London Borough of Havering Pension Fund

Review of Voting & Engagement Activity

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Executive Summary

- This paper is addressed to the Pensions Committee of the London Borough of Havering Pension Fund ("the Committee" of "the Fund") to summarise the Fund's investment managers' voting and engagement activities over the 12 month period to 30 June 2020.
- This paper should not be released or otherwise disclosed to any third party except as required by law or regulatory obligation without our prior written consent. We accept no liability where this note is used by, or released or otherwise disclosed to, a third party unless we have expressly accepted such liability in writing. Where this is permitted, the note may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given.
- During the year, the Fund had investment through three managers across seven mandates with equity exposure. These mandates comprised 65% of total assets representing equity exposure of 47% at 30 June 2020.One of these mandates, managed by GMO was sold down over the year and has since been terminated. This manager has been excluded from this paper. The other two managers are LGIM and LCIV although LCIV's policy is to delegate implementation to the underlying managers, Baillie Gifford and Ruffer.
- We note that over the year, the vast majority of votes that were eligible to be exercised were voted. Of the six mandates considered, only Baillie Gifford's DGF (93%) and Ruffer (97%) were below 99%.
- All managers demonstrated a preparedness to vote against company management on occasion although this is most prevalent in the LGIM mandates where around 18% of votes, on average, we against management. Given the index nature of these holdings, this pattern is to be expected.
- There was a commonality in the reasons why managers voted against management with Remuneration, Director re-election and Capital allocation being key themes. It should be noted that managers may vote against the re-election of directors for a number of reasons which may be unrelated to the particular director.
- LGIM and Baillie Gifford have both reviewed and updated their voting policies over the year, with the changes made being to strengthen and clarify expectations. Ruffer completed a review following year end. LCIV has not reviewed its policy although we understand that LCIV is considering the procurement of a voting and engagement provider.
- We look forward to discussing this paper with the Committee.

Equity and multi-asset: Voting policies

- The Committee has an objective of seeking to ensure that voting policies are regularly reviewed and updated to ensure that changing practices and regulation can continue to be reflected where necessary. The Fund does not have its own voting policy, having delegated this responsibility to its investment managers.
- Managers generally operate a house voting policy that that will apply in the absence of a client specific policy which, in the case of the Fund, would be determined by LCIV. LGIM operate their own voting policy independent of LCIV. LCIV presently delegates responsibility for voting to its investment managers and managers are therefore expected to vote in line with their house policy.
- Two managers with equity voting rights (LGIM and Baillie Gifford) reviewed their voting policy earlier in 2020. Ruffer has not updated its voting policy during the year under review but has subsequently updated its policy as at October 2020. LCIV has not updated its policy during the year. The main changes made by the two managers were as follows:

LGIM

- Emphasised **diversity** by adding expectation for companies in well-governed markets to have at least 25% women on their boards; emphasised **board accountability** and the importance of an external board reviewer; introduced a policy on opposing the re-election of any combined CEO/Chair; emphasised **independence** by extending their policy on the presence of a Senior/Lead Independent Director and increased their expectations around **Audit** to not support executive members on an audit committee and that the process of retendering an auditor should be disclosed.

Baillie Gifford

- Emphasised five stewardship principles, being prioritisation of long-term value creation; a constructive and purposeful board; long-term focused remuneration; fair treatment of stakeholders and sustainable business practices.
- Added detail to their policy to clarify **significant voting situations**, clarified their view of **excessive equity issuance** being detrimental to long-term value creation and framed expectations around **shareholder proposals**, expecting these to not be repetitive, prescriptive or seek to micromanage companies.

