

<b>Subject</b>	<b>Responsible Investment Update Quarter 3 2019/20</b>	<b>Status</b>	For Publication
<b>Report to</b>	Authority	<b>Date</b>	19 <sup>th</sup> March 2020
<b>Report of</b>	Fund Director		
<b>Equality Impact Assessment</b>	Not Required	Attached	No
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## **1 Purpose of the Report**

- 1.1 To provide an update for members of the Authority on responsible investment activity during the period October to December 2019

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## **2 Recommendations**

- 2.1 Members are recommended to:
- a. **Note the activity undertaken in relation to responsible investment issues during Quarter 3 of the financial year.**
  - b. **To approve continued participation in the Workforce Disclosure Initiative on a fee paying basis.**

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## **3 Link to Corporate Objectives**

- 3.1 This report links to the delivery of the following corporate objectives:

### **Investment Returns**

To maintain an investment strategy which delivers the best financial return, commensurate with appropriate levels of risk, to ensure that the Fund can meet both its immediate and long term liabilities.

Companies which are well managed and appropriately address the Environmental, Social and Governance risks which they face are more likely to deliver strong returns making the achievement of the goals set out in the Investment Strategy more likely.

### **Responsible Investment**

To develop our investment options within the context of a sustainable and responsible investment strategy.

Responsible investment is a fundamental part of the Authority's investment beliefs and are central to how the Authority invests. A central part of a responsible investment approach is transparency about the activity undertaken both by and on behalf of the Authority.

### **Effective and Transparent Governance**

To uphold effective governance showing prudence and propriety at all times.

It is an important aspect of the Authority's accountability to stakeholders that the actions which it takes in relation to responsible investment are publicly reported so that there is proper transparency in relation to the Authority's activities.

## **4 Implications for the Corporate Risk Register**

- 4.1 The actions outlined in this report raise no specific issues in relation to the Corporate Risk Register.

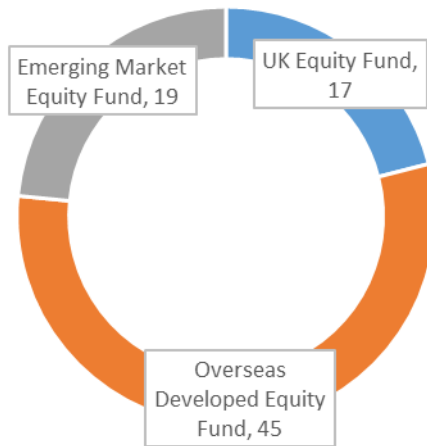
## **5 Background and Options**

- 5.1 The Authority's approach to responsible investment is delivered through four streams of activity, largely in collaboration with the other 11 funds involved in the Border to Coast pool.
- Voting – Using the voting rights attached to shareholdings to influence the behaviour of companies to move in line with best practice.
  - Engagement through Partnerships – Working with others to engage in dialogue with companies in order to influence their behaviour and also to understand their position on key issues.
  - Shareholder Litigation – Joining in legal actions which seek to punish companies for corporate “misbehaviour” and thus protect the financial interests of the members of the pension fund.
  - Active Investing – Making positive choices about which companies to invest in having considered the full range of responsible investment issues based on the premise stated above that well governed companies will produce sustainable and superior returns. This is part of the Authority's overall investment philosophy and is not covered in this report.

