Border to Coast Pensions Partnership Ltd Joint Committee

Meeting date: 20 November 2019

Report Title: Responsible Investment Policies Annual Review 2019

Report Sponsor: Border to Coast CEO – Rachel Elwell

1 Executive Summary

1.1 The Responsible Investment Policy and Corporate Governance & Voting Guidelines were developed in 2017 in conjunction with the twelve Partner Funds and are due to be reviewed annually. Both policies will then be updated as necessary through the appropriate governance channels. The process for review includes the participation of all the Partner Funds; this is to ensure that we have a strong, unified voice.

1.2 Both policies have been evaluated by Robeco using the International Corporate Governance Network Global Governance Principles, UK Stewardship Code and Principles for Responsible Investment as benchmarks. The main changes are to reflect the new Shareholder Rights Directive that came into force earlier this year and to continue the clarification of our intentions on voting and alignment with the PRI. We are not recommending any changes to underlying principles.

1.3 We have considered the feedback from the Climate Change Working Party (see section 6) in our review. Whilst the recommendation is for no substantive changes this year, there are areas recommended for further consideration which may lead to changes in future years.

1.4 The annual review and governance processes need to be completed, with policies approved and ready to be implemented ahead of the 2020 proxy voting season. We have asked Partner Funds to complete their reviews by the end of 2019 so that we are able to carry out this implementation and disclose our voting intentions to companies prior to the peak season. We have already had feedback from Pensions Officers, but the Pension Committee review process is still to take place. Given the announcement of the timing of the General Election, there is a risk that some Committees may be delayed in their reviews: we are working closely with Pensions Officers on this.

1.5 Border to Coast is considering the Responsible Investment strategic direction to 2022 to be able to fulfil increasing regulatory requirements and support Partner Funds. This will involve working with Partner Funds and pension committees through informal working groups with recommendations being reported back to the Joint Committee.

2 Recommendation

2.1 That the Joint Committee reviews and comments on the proposed revisions to the RI Policy (Appendix 1) and Corporate Governance & Voting Guidelines (Appendix 2).

2.2 That the Joint Committee supports taking the revised policies to the Partner Funds for comment and for them to consider adoption of the principles in their own RI policies in-line with industry best practice.

3 Background

3.1 We take our responsibility seriously as an active owner and steward of the investments managed for our Partner Funds with the aim being to manage risk and generate sustainable, long-term returns. The Border to Coast Responsible Investment policy sets out our approach to RI and stewardship, and the Corporate Governance & Voting Guidelines sets out the approach and principles to voting.

3.2 The 2018 review led to a significant update to the RI policy to reflect reporting requirements once Border to Coast becomes a signatory to the Principles for Responsible Investment (PRI). The Corporate Governance and Voting Guidelines were expanded to cover global corporate governance trends.

3.3 Following Board approval and support of the Joint Committee in November 2018, the revised policies were taken to the Partner Funds for comment and for them to consider adoption of the principles in their own RI policies in line with industry best practice. Three areas were identified for clarification of Border to Coast's position; climate change, diversity and political donations.

3.4 Diversity has been a focus theme for Border to Coast over the last year and will continue to be for the coming year. There is growing evidence that more diverse boards result in better performing companies leading to better investment returns and financial outcomes for investors. A briefing paper was produced in December 2018 for Partner Funds (attached as Appendix 3) to support the stance taken. Ahead of the 2020 review we will look at diversity in its broadest sense. We will consider the Parker Review which advocates for increasing the ethnic diversity of UK Boards and the Hampton-Alexander Review which promotes increasing the number of women in leadership positions.

3.5 The wording on political donations in the Voting Guidelines was broadened last year in order to be applicable to other markets removing the words '*It is therefore prudent to oppose all political donations*.' Only UK companies put binding political donation authorisations up for vote, with companies who have dual listings putting this up for vote in both markets. Political donations appear as an agenda item in the UK in order for companies not to contravene the Political Parties, Elections and Referendums Act 2000 (PPER Act 2000). Although we will not support direct political donations to political parties or individual political candidates a blanket ban on donations, due to the definition of this term in the PPER Act 2000, could prevent donations to charities and educational causes. Shareholder resolutions in several developed markets focus on political donations; we will generally support resolutions requesting greater disclosure of trade association and industry body memberships. Where given the opportunity to vote on political contributions, we will oppose any authorisations.

3.6 Climate risk was identified as an area where Border to Coast and the Partner Funds needed to develop knowledge and better understand the potential investment risks and opportunities. Support was given by the Board and Joint Committee to convene a climate change working party. Six sessions were held with assistance from Jaap Van Dam, Principal Director of Investment Strategy at PGGM in the Netherlands. External experts were invited to speak at sessions covering identifying & quantifying risk, engagement or divestment, the external manager approach and collaboration. The reflections and findings are covered in section 6 of this report.

3.7 The Voting Guidelines were broadened last year to capture differences in global governance practices to avoid having multiple policies covering different jurisdictions. We recognise that corporate governance standards vary across the globe and believe we can improve market practice through our voting rights. We want to ensure that we retain a credible voice which would be lost by blindly voting against all resolutions in markets where standards are not yet as high, whereas a vote against an important resolution will make a much more powerful statement.

