

# TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 8

## TEESSIDE PENSION FUND COMMITTEE REPORT

9 DECEMBER 2020

DIRECTOR OF FINANCE – IAN WRIGHT

### Border to Coast Responsible Investment Policy and Corporate Governance & Voting Guidelines

#### 1 PURPOSE OF THE REPORT

- 1.1 To advise the Committee of recent changes made by Border to Coast Pensions Partnership Limited ('Border to Coast') to its Responsible Investment Policy and Corporate Governance & Voting Guidelines.

#### 2 RECOMMENDATION

- 2.1 That Members note and approve the revised Border to Coast documents that are included as tracked changes versions in Appendices A and B to this report, and notes the proposed areas for future development in section 7.

#### 3 FINANCIAL IMPLICATIONS

- 3.1 There are no particular financial implications arising from this report.

#### 4 BACKGROUND

- 4.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (as amended) require the Fund to have a policy on:
- environmental, social and governance (ESG) considerations. The policy is required to take into account the selection, non-selection, retention and realisation of assets, and
  - the exercise of rights, including voting rights attached to investments.
- 4.2 To allow a practical and consistent approach to pooled investments, Border to Coast developed a Responsible Investment Policy and a Corporate Governance and Voting Guidelines document for all its Partner Funds to approve that applies across all the investments it holds on their behalf. These documents are subject to annual review.
- 4.3 Border to Coast has worked with its voting and engagement partner Robeco to update the documents, using the International Governance Network Global Governance Principles, UK Stewardship Code and Principles for Responsible Investment as benchmarks. The Partner Fund officers have had the opportunity to input to the revised

documents, which were also shared with Border to Coast's Joint Committee at its 24 November 2020 meeting.

- 4.4 In the 2019 review Border to Coast identified a number of areas for further development during 2020. In March 2020 Border to Coast held a Partner Fund Responsible Investment workshop to seek Partner Funds' views on these areas to build into the 2020 review:
- With respect to climate change, the consensus was for no targets to be set regarding carbon emissions reduction, with the direction of travel being more important. There was also a reiteration of the importance of engagement rather than divestment (from sectors as opposed to individual, poorly managed companies). The policy reflects this position; however, it is worth noting that one partner fund (South Yorkshire Pension Fund Authority) has recently set a challenging goal of making its portfolios carbon neutral by 2030.
  - Last year Border to Coast's Board requested that diversity beyond gender be considered. The option of broadening the application of the current voting policy on gender diversity to smaller companies and companies outside the UK was discussed. It was noted that voting on wider diversity matters will continue to be difficult where there is paucity of data, however the policy wording has been updated to indicate the intent to engage in this important area.
- 4.5 The investment industry's understanding of Responsible Investment matters is evolving rapidly and consequently further areas have been identified for future consideration in 2021 (see section 7). In particular a growing number of asset owners are publishing separate climate change policies and this is appropriate given its material significance to Partner Fund investment outcomes. Border to Coast will therefore during 2021 develop a standalone climate change policy building on the work already undertaken within Border to Coast and with Partner Funds.
- 4.4 The administering authorities of all eleven of Border to Coast's Partner Funds are being asked to approve the revised documents, which do not contain any changes to underlying principles. The main changes are set out in section 6 below.

## **5 REVIEW PROCESS**

- 5.1 The Responsible Investment policy and Corporate Governance & Voting Guidelines are reviewed annually or when material changes need to be made. The 2020 annual review process commenced in July to ensure any revisions required are in place and agreed with the Border to Coast's Board and Partner Funds ahead of the 2021 proxy voting season.
- 5.2 Current policies were evaluated by Robeco, Border to Coast's voting and engagement provider, considering the global context and best practice. This included consideration of the International Corporate Governance Network (ICGN) Global Governance Principles, the UK Corporate Governance Code and the UK Stewardship Code.
- 5.3 The policies of best in class asset managers and asset owners considered to be Responsible Investment leaders were also reviewed to determine how best practice has developed.

