SOUTH YORKSHIRE PENSIONS AUTHORITY

Responsible Investment Update Quarter 1 2021/22

September 2021

Contents

Highlights and Recommendations

Highlights over the quarter include:

- The casting of 6,110 individual votes at 411 different company meetings
- A number of significant "say on climate" votes
- The Authority along with one other Border to Coast Partner Fund casting its vote differently in relation to the Shell climate transition plan because of the lack of connection between this plan and the underlying business plan
- An increase in the level of engagement activity in the emerging markets
- A continuing high level of engagement around social issues as well as some increase in engagement around environmental issues driven by "say on climate".
- A new engagement theme around post pandemic labour practices.
- A continuing gradual improvement in ESG performance in all three of the equity portfolios with a noticeable positive impact from the restructuring of the Emerging Markets Fund.
- Continuing reductions in all carbon emissions metrics with a highly material reduction in the Emerging Markets Fund, although it is clear that in isolation and without further action these portfolios will not currently hit the 2030 Net Zero Goal.
- The inclusion of the Authority as a leading practice case study by external organisations in relation to both place-based impact investing and Net Zero.

The Authority are recommended to note the activity undertaken in the quarter and provide comments on the additional data contained in and evolving presentation of this report.

Background

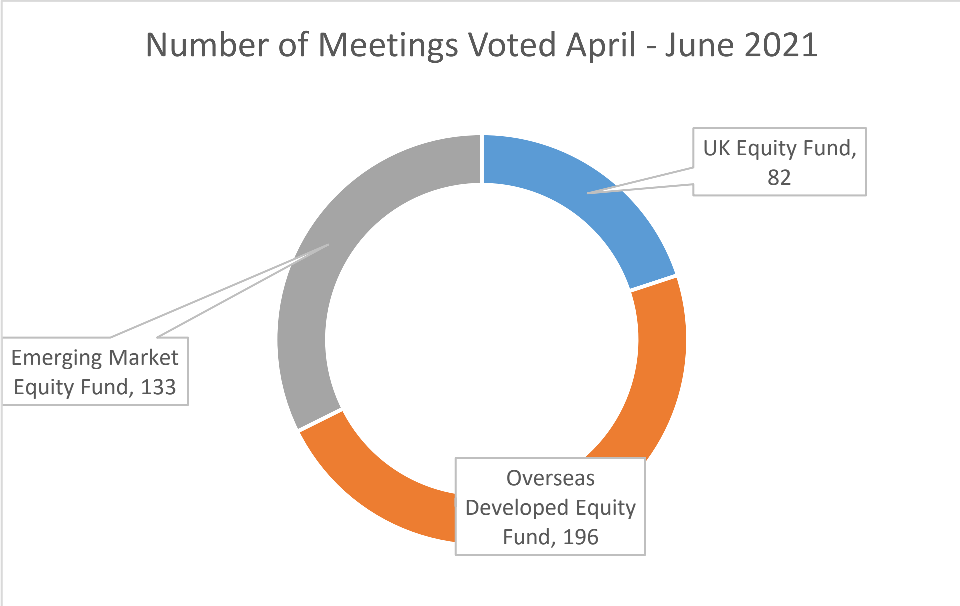
The Authority has developed a statement which sets out what it believes Responsible Investment is and how it will go about implementing it within its overall approach to investment. This statement can be found here.

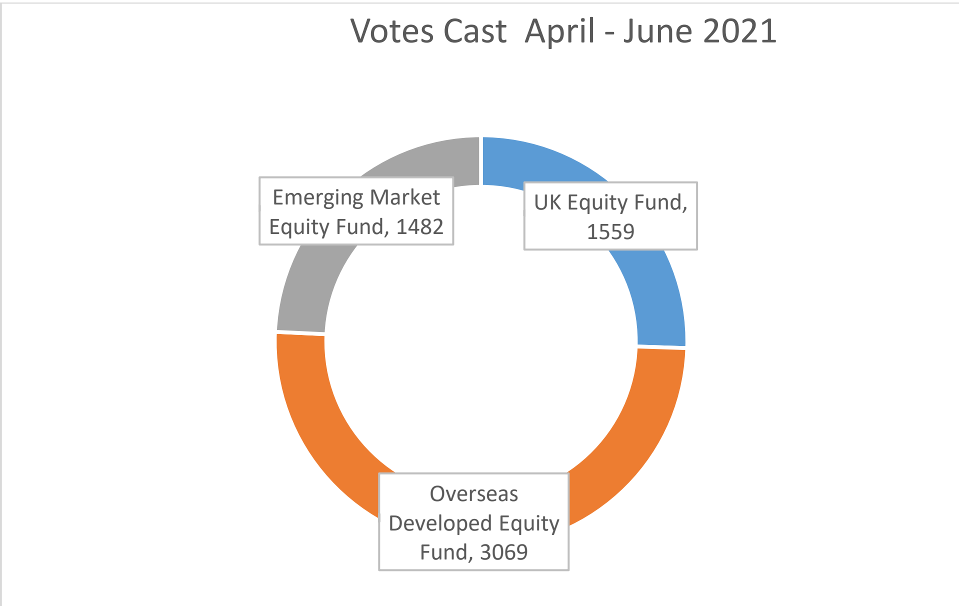
Our approach is largely delivered in collaboration with the other 11 funds involved in the Border to Coast pool. This report provides an update on activity in the last quarter covering:

- Voting – Information on how the voting rights attached to shareholdings have been used over the period to influence the behaviour of companies to move in line with best practice.
- Engagement – Information on the volume and nature of work undertaken on the Authority's behalf to engage in dialogue with companies in order to influence their behaviour and also to understand their position on key issues.
- Portfolio ESG Performance – Monitoring the overall ESG performance of the various products in which the Authority is invested.
- Progress to Net Zero – Monitoring the carbon emissions of the various portfolios where data is available in order to identify further actions required to support progress to Net Zero.
- Collaboration – Working with others to influence the behaviour of companies and improve stewardship more generally.
- Policy Development – An update on broader policy developments in the Responsible Investment space some of which directly involve the Authority and others which are of more general interest.

