CT/19/110
Investment & Pension Fund Committee
15 November 2019

INVESTMENT MANAGEMENT REPORT

Report of the County Treasurer

All recommendations contained in this report are subject to confirmation by the Committee before taking effect.

Recommendations:

(i) That the Investment Management Report be noted;
(ii) That the Committee note compliance with the 2019/20 Treasury Management Strategy.

1) FUND VALUE AND ASSET ALLOCATION

The table below shows the Fund value and the asset allocation for the Fund compared to the target asset allocation as at **30 September 2019**.

Fund Value and Asset Allocation

	Fund Value as at 30.09.19	Target allocation 2019/20	Fund asset allocation at 30.09.19	Variation from Target
	£m	%	%	%
Fixed Interest				
Global Bonds	245.4	6.0	5.4	
Multi-Sector Credit	236.3	6.0	5.2	
Cash	47.3	1.0	1.0	
	529.0	**13.0**	**11.6**	**-1.4**
Equities				
Passive Equities	1,829.5	38.0	40.2	
Active Global Equities	486.7	10.0	10.7	
Active Emerging Markets	199.4	5.0	4.4	
Lov Volatility Equities	224.8	5.0	4.9	
	2,740.4	**58.0**	**60.2**	**+2.2**
Alternatives/Other				
Diversified Growth Funds	631.7	11.0	13.8	
Property	402.4	10.0	8.8	
Infrastructure	171.5	6.0	3.8	
Private Debt	80.8	2.0	1.8	
	1,286.4	**29.0**	**28.2**	**-0.8**
Total Fund	**4,555.8**	**100.0**	**100.0**	

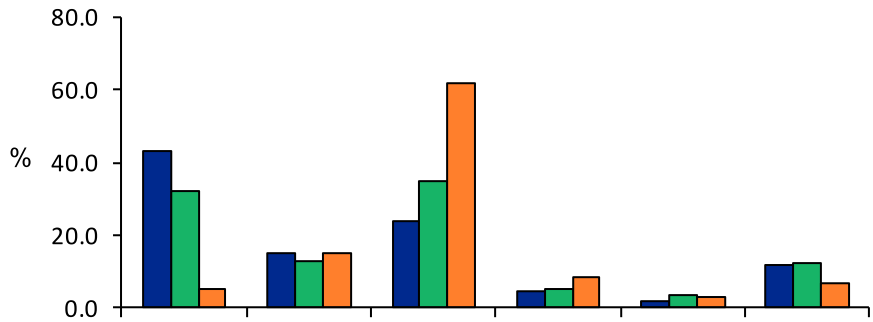
- The Fund value as at 30th September 2019 stood at £4,555.8 million, an increase of £94 million over the quarter.

- We have previously reported to the Committee on the potential to receive a significant additional deficit contribution payment into the Fund from Plymouth City Council. As a result, the sum of £72 million was paid to the Fund during October. As agreed at the September meeting of the Committee, given the underweight allocation to fixed interest, £40 million was allocated to Wellington's multi-sector credit fund and £30 million to Lazard's global bonds mandate. These investments will bring the fixed interest allocations back up to the target weight.
- The allocation to equities was 2.2% above target at the quarter end, but the additional investment in fixed interest described above will reduce the percentage weighting to around 1.2%.
- The other underweight area is the private markets allocations (property, infrastructure and private debt). New investment in private markets takes longer to achieve than in listed markets, requiring commitments to be made which will then be drawn down over time. The Fund has £175 million committed to Brunel's Infrastructure portfolio, of which to date only around £17 million has been drawn.

Geographical Weighting of Equity Allocation

- The following table gives the geographical split of the Fund's equity allocations against the FTSE World geographical weightings.

