SOUTH YORKSHIRE
PENSIONS AUTHORITY

Responsible Investment Update Quarter 2 2022/23

November 2022

Contents

Highlights and Recommendations

Highlights over the quarter to the end of June include:

- A reduced level of voting activity following the passing of peak voting season
- A similarly reduced level of engagement activity following the passing of peak voting season although with continuing focus on the priority environmental and social issues.
- The broad ESG performance of the equity and corporate bond portfolios is consistent with previous periods and at least matches the position of the benchmark index.
- Significant reductions in market values have distorted some of the carbon emission metrics for the quarter.
- Achieved 3 Stars in the latest GESB assessment of the Commercial Property portfolio, reflecting the significant improvement in data gathering in this area.
- The Authority has disclosed its first round of emissions reduction targets through the IIGCC's Paris Aligned Asset Owner Initiative.

The Authority are recommended to note the activity undertaken in the quarter.

Background

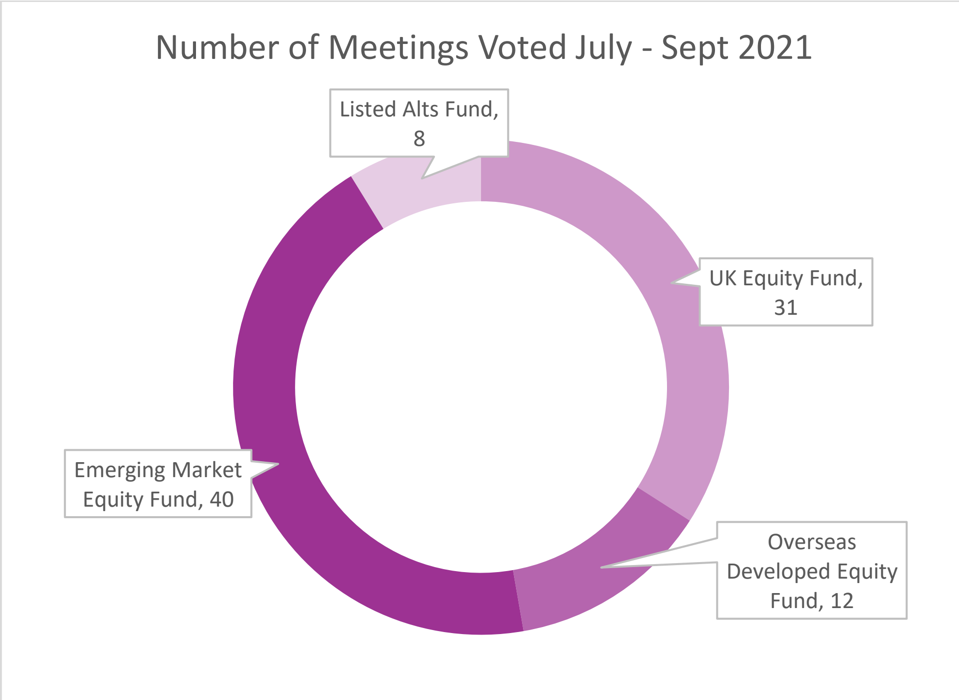
The Authority has developed a statement which sets out what it believes Responsible Investment is and how it will go about implementing it within its overall approach to investment. This statement is set out in the Responsible Investment Policy which is available on the website here.

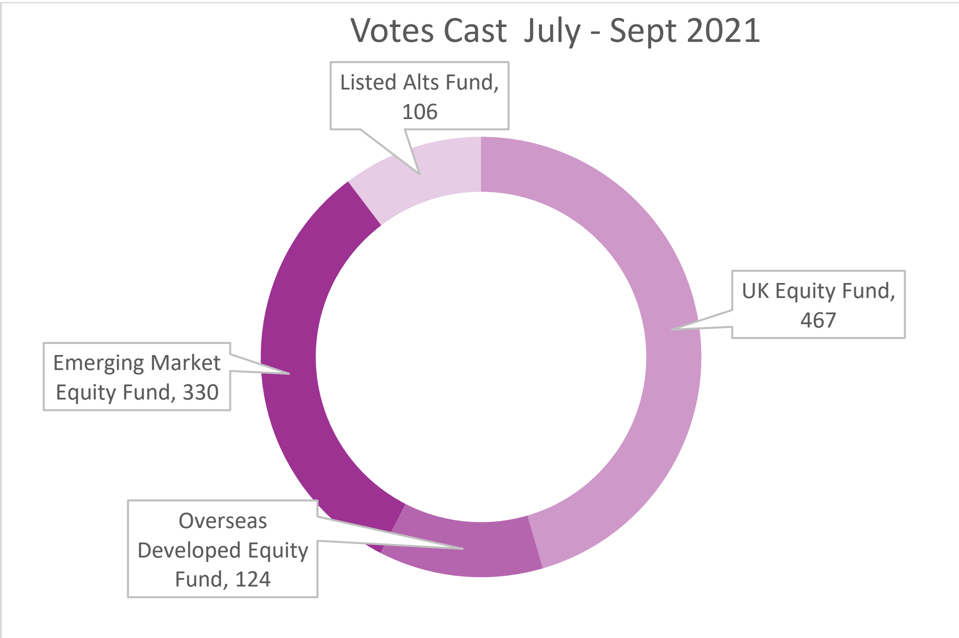
Our approach is largely delivered in collaboration with the other 10 funds involved in the Border to Coast pool. This report provides an update on activity in the last quarter covering:

- 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, and on the commercial property portfolio.
- 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.
- Stakeholder Interaction – There is considerable interaction between the Authority and stakeholders around responsible investment issues which is summarised for wider accountability purposes.
- 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

This quarter saw a significant reduction in both the number of meetings and votes cast as we move past peak voting season, with the number of votes cast being around 16% of the level seen in the last quarter. Detailed reports setting out each vote are available on the Border to Coast website here.





