Border to Coast Joint Committee

Date of Meeting: **24th November 2020**

Report Title: **Responsible Investment Policies Review (for discussion)**

Report Sponsor: **CIO – Daniel Booth**

1 Executive Summary

1.1 The Responsible Investment Policy and Corporate Governance & Voting Guidelines were developed in 2017 in conjunction with the Partner Funds and are reviewed annually. Both policies are 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.

1.3 In the 2019 review we identified a number of areas for further development during 2020. In March 2020 we held a Partner Fund Responsible Investment workshop to seek Partner Funds' views on these areas to build into the 2020 review:

- With respect to climate change, the consensus was for no targets to be set regarding carbon emissions reduction, with the direction of travel being more important. There was also a reiteration of the importance of engagement rather than divestment (from sectors as opposed to individual, poorly managed companies). The policy reflects this position; however, we note that SYPA has recently set a goal of making its portfolios carbon neutral by 2030.
- Last year the Board requested that diversity beyond gender be considered. The option of broadening the application of the current voting policy on gender diversity to smaller companies and companies outside the UK was discussed. It was noted that voting on wider diversity matters will continue to be difficult where there is paucity of data, however we have suggested an update to the wording in our RI policy, indicating our intent to engage in this important area.

1.4 The industry's understanding of Responsible Investment matters is evolving rapidly and we have therefore identified further areas for future consideration with Partner Funds in 2021 (see section 6). In particular a growing number of asset owners are publishing separate climate change policies and we believe this to be appropriate given its material significance to Partner Fund investment outcomes. We will therefore during 2021 develop a standalone climate change policy building on the work already undertaken within Border to Coast and with Partner Funds.

1.5 The annual review and governance processes need to be completed, with policies approved and ready to be implemented ahead of the 2021 proxy voting season. Partner Fund Officers have provided feedback, much of which has been taken into account in the policies; the Pension Committee review process is due to take place over this coming quarter.

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 Pensions Committees for comment and for them to consider adoption of the principles in their own RI policies in line with industry best practice.

2.3 That the Committee notes the proposed areas for future development in Section 6.

3 Background

3.1 We take our responsibility seriously as an active owner and steward of the investments managed on behalf of 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 to, and underlying principles of, voting.

3.2 The reviews in 2018 and 2019 led to changes to the RI policy to reflect the Shareholder Rights Directive and reporting requirements once Border to Coast became a signatory to the Principles for Responsible Investment (PRI). Although these involved considerable changes in structure, the underlying principles remained the same. 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 2019, the revised policies were taken to Partner Funds for comment and for them to consider adoption of the principles in their own RI policies in-line with industry best practice. All Partner Funds accepted the proposed changes.

4 Review process

4.1 The RI policy and Corporate Governance & Voting Guidelines are reviewed annually or when material changes need to be made. The 2020 annual review process commenced in July to ensure any revisions required are in place and agreed with the Board and Partner Funds ahead of the 2021 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 Network1 (ICGN) Global Governance Principles, the UK Corporate Governance Code and the UK Stewardship Code.

[1] International Corporate Governance Network - investor-led organisation to promote effective standards of corporate governance and investor stewardship to advance efficient markets and sustainable economies world-wide.

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 The climate change working party which concluded last year identified a number of key areas requiring further work and development as set out in last year's review:

- How to measure transition risk and the implications of setting targets (see 4.6)
- The role private markets will play in managing transition risk (see 4.7)
- Implications of an exclusion policy if engagement is ineffective (see 4.8)
- Continue to embed and enhance analysis in the investment process (see 4.9)
- Provide further education on the TCFD[2] for our Partner Funds (see 4.10)
- Review communication approach to managing climate change risk (see 4.10)

4.5 Whilst good progress has been made in most of these areas, we have been unable to conclude our work in all. In particular, the measurement of transition risk and scenario analysis and the implications of exclusions following ineffective engagement, are areas for further consideration before the 2021 policy review.

4.6 A Responsible Investment workshop was held for the Joint Committee in March where climate change was covered to enable us to take Partner Fund views into the 2020 RI policy review. The consensus was that Partner Funds did not want to set climate change targets or exclusions; the direction of travel was seen as more important.

4.7 Quarterly meetings are held with the Alternatives team looking at ESG with discussions on the role private markets play in the energy transition, carbon measurement challenges and ESG reporting. Investments have been made in 'new economy' themes of technology, healthcare and renewable energy via our private equity and infrastructure portfolios. Carbon measurement is particularly challenging for this asset class. We have therefore joined with other asset owners, including other LGPS pools and the Church of England, to look at how we can report across private markets.

