MARKET SICKNESS

GREATER MANCHESTER / MERSEYSIDE / WEST YORKSHIRE

STEWARDSHIP REPORT
Q1 2020

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

RESPONSIBLE OWNERSHIP

The first quarter of this year brought with it the beginnings of what was to become a personal, social and economic tragedy on an unprecedented scale.

More than 750,000 cases of Covid-19 had been recorded by the end of March worldwide, while the UK's cases exceeded 3000 forcing it into lockdown to avoid swamping the NHS.

Global markets have taken a severe beating and government coffers will face even greater pressure than the conditions following the financial crash of 2008. Chancellor Rishi Sunak has announced a furlough scheme which will cover 80% of wages up to £2500 a month but there is no doubt many companies will struggle to survive.

The second quarter ended with the FTSE 100 posting its largest fall for more than 30 years. The value of the UK's biggest companies plunged 25% over the last three months representing a collapse not seen since Black Monday in 1987. Economists already warn shareholders to anticipate zero returns from US companies while financial regulators are warning insurers and banks to suspend bonuses and dividend payments. Many other UK companies are expected to cancel share buybacks and curb executive pay.

Sectors at risk

As ever, the NLGPS will monitor our portfolio carefully. We expect the leisure and hospitality, airline and other travel companies to suffer disproportionately.

In March, John Menzies, the Edinburgh-based airline services company, announced 17,500 employees were to be furloughed which amounted to more than half its headcount. It has since warned it is on the brink of collapse and called on the state for support.

Whether the government intervenes with special measures above and beyond the furlough package for these sectors remains to be seen. Should they do so, we would hope that the Treasury would take the opportunity to impose conditions on bailouts for any companies with poor environmental, social and governance track records.

Systemic issues

Coronavirus has already started to show the cracks in a system that relies

Regulators target financial sector

Financial regulators in a number of markets have already intervened to ensure that key firms are adequately capitalized as the Covid-19 crisis puts pressure on the economic system.

The UK's Prudential Regulatory Authority (PRA) and the European Insurance and Occupational Pension Authority (Eiopa) have written to those under in respective jurisdictions warning them of the need to apply a 'prudent approach'. This includes considering pulling dividends and buybacks and stopping bonuses for senior staff. As of 31st March, all the UK banks have complied.

Eiopa has urged insurers to 'ensure that their assessment of the overall solvency needs is forward-looking, taking due account of the current level of uncertainty on the depth, magnitude and duration of the impacts of Covid-19 in financial markets and on the economy and the repercussions of that uncertainty in their solvency and financial position'. It urges insurers to suspend dividends and buybacks. Eiopa's position appears stronger than that of the PRA, which advised insurers to review their position and consider such actions rather than making them mandatory.

RESPONSIBLE OWNERSHIP

on cheap labour, the return of profits to companies over workers, alongside increasingly starved public services and falling taxes.

In a world where companies embrace the ability to profit from zero hours contracts, are not obliged to pay certain tiers of workers any sick pay and that which is available from the state is unsustainable, then we will see individuals turn up to work and either catch the virus or spread it further.

There has been industrial action from frontline workers across the globe in outrage at their alleged subjection to unsafe working practices. These include being forced to work in close proximity to colleagues; a failure by employer to supply basic PPE equipment, and the threat of redundancy should they not come into work.

Engaging for change

NLGPS will engage with companies to ensure boards are making the right decisions both from a long-term shareholder point of view and from that of their workers' health and safety. We recognise that companies will face unprecedented challenges and are engaging in a constructive dialogue. Equally we expect boards to demonstrate that they treat stakeholders fairly and share the burden that this pandemic puts on us all.

We will work to ensure the damage done by Covid-19 is mitigated where possible, and that both investors and boards learn from this tragedy. In particular we hope to help develop sustainable safety practices that protect workers and that can assist tackling future outbreaks.

We also expect to see restraint in executive pay. We note proposals from the High Pay Centre (HPC) recommending that the government learn from the global financial crisis, when bailouts for financial institions were often not accompanied conditions on their behaviour. The HPC says bailouts must include measures that ensure provisions to protect workers' rights and promote fair pay.