Geographical Split of Equity Allocation compared to the FTSE All World Index



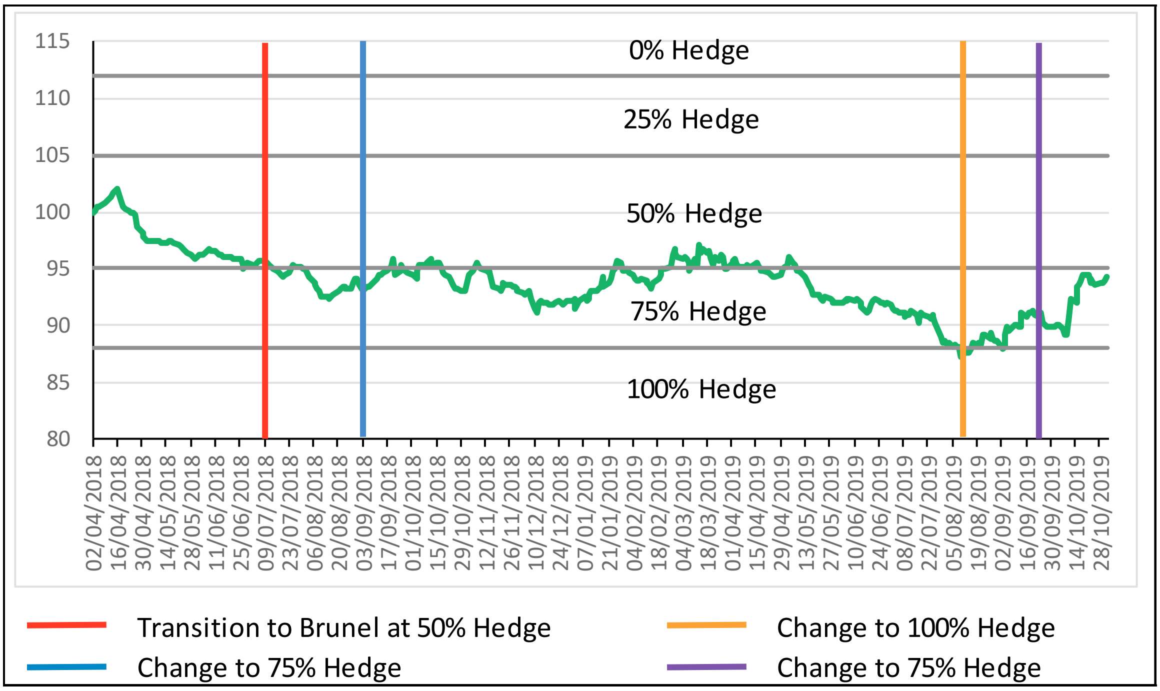
	UK	Europe Ex UK	North America	Japan	Asia/Pacific (ex Japan)	Emerging Markets
Fund as at March 2017	42.8	15.0	23.9	4.6	1.7	12.0
Fund as at Sept 2019	31.9	13.0	34.8	4.9	3.3	12.1
FTSE All World	5.4	14.9	61.4	8.4	2.9	7.0

- The Committee previously agreed that in principle, the Fund should look to reduce its overweight to UK equities by reallocating to overseas equities on a phased basis. The graph shows the progress made since March 2017 in reducing the overweight to the UK and the underweight to North America. The monthly reallocations have now been suspended, as agreed at the February meeting of the Committee.

Currency Hedging

- The following graph shows the value of Sterling against a weighted average of the other major currencies.