4.8 We currently have no restrictions or exclusions regarding sectors or specific stocks. Exclusions and divestment, in certain cases, eliminate the ability for us to drive change within a company. Partner Funds, due to having passive mandates and legacy assets, may not be able to fully adopt the Border to Coast policy if an exclusion clause was added. Externally managed mandates have not been set up with restrictions in place. The investment implications of red lines and exclusions for companies not sectors, will be considered ahead of next year's review.

4.9 Considerable work has been done to embed and enhance climate analysis into the investment process, as captured in the Border to Coast TCFD Report available on our website. This includes conducting carbon footprints on a quarterly basis on listed equity and fixed income portfolios and using the Transition Pathway Initiative Tool to assess portfolio holdings. Work continues in this area.

[2] Task Force on Climate-related Financial Disclosure ('TCFD') Set up to develop voluntary, consistent, climate-related financial risk disclosures to guide companies in providing information to investors, lenders, insurers and other stakeholders.

4.10 We continue to support and provide training for Partner Funds on climate change and recently held a session covering TCFD reporting. We are continuing to develop reporting and communication with Partner Funds to ensure we meet requirements.

4.11 The move towards asset owners and asset managers committing publicly to being net zero by 2050 is growing. This was discussed at the Board Strategy Day in August, considering how we as a company can pledge and whether Border to Coast can make a pledge to be "net zero by 2050" across our investment portfolios. This is an area for further work ahead of the next policy review. We are in discussion with officers at SYPA, where the Committee has recently made a commitment to being net zero by 2030, to understand how Border to Coast may be able to assist in this challenge.

4.12 In relation to diversity, applying the current voting policy outside the FTSE350 was seen as an area to consider. Last year the Board requested that diversity beyond gender also be taken into account. We have addressed this in the Voting Guidelines through our expectations of companies, but it is more difficult to implement through voting due to the lack of disclosure by companies. This is something that can be better addressed by engagement.

4.13 A workshop was held with the officers of the Partner Funds on 22nd September. The proposed revised policies were shared with officers and feedback and comments were received from South Yorkshire, Cumbria, North Yorkshire and East Riding. Feedback on the RI Policy covered governance, integration and escalation, and on the Corporate Governance & Voting Guidelines included comments on diversity, board evaluation, stakeholder engagement, dividends and climate change. These points along with the other proposed revisions to both policies were discussed, and amendments have been made to the draft policies. Divestment following unsuccessful engagement and specific climate-related exclusions have not been included in this review as work will be undertaken on these areas ahead of the 2021 Policy Review process.

4.14 The annual review and governance processes need to be completed, with policies approved and ready to be implemented ahead of the 2021 proxy voting season. We have asked Partner Funds to complete their review by the end of 2020 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.

5 Key changes

5.1 The Corporate Governance & Voting Guidelines have been reviewed by Robeco considering best practice. There are several minor amendments including proposed additions and clarification of text. All changes are shown as track changes in the attached Appendix 2.

5.2 Board diversity is a fast-moving area of corporate governance, with some investors publicly setting hard thresholds for female representation. Restricting these thresholds based on company size, for example FTSE350 companies, is no longer considered to be far-reaching enough. Research shows that the benefits of diversity are greatest when female representation is above the 30% level; therefore, applying a 30% expectation would be more in line with stakeholder expectations. It is important to still retain flexibility, especially for emerging markets and Japan, where the expectation is for companies to have at least one female on the board. Rounding the threshold for smaller board sizes is important to maintain feasibility for boards. Our expectations of companies in respect of broader diversity and ethnic minority representation on boards have been included in the Voting Guidelines. This is however more difficult to implement via voting due to the lack of disclosure but is something that can be addressed through engagement with companies.

5.3 On climate change, some minor changes are suggested to the RI policy and Voting Guidelines bearing in mind the comments from Partner Funds at the Joint Committee RI workshop. We expect high emitting companies and those in high emitting sectors to have climate change policies in place meeting certain requirements. If this is not the case, there is the potential to vote against board chairs where no progress is being made. This is also the case for companies rated at zero or one by the Transition Pathway Initiative[3] (TPI). There is also reference to the use of the TPI toolkit for assessing portfolio holdings and reporting on climate risk through the TCFD report.

5.4 Changes to the Corporate Governance & Voting Guidelines are summarised below.

Section	Page	Type of Change	Rationale
Diversity	5	Addition / clarification	Rewording and increasing scope of approach.
Re-election	5/6	Addition / clarification	Board member election using majority voting standard.
Board evaluation	6	Addition	Assess skills.
Stakeholder engagement	6	Addition	Company response where significant votes against received.
Directors' remuneration	6/7	Clarification Addition	Rephrasing. Greater detail on ESG incorporation in exec pay.
Annual bonus	7	Addition	Deferral of portion of short-term bonus.
Political donations	9	Clarification	Oppose political donation proposals.
Dividends	10	Addition	No publicly disclosed capital allocation strategy.
Virtual shareholder General Meetings	11	Addition	Loosen current approach but need to safeguard shareholder participation.
Shareholder proposals	12	Addition	Expand text to include types of proposal we would usually support.
Climate change	12	Addition	Vote against Chair if high emitting company with TPI score of zero or 1.

