

**NORTHERN LGPS
STEWARDSHIP REPORT
Q1 2021**

GREATER MANCHESTER / MERSEYSIDE / WEST YORKSHIRE

CLIMATE: INIT FOR THE LONG TERM

CLIMATE FOCUS



Drax power station's biomass plant for burning wood pellets and not coal

Drax under scrutiny

● We've reported previously on our participation in a collaborative engagement with Drax. Although the company has shifted away from burning coal at its Selby site, it remains a controversial business due to the nature of its alternative fuel sources and its approach to net zero. 2021 has seen a number of important developments.

In February the company scrapped plans to build gas turbines at its North Yorkshire site after criticism that this was inconsistent with the government's emissions reduction strategy, and as such is committed to the use of biomass. Then in March, Drax shareholders supported

the acquisition of Canadian biomass company, Pinnacle Renewable Energy Inc. Pinnacle will supply the wood pellets for Drax's Selby Plant where the company claims it will develop carbon capture capability to eliminate emissions produced by burning wood pellets.

The argument in favour of Drax's approach is that the combination of CO₂ absorbed by trees before they are turned into pellets, along with the use of carbon capture technology, will n a carbon positive business.

However, such claims are contested. We note that Jean Pascal van Ypersele, Professor of Environmental Sciences

and a former UN vice chair, has called on the UK to review policies on burning wood for energy, because they are contradictory to the Paris Climate Agreement. It is also apparent that plans to utilise carbon capture of emissions from wood pellets relies heavily on subsidies from government. The Drax model is also heavily reliant on an energy intensive transatlantic distribution network in order to provide the Drax site the wood pellets required in the energy generation process.

In addition, Share Action, has argued that Pinnacle obtains wood for its pellets using harmful practices such as clearcutting and logging trees from

CLIMATE FOCUS



WHAT ARE WOOD PELLETS?

Wood pellets, or woody biomass, are an energy source that burns processed, dried wood to create electricity. Pellets can be used to power anything from small household stoves to massive coal-fired power plants. The global community, notably the EU and US, has expanded its industrial usage of pellets in biomass power plants and coal-fired power plants as a means of meeting their carbon neutrality agreements.

primary forests. This is misaligned with Drax's claim to only source sustainable biomass and connects the company to destruction of Canadian old growth forests.

And since there is no requirement for biomass companies to replace those forests chopped down for fuel, questions remain over the sustainability of the natural resource employed.

Finally concerns have been raised about the threat to indigenous communities living in the Boreal forests of Canada where Pinnacle is believed to be logging. Complaints relate to noise, air pollution and the threat to decimation of their habitat.

In March, LAPFF held a webinar to discuss the approach Drax is taking. The Forum has also undertaken detailed examination of the economics, the cost and the "net zero" status of CCS. LAPFF is also examining in detail the numbers behind forests as carbon sinks, as well as timing issues given the time it takes for a mature forest to grow and become a carbon sink. ■

Public policy takes centre stage

● The first quarter was an important one for legislation that will influence environmental, social and governance issues for companies and their investors in the years ahead. Among the raft of important changes affecting NLGPS and other large institutional investors include climate risk reporting and governance rules for pension funds.

In January, the government published new rules for climate change reporting that are aligned with the Task Force on Climate-related Financial Disclosures (TCFD) and follow its consultation last August.

While the requirements, which come into force this year, will be a big step for some schemes, NLGPS agrees with Guy Opperman, pensions minister, when he said: "Failing to ensure climate risk, the most systemic risk facing financial services, is properly considered is a failure in trustees' duty to protect members."

The government is also consulting on introducing mandatory climate-related

financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships.

The consultation builds on the government's 2019 Green Finance Strategy, that all listed companies and large asset owners should disclose in line with the TCFD recommendations by 2022.

The government says 'significantly increasing the proportion of companies' reporting on ESG risks will support the UK's transition to net zero.

NLGPS welcomes the consultation since greater disclosure on climate related matters is critical in helping us make the best investment decisions in the interests of our members.