Equity and multi-asset: Exercise of votes

	LGIM PRI rating for Listed Equity Ownership (LEO) A+			Baillie Gifford LEO: A+		Ruffer LEO: A
	All World	Emerging Markets	RAFI	Global Alpha	DGF	Absolute return
# eligible votes	40,386	12,560	39,276	1,217	966	1070
% votes exercised	99.8	99.7	99.3	100.0	93.3	96.8
% against management	18.3	17.7	18.8	3.5	5.3	10.1
% abstained / withheld	0.5	1.2	0.3	1.1	1.5	2.1
% meetings with at least one vote against management	67.4	55.8	71.5	25.0	6.7	41.0

- The Fund has direct exposure to equities via LGIM and Baillie Gifford mandates, with additional exposure obtained through multi-asset mandates managed by Baillie Gifford and Ruffer. Whist these mandates represented 65% of total assets, on a look through basis, investment in equity assets represented c. 47% of Fund assets as at 30 June 2020
- The table above provides a summary of voting over 12 month period to 30 June 2020. We can observe the following from this data:
  - The exercise of voting rights was high across most mandates. Ruffer did not vote at 2 of 83 meetings in which they were eligible to invest.
  - Abstentions/withheld votes are relatively low. Managers are generally exercising their rights
  - LGIM are the most active of managers, voting against management on c18% of occasions. Given the LGIM funds are index tracking, we may expect this to be the case as LGIM do not otherwise have the option of divestment. Both Baillie Gifford and Ruffer actively select stocks and, should, on average have a greater alignment of interests.

Equity and multi-asset: Significant votes/engagement

Manager	Main reasons to vote against management	Significant votes	Main engagement themes
LGIM	1. Capital allocation 2. Remuneration 3. Director-related 4. Routine 5. Allocation of income	• The Boeing Company. Voted against re-election of the chair of the board. LGIM felt the board should be held accountable for not exercising sufficient oversight over the company's culture in light of the 737 Max accidents and therefore voted against the board chair. • Honeywell. Voted against Executive Officers' compensation package. Following engagement with the company, LGIM decided not enough of the remuneration package was assessed against performance conditions.	1. Climate change 2. Remuneration 3. Diversity 4. Board composition 5. Strategy
Baillie Gifford	1. Director-related 2. Non-salary remun. 3. Routine 4. Capital allocation 5. Reorgs./Mergers	• Microsoft. Supported a shareholder proposal on enhanced gender pay gap reporting. • Ryanair. Voted against remuneration report due to concerns over retention plan for CEO and the granting of share options to independent board members.	1. Climate Change 2. Board Matters 3. Remuneration 4. Company Culture and Employee Relations 5. Diversity
Ruffer	1. Director-related 2. Remuneration 3. Capital allocation 4. Routine 5. Reorgs./Mergers	• ExxonMobil: Voted against the re-election of all non-exec directors due to slow progress on addressing climate issues. Also voted in favour of a shareholder resolution for an independent chair. • Lloyds Banking Group: Voted against proposed remuneration policy as although it reduced the maximum pay-out, it also relaxed the vesting period and was not felt to incentive management adequately. • Ocado: Voted against re-election of the Chair due to discomfort with the Board structure and pace of rectification.	1. Climate change 2. Data disclosure (environment related) 3. Employee / community relations 4. Board structure 5. Remuneration

