Border to Coast Pensions Partnership Ltd Joint Committee

Date of Meeting: **23rd November 2021**

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 are reviewed annually and updated as necessary through the appropriate governance channels. The process for review includes the participation of all the Partner Funds 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. Policies have also been reviewed against asset managers and asset owners seen to be RI leaders.

1.3 Responsible Investment workshops are held at regular intervals for the Partner Fund Officers and the Joint Committee to discuss RI topics and issues to be included in the policy review. Topics covered included the development of the Climate Change Policy, Net Zero, the approach to exclusions and refreshing the priority engagement themes.

1.4 The annual review and governance processes need to be completed, with policies approved and ready to be implemented ahead of the 2022 proxy voting season. Partner Fund Officers have provided feedback on the proposed revisions and suggested amendments. After the Board's review, they will be shared with the Joint Committee for discussion prior to review at Pension Committee meetings.

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.

3 Background

3.1 As a responsible investor we practise active ownership, using our voting rights and engaging with investee companies 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 review in 2020 identified the need for a standalone Climate Change Policy which has been developed outside the normal RI Policy review period and was approved by the Board on 21st September and shared with Partner Funds via the Joint Committee.

3.3 The Climate Change Policy includes specific exclusions covering companies with >90% of revenue from thermal coal and tar sands. This is the first time we have had exclusions and considerable engagement was undertaken with Partner Funds on this issue. The approach to exclusions is articulated in the revised RI Policy (Appendix 1).

3.4 The rationale for more specific exclusions in the policy included the enabling of better engagement with private market managers. Exclusion of certain types of investments in Private Markets typically forms part of the side letter negotiations with the investment manager. Where an investor can point to a policy that explicitly excludes certain types of investments there is a greater probability of this being accepted by the investment manager.

3.5 The original priority engagement themes of Governance, Diversity, and Transparency and Disclosure were decided prior to launch in 2018. To reflect our growth and maturity as an organisation and the evolving nature of environmental, social and governance issues, the decision was taken to review the engagement themes (see section 6). The final four themes have been included in the RI Policy.

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 annual review process commenced in July to ensure any revisions are in place ahead of the 2022 proxy voting season.

4.2 Current policies were evaluated by Robeco, our voting and engagement provider, considering the global context and shift in best practice. This included consideration of the recently revised International Corporate Governance Network[1] (ICGN) Global Governance Principles, the UK Corporate Governance Code and the UK Stewardship Code.

4.3 The policies of best-in-class asset managers, and asset owners considered to be RI leaders were also consulted to determine how best practice has developed. Policies assessed included RLAM, LGIM, NZ Super, NEST and Brunel. We have also taken into account the Investment Association Shareholder Priorities for 2021.

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[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.

4.4 There were some areas highlighted as part of last year's review that were due to be addressed during 2021. Transition risk and scenario analysis being one area. Following the ESG/carbon data procurement and appointment of successful providers we will be able to conduct scenario analysis from early next year. We are also looking at how we can support Partner Funds in their TCFD reporting and this has been considered in the procurement.

4.5 One other area was exclusions. As we advocate engagement over divestment, we have previously not had any exclusions in place. Development of the Climate Change Policy has, however, led to the exclusion of companies with >90% of revenues derived from thermal coal or tar sands. Any exclusions must be explicit for them to be adopted by our private market managers. Considerable engagement has been conducted with Partner Funds to reinforce our active stewardship approach and dispel any concerns that we were being influenced by pressure group lobbying.

4.6 RI workshops have been held during the year for the Joint Committee at which we covered the Climate Change Policy, exclusions and engagement escalation. We also covered the engagement theme review process and the potential long list of themes. Feedback was received from Partner Funds on their preferences for key themes to be taken forward.

4.7 A workshop was held with the officers of the Partner Funds on 5th October. The proposed revised RI Policy and Voting Guideline were shared with Officers and feedback and comments were received. Feedback on the RI Policy covered climate change exclusion wording, and on the Corporate Governance & Voting Guidelines comments on diversity. These points along with the other proposed revisions to both policies were discussed, and amendments have been made to the draft policies.

4.8 After considering feedback from the Officer Operation Group, the policies were re-presented to the Investment Committee, which recommended the proposed amendments to the Board. Both policies were approved by the Board on 11th November.

4.9 The annual review and governance processes need to be completed, with policies approved and ready to be implemented ahead of the 2022 proxy voting season. After considering feedback from the Officer Operation Group and the Investment Committee, the revised policies were approved by the Board on 11th November.

4.10 We have asked Partner Funds to complete their review by the end of 2021 so that we are able to carry out this implementation and disclose our voting intentions to companies prior to the peak season.