Yet more regulatory change came in the form of the Sustainable Finance Disclosure Regulation (SFDR) this March. As part of the EU's Sustainable Finance Action Plan to redirect capital flows towards sustainable investments, the SFDR requires financial companies to

ESG REGULATIONS: WHAT'S NEW?

- Climate risk reporting and governance rules for pension funds – new tougher disclosure requirements for pension funds in line with the TCFD
- Sustainable Finance Disclosure Regulation – new rules for fund providers covering the marketing and disclosure of ESG funds
- Consultation on mandatory climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships

better define and disclosure information relating to sustainable investments and sustainability risks.

This is another important piece of regulation that helps investors make decisions about which funds to choose and the validity of the providers that offer them. ■

CLIMATE FOCUS

The Just Transition takes shape in Italy

● NLGPS has made a commitment to the Just Transition a central element of its approach to climate change. We believe that to mobilise the societal change required for net zero it is vital that the interests of affected workforces and communities are taken into account.

We are pleased that a growing number of companies are also embracing this agenda. On this point we note Italian oil company Eni's adoption of a just transition strategy as it reduces its carbon emissions over the next 30 years.

ENI signed a protocol agreed with Italian unions, Ictem Cgil, Femca Cisl, Uiltec Uil, which will provide a framework for ensuring workers are included in the company's climate change plans.

ENI has set up a joint strategy committee that will meet twice a year; a health and safety committee which will meet four times a year; and a welfare committee to discuss and promote the possibility of additional measures to support and assist workers and their families.

The protocol also covers the digital transformation, giving employees a say as ENI adopts new ways of working. ENI will regulate contractors and subcontractors; ban forced labour; and safeguard freedom of association and collective bargaining.

Nora Garofalo, FEMCA Cisl general secretary, said: "This protocol reinforces the participatory paths of industrial relations, which are essential to govern the effects of the current health emergency and to manage a sustainable energy transition. It is needed to safeguard existing jobs and prepare the 'new work' and the workers of the future."

ENI's support of just transition follows that of the Scottish energy supplier, SSE, which announced its commitment to the initiative last year. SSE has pledged to support workers as it reduces the carbon intensity of its electricity production by 60% by 2030 based on 2018 levels and has signed up to reaching net zero emissions by 2050 at the latest.

NLGPS hopes that other companies – and not just those in the energy sector – follow suit this year. ■



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NLGPS AND THE JUST TRANSITION

In March Tom Harrington, assistant director (investments), Greater Manchester Pension Fund, joined a debate with pensions minister Guy Opperman making the case for a Just Transition to a low carbon economy at an event organised by the TUC.

The virtual TUC pensions conference took place in March and gave NLGPS the chance to contribute to and hear about the latest national policies and global developments. The TUC has been increasingly vocal about the need for the interests of workers to be a key consideration in the transition to a low carbon economy. It has also been interested in ensuring that pension funds support this agenda.

Tom spoke about why NLGPS was supportive of the Just Transition agenda and the role that investor could play.



Pensions minister Guy Opperman

SOCIAL & GOVERNANCE FACTORS



Covid and care

● As the UK recovered from the devastating second major wave of Covid-19 attention has begun to turn to what can be learnt from the pandemic. As the impact has been hardest on the elderly, and, in respect of the workforce, those that care for them, the care sector is attracting greater attention.

From the very beginning of the coronavirus outbreak in 2020, it has been clear to us as responsible investors that the importance of how companies responded and took steps to protect their workforces and customers would be critical.

While the particularly high death rates at care homes can be explained by some older people's susceptibility to Covid 19, it has also drawn attention to the persistent pressure the care sector faces around funding and employment practices. In

particular we note that the role of private equity ownership has been highlighted, with allegations that standards are lower are in PE-owned homes in part due to funding pressures.

A report from the LAPFF this year, found that PE has spent more than £1.8bn in 64 retirement and nursing homes deals in the last decade, while research from LaingBuisson estimated private equity firms and funds now own 13% of UK nursing and residential homes, with 56,700 beds.