Voting Activity

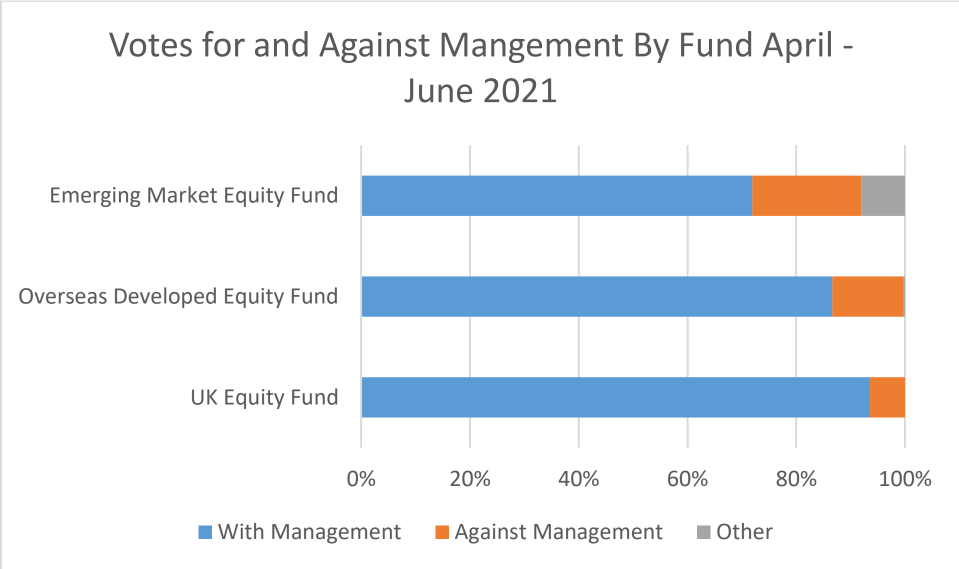
The April to June quarter is the period when a significant proportion of companies hold their annual meetings. The charts below show how the Authority's holdings in listed equities were voted in the period to the end of June 2021. Detailed reports setting out each vote are available on the Border to Coast website here .

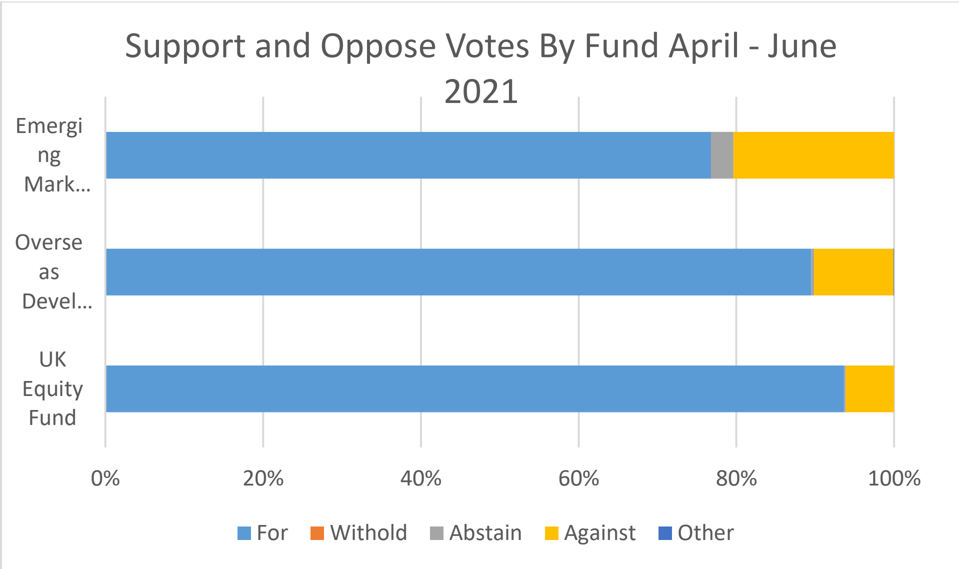




This represents a significant increase on the last quarter which represented the beginning of the peak voting season. Around 4 times as many meetings were attended and 6 times as many votes cast as in the previous quarter showing the degree to which activity peaks at this point in the year.

The pattern of support and oppose votes and votes for or against management is broadly consistent with previous quarters as shown in the charts below





The 2021 voting season saw a knock on impact from 2020's Covid affected season, with a significant amount of business carrying over or requiring more detailed analysis to understand the pandemic's impact on performance.

In terms of votes on executive pay the pandemic has led to additional specific considerations being reflected in determining how to vote. For example, if companies have received significant state aid, cancelled dividends, or had to lay off a large part of their workforce boards would be expected to reduce executives' variable pay outs or to forego bonuses entirely. Where companies failed to do this then we voted against remuneration proposals. So far this has led to Border to Coast voting against materially more remuneration proposals across all its equity funds (28% v 24% last year), which includes two funds in which SYPA does not invest.

A number of companies have brought forward specific management proposals in relation to their climate strategies giving shareholders a "say on climate". These votes are advisory and it is expected that best practice will evolve over time particularly in terms of reporting ambition levels and progress on the mitigation of climate change. By having regular votes on these issues it is possible for shareholders to continually press companies to make progress on this issue.

