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# JUST TRANSITION BUILDING A BETTER FUTURE

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**GREATER MANCHESTER /  
MERSEYSIDE / WEST YORKSHIRE**

**STEWARDSHIP REPORT  
Q2 2019**

Northern LGPS



## JUST TRANSITION



# INVESTING IN A JUST TRANSITION

As we reported in Q1, one of the initiatives that NLGPs is taking a close interest in is the Just Transition. We are absolutely committed to playing our part in tackling climate change in the most effective way possible, and we are also convinced of the need to make the transition to a net zero world in a way that takes account of the impact on other stakeholders.

Previous periods of industrial change have not been well planned and this has had a significant impact on many communities in the North and elsewhere in the UK. It is striking that in areas where the coal industry was a previously a major employer, providing secure,

well-paid, unionized jobs, the businesses that have replaced it often offer a very different model of employment. Both Sport Direct and ASOS built distribution centres in former colliery areas – Shirebrooke and Grimethorpe respectively. Amazon built a major fulfillment centre in Rugeley, a town synonymous with coal-fired power stations. All three companies have been criticized for their use of low-paid, insecure employment contracts.

The difference this time is that we know change has to take place, and we know how disruptive it might be. This foreknowledge also gives us the opportunity to plan ahead. Therefore all

parties have a responsibility to ensure that change occurs in a way that is seen to be fair.

As investors we believe we can contribute to this through the way we allocate capital, through our engagement with the companies and assets we own and through policy work. We've already done the easy part by including the Just Transition in our Responsible Investment Policy, but we want to make that commitment real.

As part of our activity in this area we have been in dialogue with the team working on the Just Transition at the Grantham Institute at the LSE. In addition our responsible investment adviser, PIRC, has been involved in discussions with leading trade union figures working on this agenda, and is part of an advisory group feeding into a new guide for investors.

And we're starting to engage on these issues too. Partly this will be through our own projects, like the work on house-builders, but we're also committed to working collaboratively with any other investors who are active in this area.

Though we're just getting started, we feel that the Just Transition is very well aligned with the interests and priorities of our beneficiaries and their dependents. We hope to make a real difference.

## JUST TRANSITION

# LAYING THE FOUNDATIONS: NLGPS HOUSE BUILDING PROJECT

The second half of 2019 has been a busy period for the responsible investment work that NLGPS undertakes, and we've been active on a range of issues in a number of markets. One of the subjects we're devoting some time and effort to is a thematic project focusing on UK-listed house-building firms.

Launched earlier this year, the project involves research, policy and engagement activity and involves companies, stakeholders and other interested groups.

An initial strand of the project was research based. We reviewed ESG reporting by the major house-building businesses in the UK on a variety of issues. As you might expect, practice amongst the focus companies is not flawless, and we identified a number of gaps in their approach.

The findings are summarised in our report **Building Firm Foundations: ESG Risks in the House-building Sector**.

Having carried out research into the sector, NLGPS has now initiated engagement with a number of companies where pooled holdings are largest. NLGPS believes that by working collectively and focusing on larger holdings member funds are able to have a greater influence.

The engagement stage of the project is intended to both enable NLGPS to mitigate potential risks from the sector and potentially enhance value. A demonstrable improvement in reporting of material ESG factors will be an initial milestone for the project. NLGPS will also consider regional dimensions to ESG risks relevant to the North.

### Our findings include:

**-Few companies have plans for capturing Scope 3 emissions that flow from homes sold and in use, to set science-based targets to be in line with the Paris Climate Agreement.**

**-Although companies disclose employment policies and conduct employment satisfaction surveys, most are heavily reliant on sub-contractors and there is little or no information on use of umbrella companies and agency workers.**

**-Few companies disclose executive pay as a multiple of average employee pay or the industry average.**

**-Companies provide little detail on warranties or the levels of claims to enable investors to understand the quality of products and potential financial and reputational risks.**

## COMPANY ENGAGEMENT

### Looking forward to H2

Since the start of 2019 NLGPS has begun developing its collective Responsible Investment work. This has involved a mixture of engagements with unique large holdings, supporting collaborative initiatives and the initiation of thematic projects.