Value of Sterling v. Weighted Average of US Dollar, Euro and Yen

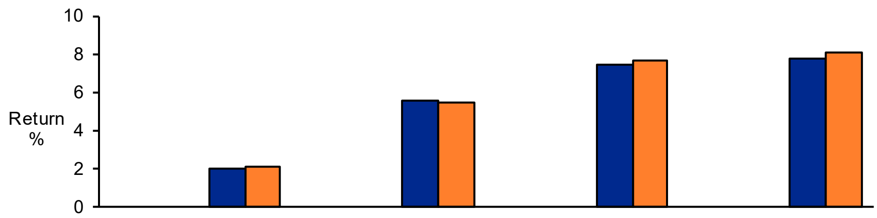


- As agreed by the Committee the allocation to Brunel's passive developed world equity portfolio was initially 50% hedged to Sterling. The transition point to Brunel is shown by the red line on the graph. However, in accordance with the currency hedging policy agreed by the Committee in June 2018, the hedge ratio was increased to 75% on 4th September 2018, as shown by the blue line on the graph. The value of Sterling fluctuated around the trigger point for moves between 75% and 50% during February and March, but no change was made at that point.
- Management of the strategy is now delegated to Brunel in conjunction with Legal and General Investment Management (LGIM), as agreed at the June meeting of the Committee. During August the trigger point to move to 100% was hit and was implemented by LGIM on 15th August in line with the agreed policy, as shown by the orange line. A subsequent increase in the value of Sterling meant that it hit the trigger for the hedge to be reduced back to 75% during September and this was implemented by LGIM on 24th September.

2) FUND PERFORMANCE

The performance of the Total Fund over the last quarter, the financial year, and on a rolling three and five year basis is shown in the following chart.

Longer Term Fund Performance Summary



	Latest Quarter	2019/20	3 Years % pa	5 Years % pa
Fund	2.0	5.6	7.5	7.8
Benchmark	2.1	5.5	7.7	8.1
Relative Return	-0.1	0.1	-0.2	-0.3

The performance statistics quoted are net of fees.

The last quarter has seen a return of +2.0%, just below benchmark, bringing the performance for the year to date to +5.6%, just above the Fund's strategic benchmark. A breakdown of the performance of the Total Fund for the quarter and three years **to 30 September 2019** and the comparative Index returns are shown in the following table:

Performance to 30 September 2019

Sector	Year To Date (6M)		Three Years		Benchmark Description
	Fund Return	Bench mark	Fund Return	Bench mark	
	%	%	%	%	
Global Bonds	7.3	7.4	2.9	2.9	BarCap Global Bonds
Multi-Sector Credit	4.1	3.2	4.5	3.7	MSC Bespoke *
Cash	1.2	0.3	1.2	0.4	GBP 7 Day LIBID
Passive Equities	7.0	6.9	9.5	9.5	Devon Bespoke Passive Index
Active Global Equities	6.0	10.6	9.1	12.5	FTSE World
Active Emerging Markets	4.0	2.1	5.9	8.1	MSCI Emerging Markets
Active Low Volatility Equities	10.9	9.9	-	-	MSCI AC World
Diversified Growth Funds	3.8	2.3	4.3	4.3	Devon Multi Asset Benchmark
Property	1.4	1.0	7.5	6.7	IPD UK PPF All Balanced Funds
Infrastructure	3.7	2.8	6.9	4.6	GBP 7 Day LIBID+5%
Private Debt	6.9	2.8	-	-	GBP 7 Day LIBID+5%
Total Fund	**5.6**	**5.5**	**7.5**	**7.7**	**Devon Bespoke Index**

*Composed of 1/3 Bank of America Merrill Lynch Global High Yield Constrained Index; 1/3 JPMorgan Emerging Markets Bond Index Plus; 1/3 CSFB Bank Loan Index.

Key issues over the quarter include:

- The small out-performance against benchmark was a result of all asset classes being ahead of their individual benchmarks with the exception of active global equities and global bonds. The under-performance of global equities contributed -0.5% to the overall relative performance, with the other asset classes collectively delivering a +0.6% out-performance.

- The most significant contribution to the under-performance of active global equities came from the Specialist Funds, whose bias towards Europe and the Emerging Markets detracted in a period where those regions did less well than other parts of the World, principally the US. The Aberdeen global equity mandate also under-perfomed, but to a lesser extent.

- The best absolute performance came from low volatility equities, with a +10.9% return.

- Global bonds produced a positive 7.3% return just below the benchmark, while multi-sector credit has delivered a +4.1% return, ahead of their reference benchmark.

- With all asset classes delivering positive returns, the diversified growth funds were able to achieve their cash plus benchmarks, although the absolute return was still disappointing given the market conditions.

- The private market investments (property, infrastructure and private debt) have all delivered positive returns, out-performing their benchmarks.