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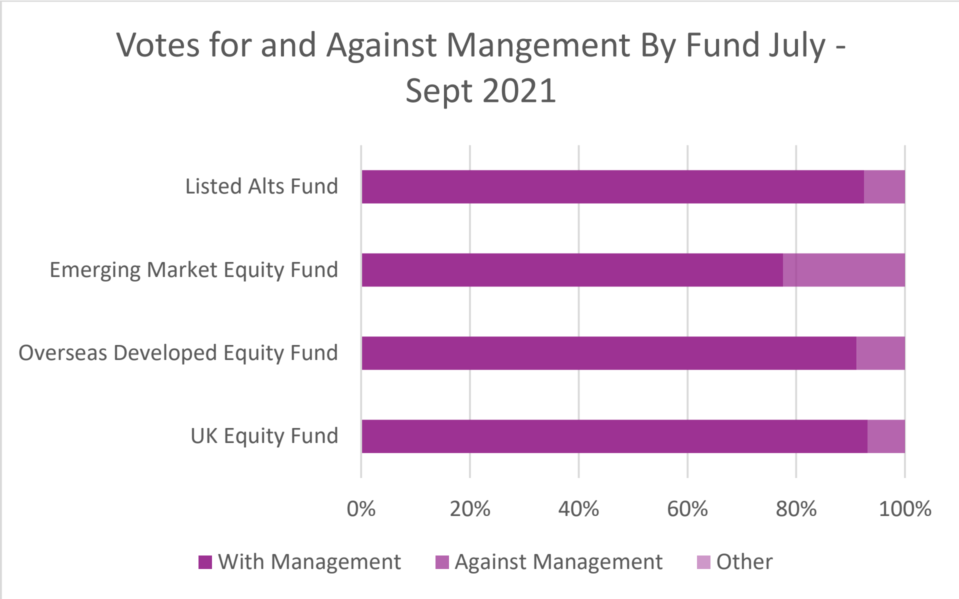
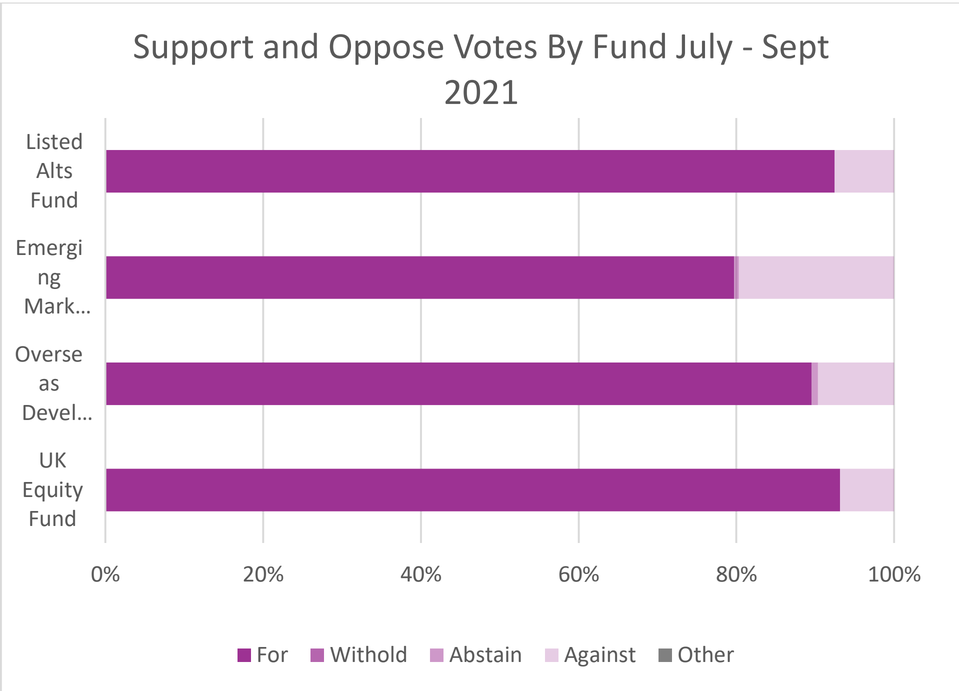
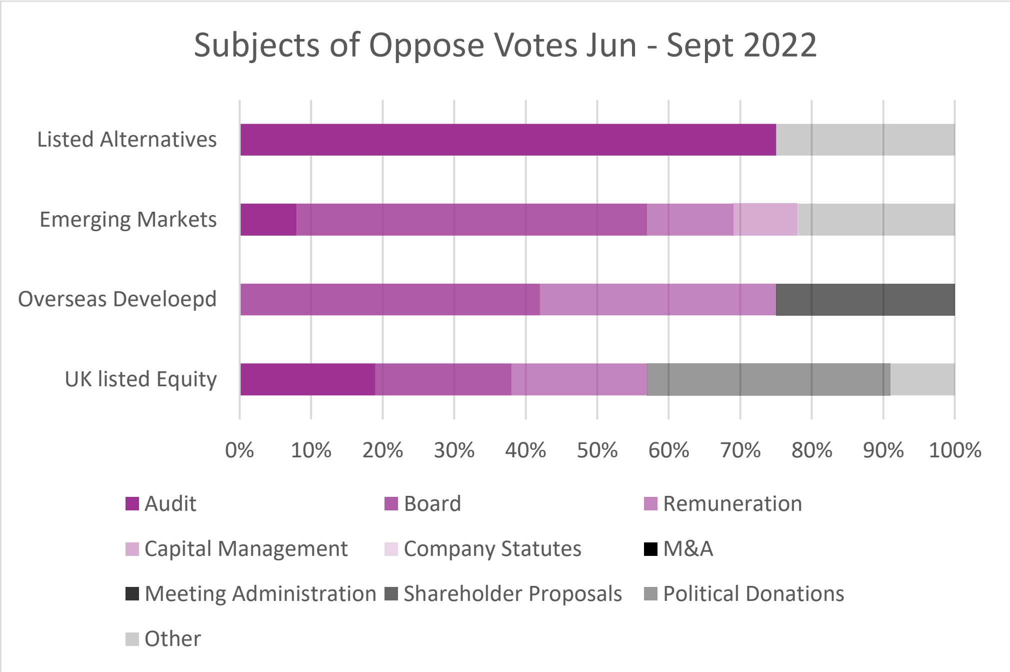
The pattern of support and oppose votes and votes for or against management is shown in the charts below.





