EXIT

GREATER MANCHESTER / MERSEYSIDE / WEST YORKSHIRE

STEWARDSHIP REPORT Q4 2020

NorthernLGPS
The Collective Asset Pool for Greater Manchester Merseyside and West Yorkshire Pension Funds

INTRODUCTION

AMERICA TURNS THE PAGE

It took more than a month after the electorate went to the polls before Joe Biden was able to seal his place as 46th President of the United States. More than 159 million Americans voted in what proved to be the highest electoral turnout in US history and one which marked a major change in direction for policy.

While President Donald Trump continued to contest the election with baseless claims of fraud, Biden taking office will lead to make major changes to the county's policy direction on areas of significant interest to NLGPS including climate change and labour standards.

Climate change

Biden faces a challenging start to his term in office. Not only does outgoing President Trump dispute the result, but he must contend with deep economic contraction and the worst global health pandemic in recent history, of which the US is one of the worst affected countries. Managing the coronavirus pandemic will be a priority with Biden expected to roll out millions of vaccines to citizens and provide extra financial support in a Covid-19 relief package.

However it is expected that irrespective of the demands from Covid-19, Biden will waste no time in returning the US to the Paris agreement on climate change. President Trump withdrew from the accord and his administration also weakened the limits on greenhouse gas emissions from cars and trucks and encouraged more drilling for oil and gas.

Trump was also keen to breathe life back into the coal industry by relaxing regulations on coal fired power stations. All of this was predicted to increase carbon emissions by 1.8 billion tonnes by 2035.

In stark contrast, Biden is committed to achieving a clean energy economy with net zero emissions by 2050.

The Democrats' ambitions include providing financial incentives to the clean energy industry and investing in 'smart infrastructure' which ensures US buildings, transport and energy are equipped to manage climate change.

These commitments are significant. Scientific analysis from Climate Action Tracker says Biden's net-zero emissions pledge by 2050 could shave 0.1° degrees Celsius off global warming by 2100.

The new administration will has also pledged to 'stand up to the abuse of

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polluters' and will take action against fossil fuel companies that disproportionately harm communities 'of colour and low income'.

And while the Biden campaign did not make reference to the just transition initiative specifically, it did commit to 'Fulfilling our obligation to workers and communities who powered our industrial revolution and subsequent decades of economic growth. This is support they've earned for fuelling our country's industrial revolution and decades of economic growth. We're not going to leave any workers or communities behind'.

Labour policy

We also expect to see a significant shift in relation to the S in ESG, and labour policy in particular. Biden pledged to be 'the most pro-union president' and his election campaign made clear his support for unionisation and collective bargaining.

There are indications that this may affect shareholders. For example, Biden has argued that share buy backs are reinforcing the disparity of wealth between boards and directors, and that CEOs are failing to invest in workers or in creating quality jobs.

He has been quoted as saying: "The results have been predictable: rising income inequality, stagnant real wages, the loss of pensions, exploitation of workers, and a weakening of workers' voices in our society."

In terms of practical policy, Biden is in favour of a $15 minimum wage and guaranteeing workers 12 weeks' paid family and medical leave. He also supports comprehensive legislation to help workers to unionise. So early movement in these areas will provide a sense of how far policy will match pre-election rhetoric.

Biden has also promised to check the abuse of corporate power over labour and hold corporate executives personally accountable for violations of labour laws. Any changes at the National Labor Relations Board will be watched closely.

Proposition 22

One particular area that might be a focus of Biden's attention is Proposition 22 which passed in California at the end of the year. Both Biden and Vice President-elect Kamala Harris opposed the initiative which allowed app-based companies such as Uber and Lyft to reverse the extension of employment rights to gig workers in the state. Defining them as contractors means employers do not need to pay minimum wage nor provide basic benefits such as sick pay. Uber and Lyft were among the companies that financed the Prop 22 legislation with as much as USD 200m and were since awarded contracts by the Trump administration to provide taxi services to public agencies.

Biden has not spoken publicly on Prop 22 but given his earlier opposition and his support for worker rights, there is a strong chance the legislation could be overturned.

New leadership boosts ESG hopes

The election of Joe Biden as president could also see a reversal of controversial legislation making it harder for pension plans to vote on environmental, social and governance (ESG) issues at company meetings.

Ahead of the November election, President Donald Trump had rushed through new Department of Labor rules which come into force in January and oblige fiduciaries to put pecuniary interests ahead of all others when exercising

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shareholder rights.

Ultimately the rule is meant to challenge pension funds investing in funds that exclude certain industries or companies on the basis of ESG concerns. However, opponents argue that the rule would just make it difficult to invest in any ESG funds at all.

Following intervention from trustees and asset managers, which NLGPS supported, much of the more draconian language in the rules has been dropped, but they still run counter to the direction responsible investors, would prefer. We hope that Biden will look at ways to clarify if not reverse the rule.

