

New Zealand Superannuation Fund

Q4 2020

The purpose of the **reo**[®] (responsible engagement overlay) * service is to engage with companies held in portfolios with a view to promoting the adoption of better environmental, social and governance (ESG) practices. The **reo**[®] approach focuses on enhancing long-term investment performance by making companies more commercially successful through safer, cleaner, and more accountable operations that are better positioned to deal with ESG risks and opportunities.

Engagement in review

The last three months of 2020 gave us reasons for despair as many countries in the Western Hemisphere were forced to impose new restrictions after a tidal wave of new COVID-19 cases washed over parts of Europe and the Americas. At the same time, we found reasons for hope as the global scientific community successfully developed a vaccine in record time. New virus variants and logistical challenges in administering the vaccine mean, however, that companies will continue to face uncertainty well into 2021.

This quarter, we continued our engagement on issues related to companies' responses to the challenges brought upon by the pandemic. In November, we participated in the World Antimicrobial Resistance Awareness Week 2020, spearheaded by the World Health Organization and convened to help avoid the further emergence and spread of drug-resistant infections. The reported misuse of antibiotics during the COVID-19 pandemic means that antibiotic stewardship needs to be emphasised now more than ever. We also wrote to boards at UK and US companies in sectors disproportionately affected by the pandemic to set out our expectations on executive remuneration practices that reflect the experience of employees, investors and other stakeholders this difficult year.

Raising awareness on antimicrobial resistance

Engagement progress update

2020 was the Investor Year of Action on Antimicrobial Resistance (AMR) – a collaboration between the Farm Animal Investment Risk & Return Initiative (FAIRR), the Access to Medicine Foundation, the United Nations Principles for Responsible Investment (PRI), and the UK Government – to galvanise investor efforts to address AMR. BMO GAM is participating as an Investor Partner because we believe that AMR is a serious threat to global public health that investors need to take urgent action against, particularly as the COVID-19 pandemic risks affecting antimicrobial stewardship activities and accelerating the spread of AMR. We began our cross-sector engagement project on AMR in 2019, and plan to continue it in 2021.

November 18 marked the beginning of World Antimicrobial Awareness Week 2020. As an Investor Partner, we committed to two initiatives during this week: 1) publishing an in-depth Viewpoint[†] explaining how major food and pharmaceutical companies are overcoming the myriad challenges posed by AMR; and 2) releasing a podcast[‡] to further raise awareness about AMR:

[†]Viewpoint – <https://www.bmogam.com/wp-content/uploads/2020/11/esg-viewpoint-antimicrobial-resistance-nov-2020.pdf>

[‡]Podcast – <https://sustainabilityleaders.bmo.com/en/news-insights/sustainability-leaders/sustainable-finance/episode-27-preventing-the-antimicrobial-resistance-health-crisis/>

[§]AMR Industry Alliance – <https://www.amrindustryalliance.org/>

Guiding companies on how they should pay executives after an extraordinary year

Engagement initiative

The COVID-19 pandemic has introduced an unprecedented level of uncertainty into the global economy, with sectors such as industrials, oil & gas and consumer discretionary disproportionately affected. The operational disruption resulting from the pandemic has caused companies to miss their strategic targets set within their pre-pandemic business plans, with some needing to cut costs, cancel dividends or even seek emergency funding from investors or governments. Meanwhile other company stakeholders, such as employees, suppliers and customers, have been met with extraordinary hardship due to cost-cutting and layoffs. Amongst all of this, remuneration committees have a difficult task at hand as they try to find a balance between ensuring that executives continue to be incentivised, retained and rewarded for their efforts, whilst also reflecting the experience of investors and other stakeholders this year.

Against this backdrop, we wrote to the chairs of remuneration committee at UK and US companies within those most affected sectors to set out our expectations, suggest principles that should guide their decision-making and invite further dialogue if they consider it useful. Accepting that committees might need to exercise discretion to override pre-set formulas and policies, we encouraged detailed disclosure to be provided that explained the company specific circumstances to that justified any action taken. We also emphasised that when determining pay outcomes full consideration needs to be given for how their stakeholders have fared during the year under review, especially its employees, and not just the company's share price performance.

Workforce-related disclosures continue to make strides

Reporting standards

We have been actively engaging companies across a wide range of industries to disclose to the Workforce Disclosure Initiative's (WDI) annual survey since its inception in 2016. Key findings from the evaluation of the submissions by 118 companies to 2019's survey include that companies are generally reluctant to provide data on staff turnover as well as on internal accountability mechanisms to support workforce governance structures, and that they are willing to submit more data against workforce metrics for permanent employees than their temporary counterparts.

