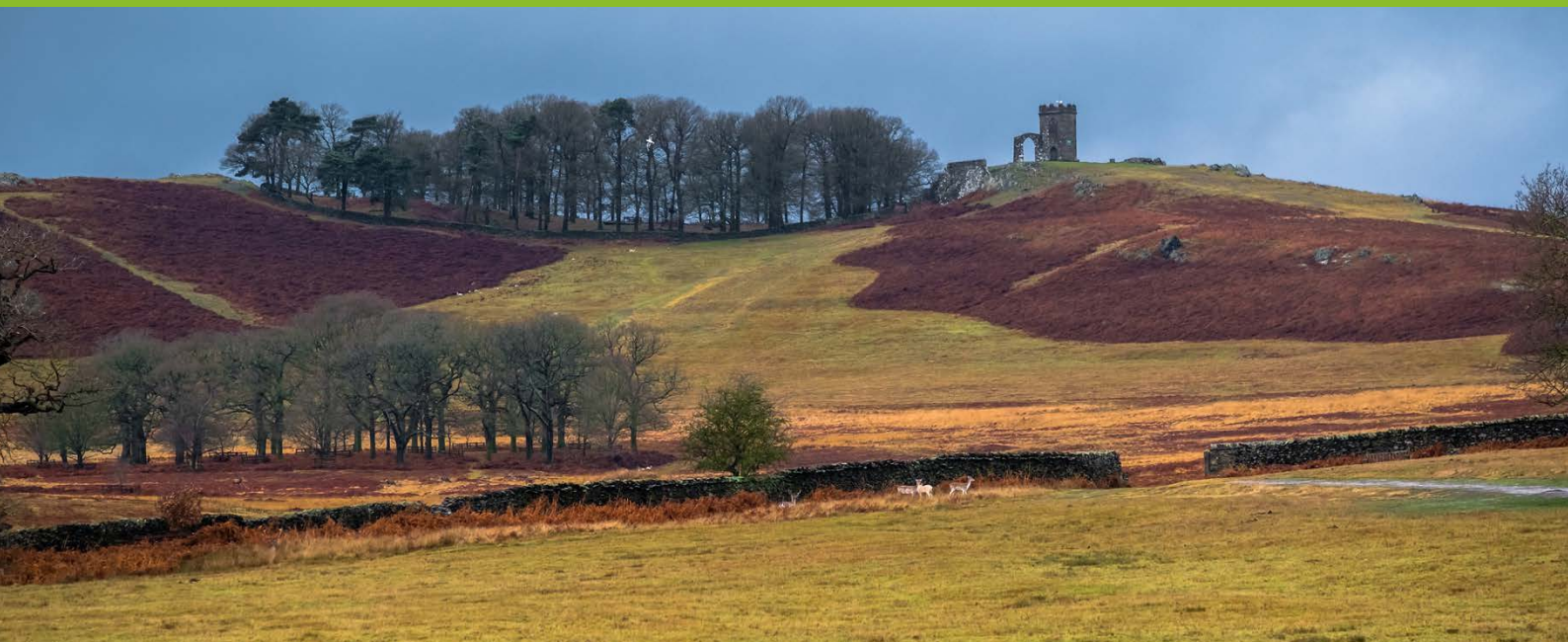




# Quarterly Stewardship Update

**SECOND QUARTER, 2020-21** (JULY - SEPTEMBER 2020)



# Responsible Investment & Engagement

## LGPS Central's approach



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

**OBJECTIVE #1**

*Support investment objectives*

**OBJECTIVE #2**

*Be an exemplar for RI within the financial services industry, promote collaboration, and raise standards across the marketplace*

These objectives are met through three pillars:



This update covers LGPS Central's stewardship activity. Our stewardship efforts are supplemented by global engagement and voting services provided by EOS at Federated Hermes (EOS). For more information please refer to LGPS Central's Responsible Investment & Engagement Framework and UK Stewardship Code Compliance Statement.