This shows a continuing slight increase in the number of votes cast both against resolutions and against the line taken by company management. As has been previously reported this reflects the "ratcheting up" of the voting guidelines in a number of areas, as can be seen from the analysis below of the subjects of oppose votes.



This indicates that votes against are more evenly distributed across topics in the developed markets than in the emerging markets as listed alternatives funds. In some cases this will be because shareholder proposals are not allowed in some markets. The three largest areas where we have opposed management relate to Board composition, Auditor appointments and remuneration, and it is worth rehearsing the reasons why this is the case.

- In the case of Board composition there are a number of things which under the voting guidelines automatically trigger an oppose vote. These include insufficient independence, insufficient diversity within the Board, and insufficient progress in terms of adapting the business to the risks posed by climate change.
- Auditor appointments are automatically opposed if reappointment would result in an unduly long term which is viewed as compromising the auditor's independence.
- In the case of remuneration votes against are triggered by executive pay packages which are either excessive in absolute terms and/or where incentive packages are not aligned with shareholder interests and/or the performance targets are poorly defined or too easily achieved.

Shareholder resolutions as can be seen from the information on notable votes in these reports can cover a whole range of issues but in the last year the focus other than on climate issues has tended to be on diversity and human rights issues particularly for US companies. The voting policy does not automatically support such resolutions and analysis is undertaken of both the company's and proponents positions before votes are decided by Border to Coast on the advice of Robeco.

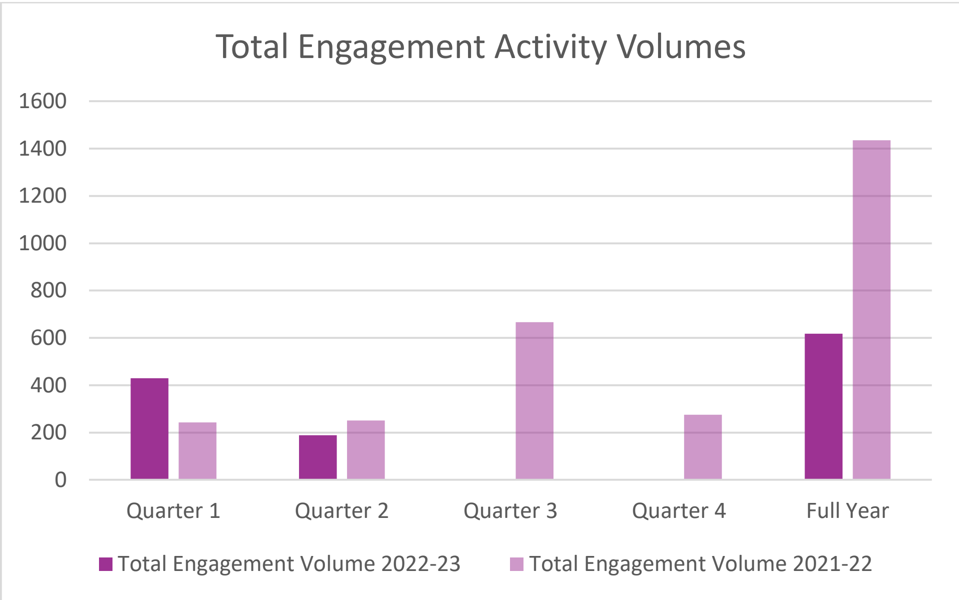
Notable votes in the quarter are set out in the box below.

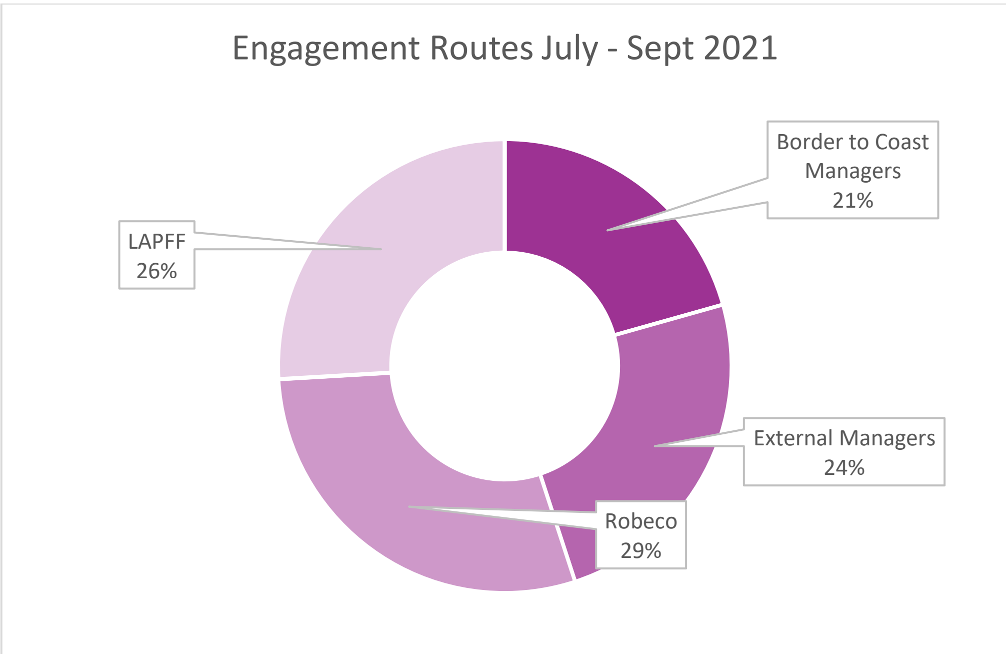
Alibaba Group is held in the Emerging Market Fund and is viewed as the "Chinese Amazon". The focus at the AGM was on the election of directors where the Founders of the Company are able to nominate a majority of the Board, which is not in line with the governance principles in our voting guidelines. We voted agains both the Chair and Chair of the Nomination Committee on the grounds of lack of Board diversity and independence. This was intentded to spur the Company to further improvement as it looks to move its primary listing to Hong Kong

Nike is held in the Overseas Developed Fund and is a global manufacturer of sportswear. THe 2022 AGM saw two particularly significant resolutions. The first was "Say on Pay" which once again drew significant opposition (up to 35% from 28% last year) based on the magnitude and structure of executive pay and incentive schemes. The second resolution sought to pause the sourcing of raw materials from China in light of current US Government advice. We abstained on this resolution as while we consider that the risks relating to China should be addressed a pause of this nature is not the only route to achieve this.