We engaged 81 companies on their participation in the WDI and enhanced labour related disclosure. Of these engaged companies, 21 (up from 17 in 2019) disclosed their efforts. The information – or lack thereof – disclosed will inform our engagement efforts going forward.

Banks up the ante on climate risk management

Engagement update

In the world of banking, this quarter was dominated by a handful of 2050 net-zero pledges and communication around respective implementation plans. Banks such as **JPMorganChase**, **Morgan Stanley**, **HSBC** and **NatWest**

all announced net zero financed emissions plans and provided additional detail on their implementation during dedicated investor meetings. Barclays publicly outlined its progress in implementing the net zero commitment that shareholders had requested at its annual general meeting this past April.

An important element of a robust net-zero strategy is a well-anchored climate risk management system. To strengthen our own engagement efforts in this regard, we have joined a working group under the umbrella of the Institutional Investors Group on Climate Change (IIGCC) created to help align the banking sector with the goals of the Paris Agreement. We also teamed up with engagement consultants Asia Research and Engagement (ARE) and a small set of other investors to jointly reach out to the five biggest banks in China to enter a dialogue on climate risk and opportunities management, and related transparency.

Collaborating to address deforestation issues in Brazil's Cerrado biome

Engagement collaboration

In Q4, the Cerrado Manifesto Statement of Support (SoS) group, of which BMO GAM is a leading investor, made a joint effort to re-energise engagement with a group of global soft commodities traders sourcing soy from the Cerrado region of Brazil. Joint letters were sent in October to affected companies to request the setting of time-bound deforestation and traceability targets, clear reporting on volumes of soy sourced from recently deforested land, and a clear and time-bound response to non-compliant suppliers.

While the traders' responses varied in terms of addressing the key points, we were overall disappointed by the long timeframes and lack of time-bound targets for achieving a deforestation-free supply chain, and the absence of traceability and transparency metrics, especially for indirect suppliers. We also undersigned a second SoS letter to focus the traders' attention on two key requests: commit to and announce a deforestation- and conversion-free (DCF) cut-off date for soy sourced directly or indirectly from within the Cerrado biome, and to adopt more robust traceability and transparency processes to ensure that the soy supply chain can be effectively monitored to combat deforestation.

2020 ends on a positive note for ESG from US regulators

Regulatory update

The U.S. Securities and Exchange Commission (SEC) and Department of Labor (DOL) formalised their pushback on the responsible investment industry through a series of proposals and rules in 2020.

This quarter we saw the DOL finalise its two main rules regarding the inclusion of ESG products in ERISA pension plans and requiring a deep cost-benefit analysis for active proxy voting. The investment community responded strongly, with the overwhelming response raising serious concerns over the underlying reasons motivating the rulemaking, as well as the impracticality of applying what is being asked of plan fiduciaries and the broader institutional investment industry.

On the first proposal concerning 'ESG investing' products, the DOL shifted its focus in the final rule away from the term 'ESG' to the use of pecuniary and non-pecuniary factors. This has been interpreted as a victory by many, with the DOL conceding that ESG factors can in fact be pecuniary, in that they can impact the risk/return profile of an investment or portfolio. Similarly, the second rule regarding proxy voting was also reframed in this way, arguing that fiduciaries must not pursue non-pecuniary objectives through their voting if at the expense of the financial interest of their plans.

On a more positive note, in December the Nasdaq Stock Exchange submitted to the SEC its proposal that it require those companies that it lists have, or explain why they do not have, at least two diverse directors, and to provide statistical information on the company's board of directors related to a director's self-identified gender, race and self-identification as LGBTQ+. We wrote to the SEC in support of the proposal.