**ADDITIONAL DISCLOSURES**

- Responsible Investment & Engagement Framework*
- Stewardship Code*
- Voting Principles*
- Voting Disclosure*
- Voting Statistics*

Signatory of:

Principles for Responsible Investment

# 01 Engagement and Stewardship Themes

*While the COVID 19 health pandemic continues and disruption is becoming the new normal, climate change is a pressing twin crisis that manifests in various ways including, for instance, through the increased number of wildfires that we have seen across various regions globally.*



Governments, industries and individual companies' ability to take drastic measures in light of the health pandemic seems unprecedented. Whether we are equally able to take necessary action against the longer-term climate threat is yet unclear. What seems clear, however, is that environmental and social sustainability are increasingly accepted as necessary catalysts for sustainable economic and financial outcomes over the long horizon. The EU is on track to establish a "sustainable investment taxonomy" as part of their Sustainable Finance Action Plan. During the last quarter, EU and China have agreed to co-chair an international taskforce on sustainable finance taxonomies which aims to set out commonalities of existing taxonomies by mid-2021. We very much welcome these developments, which will aid companies in what they should report on and investors in having access to robust, material information.

Below, we give examples of ongoing or new engagements which relate to the four Stewardship Themes that have been identified in collaboration with our Partner Funds. The bulk of our engagement effort is centred around these themes which allows us the opportunity to build knowledge, relationships (with peer investors

and companies) and to help influence and build best practice industry standards relevant to each theme. We regularly cover issues that fall outside of the stewardship themes, such as fair remuneration, board composition, diversity, and human rights, and have included two examples in this update.

Our Stewardship Themes over the current three-year period (2020 – 23) are:

- Climate change
- Plastic
- Fair tax payment and tax transparency
- Technology and disruptive industries

This quarter our engagement set<sup>1</sup> comprised 390 companies with 866 engagement issues<sup>2</sup>. There was engagement activity on 779 engagement issues and objectives<sup>3</sup>, and achievement of some or all specific engagement objectives on 180 occasions. Most engagements were conducted through letter issuance or remote company meetings, where we, our partners or our stewardship provider in a majority of cases met or wrote to the Chair, a Board member or a member of senior management.

<sup>1</sup> This includes engagements undertaken directly, in collaboration, and via our contracted Stewardship Provider.

<sup>2</sup> There can be more than one engagement issue per company, for example board diversity and climate change.

<sup>3</sup> Multiple issues are often raised in dialogue with a company that may fall outside of core engagement objectives.



## CLIMATE CHANGE ENGAGEMENTS

This quarter, our climate change engagement set comprised 148 companies with 183 engagements issues<sup>4</sup>. There was engagement activity on 157 engagement issues and achievement of some or all specific engagement objectives on 73 occasions.

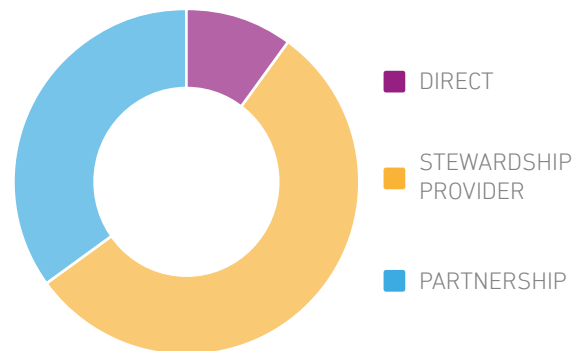
In September, letters went out to all Climate Action 100+ (CA100+) companies asking them to commit to a net-zero carbon emissions target by 2050 for their operations, products and services to end users. It is a challenging order, yet it is an order commensurate to the risks that we face as a global economy and community. Climate action failure is the stand-out, long-term risk the world faces in likelihood and impact according to the latest Global Risks Report from the World Economic Forum. If 'business as usual' continues, the world could heat up by about 5 degrees by 2100 which would cause profound societal damages and significant human harm. The letter from CA100+ investor members marks the start of a Benchmark Framework project that will allow evaluation of company progress on short-medium-and long-term trajectories to 2050, as well as scoring of companies within and across sectors.