4 Review process

4.1 The RI policy and Corporate Governance & Voting Guidelines (the Voting Guidelines) are reviewed annually or when material changes need to be made. The annual review process commenced in August to ensure any revisions required are in place ahead of the 2020 proxy voting season.

4.2 Current policies were evaluated by Robeco, our voting and engagement provider, considering the global context and best practice. This included consideration of the International Corporate Governance Network[1] (ICGN) Global Governance Principles, the UK Corporate Governance Code when reviewing the Voting Guidelines and the Shareholder Rights Directive (SRD II)[2] where requirements have been incorporated into the Financial Reporting Council's (FRC) rules when reviewing the RI policy.

4.3 The policies of best in class asset managers, and asset owners considered to be RI leaders were also reviewed to determine how best practice has developed.

4.4 A workshop was held with the officers of the Partner Funds on 10th October. Feedback was received from South Yorkshire ahead of the meeting in relation to the Corporate Governance & Voting Guidelines and covered auditor rotation, political donations and tenure. These points along with the other proposed revisions to both policies were discussed, and the draft policies reflect feedback from the officers.

4.5 The policies have been discussed at Border to Coast's Investment Committee and following review by the Board, will be put to the Joint Committee for review and Pensions Committees for consideration about whether they can align their own policies with the Border to Coast policy.

5 Key changes

5.1 The RI policy underwent a substantial rewrite last year to allow Border to Coast to satisfy future PRI reporting requirements, whilst maintaining consistency with the principles previously adopted. This year the review has taken into account SRD II requirements which are incorporated into the FCA's rule changes published at the end of May 2019, and also further improvements to satisfy PRI reporting.

5.2 ESG factors are considered when analysing potential and ongoing investments. The table covering potential issues has been expanded to include additional ESG issues as examples; this is not an exhaustive list. The additions are seen as posing increasing risks to investors, with regulation, and increased government and political pressure.

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[1] International Corporate Governance Network - investor-led organisation to promote effective standards of corporate governance and investor stewardship communicated by their Global Governance Principles and Global Stewardship Principles.

[2] Shareholder Rights Directive II - aims to promote effective stewardship and long-term investment decision making. It sets requirements in several areas, including transparency of engagement policies and investment strategies across the institutional investment community.

For example, water stress has been added as risks are both regional and multi-dimensional, and for some industries it is a material issue. Single-use plastics has risen up the agenda driven by consumers with implications for a number of industries. These issues may provide us with opportunities to work collaboratively with other investors.

5.3 The climate change section of the policy has been expanded to include extra detail on the systemic risk. As we are already implementing the specific points in the policy the wording has been changed to reflect this.

5.4 One area not included in the revised policy is Border to Coast's approach to exclusions. This is an area covered in the PRI reporting framework. We do not currently have an exclusion policy or any red-lines for investing and will need to undertake further work to assess investment implications and impact if we were to adopt any red-lines and/or exclusions and how this would affect Partner Funds' assets held outside the pool.

5.5 Impact investing is another area where our policy is currently silent: we need to increase the knowledge and understanding of impact investing across Border to Coast and the Partner Funds before we can set out our approach. This is likely to be an area of increasing political and public scrutiny in future years.

5.6 All changes are shown as track changes in the attached Appendix 1. The amendments to the RI policy are highlighted in the table below.

Section	**Page**	**Type of Change**	**Rationale**
Introduction	4	Addition / Clarification	Investment time horizon.
Integrating RI into investment decisions	5	Addition	Additional ESG issues: water stress, data privacy, single-use plastics, political lobbying.
Climate change	7/8	Addition Clarification	Extra detail on climate change as a systemic risk. Additional detail on risks and opportunities. Change from 'will therefore look to' to 'is'
Stewardship Use of proxy advisers	8/9	New sub-section	To comply with SRD II, need to name and describe use of proxy advisers.
Engagement	10 11	Restructuring Addition	Bullet points for engagement strands. Detail on engagement process – required by PRI & SRD II/FRC.
Escalation	11	Addition – new sub-section	Detail on options when initial engagement ineffective – required by PRI.
Due diligence and monitoring	11/12	Addition – new sub-section	Detail of audit of stewardship activities – required by PRI.
Communication and reporting	12	Clarification	Change from 'consider' to 'will also be reporting in line with the TCFD recommendations'.

5.7 The Corporate Governance & Voting Guidelines were expanded at the last review to reflect global corporate governance trends, not just UK best practice.

5.8 Following Robeco's evaluation this year a number of minor revisions were proposed to align the Voting Guidelines with the ICGN Global Governance Principles and the UK Corporate Governance Code. We want to avoid ambiguity within the Voting Guidelines, however best practice can vary across markets and jurisdictions; an example being Japan where the Company Law does not require the separation of the roles of chairman and CEO. This is an area for future consideration as to whether voting guidelines for some individual markets need developing. Amendments are highlighted in the table below and are a mixture of minor additions and clarifications to reflect global variations of market practice. All changes are shown as track changes in the attached Appendix 2.

