LGPS CENTRAL LIMITED

Quarterly Stewardship Report

First Quarter, 2018

LGPS Central Limited

LGPS Central, Quarterly Stewardship Report

Responsible Investment & Engagement: LGPS Central's approach

LGPS Central's approach to Responsible Investment & Engagement carries two objectives:

1. Support the Company's investment objectives
2. Be an exemplar for RI within the financial services industry & raise standards across the marketplace

These are met through 3 pillars

This report covers Central's *stewardship* activity.
For more information please refer to Central's Responsible Investment & Engagement Framework and UK Stewardship Code Compliance Statement.

ADDITIONAL DISCLOSURES:

Responsible Investment & Engagement Framework

Stewardship Code

Vote-by-vote disclosure

Signatory of: PRI Principles for Responsible Investment

LGPS ADVISORY BOARD CODE OF TRANSPARENCY

1. Introduction and Market Overview

Prior to going live, we established in collaboration with our partner funds a Responsible Investment & Engagement Framework, and a Statement of Compliance with the UK Stewardship Code. From our perspective, responsible investment has relevance both before and after the investment decision and is a core part of our fiduciary duty. We are committed to placing responsible investment at the heart of our investment process.

The quarter was a busy one from a stewardship perspective, with the proxy season in full swing, UK corporate governance under review, the European Parliament adopting a sustainable finance resolution and the UK government consulting on fiduciary duty and asking pension funds about climate risk.

Climate Change

The Environmental Audit Committee (EAC), a House of Commons Select Committee, published the responses of the 25 largest UK pension funds to the EAC inquiry into green finance. The pension funds were asked a series of questions about climate change and disclosure, including whether the funds have committed to disclosing in line with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD). Four funds within the Local Government Pension Scheme (LGPS) were included among the sample,

and each received the EAC's highest rating, reflecting the leadership position taken by the LGPS on climate change. Together with our partner funds, LGPS Central has articulated an investment belief on the financial materiality of climate change and has committed to disclosing using the TCFD's recommendations. Since climate change is one of our stewardship themes, we report on progress to date in Section 4 below.

Governance and audit

In May 2018, the Work & Pensions and Business Energy and Industrial Strategy (BEIS) Committees issued a joint report on the collapse of Carillion Plc. The report focussed on debt, the pension fund, dividend payments and the roles of external auditors and company directors. Carillion had signed the Prompt Payment Code, whose signatories should aim to pay suppliers within 30 days, but its standard payment terms were 120 days. The joint report recommends that the big four accounting firms be referred to the Competition and Markets Authority and suggested that the auditors' regulator (the Financial Reporting Council, FRC) had insufficient

Carillion Plc.

Prime Minister Shinzo Abe, Japan

powers to prevent Carillion's collapse. The FRC has established an Investor Advisory Group and, in order to be part of the dialogue to restore trust in annual accounts and external audits, we have accepted a position on this group.

Sustainable finance

The European Parliament adopted in May 2018 a resolution on sustainable finance, the culmination of the EU Commission's High-Level Expert Group ("HLEG") on Sustainable Finance. The resolution calls for updates to fiduciary duty, green bond disclosure standards, a robust taxonomy for green finance, and carbon stress tests for banks. In a UK context, LGPS Central has been part of the Green Finance Initiative's Working Group on Data, Disclosure and Risk. Together, we issued a report named Establishing The World's Best Framework For Climate-Related And Sustainability-Related Financial Disclosures, aiming to drive improvements in climate-related disclosure in the UK while focussing on financially material issues (see Section 6).

AGM season

The AGM season again saw shareholder protests over pay, with remuneration packages at Walt Disney, Tesla, Persimmon, Inmarsat and Melrose Industries catching the eye of dissident shareholders. From 2019 the new UK Corporate Governance Code will make premium listed companies obliged to explain the measures taken to appease shareholders following a 20% level of dissidence. This makes "moderate" voting dissidence more meaningful, and improves the likely level of outreach and engagement by UK companies and investors.

In Japan, a record number of companies proposed share buybacks and a gradual unwinding of the chronic levels of cross-shareholding in the Nikkei indices has continued. These developments, which improve relations with shareholders, follow the 2014-15 introduction of corporate governance and stewardship codes and Prime Minister Abe's project of economic reform.