The graphic below higlights a number of significant votes which were made during the quarter

BP plc (UK) - We supported a "Follow This" resolution that asked the company to set targets for the reduction of Scope 1,2 and 3 emissions and to report annually on their GHG emissions reduction plan. Effective shareholder feedback mechanisms are an important aspect of competent climate leadership. The resolution received around 20% support but the Board has committed to contiune to engage over its climate plans and to report progress on a regular basis.

Anhui Conch Cement (Emerging Markets) - We voted against the annual report and accounts at the Chinese cement manufacturer. Anhui scores poorly on the Transition Pathway Initiative (TPI) (1 out of 5) and our policy is to show our discontent at this through a vote at the AGM. Anhui has made investment in carbon capture and storage and set some targets for emission reduction. The Company is being engaged by Robeco and will be engaged directly by the new China managers. There is the option to vote against board members at the next AGM should escalation be necessary

Berkshire Hathaway (Overseas) - We witheld our vote for the reelection of the Chair and CEO at this US multinational conglomerate due to governance and climate action planning concerns, and voted in favour of shareholder proposals in relation to climate and diversity and inclusion reporting. The combination of Chair and CEO roles and the absence of a lead director are contrary to our governance expectations and the company is a bottom ranked TPI performer (0 out of 5). The two shareholder resolutions achieved c25% support which is significant given that Warren Buffet (the current Chair) controls c 1/3rd of votes and was opposed.

These votes draw attention to the harder stance being taken as a result of the revised voting guidelines in relation to companies which are not progressing in terms of the climate transition with the lack of progress on the Transition Pathway Initiative being a key consideration at both Anhui Conch and Berkshire Hathaway

In addition to these it is appropriate to highlight the “Say on Climate” vote at Royal Dutch Shell, as this was the first occasion when the Authority (alongside one other partner fund) made the decision to instruct Border to Coast to vote shares differently to the rest of the Partnership.

Two resolutions were involved in this case, one seeking approval of the Company’s energy transition statement and the other sponsored by Shareaction and other shareholder groups seeking more specific targets for emissions. Border to Coast’s position having taken advice from Robeco who are one of the lead engagers with Shell through Climate Action 100+ was to support the first and abstain on the second.

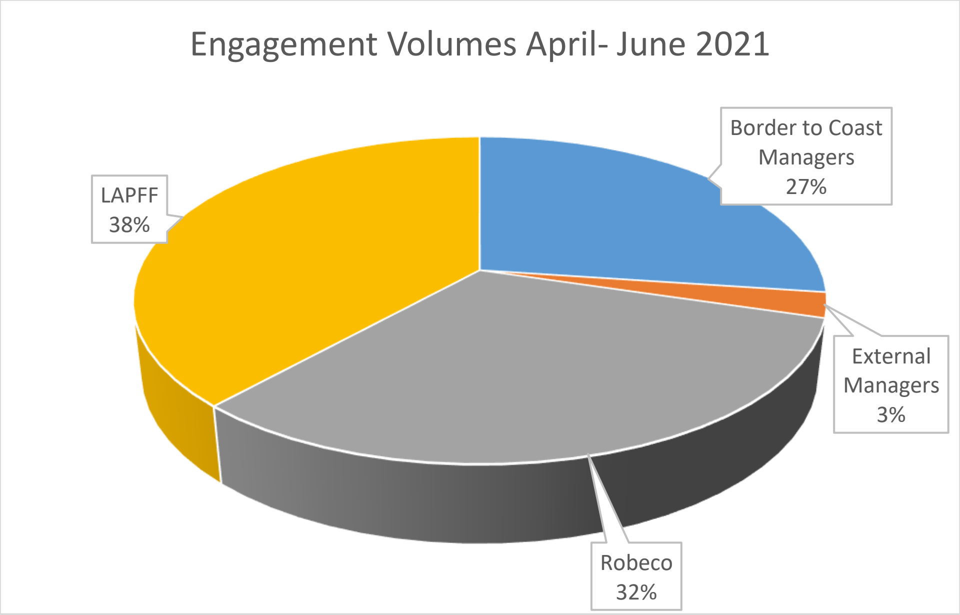
In fairness to Shell, they are generally regarded as a leader in terms of climate issues and emissions within the oil and gas sector and have been more open and transparent about the issues involved in the energy transition than some of their competitors. However, the energy transition statement contained the following caveat - “Shell’s operating plans, outlooks, budgets and pricing assumptions do not reflect our net zero emissions target”. So, in effect the energy transition plan is not reflected in their overall business strategy, which includes an increase in liquefied natural gas production in the period up to 2030.