The LAPFF report draws attention to the poor standard of care in some of those homes owned by Four Seasons which is part of the private equity house Terra Firma. And we are reminded of the collapse of Southern Cross care homes in 2011 which placed a spotlight on the way the sector was funded. Even some PE insiders have expressed concern about

the tensions between the return expectations of PE owners and the long-term needs of the care sector.

But interest in the sector goes beyond PE, and the UK. In March the Forum supported a collaborative investor initiative organized by UNI Global Union focused on issues such as standards of care, staffing levels, health and safety and wages. The companies that are part of the engagement list include listed operators and real estate investment trusts.

Looking more widely, there is increasing discussion of the funding of care in the future as the UK and other developed countries see their populations ageing. This may lead to further state intervention in the sector.

As such we expect to see public and investor interest in the sector to grow, and it is an area that we continue to watch closely. ■

SOCIAL & GOVERNANCE FACTORS



Platform employers in car crash

● Uber and Deliveroo have experienced an eventful quarter with both companies coming under fire for their labour practices.

As the gig economy has grown so have expectations of those working for platform companies, and it is also clear that the sector exhibits risk relating to the employment status of those that work in it. Legal judgements and policy shifts on such questions have often resulted in sharp share prices movements.

One such example was Uber's defeat at the UK Supreme Court in February is a ruling that means drivers are entitled to holiday and sick pay along with other benefits.

The significance, in terms of labour costs, was not lost on investors. After the ruling, Uber's share price fell steadily. This was in direct contrast to Uber's share performance after Californian law makers passed Proposition-22 which ruled

workers at app-based lift hailing companies be categorised contractors not employees. The decision saw Uber and fellow ride-hailing business Lyft's share prices rocket.

Concerns about employment standards, and corporate governance, have also dogged fellow app-based company, Deliveroo, which listed in the UK at the very end of March. Once again, the nature of the employment relationship is central to the story, with Deliveroo providing hundreds of words of commentary on the risk from challenges on this point in its IPO prospectus.

The company is set to adopt a dual-class share structure next month, a governance model many institutional investors oppose and have previously fought to remove from the UK market. Regrettably the UK Government has provided backing for such structures as part of its attempts to lure tech listings to

London. **Back in 2019 LAPFF issued a position paper restating its opposition to dual-class structures, in part in response to a trend amongst tech firms to adopt them.**

In any case a combination of concerns about labour and governance issues, and the sustainability of the business model, seem to have put many investors off. Asset managers Aviva, Legal & General, Aberdeen Standard, M&G, Rathbones, Jupiter, BMO and CCLA are among those that declined to participate in the IPO, with a listing price of £3.90 each. Not surprisingly Deliveroo's shares sunk by over a quarter on the first day of trading.

The battle over employment rights in the gig economy will not end any time soon, and new legal cases are emerging on almost a weekly basis. It is clearly one of the principal risk factors when considering whether to invest in such businesses. ■

SOCIAL & GOVERNANCE FACTORS

Hill Review looks back to the future

● Deliveroo's listing in March was trumpeted by the government as an example of the UK's attractiveness as a location for new businesses, and an early success for its plans to 'liberalise' listing rules. Shortly before the listing, Lord Hill concluded his review into the UK's listing rules with some recommendations which we believe are set to weaken the UK's corporate governance framework. The Financial Conduct Authority (FCA) will now consult on the Hill Review, but if the government proceeds with key proposals, NLGPS is concerned there will be a risk to investors.

The review was designed to raise the UK's position as a top location for company IPOs, having lost some of its influence following Brexit resulting in it being superseded by Amsterdam's exchanges. However, while we understand the desire for more listings in the City, this should not come at the expense of overturning well-established governance norms, which in turn may undermine responsible share ownership.

We oppose the suggesting of allowing dual-class share structures in the premium segment of the UK market, since this makes stewardship activity harder. Put simply, if a board knows that it can never be defeated in a vote, a company can propose whatever it likes on a meeting agenda.