LGPS Central is co-leading or in the focus group of engagements with nine CA100+ companies, the majority of which are oil & gas and mining companies. During the last quarter we continued engagement with a **diversified mining company** that is part of the Climate Action 100+ (CA100+) engagement project. Together with CA100+ peer investors we met the Chair of the Board alongside senior management representatives to discuss how the Company is progressing its climate commitment across several key parameters. These include emissions reduction targets for the Company's operations (Scope 1 and 2)<sup>5</sup>; emissions reduction for its products (Scope 3); scenario testing; governance and remuneration to reflect climate ambitions, as well as climate policy advocacy. We were encouraged to hear that the Company is doing work to test its business resilience against various temperature scenarios, including 1.5C. In connection with this, the Company is going through an annual process of "life of mines" planning to capture emissions data from each operation and consider what emissions reductions can be delivered. The Company has previously announced a projected 30% decline in its Scope 3 carbon emissions by 2035. This



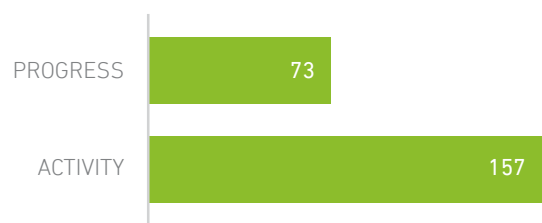
will be achieved by managed decline of its coal assets. We were informed that this projection is being tested against a 1.5C and the details of methodology and results will be made public before the end of 2020. We expressed expectations that the Company use direct and indirect lobbying to proactively advocate Paris-aligned policy interventions. We also touched on the need for investors to gain insight into the motivation of executives with regard to carbon reduction targets. We were assured that climate targets will be a material part of executive compensation and that further details will be disclosed in the near term. The Company has hired a Climate Change Policy Director in recognition of the increasing relevance of climate change across the business and to help tackle this issue in a structured way. We will continue dialogue with the Company in a manner that reflects the step-change in expectation from investors through the CA100+ Benchmark Framework project.

### ENGAGEMENT VOLUME BY TYPE



- 183 engagements in progress
- Majority of engagements undertaken via CA100+
- Step-change in investor expectations for net-zero ambition from all CA100+ companies through new Benchmark Framework

### ENGAGEMENT VOLUME BY OUTCOME



<sup>4</sup> There can be more than one climate-related engagement issue per company.

<sup>5</sup> Scope 1 are direct GHG emissions that occur from sources that are owned or controlled by the company. Scope 2 are indirect GHG emissions from the generation of purchased electricity consumed by a company. Scope 3 are other indirect GHG emissions that occur as a consequence of the use of products and services provided by the company (e.g. combustion of fossil fuels for a vehicle).

## PLASTIC ENGAGEMENTS

This quarter our single-use plastics engagement set comprised 14 companies with 16 engagement issues<sup>6</sup>. There was engagement activity on 15 engagements and achievement of some or all engagement objectives on seven occasions.

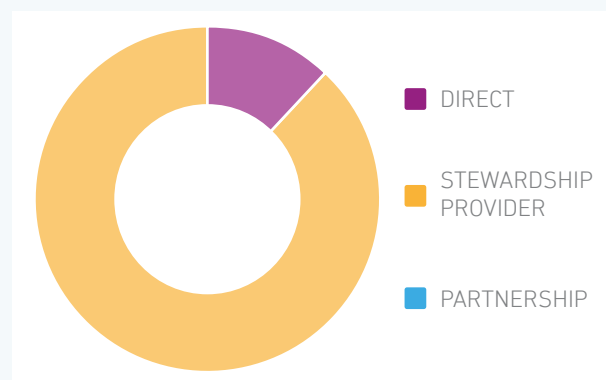
During the last quarter, we joined a sub-group of the PRI plastics working group and led by Dutch investors Achmea Investment Management and Actiam, that has set out to engage **packaging companies**. The objective is to engage and support progress for companies in a 'Plastics transition' - to reduce, re-use and replace fossil-fuel based plastics. With increasing attention from governments to the negative impacts of plastic use and consumers calling for less harmful alternatives, investee companies in the plastic value chain are exposed to increasing regulatory risks, environmental risks, reputational risks and the risk of missing out to market developments.

