

**NEWTON**

Investment  
Management

➤ BNY MELLON | INVESTMENT MANAGEMENT

April 2020

# TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES REPORT



# OUR TCFD COMMITMENT

During 2019, global focus on climate change greatly intensified. Global surface temperatures were the second warmest since records began,<sup>1</sup> greenhouse-gas emissions were the highest in history,<sup>2</sup> and a number of extreme weather events attracted global media coverage, ranging from widespread wildfires in Brazil and Australia, to severe flooding in Jakarta and the Midwest United States, and abnormal cyclones in India and Bangladesh.

In light of such events there has been a rise in climate-change activism epitomized by Greta Thunberg. We have also witnessed a plethora of pledges from both companies and politicians to tackle climate change, but real, decisive action supporting the pledges to reduce emissions has yet to surface. The uncomfortable truth is that our entire economy is based on fossil fuels, and therefore moving to a low-carbon future will affect all sectors. Furthermore, having emitted the bulk of the emissions to achieve economic growth and raise living standards, the West finds itself in the Janus-faced position of asking the developing world to reduce their emissions and perhaps by extension limit their ability to deliver growth and lift people out of poverty.

As CEO of a long-term, global active investment manager, the lack of global as well as public/private sector collaboration and ambition to mitigate climate change is deeply concerning. Science tells us that climate change could result in a deterioration in investment performance in some sectors, either as the world moves to a low-carbon future, or – more concerningly – as the growing physical impacts of global warming negatively affect the economy and society.

Emissions must be reduced and heavy industries will have to adapt; the management of transition risk as well as the real and imminent cost of stranded assets is key to securing the future. Conversely, new technologies and solutions have the potential to offer promising investment opportunities, should they receive clear governmental and regulatory support. However, the lack of clear policy direction has left many investors uncertain and unwilling to commit capital.

Focusing specifically on the investment industry, several critical questions arise. How can capital be allocated positively, into attractive investments, facilitating both a timely and just low-carbon transition, as well as delivering returns to clients? For those investing in fossil-fuel companies, how will investors influence these businesses to reallocate capital to less carbon-intensive energy sources, particularly in this time of geopolitical uncertainty?

These are complicated questions, without simple or obvious answers, but our generation must begin to answer them, and very soon.

In 2017, I commissioned Newton's first TCFD (Task Force on Climate-related Financial Disclosures) report to ensure that we were holding ourselves to the same standards as our investee companies, and specifically to explain how we were considering, and preparing for, the risks and opportunities presented by climate change.

Following the first report, I am delighted to introduce our second TCFD report which combines updates from 2018 and 2019, during which period we have made a number of positive changes. Highlights include establishing board-level oversight for Newton's actions on climate-related risks, entering into new data relationships with carbon experts, undertaking significant internal education, and establishing a climate change-focused investment group to undertake climate scenario analysis.

As active, purposeful, owners, we have been using our voting rights to push for change at AGMs. A highlight in 2019 was that, for the first time, Newton co-filed a special shareholder climate-change resolution at a global energy company's 2019 AGM calling for greater disclosure and climate action. We have also created our first climate-change voting policy, which will commence this

year, voting against chairs of companies that have inadequate climate-change disclosures, strategies and carbon-emissions performance. We have focused company engagements on material questions regarding transition plans, scenario analysis, disclosures and credit policies. However, there is of course much more we plan to do over the coming years.

Climate change is a complex and global problem, raising difficult questions to which we do not hold all the answers. However, it is through continued engagement with investee companies, alongside considering related risks and opportunities, that we seek to ensure we are fulfilling our purpose as good stewards of capital on behalf of our clients, as well as living up to the same standards to benefit our employees and shareholders.



**Hanneke Smits**  
Chief Executive Officer

<sup>1</sup> <https://www.carbonbrief.org/state-of-the-climate-how-the-world-warmed-in-2019>

<sup>2</sup> <https://www.wri.org/blog/2019/12/co2-emissions-climb-all-time-high-again-2019-6-takeaways-latest-climate-data>

# OVERVIEW

# INTRODUCTION

Responsible investment has been integral to Newton's investment process since our inception in 1978, when we began actively voting our clients' shares in the UK. Since then, our approach has evolved.

In 1998, we started to run exclusions-based portfolios; in 2005 we began conducting environmental, social and governance (ESG) reviews on recommended securities; and more recently we launched our first sustainable strategies in 2017.

We believe this 'purposeful ownership' approach allows us to better manage risk and make more informed investment decisions. Today, Newton manages \$66.0bn in assets (as at December 31, 2019) for a broad range of clients using our responsible, theme-based approach.

Owing to this heritage, and our long-term investment approach, climate change has naturally been an area of focus for some time. Scientific evidence suggests that man-made emissions are contributing to accelerated change in the Earth's temperature, and that any rise in global temperatures above 2°C (3.6°F) could result in irreversible, catastrophic changes to the global environment.

Consequently, for many years our work has included engaging with companies to understand the risks posed by climate change to the successful delivery of their business strategies, and to push for better disclosure of their management of carbon risks and opportunities.

This report explains how Newton, as a long-term active investment manager, analyzes and manages climate-related risks and opportunities both in our clients' investments, and across our business.

This report outlines our views on climate change, as well as describing our governance, strategy and risk-management approaches.

We also detail our own carbon footprint and our efforts to further reduce our operational emissions. This underlines our belief that companies should disclose climate-related financial information and take action on this emergency.

In publicly disclosing this report, we are holding ourselves accountable to the same standards that we expect from those companies in which we invest.



# 2019 HIGHLIGHTS

As part of our continuing commitment to improve our public TCFD reporting and to develop our thinking on climate change, we progressed several key elements throughout 2019:

## GOVERNANCE

To ensure that the board has oversight of climate-related issues, Newton's independent non-executive chair will now be responsible for ensuring that climate-related risks and opportunities are integrated into Newton's decision-making and business processes.

# 28.9%

The drop in emissions we have seen in our clients' portfolios since 2017

## CARBON-EMISSION REDUCTIONS

Since we began tracking our Scope 1-3 greenhouse-gas emissions in 2017, our own Scope 1 and 2 emissions have remained static; however, we have seen the emissions from our clients' portfolios drop by 28.9%. This was largely as a result of a reduction in the weight of holdings in heavy-emitting sectors and a reduction in exposure to government-issued bonds from countries with heavy greenhouse-gas emissions.

## DATA

We began working with a new service provider to integrate new carbon data in our investment process and undertake climate scenario analysis. We will continue working on this throughout 2020.

## VOTING

We created our first climate-change voting policy, which will commence this year. We will vote against chairs of heavy-emitting companies that have inadequate climate-change disclosures, management and emissions performance.

## INVESTMENT TEAM FOCUS ON SCENARIO ANALYSIS

We have created a climate change investment team to focus on the integration of climate-related risks and opportunities into our investment processes. The activities of this dedicated group of portfolio managers and analysts include undertaking and interpreting climate scenario analysis, policy tracking and analysis, and better understanding physical and technological risks. The group also seeks to identify potential opportunities for our clients' investments.

## INTERNAL EDUCATION

As part of company-wide efforts to improve awareness and integration of ESG issues, we held multiple internal presentations on climate-change investment risks and opportunities. We also spoke to a number of experts to learn more about carbon pricing, renewables, physical climate-change risks and regional climate-change legislation.

# BACKGROUND TO CLIMATE CHANGE

Global scientists have agreed that global temperature rises must be held well below 2°C (and preferably at 1.5°C) by the end of this century to avoid runaway climate change. However, based on today's climate science and current projections, achieving this goal looks a very tough challenge.