Similarly, NLGPS is concerned about the proposal to lower the limit on the free float of shares in public hands to 15%. Once again, the net effect is to reduce accountability to minority shareholders. Often limited free floats overlap with other governance concerns, NMC Health being a notable recent example.

Among other suggestions are rebranding and repositioning the FTSE 100 to increase its appeal to companies of all sizes and types; wider review of the prospectus regime so that admission to a regulated market and offers to the public are treated separately; and relaxing the rules regarding special purpose acquisition companies (SPACs).

Whilst clearly it is down to investors to undertake their own analysis and choose whether or not to invest in companies exhibiting questionable governance arrangements, the Review will ultimately make it more likely such companies list on the UK exchange. And if they achieve a sizeable market cap they may end up in index portfolios held by both institutional and retail investors.

The FCA is not expected to finish its consultation until the summer, during which time NLGPS will continue to raise its concerns with the appropriate parties. ■

Rio Tinto chair departs

● The chair of Rio Tinto, Simon Thompson, is to step down from the mining company following its devastation of two sites of cultural significance in Western Australia, but executive pay concerns remain. Mr Thompson's exit follows that of the CEO, Sebastian Jean-Jacques, and two other board members at the end of last year.

It is welcome that Rio's chair is taking responsibility for poor handling of the company's response to the indefensible destruction of two Aboriginal mines in the Juukan Gorge. However, it is disappointing to see that Mr Jean-Jacques was still paid £7.2m despite the disaster. Mr

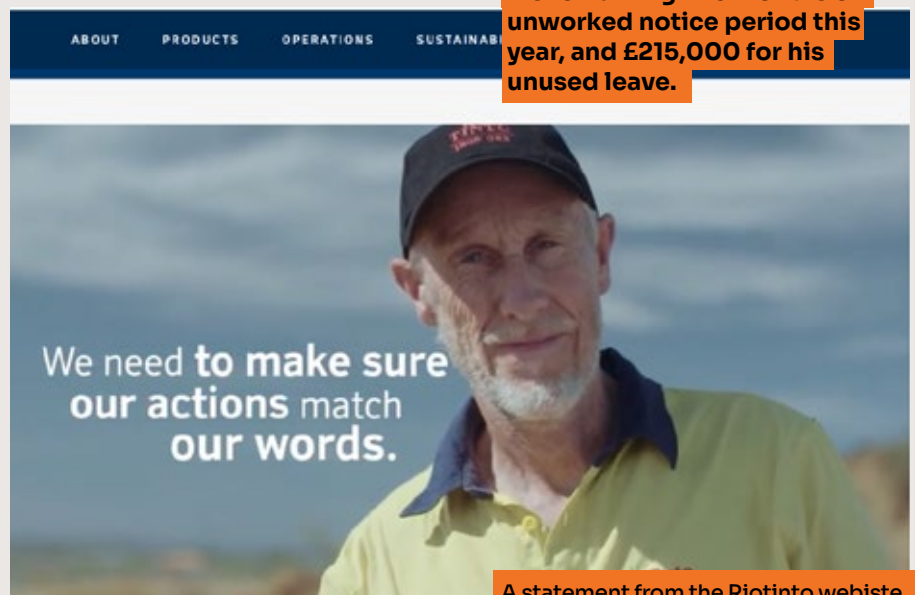
Jacques will also receive £519,000 for his remaining five months of unworked notice period this year, and £215,000 for his unused leave.

Rio Tinto sanctioned the blast in 2013 despite paying for archaeological reports that detailed signs of continuous occupation over 46,000 years and another report in 2018 which said the site has 'the amazing potential to radically change our understanding of the earliest human behaviour in Australia'.

Through our membership of LAPFF we have supported engagement with Rio Tinto to ensure that the senior leadership at the company is held accountable for their role in the disaster.