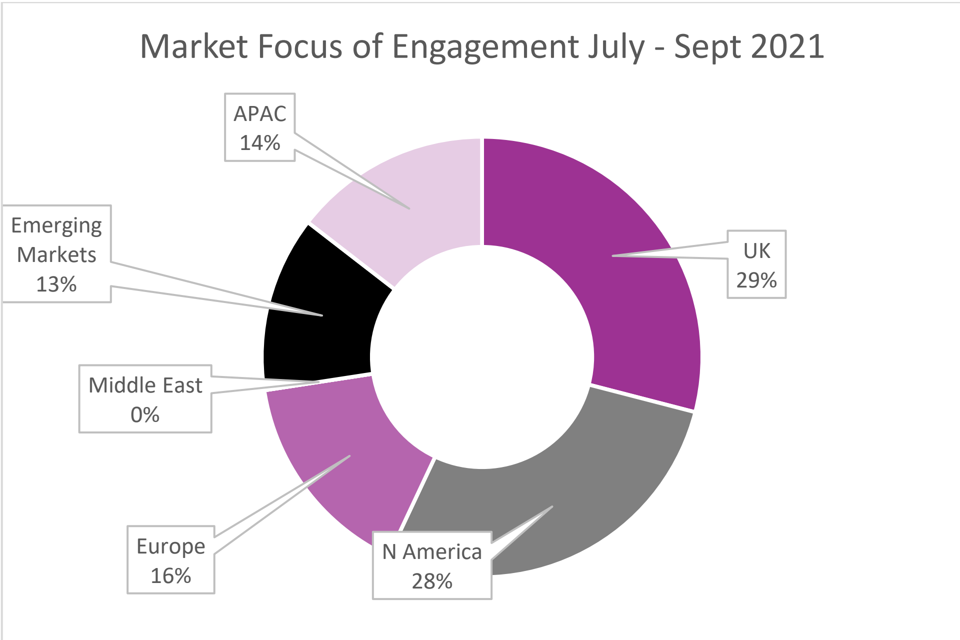
Engagement Activity

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 (in terms of the total number of pieces of engagement activity), the route for and the focus of engagement activity undertaken in the quarter, as well as the method of engagement undertaken.



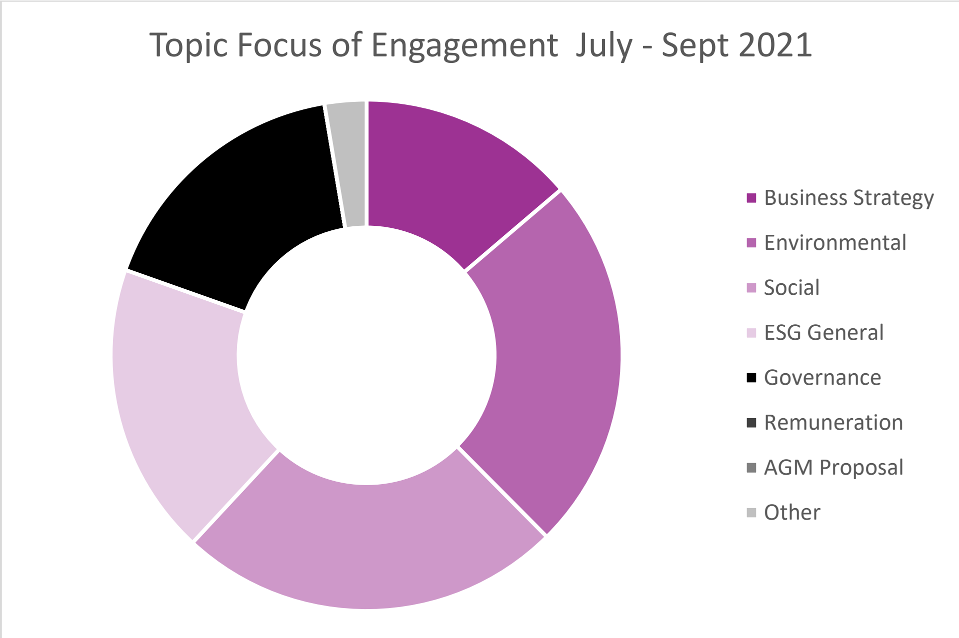


As can be seen the level of engagement activity in the quarter has reduced compared to the previous quarter with the passing of peak voting season, while there has been an increase compared to last year in the proportion of activity being carried out by Border to Coast, Robeco and the external managers with the proportion of activity being carried out by LAPFF reducing following the peak associated with CoP 26 in Glasgow.

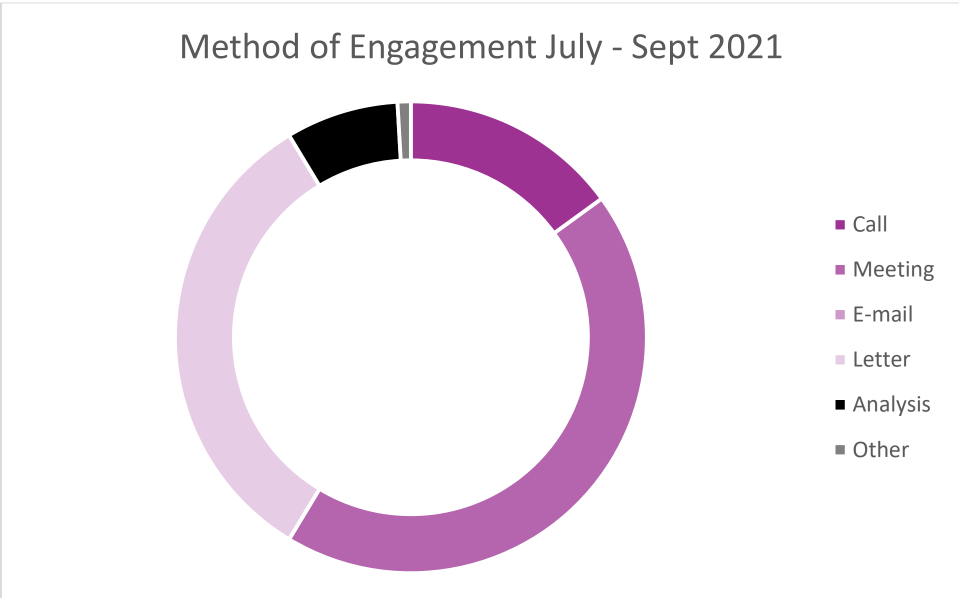


The market focus of engagement continues to normalise following last year’s disproportionate focus on the UK in the lead up to CoP 26 with the distribution now better reflecting the geographic distribution of holdings, although the UK continues to be overrepresented as our home market where it is easier to engage with companies.