We engaged a **US-based industrial packaging company** which is seeing greater interest from its customer base for sustainability in the last 4-5 years and as a result, is expanding its post-consumer resin (PCR) products, capabilities and technologies. PCR plastics are recycled materials from existing polyethylene terephthalate (considered safe and is represented on water bottles as a safe option) and other plastics. Demand for PCR is greater among customers in Europe than in North America and the Company is actively educating its customers both on the quality and safety of recycled products and on emissions impacts for specific products. In all these engagements, the investor group would like to see ambitious targets for reduction, re-use and replacement of plastic and clear Key Performance Indicators (KPIs) and timelines for how targets can be achieved. The aforementioned Company is currently going through a KPI setting procedure and we encouraged them to integrate relevant KPIs on sustainability progress in executive remuneration. The Company seems to welcome further investor input to the KPI setting process, and we will continue dialogue to discuss the development of targets and what progress is being made against those.

Together with four other investors, we continued our engagement with a **multinational food manufacturing company** headquartered in the US to discuss their global sustainable packaging targets. The Company is working towards a goal of having 100% reusable, recyclable or compostable packaging by the end of 2025. Good progress has already been made and as at the end of 2019 plastic packaging amounted to 62,488 MT with 15% of total plastic packaging not yet recyclable. The gaps that need to be closed are on multi-material packaging, cereal liners and flow-wrap. The Company is establishing regional action plans to test and learn how different solutions can help meet targets, but also to discover and discard what might not be working. These include pilot projects to use alternative packaging (e.g. all paper or metal), reduction of packaging volumes, incorporation of recycled materials, and potentially exclusion of certain materials that cannot be recycled

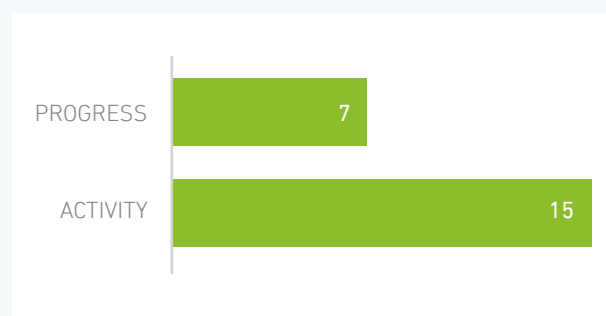
or reused. The Company is also encouraging end-of-life plastic collection and recycling infrastructure in collaboration with waste management companies. Certain markets are further behind in terms of facilitating a circular economy. Work to partner across the Company's value chain is ongoing, with a focus on addressing industry barriers to sustainable packaging both among plastic suppliers and users. We were assured that the Company board has strong ESG performance oversight. Performance against sustainability metrics is reported to a Board sub-committee on Social Responsibility and Public Policy several times a year. The investor group has asked to continue engagement with the Company and to discuss further progress against the sustainable packaging targets with a board representative at the next iteration.

### ENGAGEMENT VOLUME BY TYPE



- 16 engagements during the quarter
- Sub-group of PRI Plastics Working Group engages packaging producers to support and encourage "Plastic transition" in the form of reduction, re-use and replacement of fossil-fuel based plastics
- Engagement with US-based food manufacturing company on their global sustainable packaging targets continues

### ENGAGEMENT VOLUME BY OUTCOME



<sup>6</sup> There can be more than one plastics-related engagement issue per company.

## FAIR TAX PAYMENT AND TAX TRANSPARENCY ACTIVITY/ENGAGEMENT

This quarter, our tax transparency engagement set comprised 10 companies with 11 engagements issues<sup>7</sup>. There was engagement activity on 6 engagements and achievement of some or all engagement objectives on two occasions.

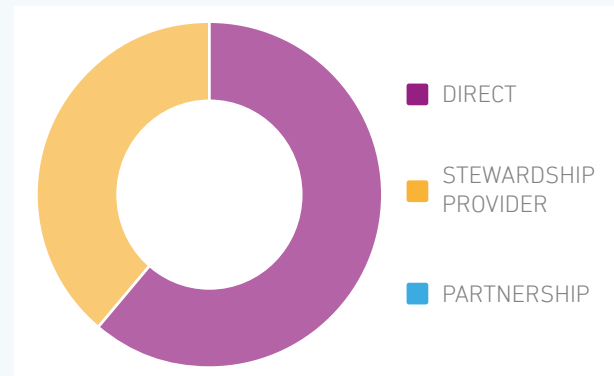
Governments continue to provide tax relief to businesses during this ongoing health pandemic and we anticipate pressure from the public to ensure that businesses that benefit from government support contribute more responsibly to society. This is likely to translate into more scrutiny of tax arrangements, employment law, worker health and safety, and executive pay against a backdrop of high unemployment and inequality. In tandem, we think investor interest and scrutiny on companies' responsible tax behaviour and their willingness to pay their fair share of tax will increase.