When we hit the mid-point of 2019, we decided to focus our attention on how to implement the RI policy during the remainder of the year. The core areas of work we identified were:

- Continuation of engagement with major holdings
- Thematic engagement with house builders
- Policy development on climate change
- Initial governance engagement with major US companies
- Development of international relationships

As you will see in the remainder of this quarter's report, much of this work is already underway but we expect to be more active in certain areas later in the year. In particular we want to build connections with companies outside the UK, so our engagement with overseas companies, and involvement in international initiatives will likely become increasingly important.

### Backing employee voice at Alphabet

NLGPS was active in support of employees at Alphabet, the company behind Google, in Q2. Google employees staged a walkout at the company in 2018 over issues including company policy on sexual harassment. Despite wanting to project a modern face to world, a number of companies in this field exhibit a so-called 'tech bro' culture of sexist behavior.

One of the demands from those that walked out was that they should have representation in the governance of Alphabet through an employee director. Subsequently a shareholder resolution was filed at the company seeking the appointment of just such as director. NLGPS was approached by the filers of

## COMPANY ENGAGEMENT



### Fashion victims

**At the very start of Q2, fashion brand Superdry held an EGM at the instigation of founder, former chief executive and major shareholder Julian Dunkerton. He had been increasingly critical of the incumbent management team and filed resolutions at the company seeking his appointment to the board along with ally Peter Williams.**

**The board responded vigorously, calling on shareholders to oppose the resolutions and back the existing team. Board members also promised to resign if the resolutions were successful. NLGPS had supported the board and voted against the two resolutions, and was represented at the EGM. However, on the narrowest margins, with 51.5% in favour, Dunkerton and Williams were elected to board. As expected, this resulted in the resignation of most directors with immediate effect.**

### NLGPS backs Climate Action 100+

All three NLGPS member funds co-filed the Climate Action 100+ resolution at BP this year. The resolution called on the oil giant to set out its strategy for ensuring that it was aligned with the Paris Goals. This includes providing detailed information on capital expenditure decisions, and on metrics and targets, and their inclusion in executive remuneration arrangements. In total 58 investors representing just under 10% of the company's issued share capital co-filed the resolution. The board recommended shareholder support, meaning that it passed at BP's AGM in April with 99% support, a record level.

In sharp contrast, US oil major Exxon successfully blocked a similar resolution. In response NLGPS and other investors voted against the entire board at the Exxon AGM in May to demonstrate their opposition to the company's frustration of shareholder engagement on the most critical issue in RI currently.

### Major holdings

As highlighted in our Q1 Stewardship Report, one aspect of the NLGPS RI programme is to undertake direct engagement with a number of major holdings. Early in Q2 we engaged with two more companies where NLGPS has significant holdings and initiated engagement with a third. We are also attending the AGM of another major holding later in the year. In all cases the collective NLGPS holding is over 1%, and in some cases considerably more.

In this initial period of our engagement programme we are putting a significant emphasis on the development of relationships with the investee companies. As such NLGPS may not publicise the content or outcomes of the engagements at this stage.

In each case we have identified ESG issues of interest and which are pertinent to the companies concerned, and we set objectives to enable us to judge progress. For example, we have encouraged one major holding to improve its board diversity, and another to change the nature of its executive incentive scheme. We will report back on progress on this aspect of our engagement work later in the year.

the resolution and agreed to support it. This is in line with our commitment in our RI policy to support employee representation at board level, alongside workplace rights.

It appears that many asset managers voted against. However we note that the issue of employee representation in governance has been raised by a number of candidates seeking the Democratic Party nomination in next year's presidential election.

Looking more widely at technology firms, through our involvement in the Local Authority Pension Fund Forum (LAPFF) we're also seeking to resist the trend towards dual-class share structures. Unfortunately a number of tech businesses that have listed in recent years have adopted these structures, giving founders much greater control than the proportion of their ownership.

Whilst this is sometimes defended on the basis of enabling the board to take a long-term approach, it can also work to entrench management. It's notable that controversial ride-hailing firm Uber did not adopt this model, in contrast to rival Lyft, after its founder CEO was forced out but remains a significant shareholder.

### Pension funds versus pensions

One of the most unusual shareholder resolutions filed this year was at HSBC. A group of former Midland Bank employees filed a resolution seeking the abolition of 'clawback' – a reduction in the value of the pension from defined benefit scheme to take account of the value of state pension entitlements. Campaigners argue that this disproportionately hurts female and lower paid workers. HSBC in turn argued that agreeing to the change would cost the bank millions. Having reviewed the arguments, sought further information from both the proponents and actuarial advisers, NLGPS supported the resolution. Unfortunately the resolution did not attract significant support, making it likely that many pension funds voted against improving employee pensions in this case.