The range of topics covered through engagement is set out in the chart below with a continuing strong focus on environmental and climate issues although social issues continue to receive a significant degree of focus. Again, following the CoP 26 peak there is a more even spread of focus across issues although given the passing of peak voting season remuneration was not a topic of any engagement this quarter.



The method by which companies are engaged is important. Letters and e mails are much more easily ignored or likely to generate a stock response from companies whereas calls or meetings allow for genuine interaction with the company.



This shows the continuation of the positive trend of the previous quarter towards forms of engagement which allow genuine interaction with the Company.

More details of the engagement activity undertaken by Border to Coast and Robeco in the quarter is available here. Significant aspects of this work in the quarter include:

- Work on natural resource management in particular addressing the negative impacts of intensive water use and waster generation (reflecting one of the priorities for engagement identified by SYPA) focussing initially on six companies with high water consumptions and operating in areas of water stress.

- Ongoing engagement with financial institutions around the financing of the climate transition, where initial assessments have indicated that alignment of plans with credible net zero trajectories is relatively low, in part due to the lack of disclosure of emissions data throughout loan books but also due to insufficient target setting. The next stages of this work include setting clear expectations for financial institutions which should, for example, include specific policies on the financing of new fossil fuel exploration. While there has been some progress particularly in the area of governance future work will push for improvements in scenario analysis and sector decarbonisation strategies.

During the quarter a new engagement theme on Diversity and Inclusion (D&I) was launched by Robeco focused on increasing diversity within the workforce. The intention is for this engagement to run continuously, rather than for the usual three-year period, gradually increasing coverage.

This engagement theme will support our priority theme of Diversity of Thought which is running for the next three years.

Why is this important?
The COVID-19 pandemic and a renewed focus on racial injustices have brought a heightened emphasis on diversity and inclusion within companies, institutions, and society more generally. Diversity of thought and experience on boards is significant for good governance, it reduces the risk of ‘group think’ leading to better decision making. There can be a positive impact on corporate performance, where benefits can be seen from recruiting and retaining talent, enhancing corporate reputation, and improved decision-making. Building an inclusive and diverse workplace creates a positive impact on the workforce leading to enhanced productivity. Therefore, human capital management strategies, which include diversity and inclusion, are important in determining a company’s underlying quality and value and factors that investors should integrate into their investment decisions making.

How will companies be assessed for engagement?
Insufficient data is the main challenge identified by investors when assessing companies’ efforts on diversity and inclusion. This can be an additional challenge due to the regulations in different jurisdictions where it is not permitted to gather certain types of data due to privacy restrictions. To determine which companies to consider as potential engagement cases, industries were identified that were seen as laggards in disclosing data on diversity. Then the Principle Adverse Impact (PAI) indicators, which are part of the EU sustainability reporting requirements, were assessed using third-party data. The 20 industries with the lowest levels of disclosures were prioritised for engagement.

What are the objectives?
Five engagement objectives have been formulated to facilitate engagement and dialogue with companies. These include:

- Developing a D&I policy with time-bound goals
- Defining and aligning strategies for talent management, covering recruitment, development, performance, and succession planning
- Disclosing workforce diversity data
- Undertaking pay equity audits
- Promoting an inclusive culture

More details of the activity undertaken by LAPFF in the quarter is available here. Key issues being worked on include:

- Continued engagement over the impact of tailings dam collapses over communities in Brazil which was furthered through direct engagement with both the affected communities and Vale during a visit to Brazil by the Forum's Chair. This visit also provided the opportunity to develop relationships with local asset owners and asset managers who will be more able to maintain consistent pressure on the companies than LAPFF can from a distance.
- Power Companies – The Forum noted significant progress with the transition plans of both National Grid (in the UK) and SSE with both companies adopting genuine science-based targets for the achievement of Net Zero.
- Electric Vehicle Manufacturers – The Forum has engaged with manufacturers around the responsible sourcing of minerals for batteries, which has the potential to negatively impact the Just Transition.
- Extending the work of the 30% Club on diversity on to a global stage where a process of engagement with three companies has begun.
- Joining in with and supporting work by the Australian Strategic Policy Institute (ASPI) on Uyghur forces labour in China.

Portfolio ESG Performance

Equity Portfolios

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

Overseas Developed

- Weighted ESG Score 7.2
- 42.0% of portfolio ESG leaders v 43.0% in the benchmark.
- 1.5% of portfolio ESG laggards v 2.2% in the banchmark.
- 5.1% of portfolio not covered all of which are investment trusts etc higher than benchmark
- Worst scoring companies 1.1% of portfolio
- Emissions below benchmark on all metrics.
- Weight of fossil fuel holdings greater than benchmark
- All 5 top emitters rated on the Transition Pathway with 2 scoring 4

United Kingdom

- Weighted ESG Score 7.9
- 71.4% of portfolio ESG leaders v 69.1% in the benchmark
- 0% of portfolio ESG laggards v 0.1% in the benchmark
- 7.9% of portfolio not covered mainly investment trusts marginally less than benchmark
- Worst scoring companies 6.5% of portfolio but all Average companies
- Emissions belpw benchmark on all measures
- Less weight of fossil fuel holdings than in benchmark.
- Top 5 emitters all rated 4 or 4* (highest ratings) on the Transition Pathway and all engaged through Climate Action 100+

Emerging Markets

- Weighted ESG score 5.5
- 24% of portfolio ESG leaders v 18.8% in the benchmark
- 16.6% of portfolio ESG laggards v 16.0% in the benchmark
- 5.0% of portfolio not covered largely investment trusts etc
- Worst scoring companies 2.8% of portfolio.
- Emissions materially below benchmark on all metrics
- Greater weight of fossil fuel holdings than in benchmark.
- 4 of the top 5 emitters engaged with the Transition Pathway with one scoring 4

In general, this shows a broadly positive picture, with all funds continuing to score better than the benchmark overall. There have been no significant movements in individual company ratings in the quarter and movements for larger holdings tend to reflect previously agreed engagement activity in particular in far eastern markets where complex cross-holdings and lack of board independence (which are common in these markets) result in governance concerns relative to the standards which are expected.