A series of resolutions at US company AGMs sought improved shareholder rights by attempting to lower the threshold amount of shareholders required to request a general meeting. In line with our Voting Principles – which we have developed with our partner funds – LGPS Central has been supportive of these proposals.

Companies and voting intermediaries have begun to experiment with blockchain technology to keep ledgers of AGM voting records and facilitate vote confirmation. Vote confirmation – assurance for investors that their votes have been properly processed and reconciled – has to date proved elusive but emerging technology and legislative pressure (for example the European Shareholder Rights Directive) are creating overdue traction.

Bob Iger, Walt Disney

Elon Musk, Tesla

2. Stewardship at LGPS Central

We aim to steward our clients' capital in a way that supports economic outcomes and sustainable growth. This includes both top-down and bottom-up stewardship.

Top-down stewardship is where, working with our partner funds, we identify themes of economic significance and of likely relevance to a majority of stakeholders and pursue broad-based engagement, usually in collaboration with likeminded investors or through partnerships. Our pension fund clients are long-term, diversified, "universal" owners and we have an interest in raising market standards as much as improving individual stocks. The themes identified in 2018 are climate change, cyber security and diversity.

Stewardship Themes


1. Climate Change


2. Cyber Security


3. Diversity

Bottom-up stewardship is where we identify specific, idiosyncratic issues at investee companies and enter a strategic dialogue with the company to improve any identified weaknesses. Stewardship is not limited to engaging and voting at listed equity companies: we employ stewardship techniques across all invested asset classes.

For each company engagement, we set objectives and milestones and we regularly review progress, escalating some engagements and drawing others to a conclusion. An extra dimension is added to some engagements and AGM votes when they attract external stakeholder attention, including campaign groups and NGOs. A recent case in point would be Royal Dutch Shell Plc, to whom most UK institutional investors have exposure via index-tracking funds.

Stewardship and Royal Dutch Shell

Shell, like all oil & gas companies, faces over the coming decade an existential challenge to its traditional business model. Naturally, our stakeholders are questioning the rationale for


Royal Dutch Shell

investments in the energy sector, based either on moral or financial concern.

Most commentators would agree that Shell has come a long way. The Transition Pathway Initiative (TPI), for example, awards Shell the highest rating for its governance of climate risks, and Shell is the only company in its sector to provide the TPI with data to assess long-term alignment with the Paris climate accord. It has taken steps to decarbonise and diversify its business away from oil and tar sands and has published an ambition to halve the net carbon footprint of its sold energy products – i.e. GHGs emitted by their customers, not just by the company – by 2050. This is a sector-leading approach. Critics of Shell point out that capital expenditure on fossil fuel-related items remains a multiple of its spend on 'new energy', and argue the company should set binding "targets" rather than "ambitions": a Dutch NGO co-filed a shareholder resolution asking Shell to commit to Paris-aligned "targets".

We recognise the risks Shell faces and have opened a dialogue to discuss climate-related risks in a context of financial materiality. In the run up to the AGM in May, we met the Chair to discuss climate-related risks, strategy and disclosure, and the shareholder resolution. We think that Shell is rightly applauded for its current leadership and we agree that laggards in the sector have far greater room for improvement. We also agree that Shell's journey is not complete. We found the resolution to be appropriately worded, giving Shell the flexibility to design and manage the targets in a way that would not be detrimental to long-term commercial interests. On balance, we voted to support the resolution, and would have reached the same conclusion were the resolution put to other oil & gas companies in same circumstances. The AGM vote, which was defeated, is not the end of the process and we look forward to continued dialogue with the company leading into the next AGM.

LGPS Central is a member of TPI, CDP, the Institutional Investor Group on Climate Change (IIGCC) and Climate Action 100+. For an issue like climate change, where the complexities of the diagnosis and the solutions are of such a magnitude, it is vital to partner with like-minded investors in order to achieve change. Climate change is not a threat that can be mitigated by acting in isolation, or by walking away from the issue. We know that different spectators will arrive at different perspectives, including in relation Shell's climate risk management, how to vote on shareholder resolutions, and whether to hold Shell in the portfolio.

In May we co-signed a letter in the Financial Times headed Oil and gas groups must do more to support climate accord. In the letter, we said:

> *"Regardless of the result at the Shell AGM, we strongly encourage all companies in this sector to clarify how they see their future in a low-carbon world."*

It is vital that investors are not divided when it comes to climate risks, and that's why we place a high value on our industry participation, which we explain further in Section 6.