- 5.4 Border to Coast's climate change working party which concluded last year identified a number of key areas requiring further work and development as set out in last year's review:
- How to measure transition risk and the implications of setting targets (see 5.6)
  - The role private markets will play in managing transition risk (see 5.7)
  - Implications of an exclusion policy if engagement is ineffective (see 5.8)
  - Continue to embed and enhance analysis in the investment process (see 5.9)
  - Provide further education on the Task-force for Climate-related Financial Disclosure (TCFD) for Partner Funds (see 5.10)
  - Review communication approach to managing climate change risk (see 5.10)
- 5.5 Whilst good progress has been made in most of these areas, work was not concluded in all. In particular, the measurement of transition risk and scenario analysis and the implications of exclusions following ineffective engagement, are areas for further consideration before the 2021 policy review.
- 5.6 A Responsible Investment workshop was held for the Joint Committee in March where climate change was covered to enable Border to Coast to take Partner Fund views into the 2020 RI policy review. The consensus was that Partner Funds did not want to set climate change targets or exclusions; the direction of travel was seen as more important.
- 5.7 Border to Coast holds quarterly meetings including its Alternatives team looking at Environmental Social and Governance (ESG) issues with discussions on the role private markets play in the energy transition, carbon measurement challenges and ESG reporting. Investments have been made in 'new economy' themes of technology, healthcare and renewable energy via Border to Coast's private equity and infrastructure portfolios. Carbon measurement is particularly challenging for this asset class. Border to Coast have therefore joined with other asset owners, including other Local Government Pension Scheme (LGPS) pools and the Church of England, to look at how to report across private markets.
- 5.8 Border to Coast currently have no restrictions or exclusions regarding sectors or specific stocks. Exclusions and divestment, in certain cases, eliminate the ability to drive change within a company. Partner Funds, due to having passive mandates and legacy assets, may not be able to fully adopt the Border to Coast policy if an exclusion clause was added. Externally managed mandates have not been set up with restrictions in place. The investment implications of red lines and exclusions for companies not sectors, will be considered ahead of next year's review.
- 5.9 Considerable work has been done to embed and enhance climate analysis into the investment process, as captured in the Border to Coast TCFD Report available on Border to Coast's website at the following web page: <https://www.bordertocoast.org.uk/sustainability/>. This includes conducting carbon footprints on a quarterly basis on listed equity and fixed income portfolios and using the Transition Pathway Initiative Tool to assess portfolio holdings. Work continues in this area.

- 5.10 Border to Coast continues to support and provide training for Partner Funds on climate change and recently held a session covering TCFD reporting. They are continuing to develop reporting and communication with Partner Funds to ensure they meet requirements.
- 5.11 The move towards asset owners and asset managers committing publicly to being net zero by 2050 is growing. This was discussed at a Border to Coast Board Strategy Day in August, considering whether Border to Coast can make a pledge to be “net zero by 2050” across its investment portfolios. This is an area for further work ahead of the next policy review. Border to Coast is in discussion with officers at SYPA, whose Committee has recently made a commitment to being net zero by 2030, to understand how Border to Coast may be able to assist in this challenge.
- 5.12 In relation to diversity, applying the current voting policy outside the FTSE350 was seen as an area to consider. Last year Border to Coast’s Board requested that diversity beyond gender also be taken into account. This is addressed in the Voting Guidelines through expectations of companies, but it is more difficult to implement through voting due to the lack of disclosure by companies. This is something that can be better addressed by engagement.
- 5.13 A workshop was held with the officers of the Partner Funds on 22nd September. The proposed revised policies were shared with officers. Feedback on the Responsible Investment Policy covered governance, integration and escalation, and on the Corporate Governance & Voting Guidelines included comments on diversity, board evaluation, stakeholder engagement, dividends and climate change. These points along with the other proposed revisions to both policies were discussed, and amendments have been made to the revised policies. Divestment following unsuccessful engagement and specific climate-related exclusions have not been included in this review as work will be undertaken on these areas ahead of the 2021 Policy Review process.