3) FUNDING LEVEL

The triennial actuarial valuation is the subject of a separate report on the agenda for this meeting. Further funding updates will not be provided until the triennial valuation is fully completed.

4) BUDGET FORECAST MONITORING

(a) Appendix 1 shows the income and expenditure for 2019/20 against the original budget forecast.

(b) Over the six months to September the contributions received exceeded the benefit payments made by £1.4 million. This was largely due to higher than usual transfers into the Fund, where new employees have transferred their pensions from other funds. Peninsula Pensions have been working on speeding up this process, and the forecast for the year has been increased as a result.

(c) The forecast for employer contributions has been increased to take into account the additional deficit contribution from Plymouth City Council, received in October, which will result in a one-off significant surplus of contributions over benefits during 2019/20.

(d) The income received as cash reflects the income from the property mandate, distributions from infrastructure and private debt investments and interest on internally managed cash. The agreed policy is for this income to be used to cover both the gap between pension benefits payments paid and the contributions received and the management costs for the year. The remaining income is from the Fund's segregated equity and bond mandates and is reinvested by the fund managers. The level of reinvested income will be lower than in previous years due to the transition of equity assets into Authorised Contractual Scheme (ACS) funds managed by Brunel where dividend income will be retained within the funds and will not be accounted for separately. However, the forecast for the year has been increased by £2 million on the basis of the income received to date.

(e) The administration costs incurred to date by Peninsula Pensions include the full annual payment to the software supplier of the pensions administration system. Therefore, although the expenditure to date looks high it is not anticipated that there will be any significant variance from the original forecast expenditure for the year.

(f) No significant variances are currently anticipated on management expenses or oversight and governance costs.

5) CASH MANAGEMENT

(a) The following table shows that the unallocated cash on deposit as at 31 October 2019, was **£38.6m**, plus **$1.7m** in US Dollars. The cash held is being maintained at a lower level than in the past, with a target level of only 1% of the Fund, and it is therefore necessary to ensure its liquidity for cashflow purposes.

Cash on Deposit

Type of Deposit	Maturity period	Actual as at 31/03/19	Average Interest Rate	Current as at 31/10/19	Average Interest Rate
GBP Deposits		**£m**	**%**	**£m**	**%**
Call and Notice Accounts	Immediate	24.1	0.77	38.6	0.72
	6 Month Notice	0.0	0.00	0.0	0.00
Term Deposits	<30 Days	0.0	0.00	0.0	0.00
	>30 Days	0.0	0.00	0.0	0.00
TOTAL GBP		**24.1**	**0.77**	**38.6**	**0.72**
USD Deposits		**$m**	**%**	**$m**	**%**
Call and Notice Accounts	Immediate	0.7	2.45	1.7	1.89

(b) The weighted average rate being earned on GBP cash deposits, as at 31 October 2019, was **0.72%.** This reflects the current low interest rate environment and the need to ensure liquidity as a result of the low level of cash being maintained. A higher rate is achievable on the US Dollars investment, but the return will also be impacted by changes in the exchange rate.

(c) The deposits in place during 2019/20 to date have fully complied with the Fund's Treasury Management and Investment Strategy.

6) ENGAGEMENT ACTIVITY

(a) As a responsible investor, the Fund should report regularly on its engagement activity. Voting and engagement are largely delegated to the Fund's external investment managers. The voting records of the Fund's principal equity managers at company meetings held over the last quarter is summarised in the following table.

Votes Cast at Company Meetings in the quarter to 30 September 2019

	Quarter to 30 September 2019		
Manager	**Number of Meetings**	**Number of Resolutions**	**Votes against managemt recommnd'n**
Brunel / LGIM Passive portfolios	388	4917	471
Brunel - other portfolios	37	357	39
Aberdeen Asset Management	9	101	8
Specialist Funds (combined)	47	688	15

The Brunel passive allocation will include all the companies in the relevant indices, both UK and across the developed world, hence there are many more meetings voted at than for the active managers. More detail on the resolutions that the managers have voted on, together with their engagement activity, is available in the managers' quarterly investment reports, distributed separately to the Committee.