We have continued collaboration with five fellow European investors to engage a selection of companies across technology, telecommunication, finance and mining sectors. In conversation with a **US-domiciled software and services company** we discussed the Company's approach to tax and how it defines and manages tax related risks. The Company established a Global Corporate Income Tax Matter Policy in 2019 and we were told that the Board stays closely involved and asks questions around tax risk through its Audit Committee. We probed the Company on its tax strategy for digital products and the use of foreign jurisdictions with lower tax rates. We are generally concerned if companies appear to utilise aggressive tax planning strategies. While the company we engaged assured us that it is not seeking tax havens, we would like to see that more clearly articulated in both policy and practice. The Company has a subsidiary incorporated in Ireland but which is tax resident in another jurisdiction paying zero tax. This raises some 'red flags' from the outset and does not appear to be in line with OECD's Base Erosion and Profit Shifting Framework. We will seek further clarification from the Company on the underlying realities and whether we might expect a change in tax practices under the newly established tax policy.

On our behalf, EOS at Federated Hermes engaged a **European banking services company** on various ESG issue including tax transparency and responsible tax behaviour. The Company has previously taken on board EOS' tax expectation and shown a willingness to go beyond standard tax policy and financial reporting, in particular: 1. Framing the bank's approach to tax within its commitment to be a responsible bank, including staff conduct; 2. Including in its approach safeguards and controls related to subsidiaries and front office staff. EOS requested a meeting with the Chair of the Board Sustainability Committee and agreed to provide views on a sustainable banking impact scorecard and the Company's latest tax transparency.

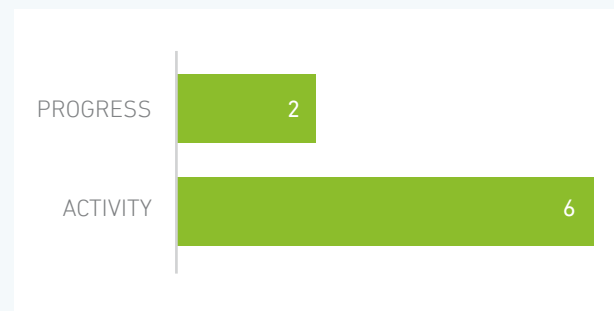
<sup>7</sup> There can be more than one tax-related engagement issue per company

### ENGAGEMENT VOLUME BY TYPE



- 11 engagements during the quarter
- Collaboration with peer European investors to engage a selection of companies across vulnerable sectors continues
- We expect continued scrutiny from investors and other stakeholders on responsible tax behaviour in a situation of prolonged COVID 19 pandemic

### ENGAGEMENT VOLUME BY OUTCOME



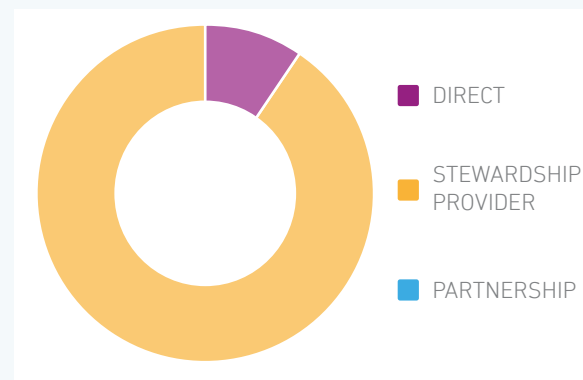
## TECHNOLOGY AND DISRUPTIVE INDUSTRIES

This quarter our technology and disruptive industries engagement set comprised 16 companies with 27 engagements issues. There was engagement activity on all engagement issues and achievement of some or all engagement objectives on four occasions.

Our attention to social media companies through engagement on social media content control continues and has been amplified by other stakeholders voicing concern about disinformation and harmful content on social media platforms. In the face of COVID 19 and a highly polarised US presidential election, it is all the more welcome that the World Federation of Advertisers has negotiated a deal with Facebook, YouTube and Twitter on harmful content including hate speech and aggression. The aim is to establish harmonised reporting standards across platforms and empower external auditors to oversee the system, which will launch in the second half of 2021.