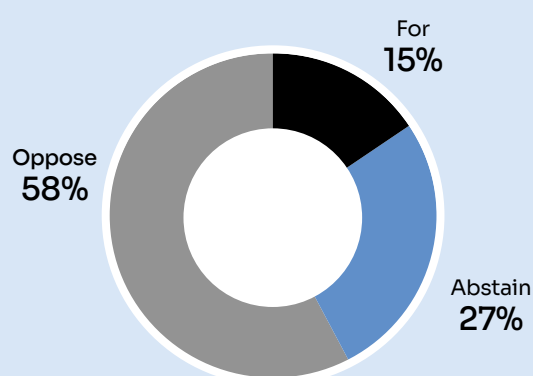
We hope that Rio Tinto will reflect both on the importance of meaningful community relations and the huge governance challenges caused by mishandling them. ■

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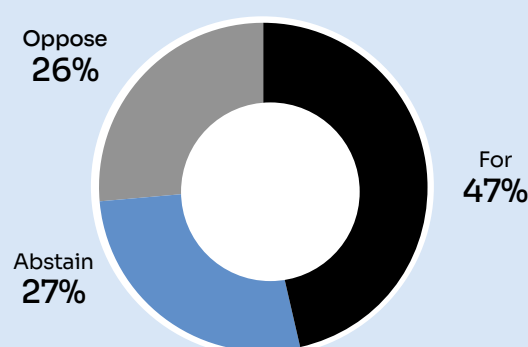


VOTING & ENGAGEMENT REVIEW

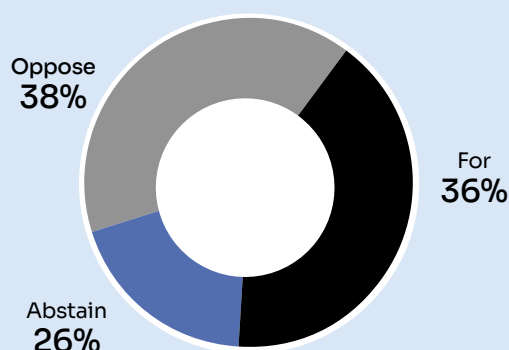
Votes on remuneration policy, Q1 2021



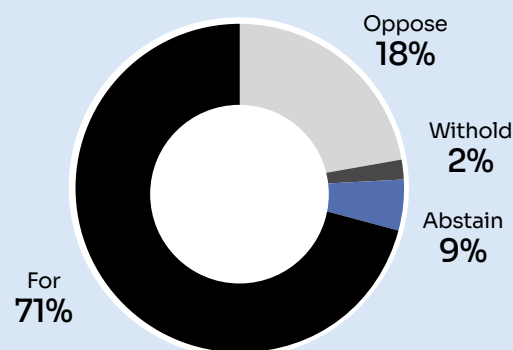
Votes on remuneration reports, Q1 2021



Auditor appointments, Q1 2021



Director elections, Q1 2021



Q1 VOTING

During the first quarter we continued to take a robust line on corporate governance issues like the need for diverse and independent boards and executive pay restraint. Regrettably too many boards continue to adopt remuneration policies that are either poorly structured or offer excessive rewards. In addition we expect to see particular restraint in relation to executive reward given the experience of the pandemic. Issues we will consider include bonus and incentive scheme awards to directors of companies that

have undertaken job cuts or reductions in terms and conditions for employees, or have utilised taxpayer support. In practice we supported a minority of advisory resolutions on pay during the quarter, and opposed more than half of the binding votes on remuneration policy or their equivalent.

We also continue to challenge boards both over issues of their own governance and of wider corporate behaviour. Once again we will consider opposing the re-election of board members at compa-

nies that we consider to have performed poorly in terms of their approach to employee welfare during the pandemic.

During Q1 we have continued to support the large majority of shareholder resolutions seeking improvements in ESG policies and practices at companies. Issues covered range from human rights and worker safety at US food company Tyson Foods, to lending to fossil fuel companies at Swedbank. Our full voting record is available online.