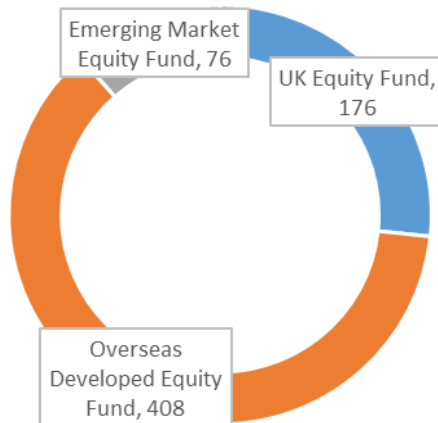
### ***Voting***

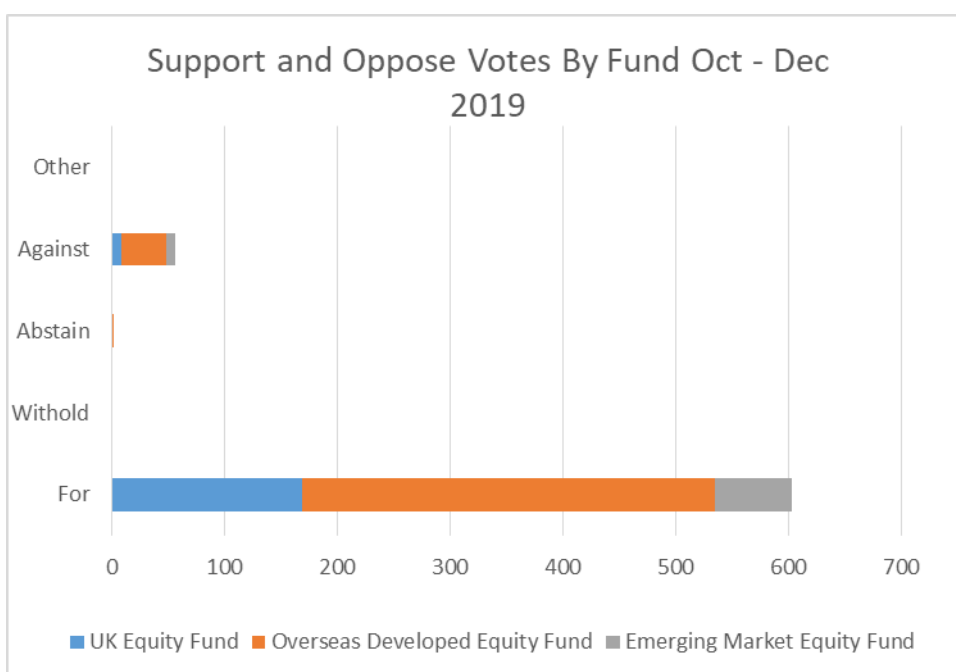
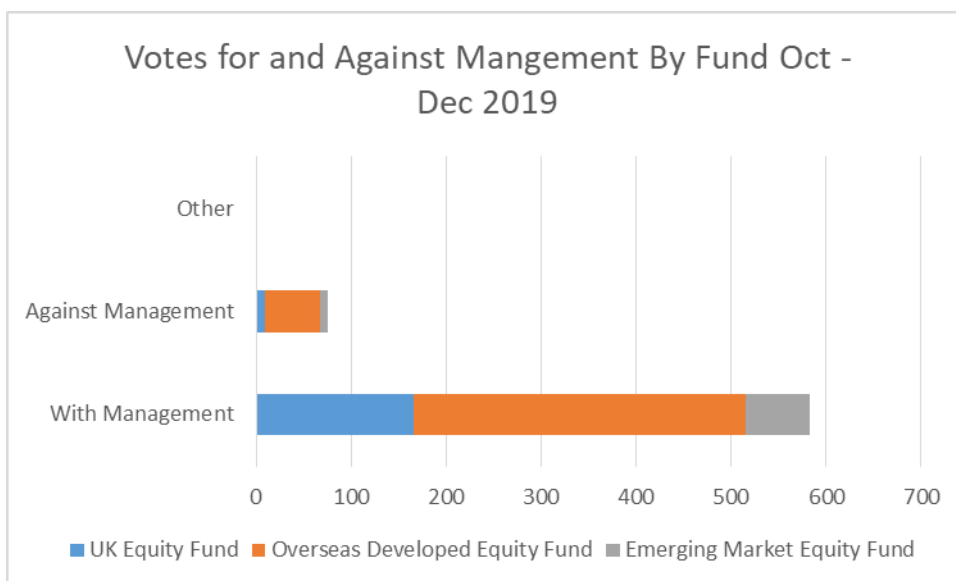
- 5.2 The charts below illustrate at a high level how the Authority's holdings in listed equities were voted in the period to the end of December 2019. Detailed reports setting out each vote are available on the Border to Coast website and in the member's on line reading room.
- 5.3 Again reflecting the fact that this is a relatively quiet quarter in terms of company meetings shares were voted on 660 resolutions at 81 meetings, with over 50% of meetings and votes being in relation to the overseas developed markets portfolio.