It is impossible to predict the duration of the Covid-19 outbreak, but we do know there will be more challenges to come. We remain committed to doing our best for members and the companies in which we invest, even in the most difficult times.

Shorting bans

Regulators in a number of markets have introduced short selling ban as the coronavirus pandemic continues to panic stock markets. Comision Nacional del Mercado de Valores, which regulates the Spanish markets, has banned short selling entirely, while the Italian Commissione Nazionale per le Societa e la Borsa has introduced a list of companies whose stocks cannot be shorted. The Belgian regulator has taken similar action. However the FCA is not following suit in the UK. Regulators say the moves are designed to protect companies and investors during challenging market conditions. Yet advocates of short selling claim a ban has zero impact and in fact can make conditions worse. They say shorting can help protect against risk and insulate portfolios.

Safety must be a priority

The Covid-19 global death toll is expected to reach into at least the hundreds of thousands before it is brought under control, with many frontline workers among those expected to be at particular risk. Workplaces appear to be one of the sites where transmission of the virus is at its highest.

There are already reports of employees across the world staging walkouts or threatening strikes unless they are provided with the basic equipment to keep them safe. Among those companies named so far are Amazon in the States, the Australian supermarket chain Coles, and the postal service in the UK.

The NLGPS believes it is imperative that companies adhere to the necessary safety standards during this pandemic if they are to avoid putting their workers in the path of serious harm and risk the long-term sustainability of their businesses.

PIRC targets pay

In March our RI adviser PIRC wrote to all companies in its research universe, urging restraint in respect of executive pay. PIRC said that all companies needed to review their approach to pay, and amounts to be paid, to their executives in the light of current events.

The letter reads: "Few if any executive pay schemes are likely to be appropriate for a company in current market circumstances and the health emergency. PIRC therefore calls on companies to suspend all payments to executives other than basic salary from the 1st April, until the end of the financial year December 2020.

"It is also important that such a review is considered in the context of its impact on employees, especially where there have been, or may need to be, redundancies or layoffs."

ENGAGEMENT

NLGPS supports ICCR statement on Covid

NLGPS was pleased to sign a statement co-ordinated by the Interfaith Center on Corporate Responsibility (ICCR) on the coronavirus response that encourages companies to act responsibly during the global pandemic in order to protect long-term value.

The statement calls on company decision makers to take the following steps during the outbreak that will provide for workers and protect reserves in the near term, and underpin long term sustainability:

1. Provide paid leave
2. Prioritise health and safety
3. Maintain employment
4. Maintain supplier/customer relationships by making timely or prompt payments.
5. Financial prudence. For example, suspending share buybacks and limiting executive and senior management compensation.

The NLGPS hopes businesses will go beyond these steps and do all that is possible to protect workers and long-term economic stability.

Through our RI partner PIRC we are in regular contact with the ICCR and other collaborative initiatives, and we expect engagement around Covid to be a constant aspect of our engagement activity throughout the rest of the year.

Engaging on the Just Transition

In January NLGPS was delighted to be involved in a pioneering engagement with energy company Drax, co-ordinated by Friends Provident Foundation.

Along with several other large institutional investors including Royal London Asset Management, Aviva Investors and the Local Authority Pension Fund Forum, we visited Drax's Selby power station in January to discuss the company's net-zero and just transition strategy.

As noted in previous reports, NLGPS has decided to make the Just Transition a central aspect of its approach to climate change. The initiative aims to ensure a fair move from polluting energy sources to a cleaner greener economy, taking account of the impacts of changes in the structure of the economy on communities and workers.

Drax Power Station is the UK's largest single source of greenhouse gas emissions and while it is making progress towards the use of bioenergy with carbon capture and storage its plans for gas expansion are, according to Friends Provident 'not without controversy or risk'.

At the same time, a report by VigeoEiris rates UK energy utility companies low on "socio-economic" issues, concluding that 'Electric & Gas companies operating in the UK could do more to prepare themselves to address the full scope of challenges posed by just transition'.