(b) The Fund is also a member of the Local Authority Pension Fund Forum (LAPFF), who undertake engagement activity on behalf of their member funds. Where significant issues arise on the agendas of company meetings, for example on remuneration policies or shareholder resolutions on climate change related issues, LAPFF will issue a voting alert to its members, including a recommendation on how to vote. There were only two voting alerts issued during the quarter, as set out in Appendix 2 to this report.

(c) Both voting alerts were related to governance concerns, largely around the independence of non-executive directors. In Sports Direct's case there were concerns around Grant Thornton's resignation as external auditors and the inability of Sports Direct to find new auditors. While LAPFF recommended voting against re-election of the entire board LGIM took the view that many of the board members were relatively new and to concentrate their concerns by voting against Mike Ashley. Given that Mike Ashley is a majority shareholder, there was never any likelihood that he would not be re-elected but a sizeable vote against would provide a warning shot across the bows.

(d) The LAPFF quarterly engagement report for the quarter to 30 September is attached at Appendix 3 to this report. The report highlights engagement with defence contractors over the conflict in Yemen and various companies that are the subject of corruption allegations.

Mary Davis

<u>Local Government Act 1972</u>
List of Background Papers   Nil
Contact for Enquiries: Mark Gayler
Tel No: (01392) 383621   Room G97

Appendix 1

Devon County Council Pension Fund Budget / Forecast 2019/20

	Actual 2018/19 £'000	Original Forecast 2019/20 £'000	Actual to 30 Sept 2019 £'000	Revised Forecast 2019/20 £'000	Variance from Original Forecast £'000
Contributions					
Employers	(137,431)	(141,000)	(70,820)	(206,000)	(65,000)
Members	(38,765)	(40,000)	(20,444)	(40,000)	0
Transfers in from other pension funds:	(6,134)	(6,000)	(12,028)	(15,000)	(9,000)
	(182,330)	(187,000)	(103,293)	(261,000)	(74,000)
Benefits					
Pensions	149,688	158,000	78,020	158,000	0
Commutation and lump sum retirement benefits	26,759	28,000	15,143	28,000	0
Lump sum death benefits	4,191	4,000	1,899	4,000	0
Payments to and on account of leavers	735	750	282	750	0
Individual Transfers	9,012	8,000	6,569	8,000	0
	190,385	198,750	101,914	198,750	0
Net Withdrawals from dealings with fund members	**8,055**	**11,750**	**(1,379)**	**(62,250)**	**(74,000)**
Investment Income					
Received as Cash	(26,021)	(28,000)	(15,508)	(28,000)	0
Reinvested by Fund Manager	(23,916)	(13,000)	(12,705)	(15,000)	(2,000)
	(49,937)	**(41,000)**	**(28,213)**	**(43,000)**	**(2,000)**
Administrative costs					
Peninsula Pensions	2,084	2,125	1,642	2,125	0
	2,084	**2,125**	**1,642**	**2,125**	**0**
Investment management expenses					
External investment management fees - invoiced	8,084	7,500	3,752	7,500	0
External investment management fees - not invoiced	5,914	7,200	2,703	7,200	0
Custody fees	78	60	0	60	0
Transaction costs	1,126	1,200	294	1,200	0
Stock lending income & commission recapture	(36)	(30)	(23)	(30)	0
Other investment management expenses	44	50	11	50	0
	15,210	**15,980**	**6,737**	**15,980**	**0**
Oversight and governance costs					
Investment & Pension Fund Committee Support	84	95	33	95	0
Pension Board	35	46	18	46	0
Investment Oversight and Accounting	310	320	84	320	0
Brunel Pension Partnership	17	20	7	20	0
Legal Support	42	40	0	40	0
Actuarial Services	24	60	105	60	0
Investment Performance Measurement	123	100	0	100	0
Subscriptions	35	40	14	40	0
Internal Audit fees	13	13	0	13	0
External Audit fees	22	25	6	25	0
	705	**759**	**267**	**759**	**0**
Total Management Expenses	**17,999**	**18,864**	**8,647**	**18,864**	**0**

