

# TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 11

## TEESSIDE PENSION FUND COMMITTEE REPORT

15 DECEMBER 2021

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 B and C to this report.

#### 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 23 November 2021 meeting.

- 4.4 In the 2020 review Border to Coast identified the need for a standalone Climate Change Policy which has been developed outside the normal RI Policy review period and was approved by the Board on 21st September and shared with Partner Funds via the Joint Committee. A copy of this policy is attached at Appendix A. The Climate Change Policy includes specific exclusions covering companies with >90% of revenue from thermal coal and tar sands. This is the first time Border to Coast has had exclusions and considerable engagement was undertaken with Partner Funds on this issue. The approach to exclusions is articulated in the revised RI Policy (attached at Appendix B).
- 4.5 The rationale for more specific exclusions in the policy included the enabling of better engagement with private market managers. Exclusion of certain types of investments in Private Markets typically forms part of the side letter negotiations with the investment manager. Where an investor can point to a policy that explicitly excludes certain types of investments there is a greater probability of this being accepted by the investment manager.
- 4.6 The original priority engagement themes of Governance, Diversity, and Transparency and Disclosure were decided prior to launch in 2018. To reflect Border to Coast's growth and maturity as an organisation and the evolving nature of environmental, social and governance issues, the decision was taken to review the engagement themes (see section 7). The final four themes have been included in the RI Policy.

## **5 REVIEW PROCESS**

- 5.1 The RI policy and Corporate Governance & Voting Guidelines are reviewed annually or when material changes need to be made. The annual review process commenced in July to ensure any revisions are in place ahead of the 2022 proxy voting season.
- 5.2 Current policies were evaluated by Robeco, Border to Coast's voting and engagement provider, considering the global context and shift in best practice. This included consideration of the recently revised 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 RI leaders were also consulted to determine how best practice has developed. Policies assessed included RLAM, LGIM, NZ Super, NEST and Brunel. Border to Coast have also taken into account the Investment Association Shareholder Priorities for 2021.
- 5.4 There were some areas highlighted as part of last year's review that were due to be addressed during 2021. Transition risk and scenario analysis being one area. Following the ESG/carbon data procurement and appointment of successful providers Border to Coast will be able to conduct scenario analysis from early next year. Border to Coast are also looking at how they can support Partner Funds in their Task Force on Climate-related Financial Disclosures (TCFD) reporting and this has been considered in the procurement.

- 5.5 One other area was exclusions. As Border to Coast advocate engagement over divestment, they have previously not had any exclusions in place. Development of the Climate Change Policy has, however, led to the exclusion of companies with >90% of revenues derived from thermal coal or tar sands. Any exclusions must be explicit for them to be adopted by our private market managers. Considerable engagement was conducted with Partner Funds to reinforce Border to Coast's active stewardship approach and dispel any concerns that they were being influenced by pressure group lobbying.
- 5.6 RI workshops have been held during the year for the Joint Committee at which Border to Coast covered the Climate Change Policy, exclusions and engagement escalation. They also covered the engagement theme review process and the potential long list of themes. Feedback was received from Partner Funds on their preferences for key themes to be taken forward.
- 5.7 A workshop was held with the officers of the Partner Funds on 5th October. The proposed revised RI Policy and Voting Guideline were shared with Officers and feedback and comments were received. Feedback on the RI Policy covered climate change exclusion wording, and on the Corporate Governance & Voting Guidelines comments on diversity. These points along with the other proposed revisions to both policies were discussed, and amendments made to the draft policies.
- 5.8 After considering feedback from the Officer Operation Group, the policies were re-presented to the Border to Coast Investment Committee, which recommended the proposed amendments to Border to Coast's Board. Both policies were approved by the Board on 11th November.
- 5.9 The annual review and governance processes need to be completed, with policies approved and ready to be implemented ahead of the 2022 proxy voting season. After considering feedback from the Officer Operation Group and the Investment Committee, the revised policies were approved by the Board on 11th November.
- 5.10 Border to Coast has asked Partner Funds to complete their review by the end of 2021 so that they are able to carry out this implementation and disclose their voting intentions to companies prior to the peak season.

## **6 Key changes**

- 6.1 This year's RI Policy review reflects work undertaken during the year, including the development of the Climate Change Policy and associated exclusions, and the refreshment of the key engagement themes. All changes are shown as tracked changes in the attached Appendix B.
- 6.2 Diversity and diversity of thought on boards and senior executive teams are significant for good governance of an organisation. This is considered in the Voting Guidelines, and this also needs to be reflected in the RI Policy. Wording has been added in the 'Introduction' section on the importance of diversity.