## THEMATIC PROJECTS

## STAKEHOLDER ENGAGEMENT

### Watching the outsourcers

The last few years have been difficult for a range of companies involved in the provision of public services or other forms of public sector contracting. Most obviously, firms involved in construction projects have fared badly. Carillion collapsed in early 2018, Interserve went into administration in 2019, and Kier Group has also struggled financially.

Companies in the wider sector have also faced challenges. Both Serco and its former auditor Grant Thornton have been criticised in relation to misreporting on the electronic tagging contract that the company had previously run. Serco appears to have turned the corner, but other companies are also under scrutiny.

Looking more broadly, a range of public service contracts are subject to greater scrutiny. For example, looking to the US some investors appear to have become wary of investing in companies linked to the controversial ICE facilities. There is also criticism of privatized prison and probation services in a number of countries, including some coverage in the specialist pensions press of investments in this area.

There is political risk to investors here. Firms that fall out of favour with national governments can find it difficult to retain or win contracts. More generally, that has been a reaction within some political parties against widespread outsourcing in principle. It would not be entirely surprising to see public policy in some of these areas swing back to a preference for public sector employment.

These issues are important to NLGPS. In our RI policy we made a commitment to monitor the effects of investments on both the provision of public services and public employment practices.

PIRC, our RI adviser has been monitoring the outsourcing sector closely since the start of 2019, and undertaken in-depth financial analysis of a number of companies. We have also undertaken some initial engagement in the sector that may increase over time.



### Employment standards and shareholder activism at Amazon

In early May, NLGPS representatives attended an investor briefing hosted by Trade Union Share Owners (TUSO) focusing on the US retail giant Amazon. The meeting heard a presentation from a worker from the Rugeley 'fulfillment centre' in the West Midlands about some of the conditions faced by warehouse workers. This was the site where journalist James Bloodworth, who spoke at our Stewardship Day in January, worked undercover.

In addition to the Amazon worker, representatives from both the GMB union and UNI Global Union also talked about both employment conditions and other challenges facing Amazon. There was also a presentation on the range of shareholder resolutions that had been filed at the company. These covered topics ranging from climate change to facial recognition software, to Amazon's policy on hate material. Notably, one resolution was filed by a group of Amazon workers seeking the adoption of a company-wide climate change policy.

Employment practices and human capital management are an important aspect of our RI policy, so we were very pleased to participate in the meeting and speak to those involved. In addition, NLGPS voted in favour of most of the resolutions filed at the company, including that filed by the Amazon workers themselves.