5 Key changes

5.1 This year's RI Policy review reflects work undertaken during the year, including the development of the Climate Change Policy and associated exclusions, and the refreshment of the key engagement themes. All changes are shown as track changes in the attached Appendix 1.

5.2 Diversity and diversity of thought on boards and senior executive teams are significant for good governance of an organisation. We consider this in our Voting Guidelines, and this also needs to be reflected in the RI Policy. Wording has been added in the 'Introduction' section on the importance of diversity.

5.3 Real estate is an asset class which we are looking to launch towards the end of 2022 and is therefore covered by the revised RI Policy which will be live from January 2022. A new section has been inserted under 'Integrating RI into investment decisions' which covers the RI approach for the fund selection process. A more detailed policy will be developed with assistance from the third-party property manager, once they are in place.

5.4 Due to the development of a standalone Climate Change Policy, the respective section within the RI Policy has been reduced and the new policy signposted.

5.5 We note that there is a lack of consistency across asset owners and managers when it comes to referencing exclusions. Some include exclusions within their main RI Policy whilst others have separate policies for each individual issue. As exclusions have been referenced in the Climate Change Policy, a paragraph has been added to the climate change section (5.6) of the RI Policy covering our approach.

5.6 The priority engagement themes have been reviewed this year using the newly developed framework. This is the first time we have reviewed our priority themes; the process we undertake has been described in the RI Policy and the new themes have been included. More detail is included in section 6.

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

Section	Page	Type of Change	Rationale
1. Introduction	2	Addition	Include wording on diversity/diversity of thought.
5.4 Integrating RI into investment decisions – Real estate	5	Addition	New asset class.
5.6 Climate change	6	Revision	Section edited as Climate Change Policy details our approach.
5.6 Climate change	6	Addition	Wording on exclusions covered in Climate Change Policy.
6. Stewardship	8	Revision	Explanation on UK Stewardship Codes signatory status.
6.2.1 Engagement themes	11	Addition	New section on key engagement themes and review process.

5.8 The Corporate Governance & Voting Guidelines have been reviewed by Robeco considering best practice. Asset owner and asset manager voting policies and the Investment Association Shareholder Priorities for 2021 have also been used in the review process. There are several minor amendments including proposed additions and clarification of text. All changes are shown as track changes in the attached Appendix 2.

5.9 We consider diversity in its broadest sense, not just gender or ethnicity to ensure boards have diversity of thought and experience. This has never been more compelling and highlighted by the pandemic with the need for companies to adapt and be innovative in order to be resilient and survive for the long-term. Diversity throughout the organisation is also important to attract and retain staff, improve productivity and profits, and develop a diverse pipeline of talent.

5.10 Gender diversity on boards has improved but Hampton-Alexander Review's initial target year of having 33% female representation on boards was 2020. Research shows that the benefits of diversity are greatest when female representation is above the 30% level, it is therefore appropriate to take a stronger voting stance now across developed markets and to ask for 33%, rather than rounding down to 30%. We will still be flexible in our approach especially for emerging markets and Japan, where the expectation is for companies to have at least one female on the board.

5.11 The Parker review published its report into ethnic diversity of UK boards in 2017. The recommendations were for FTSE 100 companies to have at least one director of colour by 2021, with the same target for FTSE 250 companies by 2024. Although progress has been made companies have had four years to put plans in place. We propose being more specific in our voting intentions by voting against the chair of the nomination committee for FTSE 100 companies where this recommendation has not been met unless there are mitigating factors or plans have been disclosed.

5.12 Lobbying by companies or trade associations in relation to climate change is a real concern. Some trade associations are taking anti-climate positions which not all their members purportedly subscribe to. This is to the detriment of companies whose operations and supply chains are threatened by the climate crisis. To stay below a 1.5°C temperature rise we need companies to align their climate actions and policies to the Paris Agreement. We will therefore support shareholder resolutions regarding lobbying activities in relation to climate change.

5.13 We continue to strengthen the Voting Guidelines on climate change and this year we have added voting against the Chair of the board where a company fails the first four indicators of the Climate Action 100+ Net Zero Benchmark, launched earlier this year.

5.14 Proposed amendments to the Corporate Governance & Voting Guidelines are highlighted in the table below:

Section	Page	Type of Change	Rationale
Diversity	5	Addition	Strengthening position on ethnic diversity at FTSE 100 companies.
Long-term incentives	8	Clarification	Splitting out executives from other employees.
Directors' contracts	8	Clarification	Executive pensions.
Lobbying	10	Addition	Company stance on climate change lobbying.
Shareholder proposals	12	Clarification	Shareholders' best interests.
Climate change	12	Addition	Strengthening voting stance to include CA100+ net zero benchmark indicators.