### Number of Meetings Voted Oct - Dec 2019



### Votes Cast Oct -Dec 2019





5.2 The majority of oppose votes and votes against management across all markets were concerned with issues of board composition and executive remuneration. This reflects the continuing issues which exist in achieving greater board diversity and independence and also in setting executive pay in a way which incentivises performance in a way which works in the wider interests of shareholders rather than individual executives. Given that resolutions on board membership and executive remuneration predominate at company meetings this pattern is unlikely to change in the medium term.

*Trends in Environmental Shareholder Resolutions*

5.3 The risks associated with the energy transition and physical impacts of climate change have put the energy sector under greater scrutiny in recent years. As a result, oil majors and utilities companies have increasingly been targeted by shareholder activism calling upon them to properly address environmental issues linked to their operations.

This activism most commonly takes the form of shareholder proposals submitted for a company's annual general meeting.

- 5.4 Growing concerns around the impact of climate change have also led to a shift in investors' voting approaches. For instance, increased collaboration amongst investors has led to a convergence of requests put forth to their issuers, starting from climate risks disclosure, to emission reduction targets, climate stress testing and climate risk governance. Similarly, the recommendations of the Task Force of Climate-related Financial Disclosures published in 2017 have become a reference point for engagement on climate issues and more broadly on ESG issues.
- 5.5 The increased pressure from investors using voting rights has also contributed to companies anticipating shareholders' concerns and addressing them through different channels outside proxy statements, which has coincided with a rise in the direct engagement between investors and companies. This increasing level of companies' responsiveness has concurrently contributed to a decline in the overall level of shareholders proposals submitted. For example, the most recent proxy season in the US saw the lowest number of shareholder proposal submissions in the last five years, from a high of 549 in 2015 to 420 in 2019.
- 5.6 This trend is in part explained by the varying means for companies to address shareholder concerns. In 2018 US proxy season, 48% of filed environmental proposals were withdrawn, while only 37% of filed proposals went to a vote. Historically, these figures were reversed, as a greater proportion of proposal would go to a vote compared to proposals that were withdrawn. However, given that engagement between institutional shareholders and companies has increased, it is likely that the decline in proposals filings could be related to discussions and engagement outside of the proxy process.
- 5.7 In the end, environmental issues are increasingly scrutinized by shareholders and corresponding shareholder resolutions can expect a growing level of support, as investors encourage more companies to improve disclosures and practices on such issues.

#### *Proposed Changes in US Rules on Shareholder Resolutions*

- 5.8 On 5<sup>th</sup> November 2019 the US Securities and Exchange Commission (SEC) proposed changes to several rules relating to the filing of shareholder resolutions and the services offered by proxy voting advisers (in the case of Border to Coast and SYPA Robeco). A significant number of prominent fund managers and other commentators believe these proposals will severely hinder shareholders rights and do not represent the long term interest of minority shareholders.
- 5.9 Shareholder resolutions serve as a useful tool to inform corporate management and boards of shareholders priorities and concerns. They have, in the last decade, been a strong mechanism in both the US and other markets for creating accountability and facilitating engagement between investors and companies while enabling the achievement of considerable change in corporate conduct. While shareholder proposals vary in quality and merit given that it is shareholders who own companies it seems appropriate that the judgement on these issues is left to shareholders. This is an ongoing debate and ultimately this is something the SEC will make a decision on in line with its political mandate.