- 6.3 Real estate is an asset class which Border to Coast are looking to launch towards the end of 2022 and is therefore covered by the revised RI Policy which will be live from January 2022. A new section has been inserted under ‘Integrating RI into investment decisions’ which covers the RI approach for the fund selection process. A more detailed policy will be developed with assistance from the third-party property manager, once they are in place.
- 6.4 Due to the development of a standalone Climate Change Policy, the respective section within the RI Policy has been reduced and the new policy signposted.
- 6.5 There is a lack of consistency across asset owners and managers when it comes to referencing exclusions. Some include exclusions within their main RI Policy whilst others have separate policies for each individual issue. As exclusions have been referenced in the Climate Change Policy, a paragraph has been added to the climate change section (5.6) of the RI Policy covering Border to Coast’s approach.
- 6.6 The priority engagement themes have been reviewed this year using the newly developed framework. This is the first time Border to Coast has reviewed their priority themes; the process undertaken has been described in the RI Policy and the new themes have been included. More detail is included in section 7.
- 6.7 The amendments to the RI policy are highlighted in the table below.

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

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

- 6.9 Border to Coast considers diversity in its broadest sense, not just gender or ethnicity to ensure boards have diversity of thought and experience. This has never been more compelling and highlighted by the pandemic with the need for companies to adapt and be innovative in order to be resilient and survive for the long-term. Diversity throughout the organisation is also important to attract and retain staff, improve productivity and profits, and develop a diverse pipeline of talent.
- 6.10 Gender diversity on boards has improved but Hampton-Alexander Review's initial target year of having 33% female representation on boards was 2020. Research shows that the benefits of diversity are greatest when female representation is above the 30% level, it is therefore appropriate to take a stronger voting stance now across developed markets and to ask for 33%, rather than rounding down to 30%. Border to Coast will still be flexible in our approach especially for emerging markets and Japan, where the expectation is for companies to have at least one female on the board.
- 6.11 The Parker review published its report into ethnic diversity of UK boards in 2017. The recommendations were for FTSE 100 companies to have at least one director of colour by 2021, with the same target for FTSE 250 companies by 2024. Although progress has been made companies have had four years to put plans in place. Border to Coast proposes being more specific in their voting intentions by voting against the chair of the nomination committee for FTSE 100 companies where this recommendation has not been met unless there are mitigating factors or plans have been disclosed.
- 6.12 Lobbying by companies or trade associations in relation to climate change is a real concern. Some trade associations are taking anti-climate positions which not all their members purportedly subscribe to. This is to the detriment of companies whose operations and supply chains are threatened by the climate crisis. To stay below a 1.5°C temperature rise requires companies to align their climate actions and policies to the Paris Agreement. Border to Coast will therefore support shareholder resolutions regarding lobbying activities in relation to climate change.
- 6.13 Border to Coast continues to strengthen the Voting Guidelines on climate change and this year have added voting against the Chair of the board where a company fails the first four indicators of the Climate Action 100+ Net Zero Benchmark, launched earlier this year.
- 6.14 Amendments to the Corporate Governance & Voting Guidelines are highlighted in the table below:

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

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

## 7 Engagement theme review

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

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

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

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

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

- 7.5.1 **Engagement objective:** Climate change is a systemic risk that poses significant risks and opportunities for investments. In high emitting sectors companies need to adapt and, in some cases, fundamentally change their business models. The aim of this engagement is to focus on the companies in high emitting sectors and banks identified as key to financing the transition to a low-carbon economy, to commit to credible plans to meet net-zero targets.
- 7.6 **Waste and Water Management:** The focus is on companies assessed as having high exposure to water-intensive operations and/or producing high levels of packaging waste and plastic pollution.
- 7.6.1 **Engagement objective:** Water is becoming an increasingly scarce and costly resource and a material financial risk for companies and investors. Packaging waste is a huge environmental problem with increasing regulation. This engagement theme will focus on engaging portfolio companies with high exposure to water-intensive operations, exposure to operations producing high levels of packaging waste to develop policies and initiatives to address the issue(s).
- 7.7 **Social Inclusion through Labour Management:** This theme seeks to blend two of the previous proposed themes around Social Inclusion and Supply Chain Management. The focus is on companies assessed as having high exposure to labour intensive operations, those scoring lower on human capital development and those that are scoring lower on supply chain labour management. This includes engaging with companies on modern slavery policies.
- 7.7.1 **Engagement objective:** Human capital management and supply chain issues are recognised as financial risks emphasised by the pandemic. Engagement will be with companies with high exposure to labour-intensive operations and lower scoring companies in relation to human capital development and supply chain labour management risk. The aim is to promote sustained, inclusive growth with productive and decent work for all, including elimination of child labour in supply chains.
- 7.8 **Diversity of Thought:** The focus will be on companies that have been flagged as not having diversity management programs in place, including UK companies that are not meeting the recommendations of the Hampton Alexander and Parker Reviews where we believe we hold sufficient market cap to have an influence.
- 7.8.1 **Engagement objective:** The need for diversity of thought and experience on boards has never been more compelling. The pandemic has caused massive economic disruption with companies needing to be able to adapt and be innovative in order to be resilient and survive for the long-term. The focus of this engagement is to enhance the diversity of boards reducing the risk of 'group think' leading to better decision making and wider diversity across the organisation to increase the resilience and long-term sustainability of companies. To ensure a pipeline of diverse talent is being developed and utilised, this engagement will also cover improving the approach to building diversity and inclusion in executive committees, other senior leadership roles and throughout the workforce.

## **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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