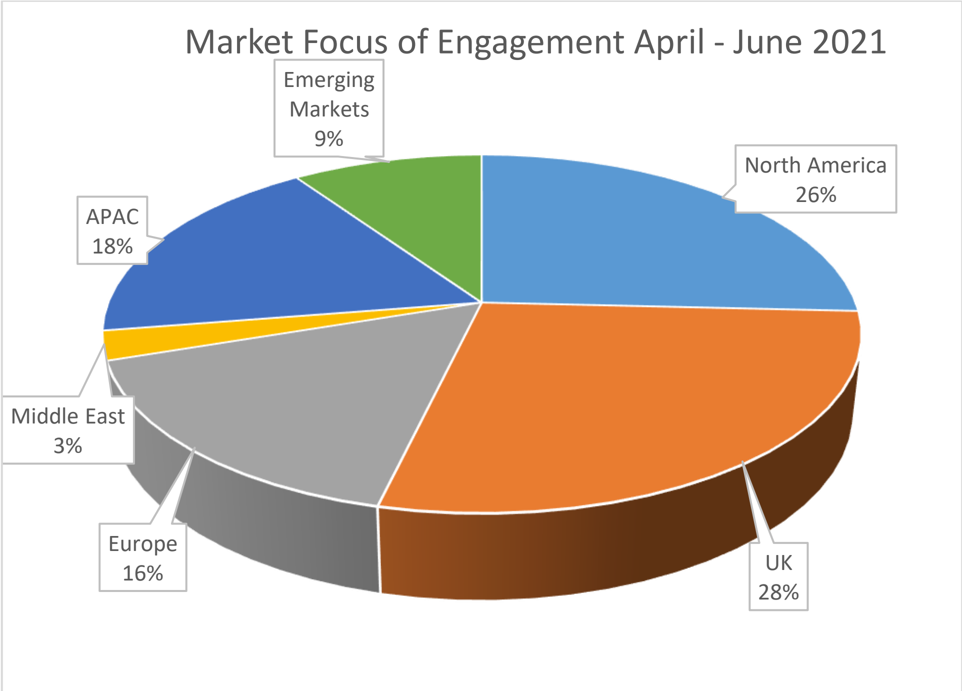
This disconnect between action and intention is a significant weakness in Shell's position a view subsequently supported by a Dutch court, and while the voting decisions by Border to Coast are not out of line with the current voting guidelines officers felt that on this occasion Shell's position did not meet the moment and risked longer term damage to shareholder value and therefore instructed that the Authority's portion of the Shell holding be voted against the first resolution and for the second, a position taken by around 11% of shareholders. Given our commitment to Net Zero we expect companies who are committed to Net Zero (as Shell are) to have targets which are fully reflected in and drive their business strategy, and the votes cast in this case reflect this.

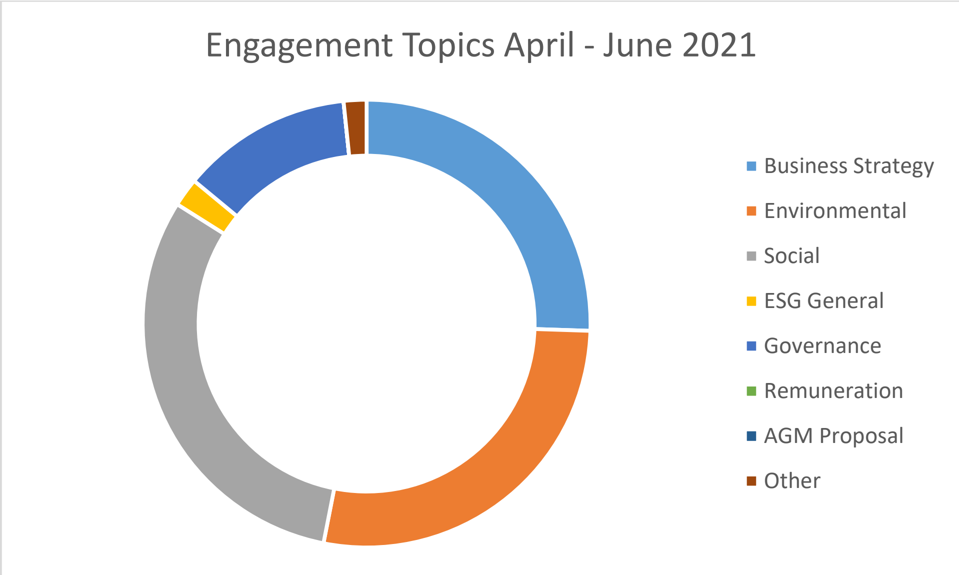
This is the first occasion on which any Border to Coast fund has exercised their right to a "split vote" out of several thousand votes cast since the company became operational in July 2018, and it should be emphasised that we were one of two funds to take this action on this occasion. This reflects the fact that rightly the bar for such a split should be high. As there was no protocol in place for a situation of this sort the Director informed the then Chair and Vice Chair of the action taken and included information in the next monthly update for Authority and Pension Board members. As the timescales involved in cases such as this are relatively short consultation prior to instructing the company is not practical. Should such a case occur again a similar approach will be followed.

Engagement Activity

Engagement is the process by which the Authority working together with other like-minded investors seeks to influence the behaviour of companies on key issues. Engagement (in distinction to voting) is an ongoing process and is undertaken by those directly managing money for the Authority such as the investment team at Border to Coast and the external managers in the Investment Grade Credit fund together with Robeco who act on behalf of Border to Coast and the Local Authority Pension Fund Forum which acts on behalf of all its member funds. The graphs below illustrate the scale and focus of engagement activity undertaken in the quarter.







Activity this quarter has seen an increased focus in Emerging Markets, which is to be welcomed as this is the portfolio area which contains the most holdings with low ESG scores.

In terms of topic focus of engagement activity there has been a significant increase in the environmental focus in part due to the various "Say on Climate" initiatives discussed above with a reduction in the level of focus on overall business strategy. While there has been some reduction in the level of interaction on social issues when compared to last year this is still at a materially higher level then pre pandemic.

More details of the engagement activity undertaken by Border to Coast and Robeco in the quarter is available here

During the quarter Robeco launched a new engagement theme focussing on labour practices in e-commerce, hospitality and on-line food delivery as the economy emerges from the pandemic. This is important because of the light which the pandemic has shone on the vulnerability and precarious employment status of many low wage workers in these sectors. Labour and human rights risks may expose companies to legal, operational, and reputational issues, while companies that manage these risks appropriately may benefit from brand value improvement, higher employer satisfaction and lower costs. The engagement is focussed on four major companies held within the Border to Coast portfolios (Amazon and Meituan in e-commerce, Intercontinental Hotels Group in hospitality, and Walmart in on-line food delivery). The engagement will be regarded as a success if the companies place labour practices and human capital strategies at the core of their corporate strategies mitigating the risk identified and therefore providing more sustainable outcomes for investors.