The carbon metrics are addressed later in this report.

Investment Grade Credit Portfolio

Similar information is now available for the Investment Grade Credit portfolio as is available for the equity portfolios. It is important to note that while the availability and quality of ESG data has been improving in recent years, there can still be material gaps across the fixed income market. This is particularly prevalent where a debt-issuing entity does not also issue publicly listed equity, which, in most cases, the fixed income issuer maps to. The highlights from this report are set out below:

Weighted ESG score 7.4 which is less than benchmark	24.4% of portfolio ESG leaders compared to 39.5% in the benchmark	0.5% of portfolio ESG laggards compared to 0.4% In the benchmark
55.0% of portfolio not covered of which 49.6% is companies not covered and 5.4% collective vehicles	Lowest rated issuers represent 1.7% of the portfolio	Emissions below benchmark on two of the three metrics but somewhat above on carbon intensity
Materially below benchmark weight of companies with fossil fuel reserves.	2of top 5 emitters being engaged by Climate Action 100+ and both rated on the Transition Pathway	

The ESG score was stable over the quarter and the below benchmark score is driven by the active positioning of the Fund holding “leader” stocks. Despite this the Fund is rated AA which is classed as Leader.

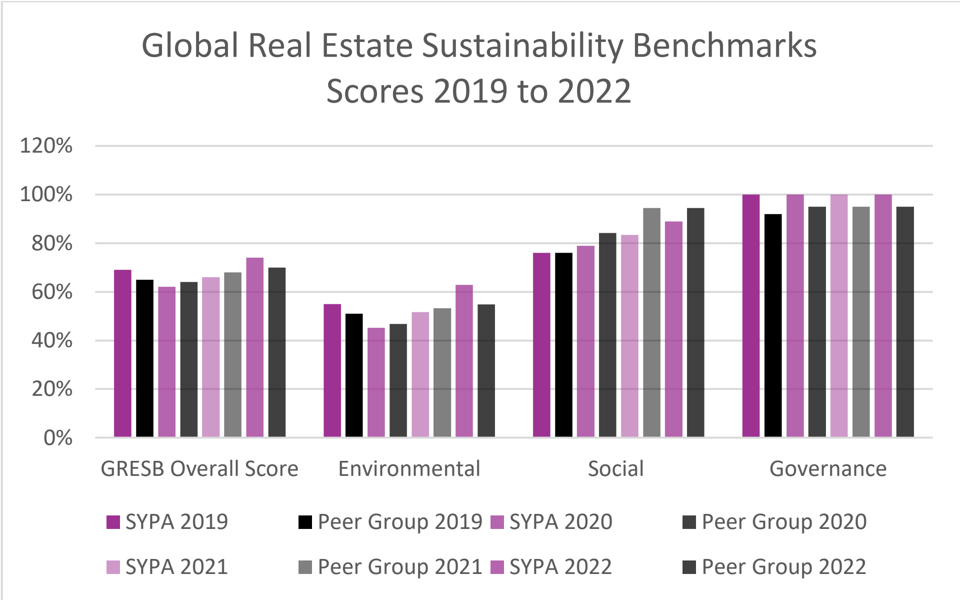
No one holding dominates emissions within the portfolio.

Commercial Property Portfolio

The latest assessment of the Fund’s commercial property portfolio using the Global Real Estate Sustainability Benchmark (GRESB) is now available. This shows significant improvement on the previous year with the portfolio now having achieved a 3 Star rating in line with the target set by abrdn as the fund manager.

GRESB assesses property portfolios through a number of lenses to provide a composite assessment, these include management, performance and ESG. In previous years the lack of data for some properties has reduced the performance score. The graph below shows the way in which

SYPA's performance has developed since 2019 in terms both of the overall score and the individual ES and G scores, compared to a peer group of around 80 similar portfolios constructed by GRESB.

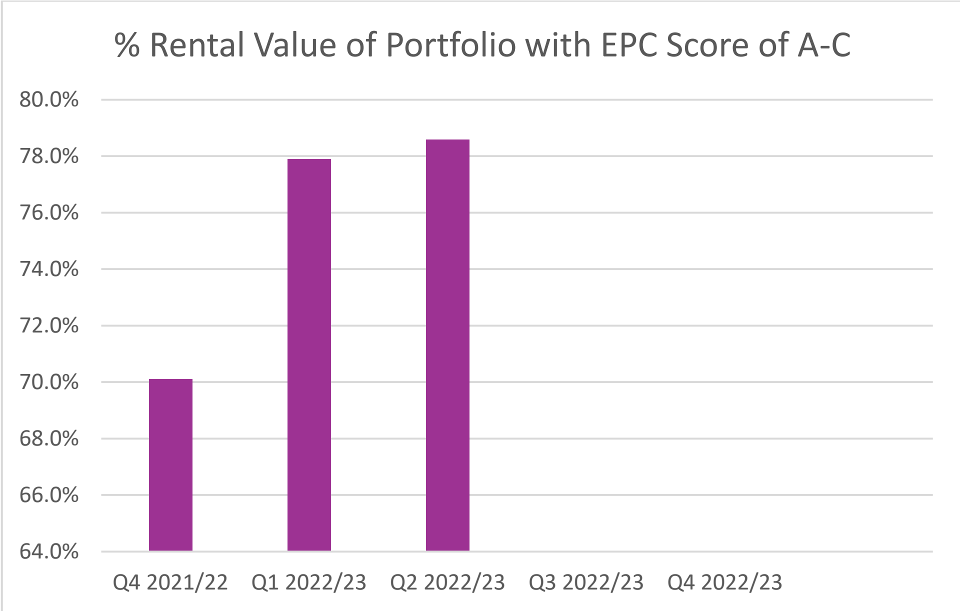


The broad trend shown in this graph is of improvement with better than peer group performance on all measures apart from Social in 2022, with an overall performance that ranks 22nd of the 80 funds within the peer group.