3. Engagement

This quarter we introduced 78 companies into our engagement set and achieved some or all of our engagements objectives on 12 occasions.

Most engagements were conducted through company meetings or letters and we mostly met the Chair or a subject matter expert.

Most engagements were in support of our stewardship themes, and this is expanded in Section 4 below. To illustrate our stock-specific engagement, we provide two case studies below.

Accounting and disclosure

We hold a position in a UK-listed hotels company, where poor operating performance and a recent management change led us to initiate an engagement. We think the annual accounts should include regular disclosure of the real estate value of the hotels portfolio, and we discussed this on a call with a member of the company's Audit Committee. Later, at the company AGM we supported a shareholder resolution calling for regular asset re-valuations, and the resolution gathered support from more than 60% of the independent shareholders. After a period of rotating interim CEOs, the company has taken the welcome move of appointing a permanent CEO, whom we look forward to meeting for continued engagement.

Strategy, succession and remuneration

Disruption from the internet giants continues to threaten 'traditional' media agency business models who have lost market share to the likes of Facebook and Google. These new entrants reach the customer in new and innovative ways at a time when large consumer goods companies are spending less on traditional advertising formats. Ad agencies need to find a new way to win, and we met the Chair of a global media company to discuss strategy and succession planning. The Chair explained the preferred path to growth, a differentiated offering that will allow the company to compete with digital entrants, and how the strategy relates to the search for a new CEO. A challenge for the company, which has a premium UK listing, will be to recruit a world-class leader on a remuneration package that both appeases its shareholder base and competes in the global race for talent. We remain in dialogue with the company.

4. Stewardship Themes

This quarter we introduced 78 companies into our engagement set and achieved some or all of our engagements objectives on 12 occasions.

Climate Change

The threat to global economic prosperity posed by climate change cannot be ignored. The London School of Economics (LSE) estimate that a business-as-usual emissions trend results in a climate value-at-risk to global financial assets of $2.5tn, whereas limiting global warming to no more than 2°C would mean the present value of global financial assets would actually increase. For pension fund investors with very long-term liabilities, the consequences of climate-related physical and transition risks are financially significant and, in recognition, LGPS Central has articulated a responsible investment belief specifically on climate change.

This quarter we have begun to work with the Climate Action 100+ (CA100+) initiative, a collaboration of institutional investors jointly responsible for $30tn in assets under management. CA100+ will engage around 150 of the world's largest and most GHG-intensive companies. We have three objectives: (i) robust governance of climate risk, (ii) climate change disclosure in line with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD), and (iii) the alignment of business models with a 2°C pathway. We are co-leading two

- Further 157 engagements in preparation stage as part of CA100+
- Thematic voting rule linked to climate change
- Co-authored climate-related UK disclosure framework

Engagement Volume by Type

Engagement Volume by Outcome

 LGPS Central Limited is authorised and regulated by the Financial Conduct Authority.

www.climateaction100.org

of the engagements, one at a large UK utility company, and a second at a diversified miner. We met both companies during the quarter in review. We found that both companies integrate assessments of climate risks into their business planning and project investment costs, both have governance structures and lines of accountability, and both support the Paris Climate Accord. We are continuing to engage the companies on target-setting and strategies for reducing life-cycle emissions, including the GHGs emitted downstream (i.e. by customers).

www.lse.ac.uk/GranthamInstitute/tpi/the-toolkit/

We also continue to work with the Transition Pathway Initiative (TPI), which leverages insight from the LSE and FTSERussell to observe climate change governance and performance for companies in high impact sectors such as Utilities, Oil & Gas, Autos and Cement. In the 2018 AGM season, we implemented a voting rule in which we voted against the Chair of any company scoring 0 on the TPI's governance rating. Such companies have failed to recognise climate change as a risk and we have used our votes to signal disappointment in the person most responsible for setting company strategy and risk appetite (i.e. the Chair). The TPI's tool will guide our climate change engagements over the coming year.

As members of the Green Finance Initiative's (GFI) Working Group on Data Disclosure & Risk, we co-authored Establishing the World's Best Framework for Climate-related and Sustainability-related Financial Disclosures, calling on the UK government and relevant regulators to integrate the TCFD recommendations into the UK corporate governance and reporting framework. Within this remit we also responded to the Department for Work and Pension's consultation on "Clarifying and strengthening trustees' investment duties". Our response welcomed the clarification on financially material ESG issues, including climate change, and recommended TCFD as the optimal climate-related disclosure framework.