In 2018, the atmospheric concentrations of carbon dioxide and other greenhouse gases once again reached new highs according to the World Meteorological Organization. Since 1990, there has been a 43% increase in warming from the use of fossil fuels and deforestation, and since pre-industrial times, global emissions have risen 147%.

Scientists have stated that global emissions must reach net zero by 2050 for there to be a reasonable chance of staying below 1.5°C.<sup>3</sup> By 2030, emissions would need to be around 25% lower than in 2018 to put the world on the lowest-cost pathway to limiting global warming to below 2°C, or 55% lower if limiting warming to 1.5°C.

Climate policies that are consistent with the 1.5°C goal will require upscaling energy system supply-side investments by between \$1.6 trillion and \$3.8 trillion per year globally on average over the 2020-2050 period, depending on how rapidly energy efficiency and conservation efforts can be ramped up.

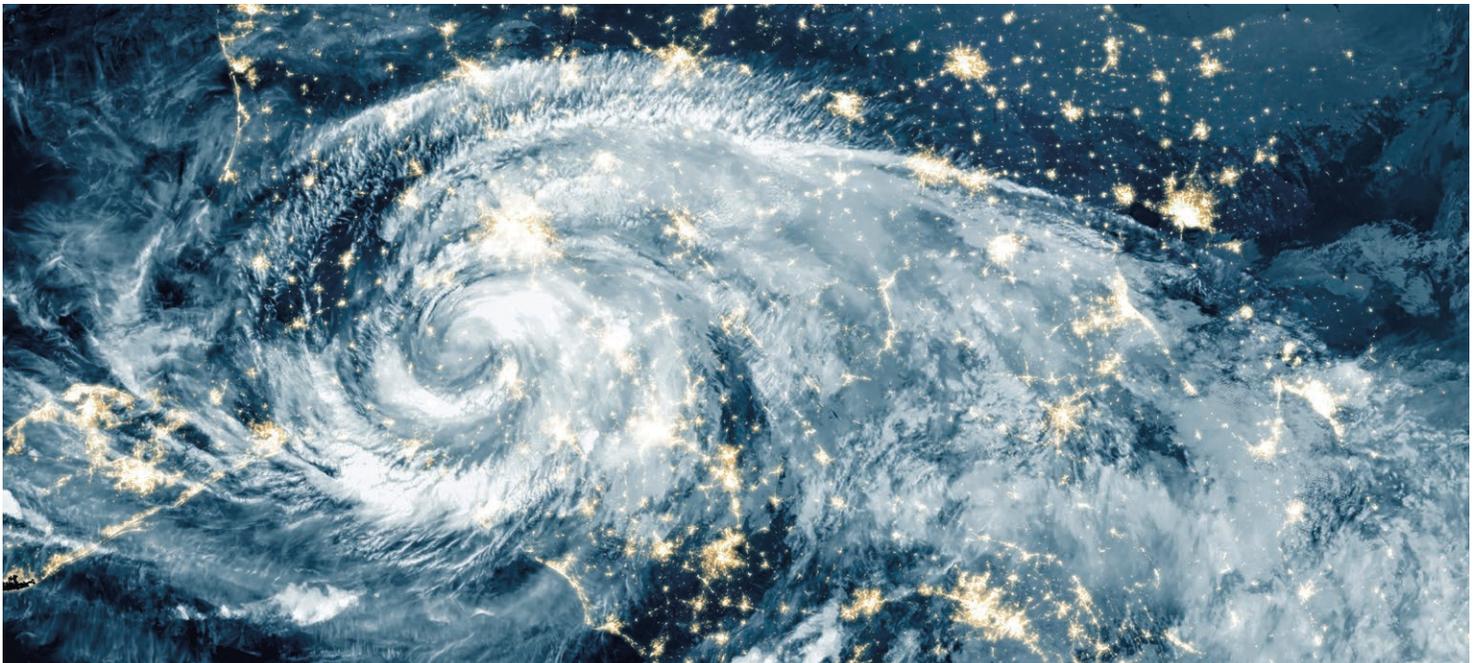
Furthermore, according to the United Nations Environment Programme's (UNEP) latest Emissions Gap Report, 1.5°C will involve "expanding renewable energy for electrification, phasing out coal for rapid decarbonization of the energy system, decarbonizing transport with a focus on electric mobility, decarbonizing energy-intensive industry and avoiding future emissions, while improving energy access";<sup>4</sup> all very challenging actions.

While this may mean that those incumbents in the heavy-emitting sectors are caught out, it also leaves the door open for many investment opportunities, whether from electric vehicles, from new types of sustainable farming, or even financing green bonds.

What is clear is that if global greenhouse-gas emissions are to reach net zero by 2050, it will require a huge collective effort from societal, corporate and investment perspectives.<sup>5</sup>

Moreover, it will mean significant change in terms of how natural resources are produced, how they are consumed, how goods are transported, and how fixed assets such as buildings are managed.

You can find more information on our wider views on climate-change science and regulation at: <https://www.newtonim.com/info/taking-action-on-the-implications-of-climate-change/>



<sup>3</sup> Source: <https://www.newscientist.com/article/2224539-un-report-reveals-how-hard-it-will-be-to-meet-climate-change-targets/>

<sup>4</sup> Source: <https://www.unenvironment.org/resources/emissions-gap-report-2019>

<sup>5</sup> Net-zero emissions will be achieved when any remaining human-caused greenhouse-gas emissions are balanced out by carbon removal, or simply by eliminating carbon emissions altogether.

# THE REPORT

# PART I. GOVERNANCE

## Board-Level Oversight

Newton is an investment management subsidiary of BNY Mellon. The Board of Directors ('the board') is comprised of executive directors, non-executive directors and BNY Mellon representatives. The board is responsible for oversight of the firm, approving the strategy of the business, and holding the Newton Executive Management Committee to account.

Newton has a strong governance framework which considers and reviews the nature, scale and complexity of Newton's activities. Climate change has been integrated into this framework in several ways:

### INDEPENDENT NON-EXECUTIVE CHAIR

At board level, the independent non-executive chair and a voting member of the Board Risk Committee, Susan Noble, is responsible for the oversight of climate-change topics. This includes ensuring that climate-related risks and opportunities are integrated into decision-making and business processes.

The governance structure chart below illustrates the relevant committees on which Susan sits.