5.15 The policies were presented to the Board on 11th November and the revisions approved. There is then a period where Partner Funds take the revised policies to their committees to begin their internal alignment process. The revised policies will be effective from 1st January 2022.

6 Engagement theme review

6.1 In 2018 we set our three priority areas for engagement with portfolio companies. These are 'Governance', 'Diversity' and 'Transparency and Disclosure'. Whilst we recognise that these areas continue to be important, we wanted to reflect our growth and maturity as an organisation and review the themes whilst also considering the views of our Partner Funds. We developed an Engagement Themes Framework consisting of four stages, to assist with the process and set our themes for the next strategic period.

6.2 The initial 'long list' of 9 potential themes was shared with the Investment Committee in April and the Board in May. Input from the Partner Funds was received via workshops held for the Officers Operation Group and Joint Committee; this was shared with the Board. Feedback from Partner Funds and the Board was then used to identify four themes to take forward to the final stage (defining objectives and milestones).

6.3 Further work, and analysis was done to determine the overall engagement objective, core objectives to be measured and the approach we will take. Assistance was also provided by Robeco. The four final themes were presented to the Board on 11th November and approved.

6.4 The four final themes with high-level aims are as follows:

6.5 **Low Carbon Transition:** Climate change is a systemic risk with potential financial impacts associated with the transition to a low-carbon economy and physical impacts under different climate scenarios. Transition will affect some sectors more than others, notably energy, utilities and sectors highly reliant on energy. The focus will be on the big carbon emitting companies and banks.

6.5.1 **Engagement objective:** Climate change is a systemic risk that poses significant risks and opportunities for our portfolio investments. In high emitting sectors companies need to adapt and, in some cases, fundamentally change their business models. The aim of this engagement is to focus on the companies in high emitting sectors and banks identified as key to financing the transition to a low-carbon economy, to commit to credible plans to meet net-zero targets.

6.6 **Waste and Water Management:** The focus is on companies assessed as having high exposure to water-intensive operations and/or producing high levels of packaging waste and plastic pollution.

6.6.1 **Engagement objective:** Water is becoming an increasingly scarce and costly resource and a material financial risk for companies and investors. Packaging waste is a huge environmental problem with increasing regulation. This engagement theme will focus on engaging portfolio companies with high exposure to water-intensive operations, exposure to operations producing high levels of packaging waste to develop policies and initiatives to address the issue(s).

6.7 **Social Inclusion through Labour Management:** This theme seeks to blend two of the previous proposed themes around Social Inclusion and Supply Chain Management. The focus is on companies assessed as having high exposure to labour intensive operations, those scoring lower on human capital development and those that are scoring lower on supply chain labour management. This includes engaging with companies on modern slavery policies.

6.7.1 **Engagement objective:** Human capital management and supply chain issues are recognised as financial risks emphasised by the pandemic. Engagement will be with companies with high exposure to labour-intensive operations and lower scoring companies in relation to human capital development and supply chain labour management risk. The aim is to promote sustained, inclusive growth with productive and decent work for all, including elimination of child labour in supply chains.

6.8 **Diversity of Thought:** The focus will be on companies that have been flagged as not having diversity management programs in place, including UK companies that are not meeting the recommendations of the Hampton Alexander and Parker Reviews where we believe we hold sufficient market cap to have an influence.

6.8.1 **Engagement objective:** The need for diversity of thought and experience on boards has never been more compelling. The pandemic has caused massive economic disruption with companies needing to be able to adapt and be innovative in order to be resilient and survive for the long-term. The focus of this engagement is to enhance the diversity of boards reducing the risk of 'group think' leading to better decision making and wider diversity across the organisation to increase the resilience and long-term sustainability of companies. To ensure a pipeline of diverse talent is being developed and utilised, this engagement will also cover improving the approach to building diversity and inclusion in executive committees, other senior leadership roles and throughout the workforce.

7 Financial implications

7.1 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 staff through attendance at conferences and specific training events

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. Increasing regulation and pressure from beneficiaries and stakeholders has propelled RI and ESG up the agenda for investors and our Partner Funds. There may be reputational risk if we are perceived to be failing in our commitment of this objective.

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 all Partner Funds are in agreement.

8.3 The increasing commitment to engage on diversity may shine a light on Border to Coast's own progress in this area. We note that this is an area of focus for the Board's Remuneration and Nominations Committee.

9 Conclusion

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

10 Author

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11th November 2021

11 Supporting Documentation

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