LAPFF has continued to work through the Climate Action 100+ collaborative group to engage with Arcelor Mittal on its climate transition plans and in particular moves to use hydrogen as a fuel within the steel making process, and also with National Grid which has now agreed a science-based target for reduction in its scope 3 emissions, which is a very significant development.

LAPFF has also continued its work in relation to mining and human rights. Many of the largest mining companies are facing very significant costs as a result of legal actions following their actions in relation to indigenous communities in various parts of the world. In some cases, these are safety issues such as lead poisoning in Zambia, sometimes issues around cultural sensitivity such as the destruction of culturally sensitive sites and sometimes failure to address issues such as some of the issues flowing from the tailings dam collapses. LAPFF is continuing to raise these issues and asking companies to quantify the impact of their actions or lack of action in terms of costs to the business which will have impacted shareholder value.

More details of the activity undertaken by LAPFF in the quarter is available here

Portfolio ESG Performance

Each of the equity portfolios is monitored by Border to Coast in terms of its overall ESG performance with data reported quarterly. This new section of the report provides a summary of performance and of changes over time. The full reports are available for members in the on-line reading room, but this summary provides a high-level indication of the position.

Overseas Developed

- Weighted ESG Score 6.6 (above benchmark) improved this quarter
- 35.1% of portfolio ESG leaders (better than benchmark)
- 3.4% of portfolio ESG laggards (better than benchmark)
- 7.1% of portfolio not covered (better than benchmark)
- Worst scoring companies 2.2% of portfolio
- Emissions better than benchmark on all metrics and reduced this quarter
- Greater weight of fossil fuel holdings than in benchmark
- 4 of the 5 top emitters highly rated on the Transition Pathway

United Kingdom

- Weighted ESG Score 7.6 improved since last quarter and maintained over benchmark position
- 60.4% of portfolio ESG leaders (better than benchmark)
- 0% of protfolio ESG laggards (better than benchmark)
- 8.7% of portfolio not covered (in line with benchmark)
- Worst scoring companies 1.8% of portfolio
- Emissions better than benchmark on all metrics and reduced this quarter.
- Lower weight of fossil fuel holdings than in benchmark.
- Top 5 emitters rated 4 or 4* (highest ratings) on the Transition Pathway

Emerging Markets

- Weighted ESG score 5.3 up in the quarter and increasing the gap to the benchmark
- 17.3% of portfolio ESG leaders (better than benchmark)
- 15% of portfolio ESG laggards (better than benchmark)
- 6.1% of portfolio not covered (worse than benchmark)
- Worst scoring companies 4.2% of portfolio.
- Emissions better than benchmark on all measures and significantly reduced this quarter.
- Greater weight of fossil fuel holdings than in benchmark.
- 3 of the top 5 emitters engaged with the Transition Pathway with one scoring 4.

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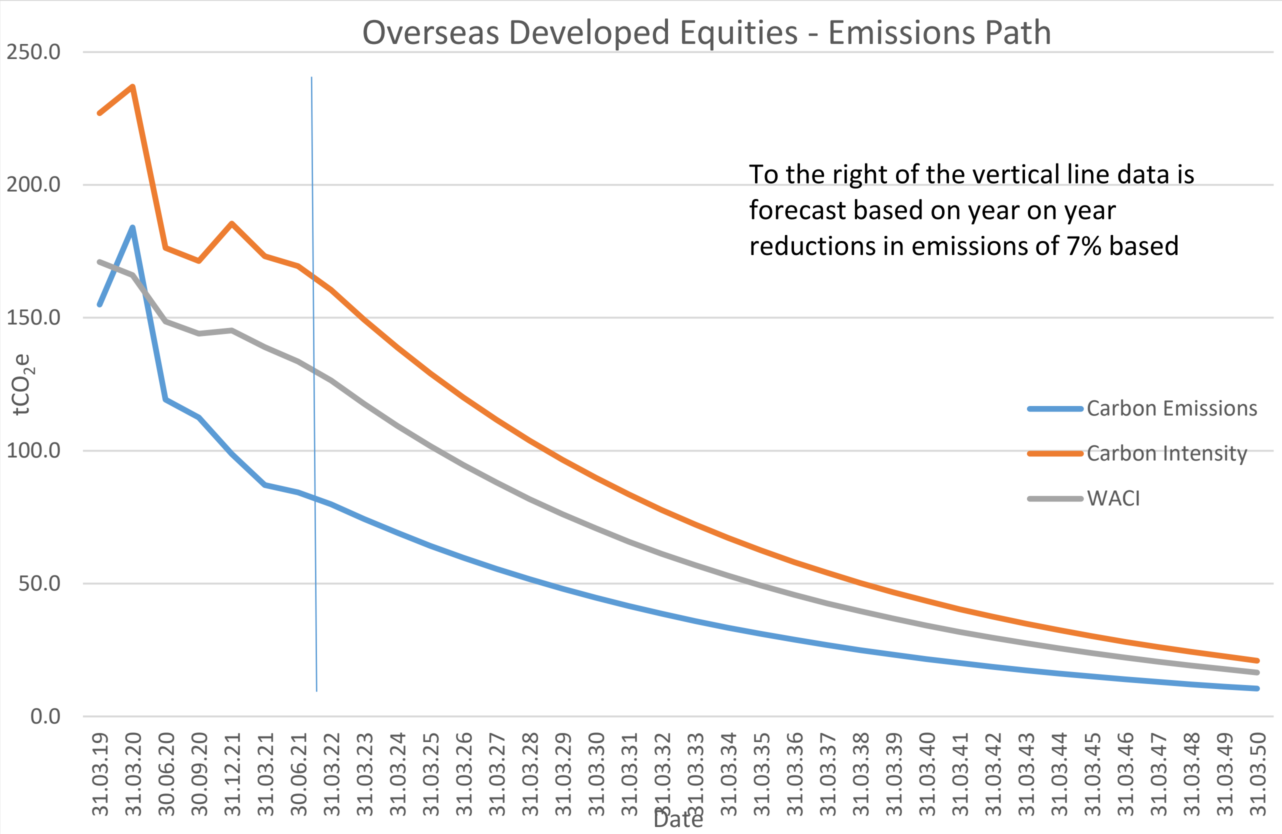
In general, this shows a positive picture with in general less exposure to companies with low ESG scores than in the benchmark indices and the worst scoring stocks representing a relatively small proportion of the overall portfolio. There are a number of further points that should be made for clarity.