Decarbonisation was top of the agenda at the meeting with Drax, and we discussed the Group's low carbon transition strategy, its alignment with the UK's 'net zero' target for 2050.

But the group took the opportunity to question Drax Group on its just transition strategy and risk management, including:

- Whether the company assessed the potential impacts of climate change-related risks and opportunities for employees, workers in the supply chain, and communities affected by business activity over the short, medium and long term?
- Has the company included the implications for employees, workers in the supply chain and communities in its climate scenario analysis?
- Whether the company is contributing to wider plans for community renewal and economic revitalisation linked to the low-carbon transition in areas where it operates?

NGLPS was encouraged by the meeting with Drax and given that Just Transition has support from 140 institutions with more than US$8trillion in assets, we are confident that further engagement with this project will lead to positive change. To date the employment-related aspects of the Just Transition remain relatively under-developed part of engagements in our view so we look forward to playing our part in addressing this.

NLGPS would also like to thank Colin Baines at Friends Provident Foundation for his role in co-ordinating the Drax engagement.

ENGAGEMENT

Fossil fuel financing under scrutiny at Barclays

Last quarter we noted more pioneering shareholder engagement as Barclay's became the first European financial institution to face a resolution on the services it provides to companies engaged in the production of fossil fuels.

The proposal, which was organised by Share Action and filed by a range of major UK pension funds including Merseyside Pension fund, sets targets for the withdrawal of financing for businesses in the energy sector that are not aligned with the 2015 Paris Agreement on climate change.

The shareholder resolution also refers to the 'just transition' wording in the Paris Accord which says tackling climate change requires the transformation of sectors and economies, with important implications for the global workforce.

As the bank's AGM fast approaches – it is to be held on Thursday 7 May – we note increasing support for the resolution. Indeed, Barclays, which does not appear to be supporting the activists' resolution, has raised its own alternative in a bid to manage the potential shareholder dissent.

In its resolution, the bank commits to aligning its provision of financial services with the goals and timelines of the Paris Agreement for customers across all sectors - rather than focusing on the energy and power sectors alone.

Both company and shareholder resolutions require 75% of the vote to pass. We will watch the AGM with interest and report on the outcome next quarter.

Disenfranchising shareholders

As we've previously reported, NLGPS has decided to increase its global activities and in particular its involvement in shareholder resolutions on ESG issues. We have supported multiple shareholder resolutions and related initiatives focused on lobbying activities in the US on climate change this quarter and we anticipate being continually busy on environmental issues as we move through the year.

However it is not uniformly positive news. Two resolutions we filed with US companies were kept off the ballot this quarter. One related to worker rights and safety, and the other sought the appointment of an employee director.

These are important governance issues and their exclusion from shareholder votes adds to our frustration at the difficulties activists experience in ensuring their voices are heard at company meetings. In particular, as we report elsewhere, issues relating to the safety and effective representation of employees are critical during the Covid-19 outbreak.

The American market can be particularly challenging. Whilst regulators in a number of countries are promoting stewardship, the American financial regulator, the Securities and Exchange Commission (SEC), has added to our concerns about investor disenfranchisement.

The SEC is looking at both tightening the rules relating to the filing of shareholder resolutions – making it harder to file – and introducing regulation of proxy advisers.

Given our experiences with filing resolutions in the US market, we do not consider there to be any grounds for making this harder.

Turning to proxy advisers, we support greater disclosure by about their processes and any conflicts of interest, and indeed the Best Practice Principles for Shareholder Voting Research has already developed a set of standards. However the SEC's approach seems intended to give much more power to companies to affect the content of proxy reports.

We do not believe that the US is a market that is characterised by excessive investor power relative to management and therefore we do not support this set of proposals.

NLGPS has supported communications to the SEC organised by the PRI. We know the regulator has been deluged with objections argues that the proposals would damage shareholder rights and be detrimental to efforts to improve corporate governance.

We hope the SEC is open to compromise and we will watch the issue closely as it unfolds.

Stewardship Challenge

The UK Stewardship Code 2020 came into force at the start of this year and marks a significant update from the 2012 version.