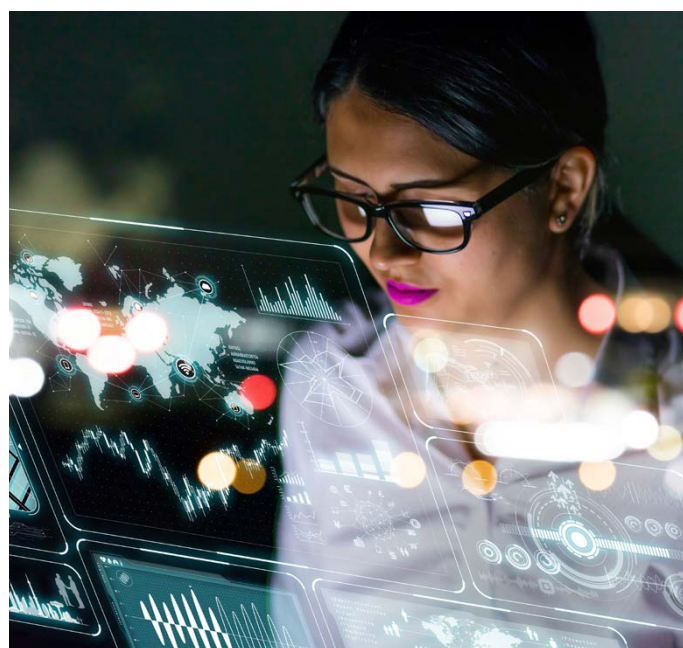
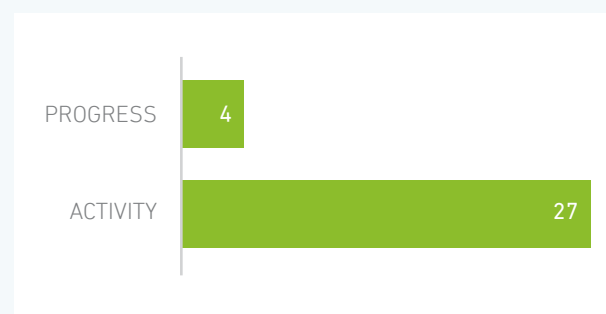
Over the last quarter, we took part in collaborative investor engagement, led by the New Zealand Crown-owned investors, with **Facebook** and **Twitter** to discuss their governance and operations to ensure appropriate social media content control. Both companies are taking encouraging steps to efficiently assess content and to remove objectionable content from their platforms. Technology is developing rapidly and with the help of AI the companies appear more effective at capturing contextual content such as hate speech. Facebook has established an Oversight Board to ensure fair decision-making in situations where free speech is at odds with authenticity, safety, privacy and dignity, and that will assist in hearing difficult and important content removal decisions. The Board may overrule management and may comment on policies in order to ensure that these are aligned with the Company's core values. Rebuilding trust with advertisers and users should be a focus for Facebook going forward. We expect them to move the discussion from a focus on risk management and mitigation to prevention. Twitter provides a public biannual transparency report which describes how content is managed in relation to issues like elections integrity, cyber security, data protection and harmful content amongst others. Twitter actively seeks collaboration with peers and other stakeholders in order to discuss the challenges and how they can best be tackled. The investor coalition has signalled to the companies the importance of board oversight and has requested to meet board directors at both companies in the next engagement.

### ENGAGEMENT VOLUME BY TYPE



- 27 engagements in progress
- Broader stakeholder concern over hate speech and misinformation amplify ongoing engagements
- Facebook and Twitter taking clear steps to increase oversight and collaborate on social media content control