2018

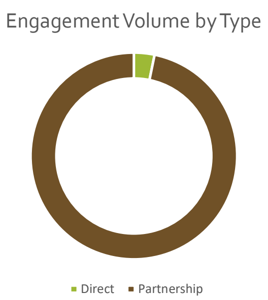
1. Extreme Weather Events
2. Natural Disasters
3. Cyber Attacks
4. Data fraud or theft
5. Failiure of climate-change mitigation and adaptation

Source: World Economic Forum Global Risks Report 2018

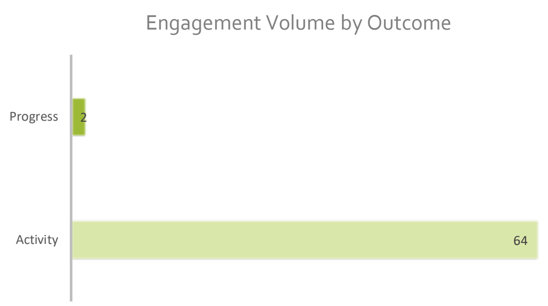
Cyber security and data protection

- PRI-led collaborative engagement
- 62 companies contacted by letter; 56 responses received
- 38 engagement meetings held

The World Economic Forum's Global Risks Report highlights cyber attacks and data fraud, pointing to disruption to businesses and consumers as a result of increasing breach-rates. The WannaCry attack disrupted 300,000 computers across 150 countries (including 80 NHS organisations) and NotPetya caused $300m of quarterly losses for businesses affected by the malware. Every modern business is cyber-dependent, and many have a competitive advantage in their collection and processing of personal data. Investors are naturally interested in building a portfolio that is resilient to threats of cyber attacks and data protection breaches.



We are part of a collaborative engagement organised by the PRI aimed at achieving shareholder assurance on companies' preparedness for cyber security threats and mitigation of data management risks (including GDPR). Of the 62 companies in the collaborative engagement, LGPS Central is leading engagements with two UK banks. We met both companies during the quarter in review and were impressed with a focus on training, embedding a risk-aware culture, leadership in a UK context, and collaboration with peers and national bodies such as GCHQ, National Cyber Security Centre and Cyber Security Alliance. However, these good practices were not always reflected in the companies' public disclosures, which we consider to be an opportunity missed. We fed back our assessments and both companies' cyber risk ratings have improved following our engagement.



Diversity

Complacency over gender equality progress has been stalled by recent scandals including the #metoo campaign, the Presidents Club dinner, and gender pay gap reporting. The under-representation of females in our economy could be costing $12tn in reduced annual GDP. In terms of corporate governance, it has long been understood that decision-making is better informed when it incorporates a diversity of perspectives, and this is borne out in corporate performance. A study from ThirtyNorth Investments finds that companies with no female board members routinely underperform those companies with one or more female on the board, and even more so relative to boards with at least 25% female representation.

LGPS Central has become a signatory to the 30% Club Investor Group and has begun to engage collaboratively with companies performing poorly on gender diversity. Following engagement meetings with three company Chairs, female directors were appointed to the boards of each of the three target companies.

Engagement Volume by Type

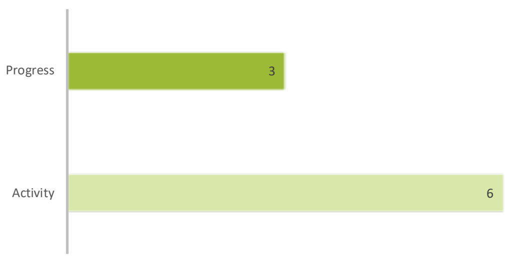
This AGM season we introduced a voting rule which aligns with our support for the 30% Club Investor Group's Statement of Intent. We have decided to oppose the re-election of any Nominations

- Thematic voting rule linked to board diversity
- Membership of 30% Club Investor Group
- Three female board appointments following engagement

Committee Chair that is making insufficient progress on board diversity (which we define to be fewer than 25% of the board comprising female directors for FTSE 100 companies and fewer than 20% for FTSE 250 companies).