The 'substantial and ambitious' revision sets even greater responsibility on shareholders to focus on the long term. In the Financial Reporting Council's (FRC) words the code:

> **'establishes a clear benchmark for stewardship as the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society'.**

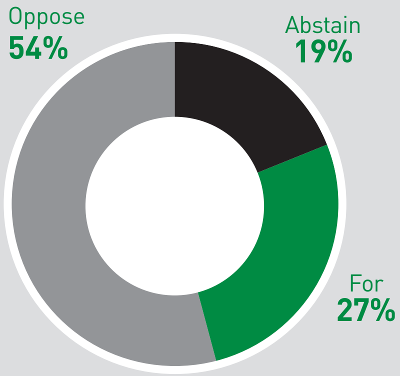
The code sets out expectations for integrating investment and stewardship, including environmental, social and governance issues. Investors will need to explain how they have exercised stewardship across asset classes. For example, for listed equity, fixed income, private equity, infrastructure investments, and in investments outside the UK.

The new approach reflects that of the NLGPS and our members and as such we continue to support the code and intend to become a signatory to the 2020 version.

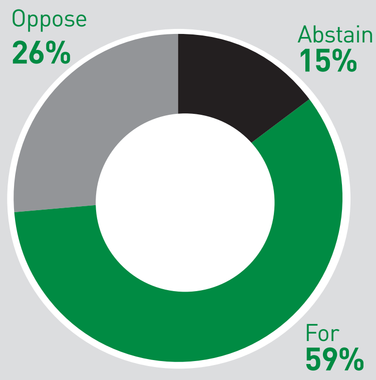
We take responsible share ownership incredibly seriously and we remain committed to following the code seriously. There will be more on this to come, particularly as the FRC transitions to its new incarnation as the Audit, Reporting and Governance Authority.

Q1 VOTING & ENGAGEMENT REVIEW

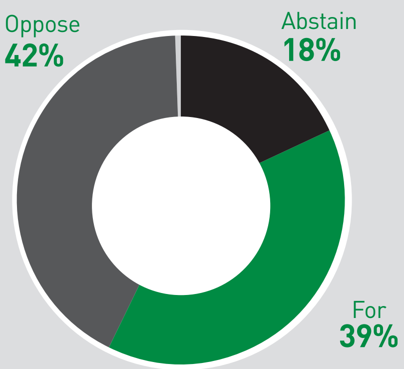
Votes on remuneration policy, Q1 2020



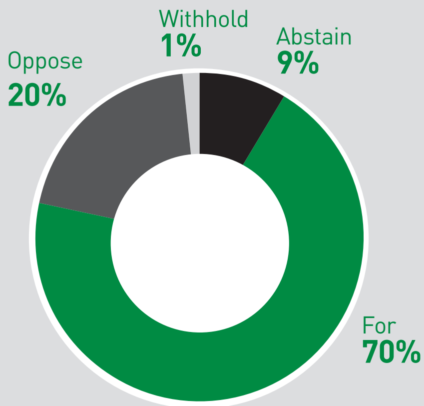
Votes on remuneration reports, Q1 2020



Auditor appointments, Q1 2020



Director elections, Q1 2020



Q1 is traditionally a quieter quarter, with less company meetings taking place. However we saw a number of companies receive significant levels of opposition.

The entire NLGPS voting record, disclosing all votes on all resolutions at all companies, is available online in a searchable database.

Overall, NLGPS funds voted at **416** meetings during the third quarter, encompassing AGMs, EGMs and Court meetings. In its role as responsible investment adviser to NLGPS, PIRC engaged with **99** companies around issues relating to meetings during the quarter, in addition to engagement activity that was not meeting-related. Our full voting record is available online in a searchable database at https://northernlgps.org/node/49

Director elections

Director elections are the most numerous resolutions we vote on each quarter. During Q1, NLGPS voted on the election of 12724 directors. In total, 70% of directors were supported, with 20% opposed. In the remainder of cases NLGPS abstained, or withheld support.