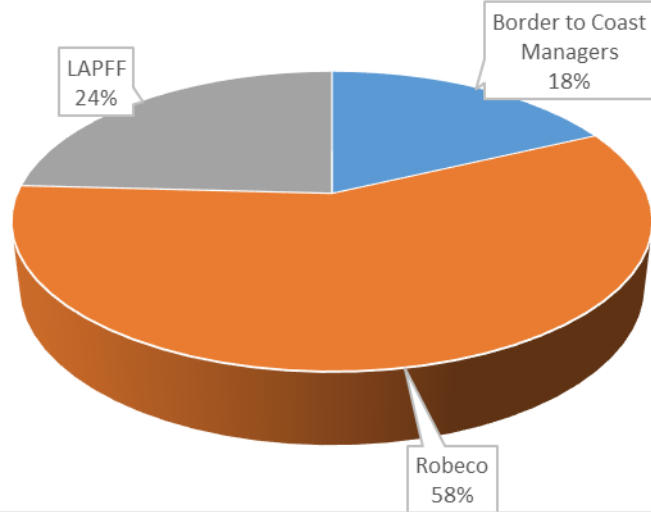
### *Voting Highlights*

- 5.10 **BHP Group** – A resolution in relation to corporate lobbying needing to be aligned with the goals and actions set out in the Paris Climate Change agreement was supported at the company's AGM. While this is an area where BHP is regarded as a leader the resolution was supported to underline the importance of this area and of conducting proper analysis of companies' involvement in trade associations that lobby on their behalf. BHP have subsequently published a report setting out their analysis of industry association memberships and identified areas of material misalignment which the company is prioritising to resolve through engagement with the relevant associations.
- 5.11 **Qantas** – This year around a quarter of shareholders in Qantas supported a resolution calling for the company to review its involvement in the forced deportation of refugees and asylum seekers. The resolution is based in the proposition that the risks associated with the company's commercial decision to participate in the deportation process through a contract with the Australian government would be mitigated by the implementation of a commensurate human rights due diligence process. In addition shareholders would benefit from additional information in order to assess how the company is managing such human rights related risks.
- 5.12 **Oracle Corp** – Votes were withheld for directors serving on the remuneration committee given the company's unresponsiveness to more than 50% of shareholders voting against the company's remuneration policy for two successive years. In this case given that Oracle's founder holds 35% of the shares the level of disapproval of this policy represents a clear majority of "independent" shareholders. Shareholders' feeling is that the remuneration policy does not properly link variable pay for the executive to individual performance and that the quantum of pay for the Chief Executive (at 7% of the company's net income (\$261m)) is excessive. Voting against members of the remuneration committee is intended to highlight the need for the committee to properly engage with the wider shareholder base on these issues.
- 5.13 **National Australia Bank** – There were two climate related resolutions at the NAB annual meeting, one concerning exposure to fossil fuel assets and the other concerned with industry association memberships and climate lobbying. Border to Coast supported both resolutions with the first securing 13% support and the second 15%.

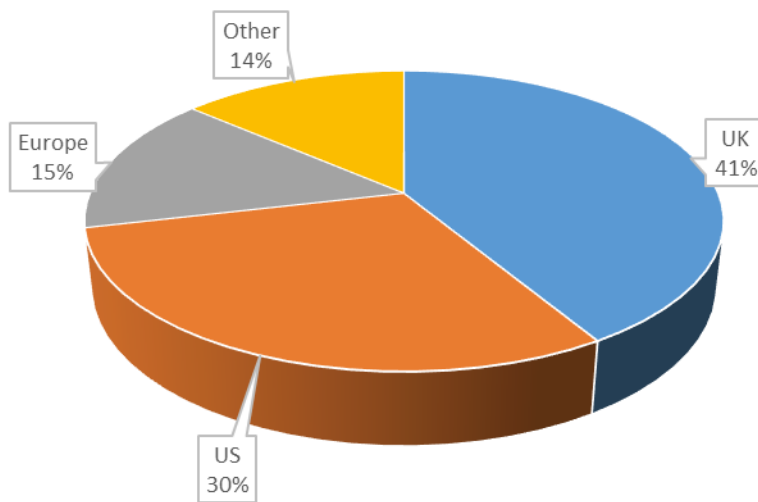
### *Engagement*

- 5.14 The bulk of engagement activity carried out in relation to the Authority's holdings is undertaken either by Border to Coast using Robeco as their agent or the Local Authority Pension Fund Forum (LAPFF) who use PIRC as their agent.
- 5.15 The graphs below illustrates how the balance of engagement with a total of 145 companies over the quarter breaks down between the different organisations, the location of the companies and the topic of engagement.