Diversity concerns stretch beyond gender, as articulated in a UK context by Sir John Parker's Report into the Ethnic Diversity of UK Boards. Sir John finds that directors of colour represent just 8% of the total (compared to 14% of the UK population), and he recommends a target of at least one director of colour on each FTSE 100 board by 2021. We have opened a dialogue with a UK-listed company that operates in Africa to understand how the composition of its senior management, executive committee and board will reflect the underlying demographics of its countries of operation.

Engagement Volume by Outcome

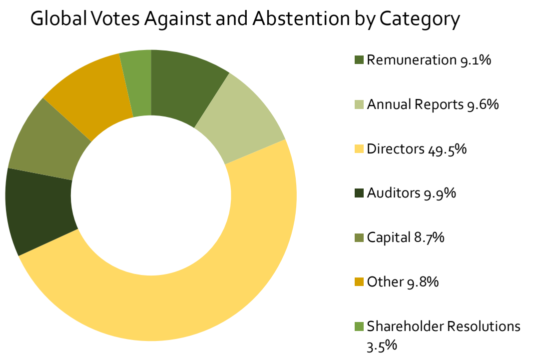


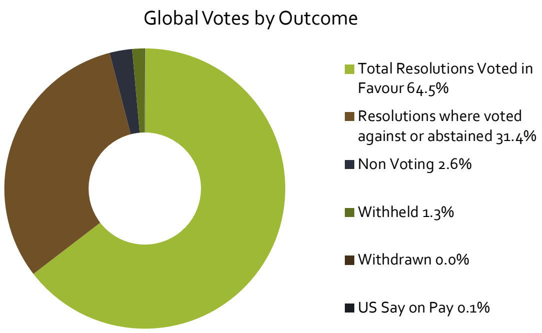
5. Voting

Policy: For UK listed companies, we vote our shares in accordance with a set of bespoke UK Voting Principles. For other markets, we consider the recommendations and advice of our third party proxy advisor.

Global

On behalf of our clients, we began voting shares at company meetings from 3rd April 2018 [1].

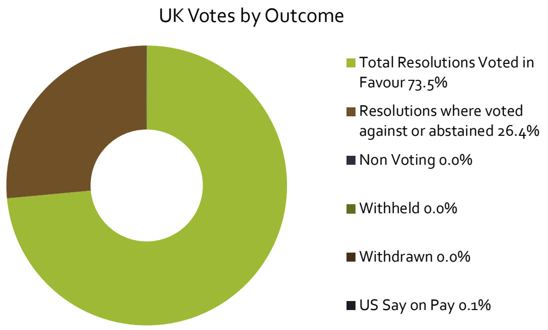




Overall we voted at 1,453 company meetings on 20,089 resolutions and we opposed or abstained from about 31% of the resolutions. Of these, most related to the re-election of directors (50%), the appointment of auditors (10%), approval of annual reports (10%), remuneration (9%), or capital decisions (8%).

UK

The UK saw a 25% year on year increase in shareholder 'rebellions' (where oppose votes total 20% or more), according to the Investment Association's register. Mostly rebellions were against the re-election of individual directors, rather than executive pay. We voted at 186 company meetings and voted to oppose or abstain about 26% of the resolutions.



Persimmon Plc. We voted to oppose the remuneration report which awarded its CEO £75m in fixed and variable pay (itself a reduction from the £110m initially proposed). A further 65% of the shareholder base failed to support the report.

Melrose Industries Plc. Following the high-profile takeover of GKN, the CEO received £42m in variable pay through a five-year Value Incentive Plan. While structurally aligned with shareholder value, we felt the Value Incentive Plan delivered excessive quantum and voted to oppose the remuneration report. The company has acknowledged the issue.

WPP Plc. After the long-serving CEO departed following a personal misconduct investigation, there was pressure on the Interim Executive Chair Roberto Quarta regarding succession planning, retirement benefits and disclosure. We were concerned regarding Mr Quarta's overboarding (he also chairs Smith & Nephew) and the aftermath of the CEO's retirement, but felt WPP needs some consistency of leadership in the short term. We decided to cast an abstain vote on balance.