5.5 The last two reviews have seen the RI policy develop substantially to satisfy future PRI reporting requirements and take account of SRD II requirements which are incorporated into the FRC's rule changes. This year there are several minor additions and amendments but no substantial changes. All changes are shown as track changes in the attached Appendix 1.

[3] The Transition Pathway Initiative ('TPI') is a global initiative led by asset owners and supported by asset managers. Aimed at investors, it is a free-to-use tool that assesses how prepared companies are for the low carbon transition. Companies are assessed to one of 5 levels based on their position in relation to the recognition and management of transition risks.

5.6 The amendments to the RI policy are highlighted in the table below.

Section	Page	Type of Change	Rationale
1. Introduction	2	Clarification	Implementation of policy.
1.1 Policy framework	2/3	Addition	Policy framework context (with thanks to SYPA).
5. Integrating RI into investment decisions	4	Addition Addition	Biodiversity. Text explaining 'overarching principles' apply to all asset classes.
5.1 Listed equities – internally managed	4	Clarification	Extra text to clarify process.
5.2 Private markets	5	Addition	Monitoring ESG policies and encourage improvement.
5.4 External manager selection	5 5	Addition Addition	Extra detail on expectations. PRI Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
5.5 Climate change	6/7	Addition Addition Addition Addition	Reference to climate risk reporting via TCFD report. Use of Transition Pathway Initiative (TPI). Vote against Chair where rated zero or 1 by TPI. Private market investment themes.
6. Stewardship	7	Addition	Extra clarification text. Commitment to 2020 UK Stewardship Code.
6.1 Voting	7	Addition	Clarification on split voting circumstances - clear rationale from Partner Fund.
6.1.1 Use of proxy advisers	8	Clarification Clarification	Monitoring of Robeco. Updated text on share blocking.
6.2 Engagement	9/10	Addition Addition Addition	Input into Robeco process for new themes. Include OECD Guidelines breaches. Sharing engagement information.
9. Training and assistance	11	Addition	Training for Investment Team, Board and Joint Committee.

5.7 The proposed changes to the climate change section in the RI policy at 5.5 are minor. It is proposed that climate change be broken out as an appendix or standalone policy. This will require substantial work and is not something that can be done in the time constraints of this policy review.

5.8 An increasing number of asset owners and asset managers are publishing separate documents defining the approach taken to climate change. This includes Brunel Pension Partnership, Local Pensions Partnership and NEST. South Yorkshire

Pensions Authority also have a separate climate policy, which references not investing in pure coal and tar sands and that SYPA will 'seek to use its influence within the wider Border to Coast Partnership to secure the agreement of appropriate goals for reducing the carbon intensity of portfolios'. We note that this is a long-standing policy and whilst not written into Border to Coast's policy, Border to Coast does not currently hold any such investments.

5.9 The policies are to be presented to the Board on 2nd November with the recommendation to approve the revisions. There is then a period where Partner Funds take the revised policies to their committees to begin their internal process of alignment. The revised RI Policy and Corporate Governance & Voting Guidelines will be effective from 1st January 2021.

6 Work to be undertaken in 2021

6.1 The following pre-work will be undertaken ahead of the 2021 Policy Review process:

- The development of a standalone climate change policy
- The measurement of transition risk and the implications of setting targets, including the potential to set a net zero carbon target
- The role of private markets in managing transition risk
- Implications of an exclusion policy if engagement is ineffective

6.2 We will also continue to develop our communication approach to enable Partner Funds and other important stakeholders to understand and oversee Border to Coast in carrying out our responsible investment remit.

7 Financial implications

7.1 Financial implications are in respect of implementation and fulfilment of the policies. The cost of the external voting and engagement provider and RI initiatives are included in our approved budget. There may be additional spend in relation to ESG data providers, consulting support and ongoing training and development of colleagues.

8 Risks

8.1 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 RI commitment.

8.2 Commitment to RI is becoming increasingly important to the Partner Funds. To maintain collective policies and the strong voice this gives us, we need to ensure that Partner Funds are supportive of Border to Coast's approach.

8.3 There is the risk that the current climate change section of the RI policy is too high level and does not meet Partner Fund expectations in this area. A standalone policy is to be developed outside the normal policy review cycle.

9 Conclusion

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

10 Author

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11 Supporting Documentation

Appendix 1: Draft Border to Coast Responsible Investment Policy
Appendix 2: Draft Border to Coast Corporate Governance & Voting Guidelines

Important Information