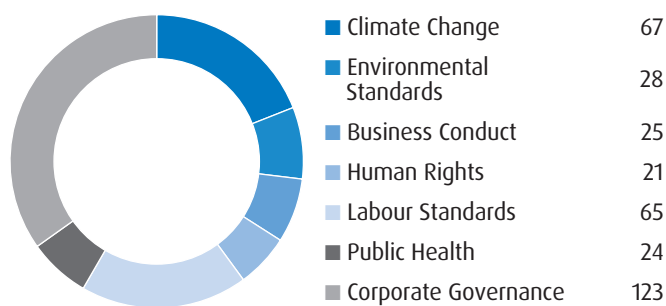
Companies engaged this quarter

Companies Engaged	Milestones achieved	Countries covered
184	66	32

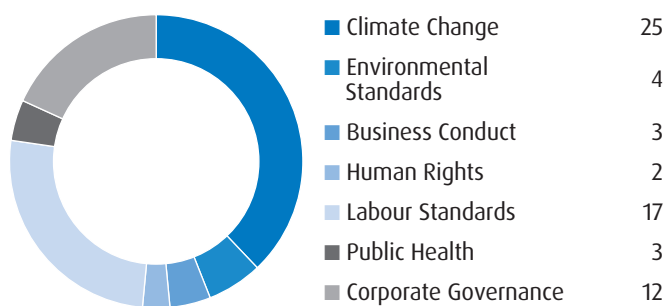
Companies engaged by region



Companies engaged by issue **



Milestones achieved by issue



* reo* is currently applied to £252bn / €277bn / \$325bn / CAD\$433bn of assets as at 30 September 2020.

** Companies may have been engaged on more than one issue.

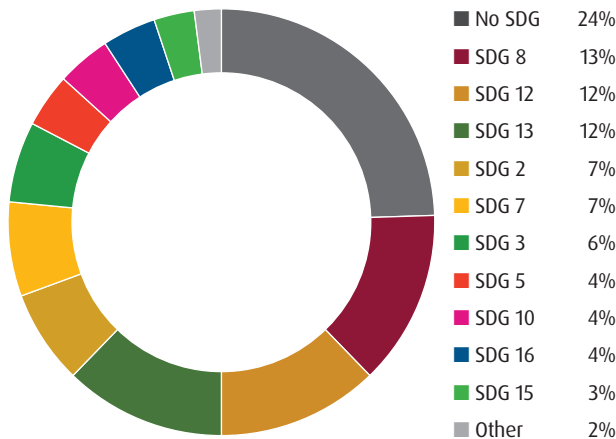
*** This report has been compiled using data supplied by a third-party electronic voting platform provider. The statistics exclude ballots with zero shares and re-registration meetings. Meetings/ballots/proposals are not considered voted if: ballots have been rejected by voting intermediaries (e.g. where necessary documentation (such as Powers of Attorney, beneficial owner confirmation, etc.) was not in place); instructed as "Do not vote" (e.g. in share-blocking markets); or left uninstructed. Past performance should not be seen as an indication of future performance. Stock market and currency movements mean the value of, and income from, investments in the Fund are not guaranteed. They can go down as well as up and you may not get back the amount you invest.

Engagements and Sustainable Development Goals (SDGs)

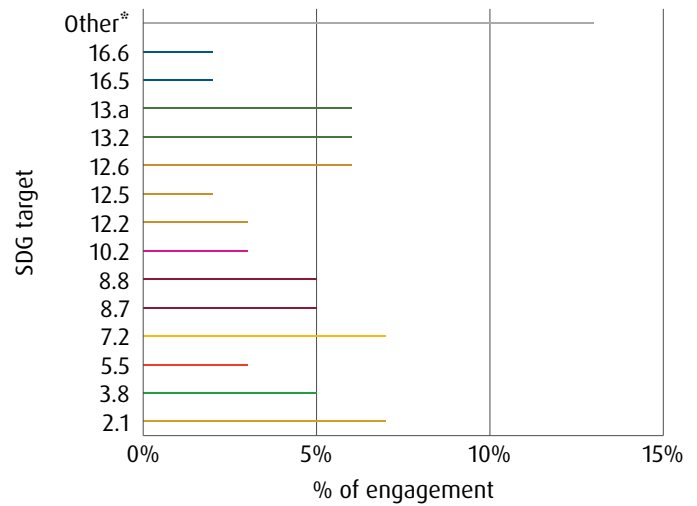
The 17 Sustainable Development Goals (SDGs) were developed by the UN and cross-industry stakeholders with a view to providing a roadmap towards a more sustainable world.

We use the detailed underlying SDG targets to frame company engagement objectives, where relevant, as well as to articulate the positive societal and environmental impacts of engagement. Engagements are systematically captured at a target level, to enable greater accuracy and achieve higher impact.

