Hermes Management: Why Some ESG Investors Take On ‘Dirty’ Investments

Hermes Investment Management is a global leader in impact investment that makes no apologies for investing in ‘dirty’ industries like oil and gas.

By
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Hermes Investment Management makes no excuses for investing in “dirty” industries.

Even as the $43 billion London-based asset manager pushes the industry to measure returns holistically — considering their impact on society and the environment — it also backs companies that large public companies that are not living up to that standard.

So can Hermes call itself an impact investor? The question gets to the heart of an issue facing the industry as impact investment takes off: how to define it.

Hermes rationalizes its approach based on engagement. By taking a seat at the table, the firm is able to question practices and encourage leaders that are in a position to address global problems such as poverty, growing inequality and climate change to do something about them.

“We, unapologetically, have exposure to ‘dirty’ sectors such as chemicals, mining and oil and gas,” says Will Pomroy, lead engager of Hermes’ SDG Engagement Equity Fund, which aims to deliver attractive returns and advance social and environmental change by helping companies deliver the U.N. Sustainable Development Goals.

“Engaging with these companies,” he noted, “is precisely what is needed from investors.”

One such company is Volkswagen. Hermes is an investor in the German automaker despite the emissions scandal that has caused it to fall out of favor with many environmentally minded investors. Instead, Hermes is using its power as a shareholder to pressure Volkswagen to transform.

Hans-Christoph Hirt, executive director of Hermes EOS, said last month that Hermes would push for the company to take more action to address climate change at an upcoming shareholder meeting.

“It has been almost four years since the emissions scandal broke and we urgently need to see tangible and credible evidence of improving governance and culture,” he said. “Investors want to see companies demonstrate the long-term viability of their business models and product offerings so that they are in a position to prosper in a net-zero emissions economy.”

In the most recent annual report for its SDG Engagement Equity Fund, Hermes noted that many companies face immediate challenges that can make it difficult for leadership to act consciously — and that having backing from a firm like Hermes can provide valuable encouragement and accountability.

But ensuring that Hermes is living up to the standard it has set for itself can be difficult, particularly because the real-world impact of its engagement with companies is not easily quantifiable or comparable across companies.

Nandika Madgavkar, senior director of the Strategic Investor Institute at Chief Executives for Corporate Purpose, says the way to assess whether a firm like Hermes is living up to its values it to see how it is leveraging its investment in companies to advocate for change.

“Investors wield a lot of power and the first step to making real change is making sure that, as an ESG investor, you have a seat at the table. The second step is raising your voice,” she told Karma. “While many companies do an effective job of listening to all stakeholders, nearly all companies take listening to the voices of shareholders seriously.”

For its part, Hermes attempts to use standardized metrics, such as those established by the Global Impact Investing Network, to set objectives and assess how portfolio companies can achieve positive social impact.

Hermes also draws a line, noting that there are industries or companies where no amount of engagement will drive results. It does not hold positions in companies that manufacture cluster munitions or anti-personnel mines, for example, and avoids tobacco or gambling companies. It does have investments in liquor companies, however.

“We consider each company on a case-by-case basis, weighing up both the ‘good’ and the ‘bad’ factors and, importantly, their capacity to improve,” the annual report states.

How Hermes acts could set a tone for the wider industry, as it is an inaugural member of the UK National Advisory Board, part of an effort launched earlier this month by the British government to advance impact investing and establish London as a leader in it.

Europe is leagues ahead of the U.S. on this front. Only 49% of U.S. institutions use ESG principles as part of their investment approach, compared with 85% of institutions in Europe and 73% in Canada, according to a survey by RBC Global Asset Management.

Hermes chief Saker Nusseibeh — who was named 2018 CEO of the Year by Financial News — is also a respected voice on responsible investment, despite coming under scrutiny for receiving high payouts from his firm.

Nusseibeh, who was born in Jerusalem and whose family are official guardians of the Church of the Holy Sepulchre, has been critical of high pay for fund managers and called on asset managers to behave well.

On June 9, The Times of London reported that six directors received a total £35 million pound ($44 million) payout in 2018 after Hermes sold a 60% stake for £260 million to Federated Investors. They also reportedly received £8 million the year prior, with £2.5 million of that thought to be reserved for Nusseibeh.

Hermes declined a request to comment for this story.

Global Approach to Impact Investing

Hermes knows a thing or two about social investing. Founded in 1983, the firm is already an old-timer in the business. With offices in London, Frankfurt, Copenhagen, Dublin, Singapore and New York and more than 600 clients, it monitors investments based on how they affect society and the environment.

It also represents $565.6 billion in assets through its engagement services arm, Hermes EOS, which provides guidance on achieving positive change and mitigating environmental, social and governance (ESG) risks.

The Hermes approach to investing was recently summed up by Nusseibeh in an interview. As he put it, "Governing something instills a sense of responsibility."

"You don't just own a share, you actually own the company, and that means you have a sense of responsibility for how the company is behaving," he said.

Examples of Hermes investments, which span every region of the world, include a liquor maker in China and a pharmaceutical manufacturer in the U.S.. Last month, Gary Greenberg, head of global emerging markets, wrote in Investment Week that the firm is "bearish on materials, real estate and utilities" and will "underweight energy with the uncertainty over the long-term outlook for fossil fuels.

Hermes also uses ESG assessments to steer clear of companies exposed to risk from climate change and other societal factors. The firm is using data about rising global temperatures to model likely outcomes for companies and determine investments, Reuters reports. As a result, it is one of several firms avoiding companies such as retailers with large footprints in Florida that face increasing exposure to inclement weather as global climate patterns shift.

Looking Forward

Hermes is continuing to grow its global presence and leadership on impact investing. The ownership deal it struck with Federated Investors, which is based in Pittsburgh, will help the company expand in the U.S.

The two companies launched the Federated Hermes SDG Engagement Equity fund last year. It focuses on long-term capital growth through investments in companies that are able to align themselves with the United Nations Sustainable Development Goals.

In an interview with Investment Week, Nusseibeh said, “We hope this fund will help bring matters of ESG to the forefront of investors’ minds in the US throughout the next year.”

As Hermes expands its global footprint, it is well positioned to play a leadership role in expanding and defining best practices in impact investment. Given that the positions its takes and the effectiveness of its engagement with traditional companies in advancing social change could have far-reaching consequences.

“The objective is not principled purity,” Madgavkar said. “It’s change.”

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