Section	**Page**	**Type of Change**	**Rationale**
Company Boards – Composition and independence	5	Addition / Clarification	Change of "9 years" to "9-12 years". Clarification that this will also depend on market practice.
Leadership	6	Addition	Changed 'must' to 'should' to cover market practice outside the UK
Diversity	7	Clarification	Additional; wording to clarify stance.
Board Evaluation	7/8	Addition	Good practice for Board to disclose these evaluations.
Directors' remuneration Long-term incentives	9 9	Addition Addition	Transparency on pay ratios Encourage Executive Directors to hold stock to align interests with those of shareholders.
Directors' contracts	10	Addition	Limit termination benefits in-line with market best practice.
Audit	10	Addition	Publish audited financial statements ahead of shareholder voting deadline – to cover the Korean market where this does not always happen. Additional text to cover audit tender requirements for markets outside the UK.
Political donations	11	Clarification	Ensure money not being used to fund political parties
Lobbying	11	Clarification	Alignment of company and trade association values.

6 Climate change working party reflections

6.1 The working party was set up to improve the wider pool understanding of climate change and identify what we can change to improve investment outcomes. Much ground was covered over the six sessions with a fast, collective learning process with areas identified where further detailed work needs to be done.

6.2 A clear shared priority is to manage risk and opportunities from climate change. It was recognised that the only revisions to the climate change section in the Responsible Investment policy were for more detail to be included on climate change as a systemic risk and on the risks and opportunities . A number of key areas to work on and next steps include:

- Considering the impact of climate change risk on strategic asset allocation
- How to measure transition risk and the implications of setting targets
- The role private markets will play in managing transition risk
- Implications of an exclusion policy if engagement is ineffective
- Continue to embed and enhance analysis in the investment process
- Provide further education on the TCFD[3] for our Partner Funds
- Review our communication approach to managing climate change risk

6.3 Thank you to all representatives on the working party from our Partner Funds and Border to Coast and all the collective work that has been done. Understanding has improved amongst those participating in the group. Bulletins have been issued for each session and shared with all Partner Funds. It is however, more difficult to ensure that all Partner Funds are involved. Rather than continue the climate change working party the suggestion is to hold a Responsible Investment meeting for all Partner Funds to attend on a quarterly basis, thus keeping communciation lines open.

7 Sustainable Investment Goals

7.1 The UN Sustainable Development Goals (SDGs) are a collection of 17 global goals which were set by the United Nations in 2015 for the year 2030. They address issues such as poverty, hunger, health, education, climate change, gender equality, water and sanitation. Their design and intention are high level, and their aim is to facilitate social and economic change to achieve a better and more sustainable future for all. Over the last couple of years, investors have become more 'SDG' aware which has led to a surge in SDG-related investment product launches. For some investors it involves measuring portfolio exposure to companies whose businesses are SDG aligned. Others have gone down the route of impact investing, allocating to specific investment vehicles with impact or SDG-aligned objectives.

7.2 The SDGs were not designed as an investment framework, but rather as a set of environmental and social goals defined by governments. There are limitations for investors looking to report or invest in line with the SDGs. There is uncertainty as to how SDGs can be used as part of the investment process and given the high-level nature of the themes, considering SDGs at the stock level is difficult. They can however, present new and thematic investment opportunities. One way of incorporating the SDGs is to include them when thinking about engagement. The Local Authority Pension Fund Forum (LAPFF) has added SDG 6 (clean water and sanitation) and SDG 11 (sustainable cities and communities) into its engagement meetings. Robeco, our Voting & Engagement Partner also map all their engagement themes to the SDGs. The SDGs can help investors to measure more specific ESG outcomes.

7.3 The SDGs are not currently covered explicitly in the Responsible Investment Policy.

[3] The Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) - The TCFD developed recommendations on climate-related financial disclosures that are applicable to organisations (including asset owners) across sectors and jurisdictions.
https://www.fsb-tcfd.org/publications/finalrecommendations-report/

8 Financial implications

8.1 Any financial implications are in respect of implementation and fulfilment of the policies. The cost of the external voting and engagement provider and RI initiatives have previously been approved. Additional spend will be in relation to ESG data providers, and ongoing training and development of colleagues through attendance at conferences and specific training events.

9 Risks

9.1 Responsible Investment and sustainability are central to Border to Coast's corporate and investment ethos and a key part of delivering our partner funds' objectives. There may be reputational risk if we are perceived to be failing in our commitment of this objective.

9.2 Commitment to RI is becoming increasingly important to the Partner Funds. In order to maintain collective policies and the strong voice this gives us; we need to ensure that all Partner Funds are in agreement.

9.3 There is the risk of not being able to comply with the amendments made to the FCA Handbook on the back of the Shareholder Rights Directive.

10 Conclusion

10.1 The Joint Committee is asked to consider the recommendations made at section 2.

11 Author

Jane Firth, Head of Responsible Investment
7 November 2019

12 Supporting Documentation

Appendix 1: Draft Border to Coast Responsible Investment Policy

Appendix 2: Draft Border to Coast Corporate Governance & Voting Guidelines

Appendix 3: Gender Diversity Briefing Paper