### CEO

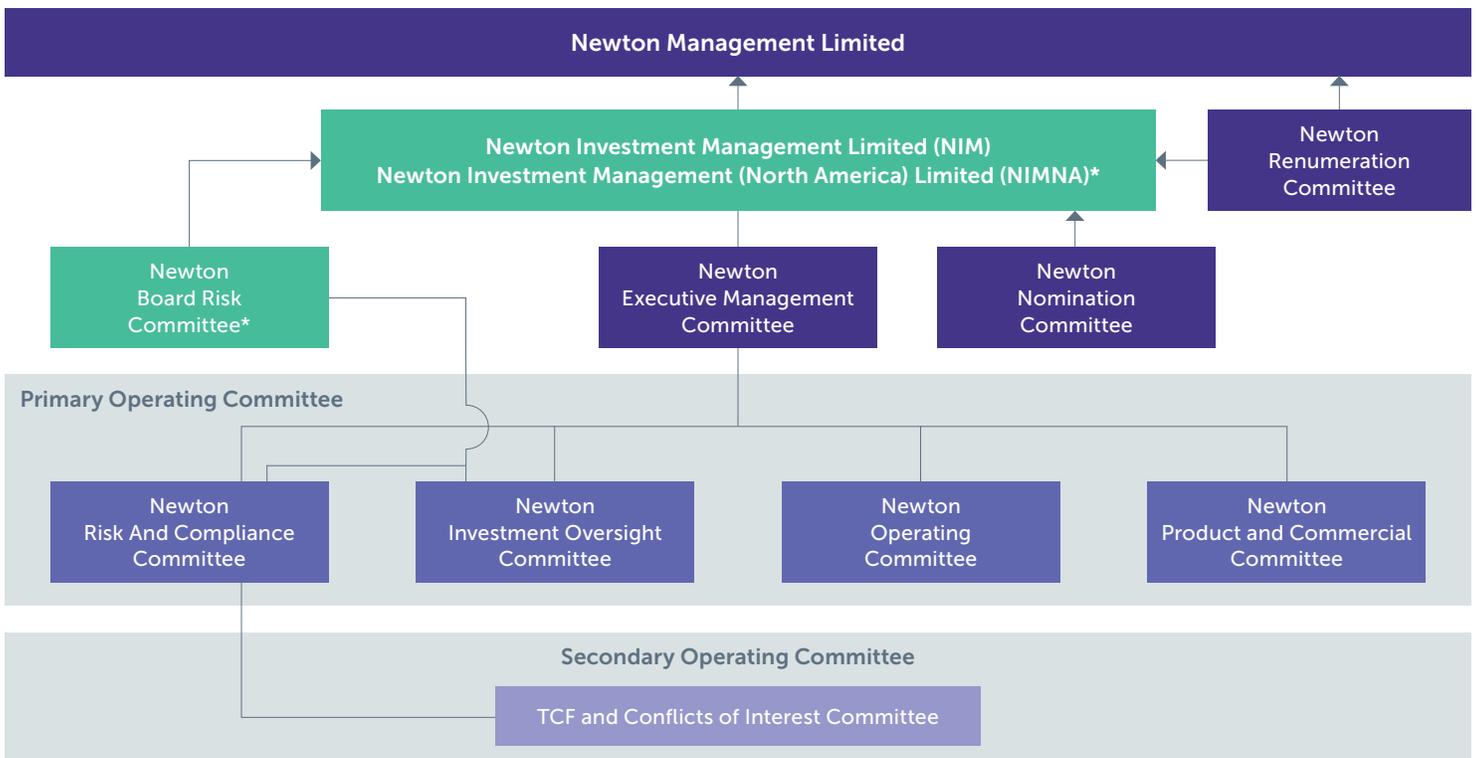
Our CEO and Newton board member, Hanneke Smits, believes that the integration of ESG matters into our investment process is crucial to our, and by extension, our clients' success, and speaks publicly on the topic.

Her mandate for Newton to report in line with the TCFD recommendations is a natural progression of how we think about long-term issues.

### BOARD RISK COMMITTEE

Climate change is viewed as a cross-function risk, and relevant and material analysis is fed back into the Board Risk Committee.

Newton Governance Structure



\*Susan Noble is Chair of the NIM and NIMNA boards, and a voting member of the Newton Board Risk Committee.



Several of Newton's theme groups, in particular *Earth matters* and *state intervention*, discuss policy changes which involve climate-related regulation, and their potential impact on current and future investment strategy. ”

## Management Oversight

Global trends that affect our business, such as climate change, are considered by our responsible investment team and global research analysts, who are economic, thematic and industry sector experts.

This research process is overseen by our Investment Oversight Committee, which has an input into strategic decision-making at board level. Our Chief Investment Officer Curt Custard reports to the board on this activity.

At present, there are three management-level processes designed to assess and manage climate-related issues:

### 1.

A Climate Change Working Group (CCWG) was established in 2018, with the responsibility of ensuring that Newton effectively manages climate-related risk and opportunities across the business, by integrating climate-change considerations into investment and business decision-making. The CCWG is chaired by the chief investment officer. Where relevant, these discussions are also fed up to the Board Risk Committee, which is chaired by BNY Mellon Investment Management's Global Head of Governance, Greg Brisk, which is then fed into the board.

The objectives of the CCWG, which reflect the risks and opportunities facing our business from climate change, are:

- Build operational climate resilience to protect Newton's own assets
- Effectively assess, integrate, monitor and manage climate-related investment risks and opportunities to protect and grow our clients' assets, supported by our climate change investment focus group
- Publish high-quality climate-related reports for clients, regulators and the public.

### 2.

Our Emerging Risk Committee, constituted by our executive directors, discusses various risks that may affect our business, and includes environmental considerations such as climate change as a standing agenda item. In addition, Newton's Operating Committee is responsible for the management of how our business is run, and also considers relevant risks. Both committees ultimately report to the Executive Committee, with the outputs from the Emerging Risk Committee being reviewed at the Board Risk Committee.

### 3.

Our chief investment officer is responsible for the management of climate risks in our investment processes.

These are the three key ways that these risks are considered:

- Before any global sector analyst recommendation is formally approved to be included in any of our clients' portfolios, our responsible investment team conducts an ESG quality review which includes consideration of material climate-related risks and opportunities. This informs the risk/reward analysis of the company, and as such is a vital part of our investment process. The responsible investment team, together with the global research analysts and portfolio managers, may also engage with companies on material ESG issues, and vote on climate-related resolutions.
- Additionally, we offer a number of sustainably focused and exclusions-based products to our clients, for which portfolio managers pay particular attention to the nature of their investments' contribution to climate change and the carbon footprint of their portfolios. There is also a monthly sustainable strategy meeting (including the sustainable portfolio managers, the responsible investment team, the chief investment officer and other relevant investment team members), where risks and opportunities associated with climate change and other key sustainability challenges are discussed.
- Newton is a thematic investor, using themes to drive investment ideas. As such, several of our theme groups, in particular *Earth matters* and *state intervention*, which monitor and analyze trends in the global economy, discuss policy changes which involve climate-related regulation, and their potential impact on current and future investment strategy. These meetings include the responsible investment team, portfolio managers and global research analysts.

# PART 2. STRATEGY

## CLIMATE CHANGE AND OUR CLIENTS' INVESTMENTS

### **How Could Climate Change Affect Client Portfolios?**

We believe that climate change poses a serious threat to the future of the planet and, as a result, our clients' investments are exposed to risks.

These risks, which are multi-layered and interconnected, change over different time horizons and between various strategies, asset classes and sectors.



We analyze the actions being taken today by a company's management to prepare for climate change, and through our engagement efforts, seek to redirect a company's strategy to thrive through such a transition. ”

# CLIMATE CHANGE – POTENTIAL WINNERS AND LOSERS

## OVER THE SHORTER TERM

Investments which have operations in areas which already, or will soon, experience the physical effects of climate change, are likely to face greater risks, for example unexpected operating costs. This could be further compounded by governments raising additional fiscal revenues to repair physical damage through corporate taxation.

## OVER THE MEDIUM TO LONG TERM

The profits of heavy emitters (defined as those companies that have high operational greenhouse-gas footprints or highly emitting products) may be adversely affected owing to the burden associated with changing processes and practices to mitigate the level of emissions released, or on account of late adaptation costs.

## OVER THE LONGER TERM

Companies with heavy emissions in their supply chain, operations or product, such as those in the industrial/energy sectors, may be adversely affected by regulatory changes that could result in higher operating costs. In turn, this may lead to a wider negative impact on demand for such products, whether owing to price increases, or because of lower levels of consumer demand for the products produced by heavy emitters on account of environmental concerns such as air pollution. At the same time, increasing scale and competitiveness of greener fuels may lead to lower energy prices, again squeezing margins for traditional energy producers.

Conversely, incumbents that are taking action, such as some utilities, or disruptive players which are providing solutions, such as renewable-energy companies or electric-vehicle manufacturers, are likely to profit. We believe that technological change will lead to winners and losers in this modern-day industrial revolution.