NLGPS also hopes there will be revision of SEC rules increased the thresholds investors must pass to raise proposals and stage interventions at AGMs. Introduced at the end of the last quarter, the rules are supposedly to stop small shareholders or activists making their voices heard.

Commissioner Elad Roisin told the SEC that the amendments to Rule 14a-8 'aim to ensure that shareholder-proponents demonstrate a sufficient economic stake or investment interest in a company before they are able to submit proposals to be included in a company proxy's statement, paid for by all shareholders'.

However, NLGPS is concerned that the changes make it even harder to influence US corporate behaviour. As larger shareholders we will continue to exercise our vote and we support any action by the new US administration to rethink this particular rule.

Moving forward after Juukan Gorge

It is difficult to find any good news in the Juukan Gorge disaster which saw mining company Rio Tinto destroy two 46,000-year-old sites of cultural significance.

However, as the quarter drew to a close, Rio Tinto and traditional landowners based in the Pilbara region of Western Australia took the first steps towards rebuilding relationships.

Puutu Kunti Kurrama and Pinikura traditional owners in co-operation with Rio have been involved in remedial work at the Juukan Gorge site in Western Australia.

This follows many months of campaigning by investors including the Local Authority Pension Fund Forum to force Rio to take responsibility for the disaster.

An Australian Parliamentary enquiry last quarter revealed that Rio's top executives had failed to read reports detailing the cultural importance of the site. Initially members of the board lost their bonuses and issued an apology, which investors subsequently made clear was insufficient.

Chief executive Jean Jacques has since forced to step down, along with several senior colleagues.

NLGPS is pleased to see Rio taking its social impact more seriously. For too long mining companies have caused devastation in the countries in which they operate. It is especially rewarding to know that shareholder pressure played such an important role in improving governance.

And it seems the Rio Tinto's negative publicity has caused other mining companies to take stock of their own relationships with the local communities in which they operate.

In October BHP became the first company to agree a deal with the First Nations Heritage Protection Alliance set up in the wake of the Juukan Gorge disaster.

In response to BHP's engagement, the Australasian Centre for Corporate Responsibility withdrew a resolution to shareholders demanding all mining cease in the area which could further devastate cultural heritage sites.

NLGPS hopes that this is just the beginning of a move towards greater corporate responsibility. We continue to actively support LAPFF's engagement work with mining companies as part of our RI activity.

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Climate focus:

NLGPS backs Make My Money Matter...

In October NLGPS partnered with Make My Money Matter (MMMM) as part of our commitment to investing 100% of our assets in line with the Paris agreement on climate change.

The MMMM initiative is designed to help pension fund members understand where their money is invested and how it can be to use responsibly without compromising on return.

These are views shared by NLGPS and by partnering with MMMM, it will be easier for members to understand the importance of sustainable investing and how it can make a positive difference, notably in achieving net zero carbon emissions by 2050.

Speaking at the time the partnership was announced, NLGPS Chair Cllr Ged Cooney said: “Collaboration is critical in driving positive change. NLGPS’ partnership with Make My Money Matter confirms our commitment to sustainable investment. We are confident through our work with other likeminded investors and organisations, that a just transition to a zero-carbon economy is completely achievable.”

...and say on Climate

As the Paris agreement on climate change approaches its fifth birthday, NLGPS is pleased to support the ‘Say on Climate’ initiative.

Initiated by Sir Christopher Hohn founder of the Children’s Investment Fund Foundation, the initiative encourages all listed companies to develop a climate transition plan and put it to a shareholder vote at their AGM.

These plans will give investors more opportunity to influence how listed companies will transition to net zero and reduce the chance for corporates to pay lip service to managing climate change risk.

Launched in December, the initiative has already secured support from numerous investors, including the Local Authority Pension Fund Forum, and from companies including Unilever.

Companies’ failure to manage their climate risk remains a key threat to shareholder value yet only 0.5% of the 40,000 listed companies globally have set validated targets in line with the Paris Agreement goal of 1.5°C, and of those that do, only 8% include any form of interim target.

Ahead of the UN Climate Change Conference COP26 next year, ‘Say on Climate’ will target the following objectives:

1. **Secure asset owners and major asset managers public support for the concept;**
2. **Voluntary adoption of ‘Say on Climate’ by leading companies;**
3. **Shareholder resolutions filed on 20-40 companies in the US, Canada, UK, EU and Australia in 2021 and 200-300+ in 2022, to force adoption;**
4. **Build pathway to mandatory regulation in key countries;**
5. **Establish ecosystem to hold investors and companies to account on quality of their climate plans.**

NLGPS is listed as a supporter here: https://www.sayonclimate.org/supporters/

Green bonds need to avoid greenwashing

In November Chancellor Rishi Sunak announced a string of ‘green initiatives’ promising to make it easier for pension funds to invest in the zero-carbon economy.

