Flash Report

Aon Factor Service

Addressing Climate Change and Social Concerns

Summary

Our multi-factor equity solution has been hugely successful, with over £1.6bn of our clients' money invested.

As part of our commitment to keep improving the solution in line with changing regulation and client needs, we are announcing changes to the strategy design.

We are updating the index of our multi-factor equity solution to incorporate meaningful exclusions targeting some of the core themes around responsible investing. In keeping with recent legislation aimed at pension scheme trustees, it will primarily focus on the issue of climate change but also addresses a number of global social concerns.

Providing exposure to academically robust sources of return remains the **primary objective** of our solution. However, based on simulations, the proposed changes would reduce the weighted average carbon intensity of the solution by approximately 46% compared to a market-cap index, and around 70% compared to the existing solution. The design change intends to reduce the risks associated with a transition to a low carbon environment while not compromising the risk and return expectations of the solution.

The changes will occur within the existing solution, and clients do not need to take any action.

Background

Our clients have become increasingly interested in and engaged by responsible investment themes, including climate change and social responsibility, and these changes will help us support our clients' changing attitudes and preferences.

We have worked with *Scientific Beta*, our chosen index provider, to thoughtfully incorporate responsible investment considerations into Aon's Factor Service. Our research focused on ensuring that we **preserve the underlying factor exposures** and diversification and stay true to the core premise of providing access to Aon's best ideas on factor-based equity investing. The research showed that we could implement these changes **without altering the factor strength of the solution**, or our assessment of the potential long-term performance.

Below we detail how the product design seeks to address both climate and social considerations.

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Detail of changes

Addressing Climate Concerns

- **We will filter the investment universe to positively tilt towards companies with a lower carbon footprint** subject to prudent sector protection and risk management constraints.
- **We will exclude coal companies.** Coal is a key contributor to climate change, and current levels of coal consumption are not compatible with the achievement of the two-degree target set by the Intergovernmental Panel on Climate Change.
- **As at present, assets will be managed subject to Legal and General Investment Management's (LGIM) 'Climate Impact Pledge'**, a global engagement initiative to improve corporate climate performance. The stewardship team at LGIM will vote on behalf of beneficiaries against the re-election of the board chair for portfolio companies ranked poorly in addressing climate change.

Addressing Social Concerns: Supporting International Norms

Rather than applying our ethical norms to clients, **we have aligned the social aspects of the product design with the UN Global Compact.** The United Nations Global Compact is a non-binding United Nations pact to encourage businesses worldwide to adopt sustainable and socially responsible policies:

- **We will exclude companies with involvement in controversial weapons (such as antipersonnel landmines or cluster munitions).** The exclusion is a legal requirement in various European countries. Companies involved with controversial weapons are excluded from UN Global Compact membership.
- **We will exclude manufacturers of tobacco products.** Manufacturers of tobacco products are excluded from the UN Global Compact. Tobacco is a common restriction for responsible investors due to the inherent harm generated by the product.
- **We will exclude companies that violate the UN Global Compact**. These are companies involved in serious violations of fundamental norms which have proven unresponsive or have failed to address their controversies over a reasonable time.

Following the changes to the index, there will be a modest increase in the expenses of the fund, by around 0.01% p.a., which we do not believe to be material, especially when set in the context of the expected long term outperformance of the multi-factor solution.

Implementation

We intend to implement the index change in Q4 2019, subject to regulatory approval.

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