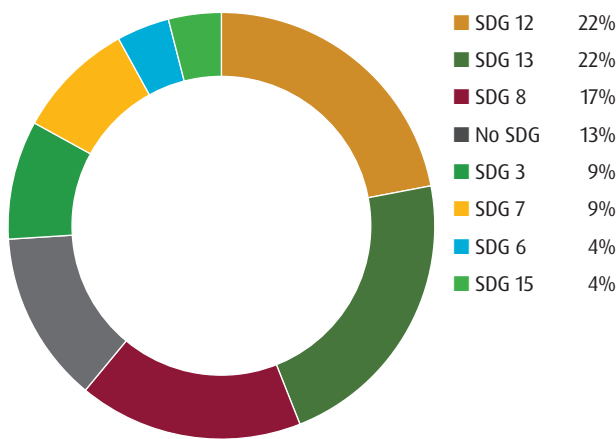
Engagement: SDG level



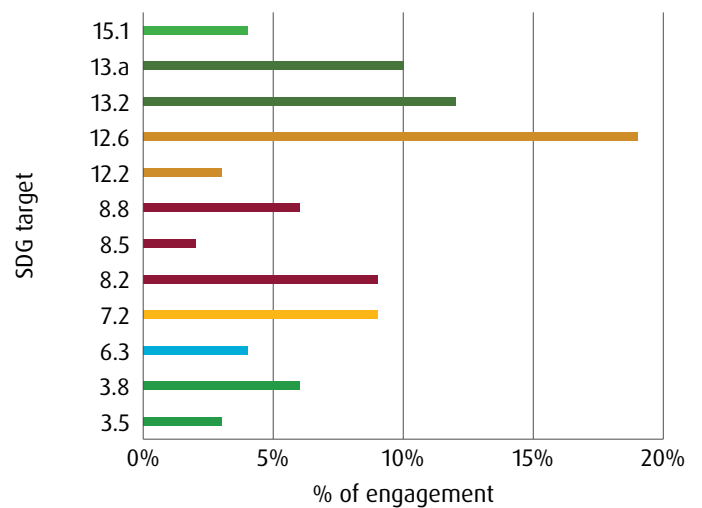
Engagement: SDG target level



Milestone: SDG level



Milestone: SDG target level



*Other represents SDG targets less than 2% of the relevant SDG Goal.

Engagement case studies

Company: General Motors Co

Country: United States

Sector: Consumer Discretionary

Priority Company: ✓

ESG Risk Rating: 

Response to engagement:: Adequate

Theme: Public Health

Issue: Social Supply Chain Management

SDG:  8.7

Background

Alongside its peers in the automotive industry, General Motors is pivoting its fleet to offer zero emission vehicles consistent with a low carbon future. Key to this strategy is the deployment of low-cost, high capacity lithium-ion battery technology, which is reliant upon minerals like cobalt. Cobalt sourcing from the Democratic Republic of Congo is linked to serious and systemic human rights violations, including child labour and poor health and safety, making management of the issue critical to the company's future success. As part of the PRI's collaborative engagement initiative on responsible sourcing of cobalt we were the lead investor on General Motors, looking to better understand how it manages the issue and push for improvements as deemed necessary.

Action

Following a review of the company's practices and standards in this area, we used several meetings with internal supply chain specialists over the course of 2020 to discuss our findings. The company has recently switched its battery strategy, moving from a third- to first-party sourcing model, meaning that much of the due diligence previously conducted by a supplier has been brought in-house. The company has a zero-tolerance policy for child labour in its supply chain and continues to rely heavily on industry collaboration in its due diligence through the audit process, mainly tools and resources developed by the Responsible Minerals Initiative (RMI) of which GM is a member. In addition, it launched an internal human rights due diligence exercise during 2020 that will cover its supply chain in order to assess if extra processes are required. During our engagement we also noted that the level of disclosure has shifted from focusing on governance and policy to be anecdotal in nature, which makes it harder to understand and assess risk management processes. We, therefore, asked for better transparency and disclosure on cobalt sourcing as well as broader social supply chain issues going forward.

Verdict

The company's first party battery technology is a key part of its current transition strategy which they hope will differentiate them from their peers. Our encouragement to the company has been for them to include their responsible sourcing as a key part of that messaging. Continuing dialogue on these issues gives us assurance against a backdrop of disclosure being less clear than before. Given the scale of human rights abuses in the cobalt supply chain, our view is that the most effective strategy will be to eliminate the use of cobalt altogether. With their recently battery technology achieving a lower portion of cobalt than rival technologies, this goal appears to be on the company's radar, but it is not clear if or when it can be fully achieved.

ESG Risk Rating: Rating of a company's ESG risk exposure and risk management compared to industry peers. Source: MSCI ESG Research Inc.

Top quartile:  GREEN Second quartile:  YELLOW Third quartile:  ORANGE Bottom quartile:  RED

Engagement case studies

Company: Wolters Kluwer NV

Country: Netherlands

Sector: Industrials

Priority Company: -

ESG Risk Rating: 

Response to engagement::

Theme: Climate Change

Issue: Executive Remuneration

Background

The professional information and software services company held a first binding vote on its executive pay policy in April 2020. The resolution did not meet the tough 75% approval threshold required to pass under the Netherlands' implementation of the Shareholder Rights Directive II. It received almost 48% votes against, a very high level of opposition in the market.