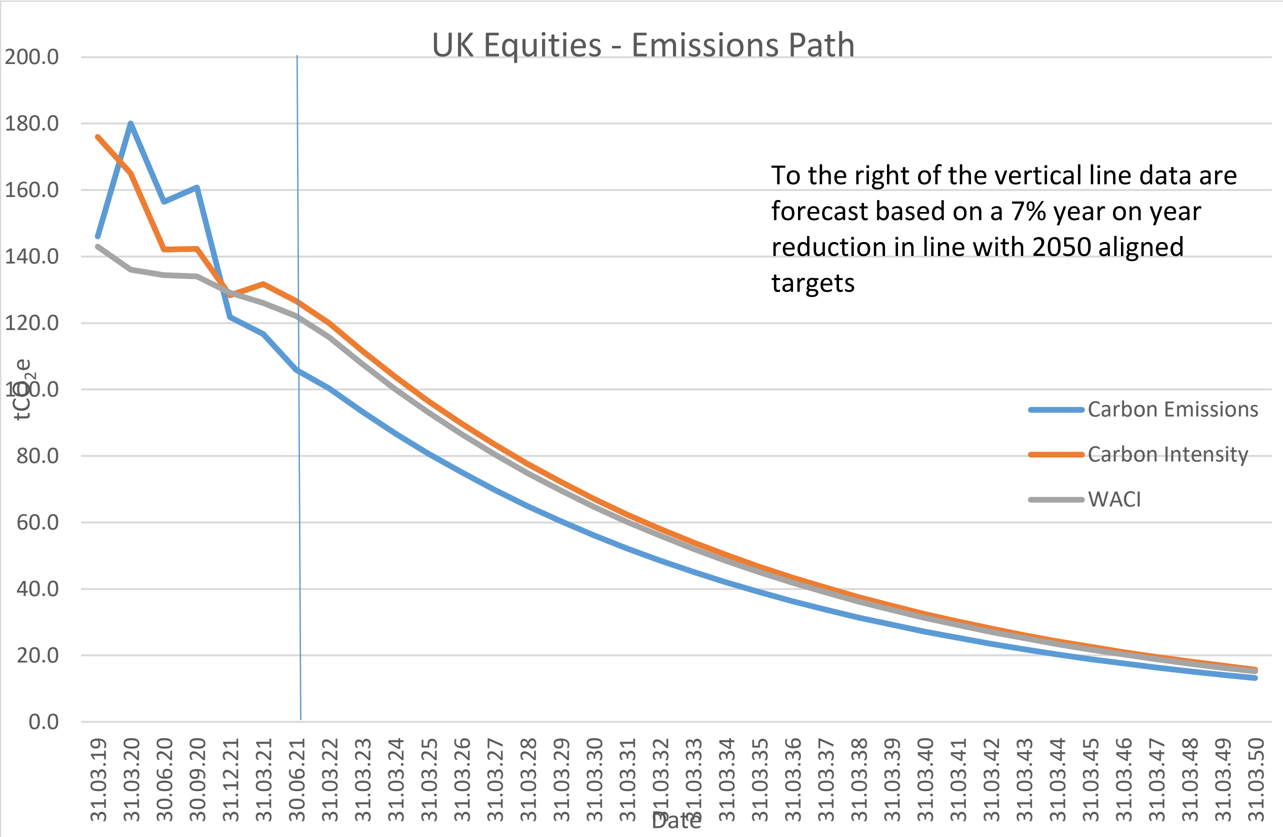
1. While the proportion of the portfolio not covered by ESG metrics is a significant piece of information provided it is within reasonable bounds it should not create issues. This reflects, for example the use of collective vehicles to achieve coverage of particular market segments (such as small cap companies). While Border to Coast will look to the managers of these vehicles to deal with ESG issues in the same way as them they are not rated in the same way as individual companies.
2. Coverage in some areas of the Emerging Markets is less comprehensive than in developed markets and also, although improving rapidly, the ratings generally do not start from as high a base.
3. The weight of holdings with fossil fuel reserves is a commonly used measure, however, given that 2 of the three funds have a greater weight than their benchmark but all three are now materially below their benchmarks on all three emissions metrics it does demonstrate that the level of emissions and the holding of fossil fuel reserves are not necessarily directly linked. However, this does indicate the potential exposure to stranded assets and is something that will be monitored going forward.
4. The Transition Pathway assessment is a key indicator of the likely progress of companies. Not unsurprisingly there is less coverage in the Emerging Markets and the assessments, in general, are less positive.