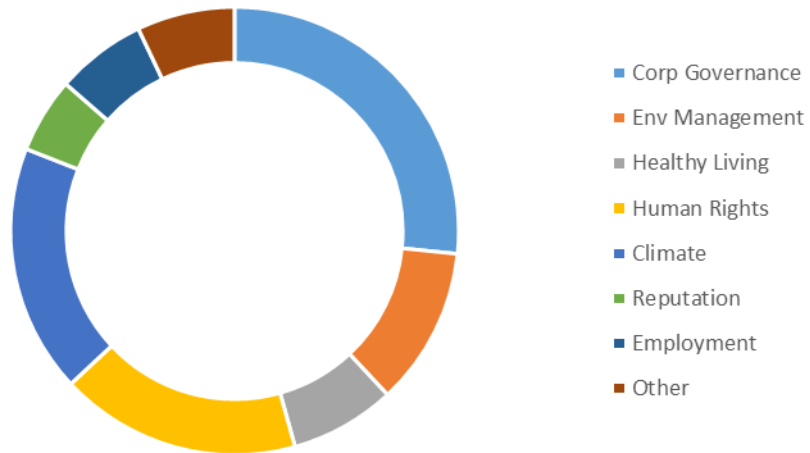
Engagement Volumes Oct - Dec 2019



Market Focus of Engagement Oct-Dec 2019



Engagement Topics Oct-Dec 2019



- 5.16 Again this quarter the majority of engagement activity took place in the UK and the US which represent the largest numbers of individual holdings within the various portfolios and also tend to contain the largest companies. In terms of the topics of engagement climate issues and environmental management continued as significant themes, with corporate governance issues also continued to be prominent, particularly in the run up to the peak voting season.
- 5.17 In terms of specific developments from engagement in the quarter the following are of note:
- Boeing committed to an independent assessment of its governance arrangements following the issues around the problems with the 737 MAX model. In addition the company has already separated the roles of Chair and CEO in line with accepted good practice.
  - Sainsbury's have committed to release a sustainability strategy early in 2020 which will set out its approach to becoming a net zero business.
  - Southern Company, a US Energy business, has announced that it will withdraw from the American Coalition for Clean Coal Electricity (ACCCE) next year. Given the general push back from American companies against shareholder resolutions and engagement on issues associated with lobbying by trade associations counter to companies' stated positions, particularly on climate issues, this is a significant step.

#### ***Property Portfolio Sustainability Performance***

- 5.18 Elsewhere on the agenda members are asked to consider an update to the Authority's policy on Responsible Investment in relation to the commercial property portfolio. Each year Aberdeen Standard (ASI) the Fund's property manager submits the portfolio for assessment against the Global Real Estate Sustainability Benchmark (GRESB), which is the accepted standard in this area for this asset class. The latest report based on data at 30<sup>th</sup> September 2019 has now been received<sup>4</sup>.
- 5.19 GRESB is a comprehensive assessment framework considering a range of aspects which results in a very detailed report of nearly 100 pages. The dimensions assessed are:
- Management
  - Policy and Disclosure
  - Risks and Opportunities
  - Monitoring and Environmental Management Systems
  - Performance Indicators
  - Certifications and Energy Ratings, and
  - Stakeholder Engagement
- 5.20 Comparator Scores are provided in a number of different forms both against the whole GRESB universe and against a comparator peer group of similar portfolios. These data are summarised below:



### *Overall Score*

**69%** compared to an overall average of 72% and a peer group average of 65%. This placed the fund 15<sup>th</sup> of its peer group of 37 UK diversified, non-listed, indirectly managed funds (and 136<sup>th</sup> of 230 in a global peer group of 230). Scores in management and policy areas (94%) were significantly ahead of the peer group and global averages, while those in implementation and measurement areas (61%) were materially behind the global average, although ahead of the peer group.

Note this score has declined from 72% in the previous year largely due to a decline in the score in the Performance Indicator section which is largely down to an increase in like-for-like energy consumption across the fund in calendar year 2018. The main limitation on improving the score in this section is data coverage (i.e. obtaining information from tenants), and discussions will take place with ASI to identify ways in which these scores can be cost effectively improved.

### *Environmental Factors Score*

The score on environmental issues was **55%** compared to a peer group average of 51% and a global average of 65%

### *Social Factors Score*

The score on social issues was **76%** which matches the peer group average and compares to a global average of 79%

### *Governance Factors Score*

The score on governance issues was 100% compared to a peer group average of 92% and a global average of 84%.

- 5.21 The conclusion that can be drawn from this work which reflects a similar pattern of results to previous years is that the policy framework which is largely derived from that provided by ASI as our fund manager is strong. The issues holding back improvement appear to be in implementation, which are more concerned with the day to day management of properties. These are issues which are being followed up in the ongoing work on the contract for the Managing Agent. Discussions are also taking place with Aberdeen Standard in terms of the strategy for each property over the coming year to ensure that issues that can be addressed while still meeting investment goals are dealt with.