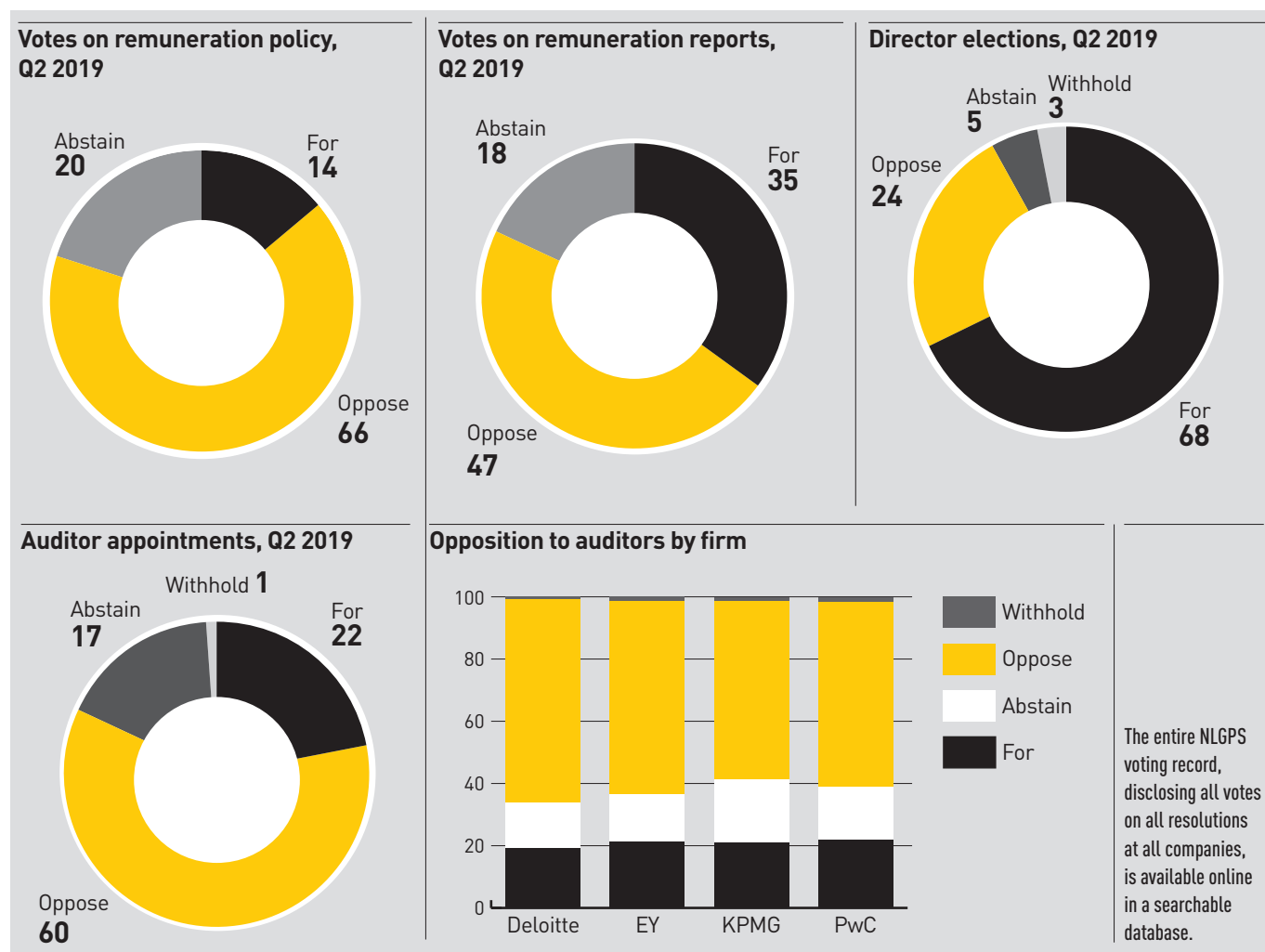
### Human Capital Management Coalition

Given our aspiration for international engagement to become a more significant element of our RI activity over time, we have been talking with a number of international investor initiatives to explore whether NLGPS would be comfortable participating. One of the international initiatives that NLGPS has decided to join is the Human Capital Management Coalition (HCM Coalition).

The HCM Coalition is a cooperative effort among a diverse group of influential institutional investors to further elevate human capital management as a critical component in company performance. The Coalition engages companies and other market participants with the aim of understanding and improving how human capital management contributes to the creation of long-term shareholder value.

Given our commitment to effective human capital management, and high standards of employment, we felt this was an initiative that fits well with our approach to RI. We look forward to collaborating with US and other international investors on this critical topic.

## Q2 VOTING & ENGAGEMENT REVIEW



### There were some director election ‘near misses’ and big revolts over pay at French companies during the second quarter

In terms of shareholder voting, the second quarter of the year is the busiest by far. This is period when most companies hold their annual meetings in many markets. Although it takes a great deal of work to do, voting at this many companies also means that there are a lot of data to look at. So in this quarter’s report we going into quite a bit of detail. As a reminder our full voting record is available online in a searchable database.

Overall, NLGPS funds voted at 1863 meetings during the second quarter. In its role as responsible investment adviser to NLGPS, PIRC engaged with 269 companies around issues relating to meetings during the quarter, in addition to

engagement activity that was not meeting-related.

#### Director elections

As we noted in the previous quarterly report, director elections are by far the most common type of resolution on meeting agendas. During the second quarter, NLGPS voted on the election of 12724 directors. In total, 68% of directors were supported, with 24% opposed. In the remainder of cases NLGPS abstained, or withheld support.

At Spanish infrastructure construction firm **ACS** we opposed a number of directors due concerns about the lack of independent representation on the

board. Three of the non-executives that we do not consider to be independent secured less than a 55% vote in favour. Joan-David Grimà i Terré secured a vote in favour of just 50.9%. However, all were narrowly re-elected.

There was another ‘near miss’ at the US-listed **Eastman Chemical Company**, where we also had concerns about a lack of board independence. NLGPS opposed the re-election of six directors and abstained on a further three. Of the six where we opposed, non-executive Michael Connors achieved a vote in favour of his re-election of just 52%.