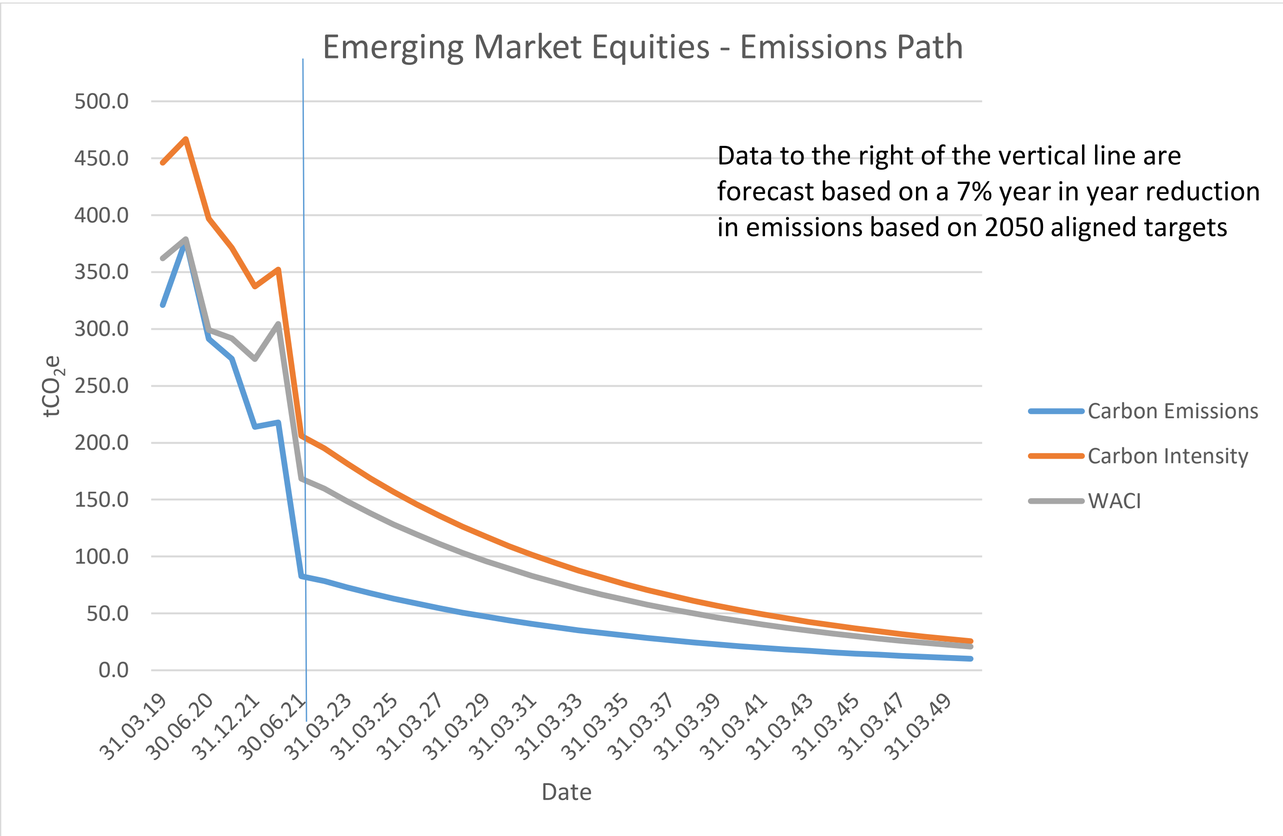
What is particularly noticeable this quarter is the impact on the Emerging Markets Fund of the introduction of the China specialist managers where the more detailed research that a specialist team can deliver is clearly influencing stock selection towards companies with better ESG credentials. While this was an expected impact of these changes the driver for them was to improve the overall investment performance of the Fund.

Progress to Net Zero

This new section of the report considers the progress of the three equity portfolios towards Net Zero using the emissions data provided on a quarterly basis by Border to Coast and projects progress forward using the 7%pa reduction required to deliver the 2050 Paris Agreement target. This is not scientific and as can be seen from the earlier parts of the graphs progress is unlikely to be linear, however, it does give a sense of the scale of the challenge we face in achieving Net Zero across this significant element of the portfolio.




UK Equities - Emissions Path
To the right of the vertical line data are forecast based on a 7% year on year reduction in line with 2050 aligned targets
Carbon Emissions
Carbon Intensity
WACI
tCO_2e
Date


Emerging Market Equities - Emissions Path
Data to the right of the vertical line are forecast based on a 7% year in year reduction in emissions based on 2050 aligned targets
Carbon Emissions
Carbon Intensity
WACI
tCO_2e
Date

While unlikely to be representative because of the impact of the pandemic the absolute emissions measure for each of the portfolios reduced by over 25% during 2020/21 with similar scales of reduction in the other measures. While clearly the pandemic has impacted the level of activity this is not the sole driver and there are some signs of positive action by companies beginning to have an impact on these metrics, and it is also encouraging that the gains made in the pandemic do not appear to be being given up as economic activity recovers, although given the lagging nature of these measures it may be a little early to come to a judgement on this,

What is also particularly noticeable in these data which reflect the position for the first quarter following the introduction of the specialist China managers to the Emerging Markets Fund is the significant reduction in all three measures for this fund, amounting to 62% for the absolute emissions measure. This reflects the impact that the more refined stock selection that these specialist managers are able to apply has on the nature of the underlying companies within the portfolio. While this results in all three metrics for this Fund now being in a similar range to the other two and this Fund now having the lowest absolute emissions following the stabilisation of the new pattern of holdings it is unlikely that future progress will be made is quite such dramatic steps.