Real assets: Stewardship and engagement

Manager	Engagement approach and examples of engagement
JP Morgan	• In order to focus and prioritize ESG efforts across the portfolio, JP Morgan has created a framework that categorizes ESG into component parts that are actionable, measurable and relate to the daily activities of an underlying investment. JP Morgan recently engaged with a third-party to align the ESG in Action framework with additional ESG metrics and disclosures. • JP Morgan’s Increased ownership of Koole Terminals led to more sustainable initiatives being implemented. This include an agreement to produce IMO 2020-compliant bunker fuel at its site at the Port of Rotterdam. This agreement supports the reduction of Sulphur emissions in order to reduce air pollution and is in line with Koole’s focus on producing environmentally friendly transportation fuels
UBS	• The UBS Real Estate and Private Markets' (REPM) responsible investment strategy has been developed by the UBS REPM Sustainability Workgroup. It comprises professionals from several countries and disciplines, ranging from engineering and construction, through to investment and business management. It sets strategies and objectives at a global level and ensures our sustainability objectives are appropriately integrated into REPM's investment strategies and property operations, in accordance with regional requirements. • The Sustainability Workgroup established an engagement framework which over the year to 30 June 2020 was primarily focused on raising awareness of climate change issues and reducing energy and water consumption with underlying investments.
CBRE	• CBRE have recently launched an internal ESG assessment framework to rate each investment’s status and approach to ESG. The primary purpose of this mapping is the identification of future ESG risks and opportunities and development of a targeted engagement strategy for each investment • CBRE worked with management at an underlying holding, a Malaysian shopping centre, to improve the holding’s ESG practices leading to the holding’s individual GRESB score rising from 50 in 2018 to 79 in 2019. CBRE also worked with management at the shopping centre to transfer to LED lighting and upgrade the water pumping system in the building, leading to a 5.2% fall in annual energy consumption and a 13.7% reduction in annual water usage.
Stafford	• Stafford maintain a Sustainable Development Goal (“SDG”) database which consists of an assessment of every underlying infrastructure asset and any applicable SDG targets applied to the relevant asset. This is a live database and is updated for any new transactions, including periodic review of existing assets.

Fixed income: Stewardship and engagement

Manager	Engagement approach and examples of engagement

Royal London	• Royal London have an established process for engaging with companies and will make the decision to engage according to the following criteria:
	    • Meet the needs and expectations of clients
	    • Material and relevant to investment decisions
	    • Has the potential to impact corporate ESG or financial performance or reduce risk
	    • Raises best practice standards within a sector or market
	    • Adds value in advancing thought-leadership and good governance
	• Across Royal London's fixed income business they engaged with underlying companies on 96 occasions over the 2019 calendar year. The most common engagement topics were: climate related, environmental management and health and safety.

Churchill	• Churchill's senior lending investment team have recently implemented a new ESG template that is broader and more enhanced than what the team were previously using. The new ESG template is being used to not only flag issues (as the previous system did) but will also help to develop proprietary ESG ratings for all of Churchill's investments. The team is currently in the process of creating these ratings, and expect to have completed the rating process by the end of 2020. • An example of engagement to develop a socially positive outcome is with portfolio company LRN. Churchill have worked with LRN to develop compliance training software that enables customers to assess, train and monitor compliance with industry and company-specific regulations, rules of conduct and requirements.
Permira	• In 2019, Permira expanded their existing ESG Group to include three investment professional advisory members and Permira's Chief Operating Officer. The group also includes members from ESG, Investor Relations, Risk and Compliance and the portfolio group. • Permira actively engage with portfolio companies, engaging with four portfolio companies on specific ESG issues within the 12 months to 30 June 2020. • Engagement activities in the past year include a site visit made to Kinaxia, a UK haulage and warehouse business. The ESG team visited the Kinaxia facility to tour operations and meet with management to discuss progress on ESG topics identified during a similar visit in 2017. New projects and ESG related aspirations were also discussed.

Recommendations

- Managers have exercised voting policies for the Fund in line with expectations and there are no immediate concerns arising at this time. In accordance with its stewardship policy, the Committee should continue to monitor the practices of its managers.
- LCIV is responsible for voting and policy for the active equity and multi-asset vehicles. At present, this responsibility is delegated to the underlying managers. It would be appropriate for these rights and responsibilities to be consolidated to represent a single LCIV position and we propose the Committee continue to engage with LCIV and investigate the possibility of adopting a combined pool policy.
- To aid the ongoing monitoring of voting activity and improve the challenge by the Fund to its managers, we propose that the Committee select a small number of issues to be more actively monitored. Climate risk disclosure has already been highlighted as one issue in the Fund’s updated policy but others could include executive remuneration, diversity and the independence of auditors. Future reporting could then explicitly consider these issues.

Thank you