Across other asset classes such as credit, markets with greater exposure to activities which produce high emissions, including the UK, Australia and Canada, are likely to be the first affected. They may experience higher adaptation costs, stranded assets and debt-repayment issues, particularly if their economies are heavily reliant on agriculture, are low-lying, or are already experiencing societal tension, which may be exacerbated by scarcer natural resources.

While it is possible to outline potential scenarios across different industries and timeframes (such as those described above), the impact – positive or negative – of any scenario will not be the same for all companies operating in a particular sector or economy. Accordingly, we analyze the actions being taken today by a company's management to prepare for climate change, and, through our engagement efforts, seek to redirect a company's strategy to thrive through such a transition. This is a complex discussion and is a vitally important part of our ESG process.





## What Are Stranded Assets?

Stranded assets are now generally accepted to be fossil-fuel supply and generation resources which, at some time prior to the end of their economic life, become no longer able to earn an economic return, as a result of changes associated with the transition to a low-carbon economy.<sup>6</sup> While the concept of stranded assets has recently been linked to action required to tackle climate change, it is an old concept that is fundamentally linked to technology evolution, and part of the creative destruction in any market economy. For instance, whaling ships which hunted for oil became obsolete when electric lights replaced oil lamps. Similarly, climate change is prompting a series of technological innovations that are creating the same potential obsolescence threat for fossil-fuel supply and generation, on account of their emissions.

## What Is Our View?

There are many projections about the future growth and decline rates of fossil fuels usage. However, whether we like it or not, the reality is that the world currently remains deeply reliant upon fossil fuels for reliable energy. We treat these long-term projections with caution though, as supply, demand and pricing are driven by many inter-related variables which become increasingly difficult to predict the longer the time horizon. Additionally, technological disruption can occur quickly.

Renewables are, in some cases, already cheaper than fossil fuels, and this is driving their faster and broader adoption. As asset-replacement cycles occur, replacing old fossil-fuel assets with a combination of renewable technologies is becoming the economically rational choice, which is good news for climate change. Broadly, we expect policy will be supportive of the transition to renewables, but it won't be a smooth journey, with tough choices for politicians seeking to gain electoral support.

Stranded assets are also a useful concept for companies to consider, to help them to ensure that they allocate capital in a sensible manner that takes into account long-term demand predictions. The use of the concept is helping to push fossil-fuel companies to become low-cost producers and find the cheapest method of extracting hydrocarbons. This will help ensure that, as demand changes over the very long term, it will be their supply that is bought, rather than the more expensive, harder-to-access and refined energy sources.

<sup>6</sup> Source: Carbon Tracker; <https://www.carbontracker.org/terms/stranded-assets/>



We are investigating ways to communicate and improve the quantified outputs of our climate scenario analysis in a manner which is statistically robust, easy to understand and grounded in reality.

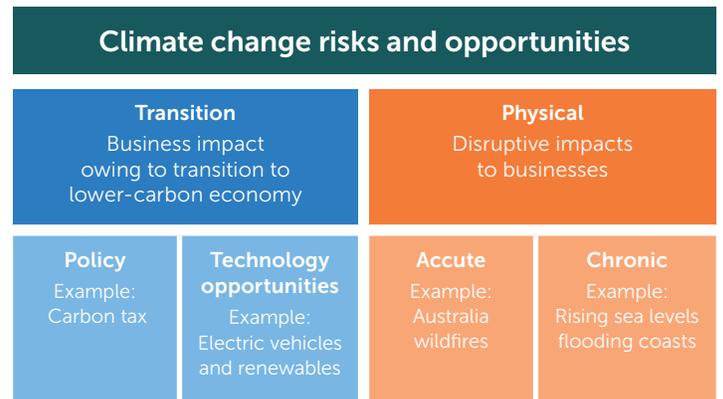


## Climate Scenario Analysis

As an investment management house, our business relies on attempts to predict the future. Indeed, our own existence is dependent upon our ability to do this consistently and accurately. However, our experience tells us that it is incredibly difficult to make precise predictions about the future, particularly where there are number of inter-related variables and 'unknown unknowns'. These difficulties increase the longer the timeframe, and the more variables, or unknowns, which are introduced. As a result, we take an extremely cautious approach to relying on scenarios that make predictions longer than five years out, especially when an issue is as complex as climate change. This makes climate scenario analysis particularly challenging when we consider the system-wide changes that are required to ensure temperature rises are limited to 1.5°C.

Taking this into account, we use scenario analysis to attempt to understand the impact of climate change on our clients' investments. During this process we consider both the transition and physical risks, alongside opportunities that are posed by climate change.

## Framing Climate-Related Risks and Opportunities



Examples of the types of scenario analysis we have conducted include:

- Forward-looking discounted cash-flow models which consider potential revenue and cost impacts of climate change
- A portfolio-by-portfolio analysis of which securities would have the most earnings at risk from a potential carbon tax
- External analysis that incorporated the latest climate science, policy updates and patent exposure.

We are investigating ways to communicate and improve the quantified outputs of our climate scenario analysis in a manner which is statistically robust, easy to understand and grounded in reality. This is undoubtedly a complex and evolving task, and will remain a key focus throughout years ahead.

# ADDRESSING THE COMPLEX ISSUE OF CLIMATE-RELATED RISKS AND OPPORTUNITIES

At present, we use a variety of approaches to identify climate-related risks and opportunities; these are incorporated into our idea generation, ESG analysis, company engagement, voting, product design and thought leadership. We also already undertake an additional element of scenario analysis within our sustainable strategy range, and conduct carbon footprinting across our clients' holdings.

Each mechanism is described in greater detail below.

## 1. Idea Generation

Our investment themes provide us with vital perspective on the investment landscape, allowing us to block out short-term market 'noise' and identify those powerful forces of fundamental change in the world around us, such as climate change. They are built upon fundamental, observable trends, rather than speculative or short-run forecasts. In thinking about climate change thematically, we use themes such as *Earth matters*, *state intervention*, technology-related *net effects*, and *population dynamics* to identify interconnected ways in which global warming can have an impact on our clients' investments. Given our active management approach, we can seek out those businesses that are alive to these risks and better placed to seize the opportunities created.

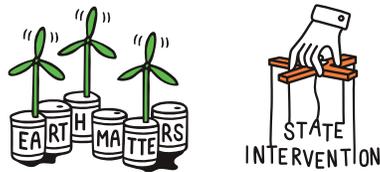
We achieve further conviction in the investment thesis of each holding through proprietary research, rigorous bottom-up analysis and the consideration of material ESG risks and opportunities, specific to each holding.

### Renewable Technologies

We see a lot of investment opportunities in renewables and have made significant investments in the area. Currently, over \$1.8bn of our clients' assets (as at December 31, 2019) are invested in green, clean energy and related technology equities and bonds.

### SECURITY SELECTION EXAMPLE – UK WIND-FARM OPERATOR

#### THEMES



#### ESG

- **Environmental**  
Strong environmental policy and implementation
- **Governance**  
Strong board structure



#### SECURITY SELECTION

#### NEWTON PORTFOLIOS

#### FUNDAMENTALS

- Beneficiary of attractive secular trends
- Strong position in growth renewables market
- Strong management team with proven track record
- Strong balance sheet
- Dual income
- Electricity exported to grid
- ROCs (Renewable Obligation Certificates)

#### VALUATION

- 5-6% dividend yield
- Management targets an internal rate of return of 7%

## 2. Climate Change Investment Group

The climate change investment team is responsible for the integration of climate-related risks and opportunities into our investment processes. This group includes representatives from equity and fixed-income portfolio management teams, global sector analysts and quantitative and investment risk analysts, as well as our responsible investment team. The activities of this dedicated group include undertaking and interpreting climate scenario analysis, policy tracking and analysis, and better understanding physical and technological risks. The group also seeks to identify potential opportunities for our clients' investments.