Speaking at the Green Horizon Summit, the Chancellor also announced robust environmental disclosure standards which the government says will give investors greater transparency into the material financial impacts from their exposure to climate change.

This means the UK will become the first country in the world to make the Task Force on Climate-related Financial Disclosures (TCFD) fully mandatory across the economy by 2025, going beyond the ‘comply or explain’ approach.

Chancellor Sunak also touted a long-term asset fund which would channel pension fund investment toward illiquid and private market opportunities.

According to the Chancellor, the series of announcements represents the government’s ambitions to make the UK a ‘world leader’ in green finance.

NLGPS welcomes the government’s efforts to allow for more green investment, particularly since the Chancellor emphasised the need for a ‘fair transition’ to a net zero economy.

However, we await more detail on the green gilts and the long-term asset fund to ensure these align to our own strict investment criteria.

This is particularly important at a time when environmental, social and governance investing is afforded so much attention. We are conscious of the dangers of green washing and will expect complete transparency from government in this area.

OTHER NEWS

"Institutional investors typically have much larger stakes than the average individual investor, they also have more clout to effect change at the companies in which they invest. The shift toward a more institutional shareholder base can be seen as a positive development."
Duncan Lamont, Head of Research, Schroders

Time to enfranchise asset owners

Barriers to shareholder voting in pooled funds could finally be removed following a pivotal report endorsed by Pensions Minister Guy Opperman.

Tackling what has long been a frustration for NLGPS, a November a white paper from the Association of Member Nominated Trustees (AMNT) – Bringing shareholder voting in to the 21st century – made clear a strategy for effective stewardship in pooled funds.

In response, the Department for Work and Pensions (DWP) will set up a working group to address 'the overly complex and archaic voting infrastructure; underinvestment in the stewardship function in fund management; and transparency of voting policies and outcomes'.

Mr Opperman agreed that it was time for the investment management community to take this issue seriously. He said trustees are not the only actors in the investment chain, adding that 'fund managers also need to step up and to play their role, for their clients'.

NLGPS supports many of the views put forward by the AMNT, most notably that 'while barriers do exist to effective stewardship on pooled funds, they are not insurmountable. It is mainly down to fund manager unwillingness to implement client policies'.

The AMNT proposes trustees develop ESG policies and use them as a benchmark to hold fund managers to account. Further the report says investment consultants could potentially downgrade fund managers that are unwilling to accept client voting policies.

The AMNT's full report can be found here: https://amnt.org/report-2020/

Globalising ownership

The trend to foreign ownership of UK listed companies has seen British pension funds fall steadily down the list of beneficial owners of domestic quoted companies.

More than half (55%) of the UK stock market is owned by foreign investors according to the Office for National Statistics, while individual investors account for 13.5% of domestic share ownership. In the 1990s more than half of the UK stock market was held by domestic pension funds and insurance companies; these institutions now account for 8.1%

This has clear implications for UK corporate governance, but according to a report from asset manager Schroders, not all of them are necessarily detrimental.

In Global Britain: should the dramatic shift in ownership of the UK stock market be feared or cheered? Duncan Lamont, head of research and analytics at Schroders, argues that rather than viewing the increase in foreign ownership as a threat to stewardship, the increase in international institutional investment should ultimately lead to more shareholder engagement.

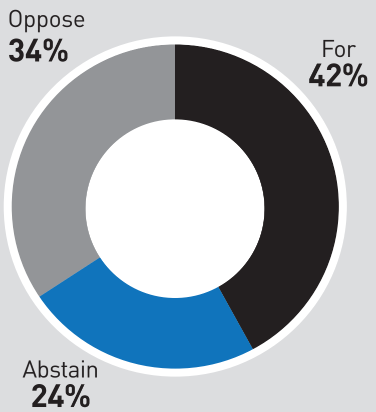
As large shareholders in assets across the globe, investment managers clearly have a duty to use their proxy voting rights effectively. And compared to individual investors, institutions are far more likely to use them. Institutional investors vote on 90% of the shares they hold; a major difference to individuals who cast votes representing less than 30% of the shares they own.

That said, we cannot ignore the dominance of a handful of investment managers who own an ever-growing proportion of the world's assets. US domiciled fund managers BlackRock and Vanguard have USD 7.81 trillion and 6.1 trillion in assets under management respectively. This gives just two investment houses significant influence over corporate behaviour, but evidence from our RI advisers PIRC suggests they are not leaders in voting on ESG issues. In addition, more exploration is required of whether international ownership of UK shares brings with it a different approach to certain issues. For example, US managers have in general been far more tolerant of high executive pay than their European equivalents.