### ***Collaborations***

#### ***LAPFF***

- 5.22 The most recent LAPFF business meeting took place during January and a briefing on the business considered has been placed in the on line reading room for members, while the quarterly engagement report is available on the LAPFF website. The most significant item discussed in terms of the way in which the Forum develops was consideration of the draft work plan for the coming year. All members will be consulted on this in due course before it is formally agreed. Given the way in which the pools, including Border to Coast have developed their activity (and resources) in the area of Responsible Investment this represents an opportunity for LAPFF to identify a role which genuinely adds value and is distinct from the Pools, while focussing on a smaller number of more defined outcomes. For example the work on engaging with communities around the Tailings Dam disasters is something that only LAPFF can

really do effectively. This feedback was provided by officers (and colleagues from other funds) at the business meeting and is reflected in the more formal feedback provided to LAPFF which has been made available for members in the on line reading room.

#### *Workforce Disclosure Initiative*

- 5.23 The Authority has been a supporter of the Workforce Disclosure Initiative (WDI) since its inception. This is an initiative which seeks to encourage companies to provide greater disclosure about their policies and practices in relation to their direct and supply chain workforces, seeking over time to achieve a step change in reporting in the same way as the Task Force on Climate Related Financial Disclosure (TCFD). The initiative has been extremely successful in moving the dial in this area, and is now supported by 140 investors (including Border to Coast in addition to the Authority). The principal source of initial financing for the initiative was a grant from the UK Department for International Development. This has been extremely successful in pump priming this work but it is now coming to an end and the initiative is looking at means to achieve longer term financial sustainability, and greater independence from Shareaction the lobby group which has hosted it. Part of this process is a proposal to move to a subscription model focussing membership on institutions such as the LGPS pools rather than the underlying funds. Border to Coast have indicated that they will become a subscribing member and while the Authority will maintain its support of the initiative's objectives as we are no longer a direct holder of investments it is appropriate for engagement with the initiative to be undertaken by the pool.

#### *Climate Action 100+*

- 5.24 Climate Action 100+ produced its progress report in October 2019. This is an investor led initiative which engages with some of the companies with the largest levels of carbon emissions. The 161 companies under engagement by CA 100 account for around 80% of global industrial emissions. Of these 70 have set long term emissions reduction targets, 9 have emissions targets that are in line with (or go beyond) the minimum goal of the Paris Agreement, 8 of companies have policies in place to ensure lobbying activity is aligned with climate change, 40 undertake and disclose climate scenario analysis, 30 of companies have formally supported the TCFD and 77 have defined board level responsibility for climate change. Clearly further and faster progress is desirable but it has to be recognised that some of these companies operate in sectors such as iron and steel where decarbonisation is particularly challenging and the accelerating rate of progress shows that there is beginning to be increasing alignment and understanding between companies and investors over these issues.
- 5.25 Details of the work being undertaken by other collaborations supported either by the Authority or Border to Coast is available in the quarterly reports to which links are provided as background papers.

## 6 Implications

6.1 The proposals outlined in this report have the following implications:

Financial	There are no specific financial implications arising from this report. Provision exists within the relevant budgets to support the Authority's involvement in collaborative initiatives and its share of the costs of work undertaken by Border to Coast.
Human Resources	None
ICT	None
Legal	Participation in these activities is within the statutory powers of the Authority and is positively encouraged by the LGPS Investment Regulations.
Procurement	None

**George Graham**

**Fund Director**

<b>Background Papers</b>	
<b>Document</b>	<b>Place of Inspection</b>
Local Authority Pension Fund Forum Quarterly Engagement Report	<a href="http://www.lapfforum.org">www.lapfforum.org</a>
Border to Coast Voting Reports	<a href="https://www.bordertocoast.org.uk/?d1m_download_category=voting-activity">https://www.bordertocoast.org.uk/?d1m_download_category=voting-activity</a>
Border to Coast Quarterly Engagement Report	<a href="https://www.bordertocoast.org.uk/?d1m_download_category=engagement">https://www.bordertocoast.org.uk/?d1m_download_category=engagement</a>
Robeco Quarterly Engagement Report	<a href="https://www.bordertocoast.org.uk/?d1m_download_category=engagement">https://www.bordertocoast.org.uk/?d1m_download_category=engagement</a>