[1] The data presented here relate to voting decisions for securities held in portfolios held within the company's Authorised Contractual Scheme (ACS)

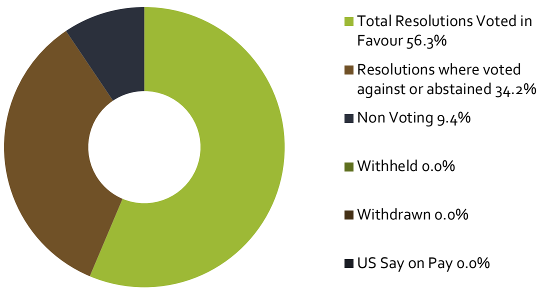
Millennium & Copthorne Plc. We voted to oppose the re-election of five board members (over independence concerns), to oppose a poison pill, and to oppose the re-election of the auditors (owing to tenure). We supported a shareholder resolution calling for regular disclosure of an asset re-valuation.

Royal Dutch Shell Plc: We voted to oppose the remuneration report and we voted to support a shareholder resolution calling on the company to set long-term targets aligned with a 2°C transition.

Europe ex-UK

We voted at 305 company meetings and voted to oppose or abstain about 34% of the resolutions.

Europe ex-UK Votes by Outcome



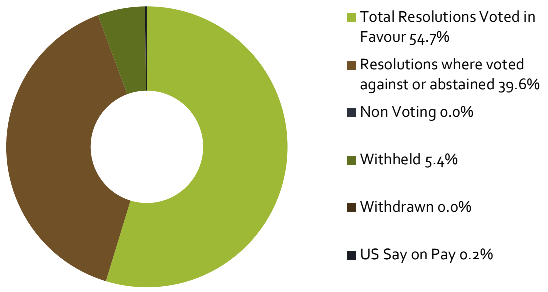
Safran SA. We voted to oppose the CEO remuneration policy and report. We are concerned that the variable compensation is rewarded for performance against targets that are not fully clear, and by a lack of claw back provisions.

Volkswagen AG. We voted to oppose all members of the Management Board and the Supervisory Board bar one. The members of the boards we opposed are insufficiently independent, which is a governance risk for VW given the influence of Piëch and Porsche family members, and as the diesel emissions scandal continues to complexify.

North America

We voted at 393 company meetings and voted to oppose or abstain about 39% of the resolutions. Sixty-one US AGMs included resolutions calling for a lower threshold of shareholder support support to call extraordinary shareholder meeting. We voted to support these resolutions to improve company accountability to shareholders.

North America Votes by Outcome



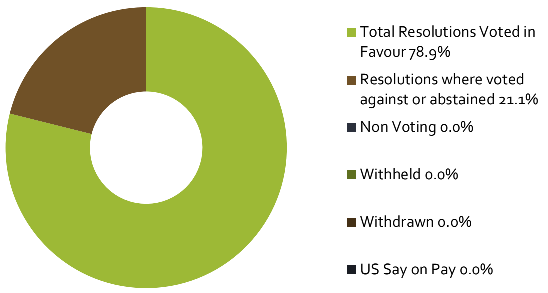
Tesla Inc. We voted against the re-election of Kimbal Musk (Elon's brother) and Antonio Gracias (the Lead Director) on concerns that they do not bring sufficient levels of independence to their non-executive roles. We supported resolution to adopt a policy that the chair of the board should be independent, and separated from the CEO role.

Amazon Inc. We opposed the re-election of the Lead Director as we feel her long tenure calls into question her ability to provide a sufficiently independent counterweight to Jeff Bezos, who has the combined role of CEO & Chair. We supported a shareholder resolution for an independent chair and another supporting board diversity.

Japan

We voted at 428 company meetings and voted to oppose or abstain about 21% of the resolutions.

Japan Votes by Outcome



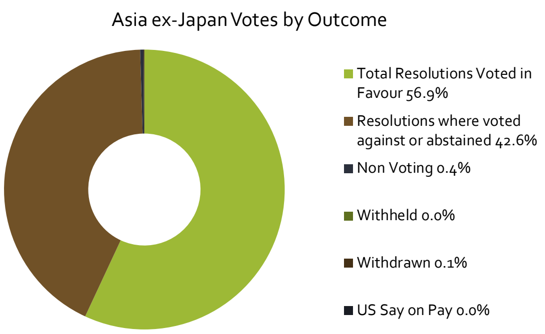
A record number of Japanese companies proposed share buybacks, including 20 that had never bought back shares in their history. Although about 50% of the Topix constituents are net cash, against around 20% for US and EU markets, Japanese companies have been far slower to return capital to shareholder.

Mitsubishi Corp. Japan's Companies Act revision has led to the appointment of more 'outside' directors in an attempt to increase independence on company boards. Some of the outside directors to be appointed have close relationships to companies, related parties or the government. Concerns over independence led us to vote against two outside directors at Mitsubishi Corp.