### ENGAGEMENT VOLUME BY OUTCOME





## Examples of engagement outside of stewardship themes



### **BROADER SUSTAINABILITY, INCLUDING BIODIVERSITY, LAND-USE AND RIGHTS OF INDIGENOUS PEOPLES**

Our engagement on the long-term investments risks inherent in deforestation continues, both at policy and company levels. We recognise the crucial role that tropical forests play in tackling climate change, protecting biodiversity and ensuring ecosystem services, which again has an impact on economic development and the stability and well-functioning of capital markets. During the last quarter, investors led by Storebrand (Norway) and BlueBay Asset Management (UK), has formed an Investors Policy Dialogue on Deforestation (IPDD) initiative. LGPS Central is on the Advisory Committee of IPDD which during the last quarter met with the Ambassador of the EU delegation in Brazil to discuss IPDD's core expectations. We expect Brazilian authorities to halt and reverse deforestation while allowing investors access to data to monitor progress. This message has been communicated from investors over the last 4-5 months to the highest political levels, including to the Brazilian Vice President, the Governor of the Brazilian Central Bank and members of the Brazilian Congress. IPDD will be a two-year project that also aims to span other regions of the world that face deforestation risk. Alongside the policy engagement project, 80 investors including LGPS Central have sent letters to three Brazilian meat processors calling on the companies to better manage deforestation risks and to provide full traceability across their entire cattle supply chain. Two of the companies have made subsequent public commitments to traceability. One is committing to achieving full traceability in the Amazon by 2025 and the Cerrado by 2030, thus aiming to have a deforestation free supply chain by 2030. The other pledges to full traceability of its supply chain, including indirect suppliers, by 2025 (Amazon biome).

### **DIVERSITY**

LGPS Central has been a member of the 30% Investor Club since inception of the Company. Diversity continues to be on our radar as a key element of good governance, though we see varying degrees of uptake across markets of a more balanced representation of gender, culture, ethnicity etc. at board and management levels of companies. Japanese boards have one of the lowest proportions of female representation in major markets and therefore it is highly welcome that the 30% Investor Club opened a 30% Investor Club Chapter in Japan in May 2019. Together with fellow 30% Investor Club members, and led by Royal London Asset Management, we engaged a Japanese financial services company on the issue of diversity and inclusion during the last quarter. Interestingly, the Company had not been approached by investors to discuss diversity previously, so this was the first dialogue on the issue. The Company explained that it views diversity of people, not just on gender but more broadly on ethnicity, age and nationality, as its greatest asset. A Diversity Promotion Committee has been established to ensure that measures such as child-care leave, flexible and shortened workhours, flexibility to change work location, support of women's empowerment (e.g. through leadership seminars) are offered to employees across the organisation. A general hurdle to achieving greater diversity at board level is the fact that historically, Japanese women in their 40ies and 50ies gave up their carrier to raise a family. During the investor meeting, we found the company had no targets for gender representation on the Board and deemed 30% Club aims unrealistic. Its only gender diversity goal is to increase female senior executives, which currently represent 4%, from 10 people to 20 people by 2025. We encouraged the Company to set and/or increase targets for diversity at all levels of the organisation and to provide more information to investors on how these targets will be met going forward.



## 02 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, EOS at Federated Hermes.

### COMMENTARY

Between July - September 2020, we:

- Voted at 354 meetings (4,197 resolutions) globally
- Opposed one or more resolutions at 170 meetings
- Voted with management by exception at 25 meetings and abstained at three meetings.
- Supported management on all resolutions at the remaining 156 meetings.

A full overview of voting decisions for securities held in portfolios within the Company's Authorised Contractual Scheme (ACS) – broken down by market, issues and reflecting number of votes against and abstentions – can be found [here](#).

LAPFF issued alerts for four companies on five resolutions during this quarter. We voted in alignment with LAPFF recommendations in all of these cases.

### EXAMPLES OF VOTING DECISIONS

At the AGM of **Alibaba Group (Alibaba)**, we voted against the re-election of Kabir Misra. Misra is a representative of a major shareholder (Softbank) in Alibaba and the Company has not determined him as independent. His election would take the overall board independence to 45% and below the majority. As a consequence, and in order to send a clear signal to the company about the importance of majority independence on the board, we also voted against non-independent director Maggie Wei. Wei is one of two female directors on the Alibaba board. While we would like to see a more gender diverse board, establishing a board that is majority independent is a necessary building block in order to foster

that diversity going forward. Near 20% of shareholders opposed the election of these two directors at the AGM. Alibaba has put in place the "Alibaba Partnership" and related voting agreements, which limit the ability of shareholders to nominate and elect directors. The Alibaba Partnership currently comprises 36 members and has the right to nominate and appoint up to a simple majority of the directors of Alibaba. Our stewardship provider is seeking dialogue with Alibaba to discuss the nomination committee and the Alibaba Partnership. Alibaba founder Jack Ma is stepping down from the board which currently leaves the nomination committee without a chair.