VOTING & ENGAGEMENT REVIEW

GYM GROUP

As part of the NLGPS holdings-based engagement, Cllr Ged Cooney met with the Chair of The Gym Group, Penny Hughes, during February to discuss a range of environmental, governance and social issues. Given the nature of the company's core offering, the group's operations had been profoundly impacted by Covid-19. However, Ms Hughes considered the company to be well positioned to take advantage of some of the longer-term post-covid trends relating to improving public health.

Cllr Cooney pressed the company on the working conditions of their employees. Gym Group operates hybrid employment model in which the fitness trainers are typically contracted by the company for 12 hours a week whilst simultaneously running their own business within the gym. Although this model offers some guarantee of earnings, the self-employed status of the majority of trainers offers little financial security over a prolonged period. Covid-19 has emphasized the devastating impact insecure working conditions can have on individuals, families and communities. The business, regulatory and reputational risks associated with companies relying on an employee base of insecure workers has played out numerous times during the pandemic.

Cllr Cooney asked the company about the impact an employment model of this nature can have with regards employee savings and inquired as to the reason for such a low employee uptake on the company pension scheme. The company stated that all employees enroll automatically into the pension scheme when they are over the age of 22 providing monthly earnings exceed £833. A contributing factor towards the relatively low uptake on the company pension is likely the employment model currently operated by the company.

Cllr Cooney also requested that the company set ambitious long-term emissions reduction targets and agree to report in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). In March, the company published its annual sustainability report which included a commitment to setting ambitious long

term emissions reduction targets as well as a commitment to conducting a climate change materiality and risk assessment in line with the recommendations of TCFD during 2021.

PAGE GROUP

In January, another holdings-based engagement saw Cllr Cooney meet with the Chair of FTSE250 recruitment company Page Group to discuss diversity, skill gaps in the UK market and the role recruitment firms play in ensuring adequate working conditions for the individuals recruited, specifically with regard to lower cost labour. On diversity, recruitment companies play a key role in ensuring the long list of potential employees drawn up for any one position includes the relevant skills and experience to successfully fulfil the role but also a pool of candidates that are appropriately diverse in terms of gender, ethnicity and social class. Page group itself has adequate gender representation at the board level but it remained unclear as to the extent to which the company championed diversity in its broadest sense, particularly with regards the organisations it services. Similarly, it wasn't clear the extent to which working conditions and terms of employment were considered before recruiting for clients. The issue of skills gaps in the UK labour market focused on the lack of non-executive directors with adequate experience in sustainability, an ongoing governance concern facing all industries and sectors that are adjusting the way in which they operate to align with a low carbon economy.

PIRC ENGAGEMENTS

In its role as stewardship advisor to NLGPS, PIRC engaged with companies in respect of 131 meetings held during the quarter, in addition to engagements that were not related to meetings.

VOTING ON ESG ISSUES

Last quarter we reported on the 'Say On' Climate initiative which encourages all listed companies to develop a climate transition plan on which shareholders will vote at the AGM.

NLGPS signaled our support for the initiative at the end of last year and we are pleased to note that by the close of the quarter, at least 20 companies had adopted the 'Say on Climate' initiative voluntarily. These include M&G; Woodside Petroleum; Total, Glencore; Nestle; Ferrovial; and Royal Dutch Shell. It also looking likely that major banks including Barclays and HSBC are set to get on board.

However, it is important to note that while we welcome the length to which companies are embracing 'Say on Climate', simply producing a climate transition plan and putting it to a vote does not guarantee our support at the AGM. NLGPS will still hold companies to our own standards on managing climate change risk, and we will expect company boards to demonstrate a commitment to meeting the Paris accord in line with our objectives. ■

'SAY ON CLIMATE' OBJECTIVES:

1. To secure asset owners and major asset managers public support for the concept;
2. Voluntary adoption of 'Say on Climate' by leading companies;
3. Shareholder resolutions filed at 20 – 40 companies in the US, Canada, UK, EU and Australia in 2021 and 200–300+ in 2022, to secure adoption;
4. Build a pathway to mandatory regulation in key countries;
5. Establish an ecosystem to hold investors and companies to account on the quality of their climate plans.