The Social score reflects a reasonable score of 8.5/11, but this compares to an average of 9.5. This area covers engagement with tenants and the community which while important and certainly of significance in multi-let office buildings and industrial estates is not as great a priority as other areas where efforts to secure improvement have been focussed in recent years.

The performance score which is not shown above as the full time series is not available has improved and is now above the benchmark average although still below the global average of all GRESB participants. This reflects the improvements in data which allowed the provision of emissions data at 31st March although there is much further to go in securing complete data which will, in part, be achieved through the inclusion of data provision requirements in new leases and the installation of automatic data collection technology where it is cost effective to do so. However, in general terms the portfolio is performing at least as well as the peer group in most areas.

In terms of the regular indicators produced the key metric is the proportion of the portfolio with Energy Performance Certificates rated as A-C. As shown in the graph below this has increased by nearly 1% in the quarter with some specific further work targeted at Scottish properties where new legislation will require further improvements in energy efficiency. Further improvements will come through a number of planned solar installations across the portfolio which have already been agreed.

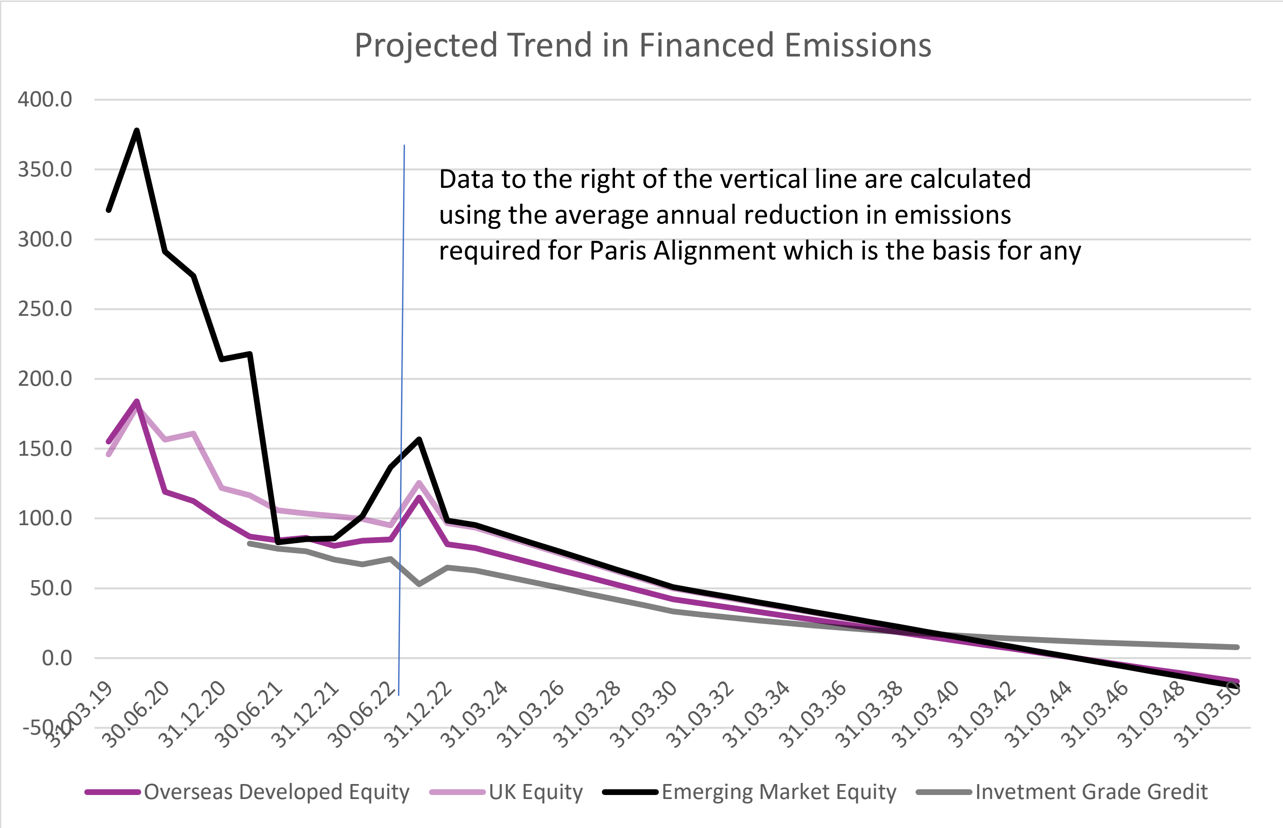


A further significant indicator of progress in this area is the proportion of the portfolio's asset value which is covered by sustainability certification (in this case BREEAM) which currently stands at 32% compared to 10% last year. This reflects some impact from the disposals within the portfolio, and it should be remembered that SYPA has, as yet, not looked at the option of in use certification which would probably increase this further but which has a cost which needs to be justified in comparison to investment in things such as solar panels which have a direct impact on the performance of buildings and on the level of emissions from the portfolio.

Abrdn as our fund manager have commissioned work to establish the changes that will be necessary to set the portfolio properly on the road to Net Zero. This will be reported to officers before Christmas and an update will be provided in the next report.

Progress to Net Zero

This section of the report considers progress towards Net Zero using the emissions data provided on a quarterly basis by Border to Coast. The graph below shows the trend for what is now termed financed emissions (i.e. absolute carbon emissions) which is the main indicator for which targets have to be set. This covers the four portfolios for which emissions data are available.



There has been a spike in all the measures over the last quarter largely due to the turmoil in markets impacting the $ invested element of the metric, i.e., at a time of falling asset values the same absolute volume of carbon emitted results in a larger measure in terms of tCO_2e/$m invested. Some post-September recovery in markets will address this, while the recession forecast by some commentators may also result in a reduction in absolute emissions.