At the **AGM of Vodafone Group Plc**, we voted against the re-election of a board member, David Thodey (member of the audit committee) due to concerns around over-boarding. David Thodey has three other non-executive appointments in addition to Vodafone. These include two chairmanship positions at Xero Limited and Tyro Payments, and Thodey is also a member of the audit and nomination committee at Ramsey Health Care Limited. Overall, this means significant commitment especially during the ongoing Covid 19 pandemic which could undermine his ability to serve effectively as a non-executive director of Vodafone. As stated in LGPS Central's voting principles, we expect board members to devote sufficient time to their directorships, to refrain from becoming "over-boarded" and to attend all relevant meetings including committee meetings (audit, nomination, remuneration or other). This is in line with the UK Corporate Governance Code which recommends that non-executive directors should have sufficient time to meet their board responsibilities. The day before Vodafone's AGM, the Company announced that it had received notice from David Thodey of his resignation from the Vodafone Board, which means he did not seek re-election at the AGM.

At the AGM of **Tesla**, we opposed the ratification of Named Executive Officers' Compensation. Tesla focuses remuneration around salary and equity awards. The focus is exclusively on equity awards for the CEO which the company argues aligns his interest with those of shareholders. We are concerned that the scale of potential awards is too high. In 2018, CEO Elon Musk was awarded \$2.3 bn by the company, largely in stock options. We are also concerned about the fact that share options for the CEO can vest already this year, only one year since setting the award scheme, which in our view is not long term. On our behalf, EOS has expressed concern to Tesla over excessive award options capable of vesting in a short time frame to boost low executive base pay. More than 15% of shareholders voted against the executive pay which is a notable dissent that the company should heed. Further to this, we supported a shareholder proposal put to the AGM asking Tesla to embed respect for human rights within operations and through business relationships. Tesla is exposed to significant human rights risks in its operations and supply chain which may have a material impact on the Company. Existing disclosures to provide evidence of effective human rights due diligence is underwhelming. The requested report would describe (1) board oversight of human rights and (2) human rights due diligence processes, including systems for providing meaningful remedy when adverse human rights impacts occur. The Company appears to lack a clear "tone from the top" on these issues, including on labour relations issues, worker health and safety violations, and discrimination and harassment. Looking at the voting result, this concern is shared by approximately one quarter of the shareholder base.

At the AGM of **Diageo**, we voted against the Remuneration Policy on the grounds that it allows for excessive pay. Near 7% of shareholders opposed the Policy. Through our stewardship provider, EOS, we have engaged Diageo on the design of the remuneration policy and on actions taken in light of the health pandemic impacting the remuneration report. The primary concerns which have been voiced to the Remuneration Committee Chair are variable pay opportunity at 700% of base salary (and a high base salary); continued use of options; poor malus and clawback provisions. As stated in LGPS Central's Voting Principles, we hold the view that remuneration should be no more than is necessary and sufficient to attract and retain talent. Levels of executive remuneration that are, or are perceived to be, excessive and unfair can be demotivating to staff and reputationally damaging to the company. The main reason for Diageo's approach to executive remuneration is the extent to which they are competing with US companies for talent. However, we remain generally concerned about pay practices in the US (opposing c. 80% of pay proposals in the US) hence this argument did not overturn our opposition to the remuneration policy. The Company decided to award the 2020 LTIP at normal levels, despite share price decline although there is a commitment to revise downwards at vesting if there have been disproportionate gains as a result of a rally in the market. On a positive note, the Company has signalled that it will introduce ESG measures into the LTIP, which will likely bring a more rounded approach to the remuneration scheme and align to long-term value

LGPS CENTRAL LIMITED'S

# Partner Organisations

**LGPS Central currently contributes to the following investor groups:**







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All information is prepared as of **11.11.2020**.

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Registered in England. Registered No: 10425159.

Registered Office: Mander House, Mander Centre, Wolverhampton, WV1 3NB

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