## 3. ESG Analysis

Every security which our global sector research analysts wish to recommend must have an in-depth ESG quality review completed by our responsible investment team. These reviews provide a chance to identify and analyze material ESG risks and opportunities, and feed these into our investment decision-making process, to enable our portfolio managers to consider these risks prior to investing. Where material, climate-related risks and opportunities are highlighted to our global analysts and portfolio managers for consideration before recommendation and investment.

## 4. Corporate Engagement

Based on the risks and opportunities identified in our ESG reviews, we engage with executive teams on management and execution of climate-related risks and opportunities, in order to incorporate further details into our investment thesis. We also engage with companies on governance structures and accountability, to seek to understand how the board is overseeing climate risks. For example, we will consider if directors have the appropriate expertise to understand how the business will be affected by climate change, especially where a company is a heavy emitter.

We encourage all companies to set a climate-change strategy, with company-specific greenhouse-gas emissions targets and to evaluate the potential impact of a range of carbon prices, to ensure appropriate planning and capital-allocation decisions. We often discuss broader related issues including water stress, and the impacts of extreme weather on physical assets, to understand how significantly a company may be affected by climate change.

Positively, we also use engagement to understand further how companies are considering and looking to build on opportunities around clean technology and renewable energy, and if in fact they may benefit from these technologies.

# CORPORATE ENGAGEMENT: CASE STUDIES

## US Investment Bank

**Issue:** The bank has been a significant financier of companies producing the most polluting types of fossil fuels.

**Action taken:** We have met management and emphasized the financial risks associated with climate change, and have highlighted that the TCFD is a useful mechanism to assess and disclose climate-related financial risks.

**Outcome:** The bank explained that it would be winding down its fossil fuel-related merger and acquisition advice, investing substantially in clean tech and banking services, and that it was preparing its first TCFD report.

## Chinese Insurance Company

**Issue:** Coal demand is weakening globally owing to the energy transition which is causing some coal-related businesses to fail. We needed to understand the impact this could have on the valuation of the company as it provides insurance to the sector.

**Action taken:** We have stress-tested the valuation model by assuming that all coal-related insurance revenues and assets went to zero.

**Outcome:** Given the small exposure to the coal sector, we concluded that coal exposures were not material to the investment case.

## UK Utility Company

**Issue:** The company has been at risk of being on the wrong side of energy policy and exposed to tax increases, but also has opportunities to 'green' the UK energy system.

**Action taken:** Since 2017, we have held regular one-to-one and group ESG engagements to better understand the company's view on climate change, its risks and opportunities.

**Outcome:** The company has reacted positively. At the beginning of 2018, the business set customer use emissions targets, which was a key step forward and a response to a Climate Action 100+ program request at previous AGMs. It also aims for its own operations to become carbon neutral by 2050.

## 'Big Four' Accountancy Firms

**Issue:** We are concerned that climate change will result in stranded assets and disruption to the capital markets.

**Action taken:** We have met three of the 'big four' accounting firms to discuss their auditing methodologies.

**Outcome:** The firms committed to training their partners in climate risk and ensuring sufficient challenge in accounting assumptions.

## Korean Battery Manufacturer

**Issue:** The concept of a 'just transition' is one that is sustainable, but also fair for those who stand to lose out, for example financially or through increased risks of human rights abuses. One such example is with child labor in cobalt mining, where cobalt is the core raw ingredient in electric-vehicle batteries. With the potential boom in demand for electric vehicles, the risk of child labor could increase significantly.

**Action taken:** After visiting China and South Korea to look at the supply chain in person, we realized that an issue with child labor existed – linked to the poor economic situation in the Democratic Republic of the Congo (DRC), where most cobalt is extracted – and raised it with management.

**Outcome:** We were able to get the company to publish an internal report that assessed its involvement with child labor in cobalt mining, and raised the profile of the issue internally. The company has also been working with the Responsible Cobalt Initiative as the best way to drive real change, and in 2019 it announced a plan, together with industry partners, to establish local community programs in one of the cobalt mining regions in the DRC.

## 5. Collaborative Engagement

Where we believe it is appropriate and will allow us to be more impactful we also seek to collaborate with other investors, and sit on bodies and panels that support more rigorous management of climate-related risks and opportunities. Accordingly, we are active members within the Climate Action 100+ program (climateaction100.org), and are members of the Institutional Investors Group on Climate Change (IIGCC) Corporate Engagement Group (iigcc.org).



Climate Action 100+ is a five-year initiative led by investors to engage systemically important greenhouse-gas emitters and other companies across the global economy that have significant opportunities to drive the clean energy transition and achieve the goals of the Paris Agreement.

Launched in December 2017 at the One Planet Summit, Climate Action 100+ is now backed by more than 360 investors with more than \$40 trillion in assets under management. As part of this initiative, Newton currently co-leads and/or supports collaborative engagements with six companies.



Newton is a member of the IIGCC, which provides investors with a collaborative platform to encourage public policies, investment practices and corporate behavior that address long-term risks and opportunities associated with climate change.

Newton sits on the IIGCC Scenario Analysis Working Group and IIGCC Shareholder Resolutions Sub-Group.

### COLLABORATIVE ENGAGEMENT: CASE STUDY

#### Global Resources Company

**Issue:** The company is one of the highest greenhouse gas-emitting companies in the world.

**Action taken:** Alongside other investors, we are part of the Climate Action 100+ group that engages with the company. The group meets regularly with senior executives to understand their plans in relation to climate change and push for greater action where appropriate.

**Outcome:** The company has announced an ambitious and industry-leading climate-change strategy that includes becoming net zero on Scope 1 and 2 emissions by 2050, with science-based targets in the interim. It has also created a fund to progress research into low-carbon solutions. We continue to work with the company to help further define shorter-term milestones on action to be taken in the next decade.



We will look to vote against the re-election of chairs of heavy emitting companies' boards that have inadequate climate-change disclosures, management and emissions performance. ”

## 6. Voting

Where we believe they are material and well-founded, we support shareholder proposals on climate change.<sup>7</sup> One example of our voting practice was the 'Aiming for A' shareholder resolutions which sought greater disclosure on climate change from oil companies. We engaged with proposers of the resolution, and the companies individually, before voting in favor of the resolutions. We have also supported similar resolutions since.

To advance our voting activities on climate change, we created our first climate-change voting policy, which will commence this year. We will look to vote against the re-election of chairs of heavy emitting companies' boards that have inadequate climate-change disclosures, management and emissions performance. This will include the consideration of how risks and opportunities presented by the low-carbon transition are managed, as well as a company's own Scope 1 and 2 emissions.

### VOTING ENGAGEMENT: CASE STUDY

#### Global Energy Firm

In 2019 we co-filed a special climate-change shareholder resolution, alongside colleagues in Climate Action 100+, asking a global energy firm to explain its thinking on climate change and how its business is aligned with the Paris Agreement. This initiative took place after more than six months of engagement, and investors felt that the friendly shareholder resolution would encourage the firm to explain how it considers its business strategy to be consistent with the goal of the Paris Agreement to keep global warming to well below 2°C. We also asked the company how it evaluates the consistency of each new material capital investment with the goals of the Paris Agreement, and which measures and targets it plans to use.

In addition, we sought information on the anticipated levels of investment in oil and gas and other technologies; targets to promote operational greenhouse-gas reductions; the estimated carbon intensity of energy products; and the linkage of targets with executive remuneration.

The Board positively supported the proposal, and at the company's AGM the resolution received global investor approval. We are very pleased with the result, as it demonstrates what can happen when we engage constructively with companies and work together with other investors on important issues.

