As momentum investors, the fact that it is ex-post is not in itself an issue, however it is difficult to argue what additional benefit such a measure would bring to the process that isn't already covered in the Earnings Revisions and Share Price Relative trend measures.

3.4 Alpha generation

From Origin's perspective the most significant question with regard to fiduciary responsibility is whether it is possible to add alpha through ESGI.

As noted in the Introduction, there is a huge amount of research on this subject, the results of which are certainly mixed. Depending on data set, timeframe, geographical focus, it's possible to manipulate the outcome in either direction, added to which there is a lot of opinion, speculation and susceptibility to data quality clouding the entire issue.

That said, Origin DO believe that the consideration of the financial risk associated with emitted carbon (potential for contingent liabilities) should be a source of alpha in and of itself. So why is that?

In preferring companies with lower levels of carbon emissions in their production processes, asset owners are effectively increasing the cost of capital associated with carbon heavy processes and rewarding companies without heavy emissions with lower costs of capital. As more and more asset owners build in explicit targets around portfolio level emissions, capital is withdrawn from certain heavily emitting areas and the cost of capital charged for such projects will rise. While this trend is in place, companies subject to rising cost of capital will inevitably see a reduction in their enterprise value.

There is an argument to say that once this trend is complete, the steady state return of companies with higher cost of capital should actually be higher, as investors demand higher returns to compensate them for the extra risk. That is true, but here is the crucial point. We do not consider that this trend is complete. Those that know us will be aware that the following of trends is a big part of our investment process. We never anticipate turning points in advance, rather, as a point of principal, we consider the trend to be our friend. Consequently we would consider this trend to rising cost of capital associated with carbon emitting projects to be indefinite and as a result would consider that the tilting away from companies enduring this increasing cost of capital to be a source of future excess return over benchmark.

4. <u>Conclusion</u>

ESGI is, and will remain, an important and divisive topic. There is an ever-expanding canon of research, data, information and disinformation on the subject. It is also an emotive topic and there are few studies conducted without any hidden (or not so hidden) agenda.

Philosophically, Origin supports the underlying themes of environmentalism, social responsibility and good governance, and the goals behind the promotion and expansion of the incorporation of ESG considerations into the investment management industry. As noted previously in this paper, the Firm actively incorporates financial risk metrics around carbon emissions into its investment process along with additional metrics on governance (accounting quality). However, Origin does not believe there is sufficient evidence that blanket incorporation of a broad swathe of ESG factors into the investment process will be of further benefit to its clients, and if anything may ultimately harm the Firm's ability to generate alpha on behalf of those clients.

Origin continues to work with its clients on implementing their specific requirements with regard to ESG integration, and given the systematic and process driven nature of Origin's investment approach, the Firm is very capable of incorporating any client's individual needs in this regard.

For further information on any of the topics discussed in this paper, or to discuss the options available to clients, please do not hesitate to contact the team at sustainabilityteam@originam.com.

December 2022