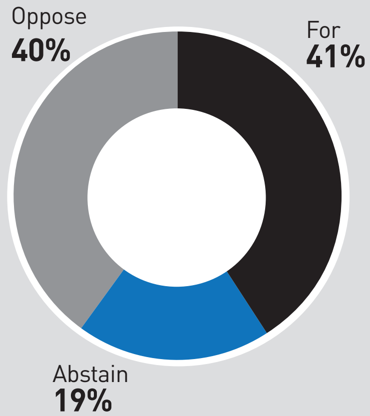
The other side of the trend highlighted by Schroders is that, as domestic ownership of domestic equities has fallen, UK asset owners are increasingly exposed to international companies. This brings its own challenges, since engagement is less developed in other markets, and asset owners also have to be mindful of balancing general ESG principles with local conditions.

Q4 VOTING & ENGAGEMENT REVIEW

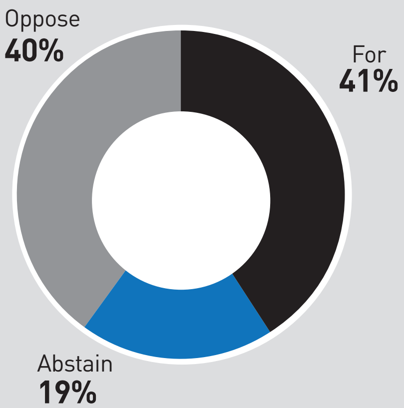
Votes on remuneration policy, Q4 2021



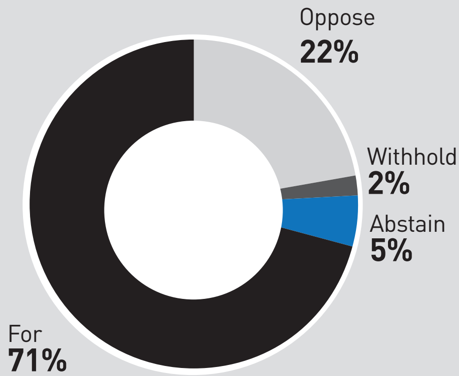
Votes on remuneration reports, Q4 2021



Auditor appointments, Q4 2021



Director elections, Q4 2021



Overall, NLGPS funds voted at 467 meetings during the third quarter. In its role as responsible investment adviser to NLGPS, PIRC engaged with 172 companies around issues relating to meetings during the quarter, in addition to engagement activity that was not meeting-related.

Director elections

During Q4, NLGPS voted on the election of 1380 directors. In total, 71% of directors were supported, with 22% opposed. In the remainder of cases NLGPS abstained, or withheld support.

Executive remuneration

NLGPS opposed companies on advisory votes on remuneration in 40% of cases, and abstained on 19%. We opposed 34% of remuneration policies, compared to 24% abstain and 42% for.

Auditors

During Q3 we voted against 40% of auditor appointments, and supported 41%. We abstained or withheld support in the remainder of cases.

Shareholder resolutions

We voted on 50 shareholder resolutions in Q4, supporting 40, abstaining on 4 and opposing the remainder.

Engagement with large holdings

In October, NLGPS engaged with Man Group plc to discuss concerns raised by NLGPS with regards to variable remuneration. Man Group plc, which operates in the alternative investment management sector.

Cllr Cooney questioned the company on the extent to which they view their businesses compensation structure as contractual issue, with regards to the fulfilment of fiduciary obligations in operating in the interests of all stakeholders, as opposed a means by which to motivate and retain talent. The company outlined performance-based incentive schemes is very much ingrained in the culture of the business and argued profits resulting from good performance were redistributed back to shareholders. The board considers their pay structure is well aligned with the interests of shareholders generally. Cllr Cooney questioned the extent to which alignment is possible given performance is benchmarked on a relative basis as opposed to the actual return as experienced by shareholders. The company pointed to a number of metrics within the remuneration policy to balance a compensation structure that is geared towards relative returns.

In December NLGPS engaged with Synthomer plc, a UK-based chemicals business, to discuss a range of sustainability issues. The company manufactures aqueous polymers the demand for which has increased dramatically during 2020 in response to the world's need for personal protective equipment (PPE).

Cllr Cooney questioned the company in relation to its supply chain management, particularly its provision of polymer to PPE manufacturers in Malaysia, one of which has been accused of major breaches of basic human rights. The company reported it had good traceability of its product and actively engaged with their customers on these issues. It will not tolerate modern slavery anywhere within its value chain.

Cllr Cooney also questioned the company with regards to its environmental and sustainability practices, specifically the company's dependency on the petrochemical industry and the risks associated with this reliance over the medium to long-term. As well as pushing for TCFD alignment Cllr Cooney also questioned the company with regards to its strategy on mitigating water risk. The chemical industry is notoriously water intensive and Cllr Cooney requested that the company undertake and disclose a comprehensive water risk mapping exercise to outline areas of the business that may struggle in future scenarios in which fresh water is scarce.