At Belgium-listed bank **KBC** we opposed a number of non-executives due to concerns such as long tenure, time commitments and the influence of the major shareholder. Non-executive Frank Donck, one of the directors we

opposed, achieved a vote in favour of his re-election of just 63%.

In the UK at gambling software and services supplier **Playtech** we opposed the re-election of the chair, Alan Jackson over excessive board tenure. He was re-elected, but with a 36% vote against. The company was also hit by large votes against executive pay (see below).

At **Smurfit Kappa** in Ireland we opposed the re-election of a number of directors over concerns such as time commitments and lack of board attendance. One of the directors we opposed, non-executive Christel Bories, received a 34% vote against.

#### Executive pay

Turning to executive pay, shareholders typically have advisory votes in most markets, for example on a report on pay

## Q2 VOTING & ENGAGEMENT REVIEW

practice during the year. The UK also has regular forward-looking binding votes on remuneration policy. As discussed in the previously quarterly report, the binding votes can be far more significant, as companies can be prevented from introducing new elements if they lose the vote.

Overall, NLGPS opposed companies on advisory votes in 47% of cases, abstained in a further 18% and supported in 35%. Oppose votes on remuneration policy stood at 66%, compared to 20% abstain and 14% for.

France was a hotspot for high votes against pay in Q2. The most striking result was at carmaker **Renault**, where we opposed on the vote to approve the compensation arrangements for the chair and chief executive. This was defeated with a massive 88% against.

We also opposed a number of resolutions at glasses manufacturer **EssilorLuxottica**. There were votes against of around 42% on three resolutions relating to the compensation of specific directors.

At aerospace and defence company **Thales Group** we opposed both the remuneration report and remuneration policy resolutions, both of which received votes against of around 40%.

We opposed four resolutions relating to executive pay a

customer relations management business **Teleperformance**. Of these the vote on remuneration policy received a 42% vote against and three others received around 30% against.

These all represent very high votes against pay, and suggest that, if trends continue, we might expect to see more defeats in France in the future.

Back in the UK, we opposed the remuneration report at gaming group **GVC**, which received a total vote against of just over 42%. This follows a string of large votes against **Ladbrokes** over pay.

At **Standard Chartered** we opposed both the remuneration report and the remuneration policy. The votes against were 10% and 36% respectively.

We also opposed the remuneration policy at **Playtech**, which received a vote against of 40%.

In the Netherlands we voted against two resolutions to approve the remuneration and bonus of the president and chief executive of **STMicroelectronics**. These received votes against of 38% and 31% respectively.

And in Switzerland we opposed a number of resolutions relating to remuneration at private equity manager **Partners Group**. Of these the remuneration report received a 30% vote against.

### Auditors

NLGPS also has the opportunity to vote on hundreds of auditor appointments. We consider that the veracity of financial reporting is one of the first lines of defence for shareholders, and want to eliminate and potential conflicts of interest caused by factors such as long tenure, or the undertaking of non-audit work. However, we also know that shareholder challenge to auditor appointments is extremely weak. Therefore we have chosen to take a firm stance to try to improve accountability in this area.

During Q2 we voted against 60% of auditor appointments, typically in response to high levels of non-audit work being undertaken or long tenure. We abstained in a further 17% of cases.

High votes against auditors are rare, but during Q2 we voted against the reappointment of Deloitte at both **Anglo American** and **Lookers PLC**, where there were votes against of 20% and 18% respectively.

There is some variation between auditors in terms of our level of support. We opposed Deloitte most often, and voted for least often, of the Big Four. In contrast we voted for KPMG most often. We are looking into industry trends that may be driving these outcomes.

### Shareholder resolutions

In addition to supporting the shareholder resolutions at **Amazon, Google, BP** and **HSBC** mentioned in the news section of this report, we also voted on dozens of others during Q2. The US is the market where most resolutions are filed, and the topics they cover range from governance reforms, likely splitting chair and chief executive roles, to human rights, climate change and employment standards.

Of over 450 shareholder resolutions, we supported just under 79%. In terms of themes, we supported: 94% of resolutions relating to political spending or lobbying; 100% of resolutions seeking an independent chair or the separation of chair and CEO positions; 100% of resolutions on employment-related issued including the gender pay gap and sexual harassment, and 100% of resolutions on environmental issues including disclosure of more comprehensive emissions data, adoption of company-wide climate policies, the impact of non-recyclable packaging and so on.