6. CHANGES

- 6.1 The Corporate Governance & Voting Guidelines have been reviewed by Robeco considering best practice. There are several minor amendments including proposed additions and clarification of text. All changes are shown as track changes in the attached Appendix B.
- 6.2 Changes to the Corporate Governance & Voting Guidelines are summarised below.

Section	Page	Type of Change	Rationale
Diversity	5	Addition / clarification	Rewording and increasing scope of approach.
Re-election	5/6	Addition / clarification	Board member election using majority voting standard.

Section	Page	Type of Change	Rationale
Board evaluation	6	Addition	Assess skills.
Stakeholder engagement	6	Addition	Company response where significant votes against received.
Directors' Remuneration	6/7	Clarification Addition	Rephrasing. Greater detail on ESG incorporation in exec pay.
Annual bonus	7	Addition	Deferral of portion of short-term bonus.
Political donations	9	Clarification	Oppose political donation proposals.
Dividends	10	Addition	No publicly disclosed capital allocation strategy.
Virtual shareholder General Meetings	11	Addition	Loosen current approach but need to safeguard shareholder participation.
Shareholder proposals	12	Addition	Expand text to include types of proposal we would usually support.
Climate change	12	Addition	Vote against Chair if high emitting company with Transition Pathway Initiative (TPI) score of zero or 1.

6.2 The amendments to the Responsible Investment policy are highlighted in the table below.

Section	Page	Type of Change	Rationale
1. Introduction	2	Clarification	Implementation of policy.
1.1 Policy framework	2/3	Addition	Policy framework context (with thanks to SYPA).
5. Integrating RI into investment decisions	4	Addition Addition	Biodiversity. Text explaining 'overarching principles' apply to all asset classes.
5.1 Listed equities – internally managed	4	Clarification	Extra text to clarify process.
5.2 Private markets	5	Addition	Monitoring ESG policies and encourage improvement.
5.4 External manager selection	5 5	Addition Addition	Extra detail on expectations. PRI Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.

Section	Page	Type of Change	Rationale
5.5 Climate change	6/7	Addition	Reference to climate risk reporting via TCFD report.
		Addition	Use of Transition Pathway Initiative (TPI).
		Addition	Vote against Chair where rated zero or 1 by TPI.
		Addition	Private market investment themes.
6. Stewardship	7	Addition	Extra clarification text. Commitment to 2020 UK Stewardship Code.
6.1 Voting	7	Addition	Clarification on split voting circumstances - clear rationale from Partner Fund.
6.1.1 Use of proxy advisers	8	Clarification	Monitoring of Robeco.
		Clarification	Updated text on share blocking.
6.2 Engagement	9/10	Addition	Input into Robeco process for new themes.
		Addition	Include OECD Guidelines breaches.
		Addition	Sharing engagement information.
9. Training and assistance	11	Addition	Training for Investment Team, Board and Joint Committee.

6.3 An increasing number of asset owners and asset managers are publishing separate documents defining the approach taken to climate change. This includes Brunel Pension Partnership, Local Pensions Partnership and NEST. South Yorkshire Pensions Authority (SYPA) also have a separate climate policy, which references not investing in pure coal and tar sands and that SYPA will 'seek to use its influence within the wider Border to Coast Partnership to secure the agreement of appropriate goals for reducing the carbon intensity of portfolios'. This is a long-standing policy and whilst not written into Border to Coast's policy, Border to Coast does not currently hold any such investments.

## **7 WORK TO BE UNDERTAKEN IN 2021**

- 7.1 The following pre-work will be undertaken ahead of the 2021 Policy Review process:
- The development of a standalone climate change policy
  - The measurement of transition risk and the implications of setting targets, including the potential to set a net zero carbon target
  - The role of private markets in managing transition risk
  - Implications of an exclusion policy if engagement is ineffective
- 7.2 Border to Coast will also continue to develop their communication approach to enable Partner Funds and other important stakeholders to understand and oversee Border to Coast in carrying out their responsible investment remit.

## **8. NEXT STEPS**

- 8.1 Border to Coast will continue to work with its Partner Funds to develop and update its approach to Responsible Investment and Corporate Governance.

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