Panasonic Corp. We voted against the election of several inside and outside directors following a bribery scandal in which the company was fined by the Securities and Exchange Commission for offences under the Foreign Corrupt Practices Act.

Asia ex-Japan

We voted at 111 company meetings and voted to oppose or abstain about 43% of the resolutions.

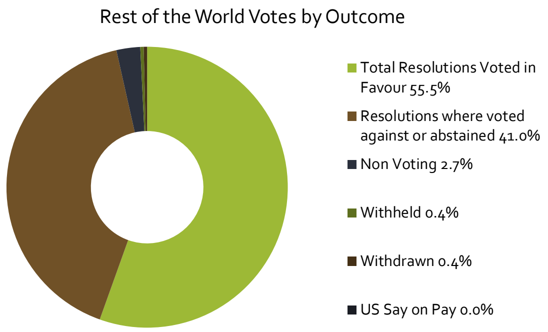


Tencent Ltd. The company proposed a pair of resolutions seeking the authority to issue shares of up to 30% of current share capital. We opposed the resolutions over concerns about dilution.

Shougang Fushan Resources. As part of our thematic voting instruction related to climate change, we decided to oppose the company chair's re-election. As a mining company, Shougang Fushan has high exposure to climate risks, but scores the lowest rating in TPI's assessment of climate change management quality.

Rest of the World

We voted at 30 company meetings and voted to oppose or abstain about 41% of the resolutions.



Rio Tinto Ltd. We decided to support a shareholder resolution requiring the company to regularly review its memberships of and payments to industry associations, and to consider whether the industry association views diverge from the company's own. While the company has made laudable engagement efforts with some groups, particularly on climate change issues, we felt the resolution was well worded, reasonable, and flexible.

6. Industry Participation

LGPS Central is an active participant in the investment industry and responds to relevant stakeholder consultations, contributes to key RI-related advisory committees, and makes select speaking appearances at investment conferences.

At the Responsible Investment Forum Europe in June, the PRI launched its new framework to assist in the ESG monitoring of General Partners (GPs; i.e. fund managers) by Limited Partners (LPs; i.e. investors allocating capital to funds). As part of the working group contributing to this tool, LGPS Central were supportive of simplifying reporting burdens on GPs, and focussing on financially material ESG risks and opportunities. We also called for diversity metrics – whether at the GP level or at the portfolio company – to be included as a regular disclosure item.

As part of our role on the Green Finance Initiative's (GFI) Working Group on Data Disclosure & Risk, we contributed to the GFI's consultation response to DWP (Department for Work & Pensions) on "Clarifying and strengthening trustees' investment duties". Our response welcomed the clarification on financially material ESG issues, including climate change, and recommended TCFD as the optimal climate-related disclosure framework. Earlier in the year, we contributed to Establishing the World's Best Framework for Climate-related and Sustainability-related Financial Disclosures, calling on the UK government and relevant regulators to integrate the TCFD recommendations into the UK corporate governance and reporting framework. LGPS Central will make its own climate-related disclosures using the TCFD's framework.

LGPS Central currently contributes to the following groups:

- Cross-Pool Responsible Investment Group
- UK Pension Fund Roundtable
- BVCA Responsible Investment Advisory Group
- PRI Listed Equity Integration Advisory Sub-Committee
- TPI Steering Committee & Technical Advisory Group
- GFI Working Group on Data, Disclosure & Risk
- FRC Investor Advisory Group
- LAPF SIF Advisory Board

This quarter our Director of Responsible Investment & Engagement spoke at three investment conferences:

RI Europe

- Why some investors do RI and others do not

SPS Conferences ESG & Sustainable Investments

- Investor ESG insights, 'putting it all together'

Institutional Investor Institute UK & Ireland Summit

- The Next Steps in ESG Investing & ESG Effectiveness workshop

LGPS Central Limited's Partnership Organisations

30% Club
GROWTH THROUGH DIVERSITY

BVCA
British Private Equity & Venture Capital Association

CDP
DISCLOSURE INSIGHT ACTION

IIGCC
Institutional Investors Group on Climate Change

ICGN
International Corporate Governance Network

PRI
Principles for Responsible Investment

Transition Pathway Initiative

Climate Action 100+
Global Investors Driving Business Transition

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