Action

We held several meetings with the company before and after the AGM. We urged removal of the disproportionate number of US companies from the pay peer group, a practice which we believe has contributed to driving up quantum of executive pay beyond levels acceptable in the Dutch market. We also urged the removal of the provisions allowing shares to fully vest in the event of a change in control, which is not aligned with Dutch and international best practice. We encouraged improved reporting of performance targets (including those linked to ESG metrics) under both the bonus and long-term incentive plan. We, and many other investors, expect that targets attached to long-term incentive plan (LTIP) be disclosed ex-ante. As we had requested, bonus targets will be reported ex-post and all ESG-linked targets are independently verifiable and quantifiable. We have been disappointed that the company only committed to disclosing LTIP targets retrospectively but appreciate the future commitment to improve. In the context of the Covid-19 pandemic, the CEO voluntarily reduced her long-term incentive plan quantum by 10% and will receive no base salary increase in 2021, although this alone is unlikely to reduce concerns around pay quantum.

Verdict

We have welcomed the positive evolution in the company's responsiveness to investor engagement following the failed pay vote. Our initial opinion was that the company was primarily seeking to hear from investors how to pass the vote in 2021. We have subsequently been reassured that there is genuine commitment to aligning pay practices and disclosure with the market and investor expectations.

ESG Risk Rating: Rating of a company's ESG risk exposure and risk management compared to industry peers. Source: MSCI ESG Research Inc.

Top quartile:  GREEN Second quartile:  YELLOW Third quartile:  ORANGE Bottom quartile:  RED

Appendix



SDG	Target	Target Summary
SDG1	1.1	Eradicate poverty and ensure a living wage for all
SDG1	1.4	Ensure equal rights to resources and basic services
SDG2	2.1	End hunger and ensure access to safe and nutritious food
SDG2	2.4	Implement climate-resilient and sustainable food production
SDG3	3.4	Reduce mortality from non-communicable diseases and promote mental health
SDG3	3.5	Increase the prevention and treatment of substance abuse
SDG3	3.8	Access to medicines and health-care
SDG5	5.1	End all forms of discrimination against women and girls
SDG5	5.5	Ensure full equality of opportunity for women, including at leadership levels
SDG6	6.3	Improve water quality by reducing pollution
SDG6	6.4	Increase water-use efficiency to address water scarcity
SDG7	7.2	Substantially increase the global share of renewable energy
SDG8	8.2	Achieve greater productivity through innovation.
SDG8	8.5	Achieve full and productive employment for all
SDG8	8.6	Reduce the proportion of youth not in employment or education
SDG8	8.7	Eradicate forced labour, modern slavery & human trafficking
SDG8	8.8	Protect and promote safe working environments for all workers
SDG9	9.1	Develop resilient and sustainable infrastructure
SDG9	9.4	Upgrade and retrofit industries to increase sustainability
SDG10	10.1	Achieve a higher rate of income growth for the bottom 40%
SDG10	10.2	Empower and promote inclusivity for all
SDG10	10.4	Adopt policies to progressively achieve greater equality
SDG10	10.5	Improve the regulation and monitoring of financial markets
SDG11	11.3	Sustainable urbanisation to aid human settlement management
SDG11	11.6	Reduce the negative environmental externalities of cities
SDG12	12.2	Sustainably manage and make efficient use of natural resources
SDG12	12.3	Halve global food waste at the production and consumer level.
SDG12	12.4	Manage chemical usage and waste throughout their life cycle
SDG12	12.5	Reduce waste through prevention, reduction, recycling and reuse
SDG12	12.6	Encourage companies to adopt sustainable practices and enhance ESG reporting
SDG13	13.2	Integrate climate change plans into policies and strategies
SDG13	13.a	Address climate change mitigation for developing countries
SDG14	14.1	Prevent and reduce marine pollution of all kinds
SDG15	15.1	Ensure sustainable usage of terrestrial freshwater ecosystems

Appendix (continued)



SDG	Target	Target Summary
SDG15	15.2	Promote the implementation of sustainable management of forests
SDG15	15.5	Take urgent action to reduce degradation of natural habitats
SDG15	15.a	Increase financial resources to conserve ecosystems
SDG16	16.5	Reduce corruption and bribery in all their forms
SDG16	16.6	Develop effective, accountable and transparent institutions