<sup>7</sup> Where clients have afforded us discretion over the exercise of their voting rights.



Newton offers both screened and sustainable products, in conjunction with core ESG analysis. ”

## 7. Product Design

To help our clients integrate climate change, sustainability, and other important considerations in their portfolios, Newton offers both screened and sustainable products, in conjunction with core ESG analysis, which is applied consistently across all our clients' managed portfolios.

For our exclusions-based products, we offer portfolios that do not invest in thermal coal, tar sands and oil shale, as these are the most carbon-intensive fossil fuels.

### CORE



- Analysis of material ESG issues fully integrated into security selection process
- Engagement used to drive ESG improvement in support of investment performance
- No specific exclusions applied, maximizes opportunity set
- May invest in securities with ESG risks if valuation reflects that risk
- Aim to achieve the best risk-adjusted return for investors

### SCREENED



- Sectors excluded on basis of clients' values
- Aligns investors' investments with those values
- Helping clients achieve their objectives
- Reduction of investment opportunity set

### SUSTAINABLE



- More emphasis on positive societal outcomes
- Optimal outcome for all stakeholders
- Principles-based red lines ensure minimum standards
- Lens to identify opportunities
- Omits securities with positive short-term prospects but negative ESG profiles



The sustainable suite of products (equities, multi-asset and fixed income) uses an explicit quantitative climate-change model, which we call the 'climate change red line'.

## Sustainable Strategy 'Red Lines'

For our sustainable strategy range, we incorporate a series of proprietary 'red lines' in order to ensure the poorest-performing companies from an ESG perspective are not eligible for investment.

We also aim to identify companies which are either ESG related solution providers, best in class ESG credentials or those transitioning their business models to better deal with ESG issues. As a result, the sustainable suite of products (equities, multi-asset and fixed income) uses an explicit quantitative climate-change model, which we call the 'climate change red line'.

The aim of this model is to screen out the worst of the emitters that will be most affected by policy changes, and which are incompatible with the aims of the Paris Agreement.

This is primarily achieved through:

- Tailoring cash-flow forecasts by internalizing a cost of carbon during the valuation process
- Understanding the carbon footprint and carbon intensity of each portfolio
- Analyzing the portfolio's exposure to stranded assets.

Our sustainable investment process incorporates some 'red lines' in order to ensure the poorest-performing companies are not eligible for investment.

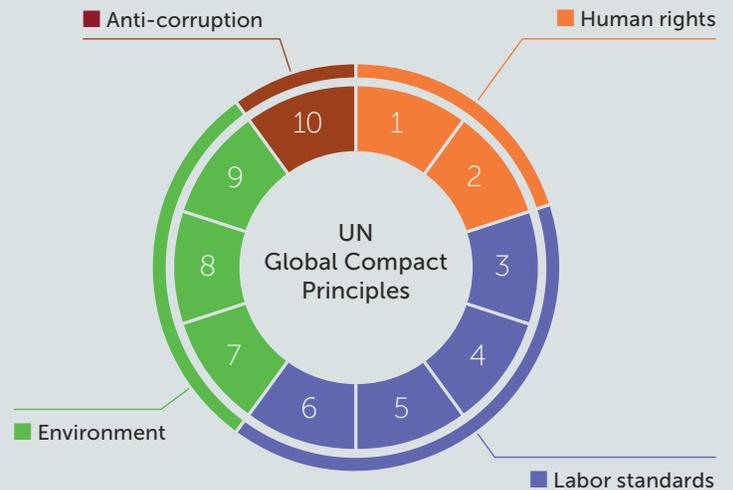
### 1. Violation of UN Global Compact Principles of sustainable corporate performance

We monitor compliance with the UN Global Compact Principles. The UN Global Compact is a United Nations initiative to encourage organizations worldwide to adopt sustainable and socially responsible policies, and to report on their implementation.

### 2. Climate change and the Paris Agreement

At the COP (Conference of Parties) 21 Paris Climate Conference in 2015, participants agreed to reduce carbon dioxide (CO<sub>2</sub>) emissions and to limit global warming to well below 2°C.

↓ Our sustainable strategies do not invest in companies which fail the following test and are therefore deemed incompatible with a world aligned with the Paris Agreement.



### Heavy emitting sector

Sectors affected by International Energy Agency's atmospheric CO<sub>2</sub> target of 450 parts per million globally

and is

### Unprofitable with 2°C world policy

Internalized cost of carbon at \$140/tonne<sup>8</sup> produces negative net income (calculated as 5-year average net income – (5-year average scope 1 & 2 emissions x \$140))

and has

### No/weak emission reduction targets vs. sector

MSCI carbon emissions reduction target rated as 'No target' or 'Weak target from medium to high base'

is

## UNPROFITABLE IN A PARIS AGREEMENT-ALIGNED WORLD

<sup>8</sup> \$140/tonne is price per tonne consistent with 2°C of change as per Paris Agreement.



## 8. Thought Leadership

To help develop climate thinking across the investment industry, members of our team sit on various industry bodies, including:

- **The IIGCC Scenario Analysis Working Group and IIGCC Shareholder Resolutions Sub-Group** (iigcc.org)
- **Investment Association Climate Change Working Group** (theia.org)
- **The Science Based Targets Initiative Expert Advisory Group** (sciencebasedtargets.org)
- **The Climate Disclosure Standards Board Technical Working Group** (cdsb.net)
- **CDP Investor Signatory** (cdp.net)
- **Transition Pathways Initiative Signatory** (transitionpathwayinitiative.org)

We also regularly publish thought-leadership content on our website:

[newtonim.com](http://newtonim.com)



Newton is a signatory of the CDP (Carbon Disclosure Project), which is an independent not-for-profit organization holding the largest database of primary corporate climate-change data in the world. The data is collected annually by the CDP through questionnaires and assists us in identifying climate, forest and water-related risks.



Newton is a supporter of the Transition Pathway Initiative (TPI). The TPI is a global initiative led by asset owners and supported by asset managers. Aimed at investors and free to use, it assesses companies' preparedness for the transition to a low-carbon economy, supporting efforts to address climate change. Launched in 2017, it is rapidly becoming the 'go-to' corporate climate action benchmark.



# CLIMATE CHANGE AND NEWTON'S ASSETS

Climate change will increase the severity and frequency of extreme weather events which can affect the buildings in which we operate and the ability of our employees to work effectively.

As an asset manager operating largely in London, our operational impact on climate change is relatively small. However, there are opportunities for us to make cost savings, build climate resilience and make a positive contribution to the global efforts to avoid runaway climate change.



Our operational climate strategy involves the following strands:

## BUILDING RESILIENCE

Our business continuity plans incorporate environmental risk assessments, and prepare the business for the increased likelihood of natural disasters associated with climate change affecting our offices.

## REDUCING ENERGY CONSUMPTION

A number of energy-efficiency projects have been implemented such as lighting control and heating, ventilation, and air conditioning (HVAC) upgrades. These projects help reduce energy costs and our greenhouse-gas footprint.

## ENERGY PROCUREMENT

Via our parent company, BNY Mellon, we purchased renewable electricity to help reduce our carbon footprint and demonstrate demand for cleaner energy sources to the market. In 2018, 32,000 tonnes of carbon dioxide equivalent (tCO<sub>2</sub>e) in carbon offsets and 311,700 megawatt hours (MWh) of renewable-energy products and certificates were purchased for all of BNY Mellon's operations, to cover 100% of global electricity consumption with renewable sources and achieve carbon neutrality.

BNY Mellon has also set a greenhouse-gas emissions reduction target in line with a well-below 2°C science-based target methodology. The goal is to reduce Scope 1 and 2 greenhouse-gas emissions by 20% by 2025 from a 2018 base year.