In the US we opposed or did not support directors at companies including **VISA**, **TE Connectivity**, **Starbucks**, **the Cooper Companies, Franklin Resources, D R Horton** and **F5 Networks**. All of these companies received votes of over 8% against at least one director. Reasons for opposition included a lack of independence on the board, and concerns about companies' policies and practices on social and environmental issues.

In Europe significant votes against directors were only cast at Swiss companies in our portfolio, such as **Novartis**, **SGS, Schindler** and **ABB**. With the exception of **ABB**, we opposed or did not support directors at all these companies, typically due to concerns about board independence. At **SGS** five directors received votes against of over 20% and, of these, two received votes against of over 30%. We opposed all five.

In the UK, we opposed the election of directors at companies including **PureCircle, Shaftesbury, Hyve Group, Britvic, Mitchells & Butlers, Stock Spirits Group, Micro Focus** and U**DG Healthcare**. At **PureCircle** the senior independent director Guy Wollaert came very close to being removed from the board, receiving a 48.5% vote against. We opposed due to concerns about independence. At **Shaftesbury** the chair Jonathan Nicholls received a vote against of almost 33%. We opposed due to concerns about time commitments.

Executive remuneration

Overall, NLGPS opposed companies on advisory votes on remuneration in 26% of cases, abstained in a further 15% and opposed in 26%. Oppose votes on remuneration policies stood at 54%, compared to 19% abstain and 27% for.

In the US we opposed **Qualcomm** on the advisory resolution on its executive remuneration policies, which was defeated with a huge 79% vote against. We also opposed the same resolution at the **Walt Disney Company** that narrowly passed with a 46% vote against. Amongst those who have criticized executive pay at the company is Abigail Disney, a granddaughter of the company's co-founder Roy Disney.

In Europe we opposed remuneration policies at companies including **Genmab** in Denmark, **ABB** in Switzerland, and **Davide Campari** in Italy and abstained on the policy at **UPM-Kymmene** in Finland. Of these **Genmab** came closest to having its resolution defeated by shareholders, with 44% voting against.

In the UK we opposed or abstained on the remuneration reports of **Diploma, Shaftesbury, SSP Group, Stock Spirits Group, Countryside Properties** and **Crest Nicholson**. Although none were defeated, all received votes against of over 20%. In the case of **Diploma**, oppose votes and abstentions totaled over 47%.

On remuneration policy votes, we opposed or abstained at **Plus 500, Greencore, Paragon Banking Group, Stock Spirits Group** and abstained at **Redde Northgate**. All of these companies received votes against of over 20%, though none

Q1 VOTING & ENGAGEMENT REVIEW

were defeated. At **Redde Northgate** oppose votes and abstentions totaled just under 40%.

Auditors

During Q3 we voted against 42% of auditor appointments, typically in response to high levels of non-audit work being under-taken or long tenure, and support 39%. We abstained or withheld support in the remainder of cases.

In the US we opposed the reappointment of the auditors at **F5 Networks, Micron Technology, The Cooper Companies** and **Rockwell Automation**. Concerns included the length of tenure of the auditor (over ten years). In all cases the companies received a vote against of over 5%.

In Europe we opposed auditor appointments at companies including **UPM-Kymmene** in Finland and **Novartis** and **SGS** in Switzerland. All three companies received a vote of at least 5% against and **UPM-Kymmene** saw the highest vote against at over 11%. We had concerns about both the value of non-audit work undertaken and the length of tenure of the audit firm.

In the UK the only significant vote against an auditor appointment during Q1 was at **Aberforth Smaller Companies Trust** where votes against and abstentions were over 8% in total. We voted against due to concern about the tenure of the audit firm.

Shareholder resolutions

During Q1 we voted for shareholder resolutions at US companies including **Deere & Company, Tyson Foods, Apple, The Walt Disney Company, AmerisourceBergen, Walgreens Boots Alliance** and **Becton, Dickinson and Company**. The resolutions focused on issues including human rights risks assessments (**Tyson**); proxy access (**Apple**); lobbying (**The Walt Disney Company**); deferral of variable pay (**AmerisourceBergen**); and the appointment of an independent chair (**Walgreens Boots Alliance**). None of the resolutions passed, although several achieved a vote in favour of over 30%.