As has been made clear previously the forecast reduction in emissions shown is dependant upon Border to Coast delivering the targets set out in their own Net Zero Strategy which depend on changes within the investment process as well as on the actions of individual companies. Officers will be engaging with Border to Coast in the coming months to further understand both the nature of the changes being made to the investment process and their likely impact and will be seeking in the forthcoming review of the Authority's own responsible investment policies to look for a further ratcheting up of pressure on companies to adapt their behaviour.

Beyond this the investment strategy review may result in changes to the mix of assets that reduce the level of emissions from the portfolio but this process is at too early a stage to determine whether this is likely to be the case. Following the conclusion of Project Chip rapidly moving the agricultural portfolio into the position of being a positive contributor will also assist in improving the overall position. However, as has previously been reported there remains a very strong probability that the Net Zero Goal will be missed although there is a possibility should all portfolios achieve the reductions targeted by fund managers that a date earlier than 2050 could be achieved.

It should also be borne in mind that while there is, rightly, a significant focus on emissions there is no credit in the calculations for the emissions avoided by the significant investment by the Authority in renewable energy and other climate solutions and this is something that we will look to begin reporting on in future.

As reported elsewhere the formalisation of TCFD reporting requirements within the LGPS regulations will require us to begin producing a wider and more comprehensive range of data which we will need external assistance with. Discussions have begun with Border to Coast colleagues about how best to deliver this in a collaborative way in order to reduce cost and avoid duplication.

Stakeholder Interaction

Over the quarter there has been a range of stakeholder interaction, although at a slightly lower level than in the previous quarter.

The focus has been entirely on climate related issues of one sort or another with continuing calls to divest from oil and gas companies, and potentially to use any funds released for more local investment.

There was also a call to "rewet" those elements of the Fund's agricultural holdings which are on peat-based soils in order to act as a sequestrator. As indicated elsewhere one of the objectives which Project Chip is seeking to achieve is the more active management of these holdings to achieve positive climate benefits. The vast majority of the holdings are on silt-based soils and in these cases "rewetting" may not be the most appropriate route and therefore appropriate scientific studies are already being commissioned to look at the options that might be available 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.

LAPFF held its most recent business meeting at the beginning of October alongside its AGM. The AGM considered the usual business including the election of members of the Executive. These include two Border to Coast colleagues, Cllr Doug McMurdo of Bedfordshire as Chair and Cllr Wilf Flynn from Tyne and Wear as a member of the Executive. Of note is the fact that all elections were unopposed and that there is a lack of diversity with for example only 3 women amongst 15 executive places. The Executive has identified this as an issue and set up a working group to examine options to address the issue.

The meeting also approved the accounts which indicated an underspend during the year and the maintenance of healthy reserves.

The Business Meeting considered

- A draft report to the consultation on the transition from the Financial Reporting Council (FRC) to the Audit Reporting and Governance Authority (ARGA). In itself the creation of ARGA is the culmination of a long running campaign by LAPFF over the need for regulation in this area to be genuinely independent of the accounting profession and accountable to stakeholders. The response highlighted a number of areas where the consultation appears to depart from the principles set out in the Kingman Review which led to the proposal to create ARGA.
- Issues surrounding Drax and Biomass where engagement is going on in relation to whether the wood being used by Drax to generate power is actually coming from genuinely sustainable forests.
- An update on the recent report of the parliamentary Climate Change Committee on reducing emissions, which highlighted a number of areas for potential future engagement with companies.
- The addition of a further member fund to the Forum bringing the total number of members to 86 Funds and 6 Pools across Scotland, England and Wales.

In recognition of the pivotal role that banks, and financial institutions play in the transition to a low carbon economy, the Transition Pathway Initiative (TPI), in collaboration with the Institutional Investor Group on Climate Change (IIGCC) recently published a framework to assess banks on how they are transitioning to net zero . The Framework has been used to assess 27 banks across several areas, including commitments, targets, strategy, governance, policy engagement and reporting . The results showed that, although banks have made progress, there is still significant work needed for the sector to align with a 1.5 ° pathway.

The Authority is signed up to IIGCC's Paris Aligned Asset Owner Initiative (more details here) and has worked with the initiative's Net Zero Investment Framework to develop its approach to Net Zero, A requirement of this initiative is that signatories disclose various targets and other information. SYPA is part of the second round of disclosures alongside 12 other asset owners. The targets reflect the plans in place for the relevant pooled products in which we are invested and will be reviewed alongside the investment strategy review. Further details can be found here.

To recognise the fast -changing landscape for responsible investment, the Principles for Responsible Investment (PRI), to which Border to Coast is a signatory, has launched a global consultation to explore topics including the PRI's vision, mission and purpose, the future of responsible investment and the value it provides to its signatories . The PRI is proposing to hold conversations with signatories from September to December and host a formal online consultation due to close in January 2023, which we would expect Border to Coast to respond to.

The Authority has been shortlisted for two awards in the Pensions for Purpose Annual Awards. These are

- The Impact Investing Principles Adopters Award which relates to the strength and quality of our work in turning the principles which we have adopted into a reality within our investment approach. This was the award that we won last year.
- The Place Based Impact Investing Award which celebrates initiatives concerned with impact investing achieving impacts in specific places. This relates to the work we have done with CBRE on our local loans portfolio.

Unfortunately, due to rail strikes during November the presentation has been delayed until February 2023.

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.

The major policy issue relating to LGPS currently is the consultation on the introduction of TCFD reporting to the sector. The Authority contributed to responses by the Border to Coast Partnership and the Scheme Advisory Board, while LAPFF also produced a response, but did not respond itself in order to minimise the call on resources and allow officers to focus on preparing to implement the new requirements. The key issues raised in responses concerned:

- The potential for the data published to be used as a weapon against funds through the creation of league tables based on data without context.
- The significant challenges of aggregating data across the whole LGPS.
- The challenges that exist in scenario analysis and the need to agree a minimum set of common scenarios to be used.
- The well-known issues around missing or poor-quality data.

In addition to this elsewhere on the agenda the Authority is being asked to endorse Border to Coast's updated responsible investment policies.