# 20%

BNY Mellon's goal for the reduction of Scope 1 and 2 greenhouse-gas emissions by 2025 from a 2018 baseline



Each of the above initiatives enables us to make a positive contribution to reducing the risks of climate change, as well as preparing our business for the consequences of a changing climate.

# PART 3. RISK MANAGEMENT

## Climate Change and Our Clients' Investments

Through integrated ESG analysis, embedded into our global investment process, material climate-change risks and opportunities are highlighted to our global analysts and portfolio managers.

Throughout our ESG analysis, our investment team will review company reports, third-party data providers and dedicated climate-change research, and may also speak to company management or directors, external analysts, consultants, subject-matter experts or non-governmental organizations to better understand and evaluate potential risks and opportunities.

This process involves discussion between our responsible investment team, sector analysts and portfolio managers. Recent output of this approach has highlighted climate-related investment risks linked to medium-term methane leakage concerns for a credit investment in a gas pipeline company, possible water stress for a semiconductor manufacturer, and clean technology opportunities for a conglomerate engineering company.

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Once an investment is made, we monitor an investment's climate-change performance through regular engagement and annual ESG data updates. ”

Once an investment is made, we monitor an investment's climate-change performance through regular engagement and annual ESG data updates. Recent examples of this have been discussions with UK oil & gas companies to encourage the setting of concrete emission-reduction targets, and with North American utility companies to encourage public reporting in line with the TCFD recommendations.

We use annual general meetings as another way to monitor and engage with companies to reduce the risks from climate change, as well as to support climate change-related resolutions and work with other investors where appropriate.

In relation to our sustainable strategies, the 'climate change red line' restriction is hard-coded into our risk-management system, which prevents portfolio managers from purchasing stocks that violate the climate criteria.



## Climate Change and Newton's Assets

We work with the business continuity team of our parent company to understand and manage a broad set of short, medium and long-term business continuity risks, of which climate change is one component.

We assess that our current risk from physical climate change is low, and therefore have commensurate systems, processes and controls in place to ensure that our exposure to physical climate risk is mitigated.

The business continuity programs focus on three areas – crisis management, business resumption and technology recovery – and are designed to ensure resilience and preparedness to withstand and recover from natural or man-made disasters.

“

Our commercial sustainable and sustainability focus groups work to ensure that our sustainable and screened products remain relevant and suitable for our clients. ”

A further risk to our assets are that climate change, including the associated risks, render our business model or products obsolete. Our commercial sustainable and sustainability focus groups work to ensure that our sustainable and screened products remain relevant and suitable for our clients, as global sustainability challenges, of which climate change is a key facet, evolve.

# PART 4. METRICS AND TARGETS

## Climate Change and Our Clients' Investments

We analyze all investments recommended by our global sector analysts for greenhouse-gas emissions and climate change-related performance data.

As we have discussed, these disclosures are just one input into our investment analysis when considering climate change.

This data is sourced via our ESG and climate-change research providers, such as the CDP (formerly Carbon Disclosure Project), MSCI, ISS Climate Ethix, TPI (Transition Pathway Initiative), Bloomberg, investor relations communications, corporate disclosures and by speaking directly to company management.

This information forms a picture of the robustness of a company's accounting methodology (including boundary, scopes, and treatment of gray accounting areas such as joint ventures and leased assets). It also enables a performance assessment of Scope 1 (direct) emissions, Scope 2 (indirect) emissions (using both market and location-based methodologies), and intensity (emissions per revenue) measures over previous years. In addition it highlights clean or technology investment opportunities.

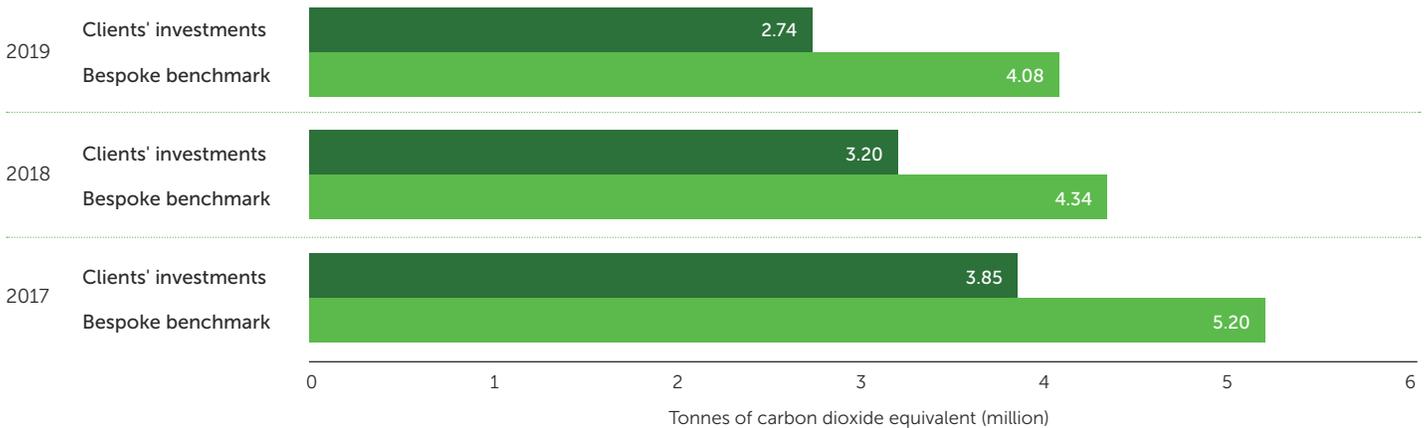
However, we believe that the data currently disclosed by companies does not typically show how climate change could materially affect their viability as a going concern or their future financial performance. Therefore, where necessary, our analysts consider other strategic, qualitative disclosures and risk measures.

As part of our client offering, we also conduct carbon footprinting and climate-change analysis across our different investment portfolios.

This analysis identifies a portfolio's overall carbon footprint and carbon intensity, and highlights emissions-heavy companies to prioritize engagement with. It also shows a portfolio's exposure to green investments and carbon-related assets, contributions to a lower-carbon economy. The footprint analysis also highlights those companies that have science-based targets and helps monitor performance over time.

We regularly measure the carbon footprint of all our clients' holdings and in our largest investment portfolios in order to maintain a clear view as to how our portfolios are positioned.

### Scope 1-3 Emissions of Our Clients' Investments



Newton's greenhouse-gas emissions are calculated using the World Business Council for Sustainable Development (WBCSD) Greenhouse Gas Protocol operational control methodology, as disclosed below.

We have assessed the World Resources Institute (WRI)/WBCSD 15 categories of Scope 3 emissions<sup>9</sup> and concluded that our material Scope 3 emissions source is our clients' investments. The emissions from our clients' investments have been calculated using a methodology developed by an independent research consultant that uses percentage of enterprise value<sup>10</sup> held combined with actual and modelled (where emissions data is not published) carbon data.

As at December 31, 2018, our clients' Scope 3 emissions were 3,203,851 tonnes of carbon dioxide equivalent (tCO<sub>2</sub>e), 26.2% less than the emissions of our benchmark portfolio.<sup>11</sup> Subsequently, in 2019 this fell to 2,736,232 tonnes of carbon dioxide equivalent (tCO<sub>2</sub>e), 32.9% less than the emissions of our benchmark portfolio.

<sup>9</sup> ISS definition: Indirect emissions of a company are known as 'Scope 3' emissions, following the Greenhouse Gas Protocol, and are classified into 15 sub-categories including supply chain, business travel, investments and others.