At this stage without further action, it is, as anticipated, clear that the 2030 objective will not be achieved in relation to the equity portfolios in isolation. There are two steps which can accelerate progress without fundamentally challenging the overall investment strategy.

- Changes which are being worked on by Border to Coast to the way in which the equity products are managed in order to make the investment process more “climate aware”. These are now being actively discussed with partner funds and seem likely to result in more rapid progress in a positive direction through the application of interim emissions targets.
- The opportunity presented by the Investment Strategy Review following the 2022 valuation where we will have the opportunity to consider how much equity exposure, we need to maintain in order to meet the fund’s liabilities and also what the appropriate balance of exposures between the different markets is.

This element of our reporting will evolve over time and we will need, when available to consider how to bring data from other asset classes into the picture in order to achieve a “whole portfolio picture”. In the meantime, as equities are the largest single asset class exposure it makes sense to concentrate some effort in this area.

Collaborative Activity

This section focuses on the activity undertaken in the quarter through the various collaborations in which the Authority is either directly involved or indirectly involved through Border to Coast.

The Workforce Disclosure Initiative works in a similar way to a number of the early climate initiatives promoting transparency among companies about workforce issues to allow investors to understand more clearly whether the company faces significant risks as a result of its workforce practices.

The WDI has launched its findings report for its 2020 survey results. The survey covers topics including wage levels, staff turnover and workers' rights. 141 companies responded, up 20% from the previous year, with every economic sector covered. The high-level findings saw companies:

- Improving transparency on pay, with more progress needed to tackle inequalities.
- Having diversity and inclusion as priority areas.
- Making commitments to human rights, which are not always matched in practice.
- Are often not explaining how they are taking responsibility for their supply chains.

The 2021 survey is now underway with the target list covering over 1,000 companies. Border to Coast will again be engaging with a number of companies encouraging them to respond.

In their 2020 report, "Investing with Purpose", The Asset Management Taskforce (a group comprised of government, senior asset management representatives and other key stakeholders), recommended that a dedicated council representing UK pension schemes should be established to promote and facilitate high standards of stewardship of pension assets.

In response to this recommendation, the DWP has created the Occupational Pensions Stewardship Council, of which Border to Coast have joined as an inaugural member. The council provides a forum for sharing experience, best practice, and research, and providing practical support. The LGPS Scheme Advisory Board is also participating as an observer.

Policy Development

This section of the report highlights a number of the key pieces of policy related activity which have taken place during the quarter.

Impact Reporting
Over the quarter work continued with Minerva to put the groundwork in place for the Authority's first impact report. This has involved data gathering from fund managers, particularly across the alternatives portfolio. It had been intended to complete the report in June alongside the annual report, however, it is clear that it will take somewhat longer to get the required information from a sufficient proportion of the alternatives managers. It will be possible to include some highlights in the annual report but it makes sense to delay publication of the full impact report. This does not impact the statutory reporting processes, but it will put a delay in to our ability to assess the required "distance to travel" in terms of net zero.

Place Based Impact Investing
The Director has contributed to research sponsored by the Impact Investing Institute on Place Based Impact Investing. This work was published in a "White Paper" on 26th May and the Authority is quoted as a case study. A copy of the report has been placed in the on line reading room or is available through the Impact Investing Institute website here.

Net Zero Top Tips for Pension Scheme Trustees
The Prince's Accounting for Sustainability Project (A4S) has undertaken a study with a number of investors to produce some helpful suggestions for trustees as to how to approach the Net Zero discussion. SYPA alongside institutions such as NatWest, NEST and Scottish Widows was selected to provide a case study which is available here.

DWP Consultation on Social Impact
The DWP has launched a consultation aimed at private sector pension funds on the consideration of social impact. This follows on from the recent consultation on the recognition of climate risk by private sector funds. While an interesting development this does not seem to raise any specific issues for action by the Authority.

Introduction of TCFD Reporting to the Local Government Pension Scheme
MHCLG have indicated an intention to consult on regulations which will require LGPS funds to report in line with the requirements of the Task Force on Climate Related Financial Disclosure (TCFD). SYPA has done this for a number of years and the work that is being undertaken with Minerva is intended to improve the level of disclosure we can provide. It is likely that we will need to commission external resources to undertake further scenario analysis to address gaps in what we are currently able to produce, however, this is more a consequence of SYPA improving its reporting as part of our pursuit of net zero than a consequence of the new regulations.

Improvements to the Responsible Investment Approach for the Commercial Property Portfolio
Discussions have been held with ASI the Authority's commercial property manager to secure improvements in the reporting of ESG metrics in relation to the property portfolio. Previously the ability to report on these metrics was limited by the arrangements with the managing agent. These have been addressed in the new contract, which is now operational, although it will take some time to complete the initial data gathering. This work is intended to support an improvement in the portfolio's score on GRESB (the Global Real Estate Sustainability Benchmark), although because of the timescales for data gathering it is expected that the full impact of the work will only come through in the 2022 exercise. However, a material improvement in the average energy performance rating of the portfolio is expected during this financial year.

National Framework for Stewardship Services
The current national LGPS procurement framework for stewardship services which covers voting and engagement services as well as projects such as the Impact Reporting project being carried out by Minerva, which was procured under the current framework, is due for renewal. The Director has agreed that the Authority should act as a founder for the new framework and is participating in the steering group which is overseeing the procurement process.

As the data provided by Border to Coast in relation to ESG scores and carbon emissions is provided by an external third party the following legal wording is required to be included within this report.