<sup>10</sup> ISS methodology: Shares = equity method whereas multi-asset portfolios use enterprise value

<sup>11</sup> The benchmark used is custom designed and comprised of 60% equities and 40% fixed-income holdings, in order to best reflect our house holdings.



Since 2008 BNY Mellon has reduced its footprint by 52% from a 2008 baseline, achieving its target of a 40% reduction by 2020 two years early. ”

## Climate Change and Newton's Assets

In terms of the emissions from our own operations and the energy we buy to support them, Newton forms part of BNY Mellon's (our parent company) greenhouse-gas measurement and target-setting process. Since 2008 BNY Mellon has reduced its footprint by 52% from a 2008 baseline, achieving its target of a 40% reduction by 2020 two years early. A new target-setting process at BNY Mellon is currently underway.

The data below shows Newton's Scope 1 and 2 emissions.

| Summary of Newton's Emissions and Methodology                         |                |           |           |           |                        |
|---|----------------|-----------|-----------|-----------|------------------------|
| All units in tonnes of carbon dioxide equivalent (tCO <sub>2</sub> e) |                | 2017      | 2018      | 2019      | Notes<br>(see page 25) |
| <b>Newton – Scope 1</b>   |                | 58        | 50        | 58        | 1                      |
| <b>Newton – Scope 2</b>   | Market-based   | 0         | 0         | 0         | 2                      |
|   | Location-based | 1,329     | 1,385     | 1,534     | 3                      |
| <b>Sub-total: Newton – Scope 1 and 2</b>                              | Market-based   | 58        | 50        | 58        | –                      |
| <b>Offsets</b>  |                | (58)      | (50)      | (58)      | 4                      |
| <b>Total: Newton – Scope 1 and 2 emissions</b>                        |                | <b>0</b>  | <b>0</b>  | <b>0</b>  |                        |
| <b>Total: Client investments – Scope 3 emissions</b>                  |                | 3,853,830 | 3,203,851 | 2,736,232 | 5                      |
| <b>Total: Custom multi-asset benchmark</b>                            |                | 5,200,850 | 4,342,198 | 4,081,529 | 6                      |
| <b>% below benchmark</b>  |                | 25.90%    | 26.22%    | 32.96%    | –                      |
| <b>Newton – weighted average carbon intensity</b>                     |                | 79        | 81        | 67        | 7                      |

Source: BNY Mellon. Data as at December 31, 2019.

## Overall Emissions

Based on our consultant's analysis and to put our clients' total Scope 1, 2 and 3 emissions into context, approximately 2,736,232 tCO<sub>2</sub>e is the equivalent of powering around 315,743 homes for a year. Newton's own Scope 1 and 2 emissions equal 58 tonnes, which is the equivalent of powering 10 homes for a year.<sup>12</sup>

<sup>12</sup> Source: United States Environmental Protection Agency: <https://www.epa.gov/energy/greenhouse-gas-equivalencies-calculator>

## Methodology Notes

1. Newton's Scope 1 emissions include emissions from the tracked use of fuel oil and refrigerants and estimated use of natural gas in occupied facilities that use natural gas. Natural gas is estimated based on the average use per square foot for BNY Mellon's real-estate portfolio. BNY Mellon calculates the entire Scope 1 emissions for these facilities, and allocates a portion to Newton based on the portion of staff employed by Newton. Allocated emissions from enterprise data centers are also included on a revenue-based allocation.
2. BNY Mellon procures renewable electricity products globally, including Renewable Energy Credits (RECs), Guarantees of Origin (GOs), International-RECs and PowerPlus™ instruments, equal to the amount of Scope 2 electricity purchased. Newton's electricity use is included in BNY Mellon's electricity purchases. Therefore, Newton also uses 100% renewable electricity through the instruments described above which results in zero market-based Scope 2 emissions.
3. Location-based Scope 2 electricity emissions are tracked or estimated for BNY Mellon's real estate footprint. There is a portion of the leased portfolio where electricity consumption is included within the lease cost and BNY Mellon is not sub-metered for electricity or other energy. As a result, BNY Mellon does not receive a utility invoice for electricity consumed at these specific locations. Based upon accurate knowledge of annualized typical watts per square foot for like facilities within our portfolio, BNY Mellon includes a watts per square foot estimate for properties where electricity is included in rent. A factor of 1.75 watts per square foot per hour is utilized. In this way, BNY Mellon approaches a more realistic Scope 2 indirect number versus leaving that usage out entirely owing to lack of data. Newton's location-based Scope 2 emissions are calculated based on electricity used in or estimated for a facility occupied by Newton and the portion of staff in a facility that are employed by Newton. Allocated emissions from enterprise data centers are also included on a revenue-based allocation.
4. BNY Mellon has been carbon neutral (net zero greenhouse-gas emissions) for Scope 1 and 2 emissions from 2015 through 2018, and plans to maintain carbon neutrality through 2025, through setting emission-reduction targets in line with a well-below 2 degree science-based target methodology. Instruments for carbon neutrality have been procured for 2019, and the company's carbon neutral status for 2019 will be verified by a third party later in 2020. After taking steps to reduce the company's energy use and resulting emissions and purchasing renewable electricity, BNY Mellon procures carbon offsets for the remainder of its Scope 1 emissions. The carbon offsets purchased provide financing to projects around the world that achieve emissions reductions and other social and environmental benefits. BNY Mellon's carbon neutral program includes emissions attributable to Newton; therefore, Newton is also carbon neutral for Scope 1 and 2 emissions.
5. We have assessed the 15 categories of Scope 3 emissions within the GHG Protocol and concluded that our clients' investments are the most material component. Newton calculates its Scope 3 clients' investments emissions using the following methodology:  
**For a corporate equity or bond:**  
(Value of security held/ enterprise value of corporate entity)  
\*Scope 1 and 2 emissions of the corporate entity.  
**For a government bond:**  
(Value of security held/total government debt)  
\*Scope 1 and 2 emissions from government activities)  
+ (emissions in industry that result from government expenditure).
6. The custom benchmark is comprised of 60% equities and 40% bonds which best reflect Newton's house holdings to compare our emissions against.
7. The TCFD recommendations state asset owners and managers publicize this key metric in their disclosures. The metric calculates a portfolio's exposure to carbon-intensive companies, expressed in tCO<sub>2</sub>e/\$m revenue. Scope 1 and Scope 2 greenhouse-gas emissions are allocated based on portfolio weights (the current value of the investment relative to the current portfolio value), rather than an equity ownership approach.

While the reporting guidelines for investment emissions in the Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard emissions are mostly clear, accurately capturing Scope 3 emissions is complex. This complexity is caused by a number of factors including the lack of globally available Scope 1 and 2 emissions disclosures, the inherent double counting involved in capturing Scope 3 emissions, and a lack of definitive guidance on sovereign bond emissions. While the above represents our best efforts in capturing the data, it is worth highlighting that methodologies may change or we realize that there are different ways of capturing and presenting the data in the future.

# PART 5. CONTINUING OUR JOURNEY

Reporting in line with the TCFD recommendations on how climate change is considered within our business is a complicated, multi-year process.

We have begun to meaningfully track the Scope 1-3 emissions performance of our own assets and our clients' investments, and will be looking to establish measures in next year's report to make it easier to compare year-on-year performance. We have also strengthened our governance and oversight of climate-change risks and opportunities at Newton, and will continue to think about how to better integrate climate-change information into our risk management and processes.

We are working to further explore scenario analysis, and how we can better measure and report our exposure to climate-related risks and opportunities over time.

There is ample complexity, but this does not mean we should avoid the challenge. Throughout 2020, we will work to better understand how this complex issue will affect Newton and, most importantly, our clients' assets over the short, medium and long terms, and how we can play a part in limiting global warming to well below 2°C.





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