Appendix 2

LAPFF Voting Alerts

Company	AGM Date	Target Resolution	LAPFF Recommendation	Voting Record			Outcome
				Brunel	LGIM	Aberdeen	
Sports Direct	11-Sep-19	Approve the report and accounts	Oppose	N/A	For	N/A	Approved (99.1% votes for)
		Elect David Daly	Oppose	N/A	For	N/A	Approved (99.9% votes for)
		Re-elect Mike Ashley	Oppose	N/A	Against	N/A	Approved (91.0% votes for)
		Re-elect David Brayshaw	Oppose	N/A	For	N/A	Approved (95.1% votes for)
		Elect Richard Bottomley	Oppose	N/A	For	N/A	Approved (96.8% votes for)
		Elect Cally Price	Oppose	N/A	For	N/A	Approved (99.9% votes for)
		Elect Nicola Frampton	Oppose	N/A	For	N/A	Approved (97.5% votes for)
RyanAir	19-Sep-19	Re-elect David Bonderman	Oppose	N/A	Against	N/A	Approved (75.2% votes for)
		Re-elect Michael Cawley	Oppose	N/A	Against	N/A	Approved (78.0% votes for)
		Re-elect Kyran McLaughlin	Oppose	N/A	Against	N/A	Approved (71.1% votes for)
		Re-elect Howard Millar	Oppose	N/A	Against	N/A	Approved (70.0% votes for)
		Re-elect Dick Milliken	Oppose	N/A	Against	N/A	Approved (95.9% votes for)
		Re-elect Michael O'Brien	Oppose	N/A	Against	N/A	Approved (96.2% votes for)
		Re-elect Michael O'Leary	Oppose	N/A	For	N/A	Approved (98.1% votes for)
		Re-elect Julie O'Neill	Oppose	N/A	Against	N/A	Approved (81.6% votes for)
		Re-elect Louise Phelan	Oppose	N/A	Against	N/A	Approved (82.4% votes for)

Sports Direct and Ryanair are only held in the passive portfolios managed by Legal and General Investment Management (LGIM).

Appendix 3

https://www.paimages.co.uk/image-details/2.40966766 https://c7.alamy.com/comp/FPA9ER/london-uk-18-

Quarterly Engagement report

July-September 2019

Local Authority Pension Fund Forum

BAE Systems, Boeing, Lockheed Martin, Petrobras, ArcelorMittal, National Grid

Amnesty International campaigners drawing attention to UK-manufactured arms being used to commit war crimes in Yemen.

YEMEN

LAPFF engages with defence contractors over Yemen

LAPFF uses community engagement to link stakeholder input to investor value

Objective: ascertain if defence companies have increased their scope for building leverage in setting or influencing contract terms with national governments in relation to social and environmental factors.

Achieved: the reputational damage facing local authority funds as a result of holding Aerospace and Defence companies has been outlined.

In progress: through dialogue the companies have begun to recognise the populations affected by their products as one of their stakeholder groups.

After four years of deadly civil war, according to the UN, over 18 million Yemenis currently lack access to clean drinking water

Over the summer, LAPFF has been engaging with a number of defence companies cited for their role in supplying weapons to the Saudi coalition for the war in Yemen. The LAPFF Executive approved this engagement because LAPFF funds have been targeted by protestors concerned about the role of local authorities in funding this war.

Initially, the Forum contacted nine companies for engagements – BAE Systems, Boeing, Lockheed Martin, Raytheon, Thales, General Electric, General Dynamics, Textron, and Airbus. LAPFF has managed to hold meetings with three companies, BAE, Boeing and Lockheed, despite expecting little or no response from the companies approached.

A limited response was expected owing to the close relationship between defence companies and national governments. This relationship also meant it was not clear at first how to structure these engagements. If companies are contracting with governments in relation to national security, there seems to be little scope for them to influence the governments' approaches to this issue, and the companies engaged pushed this line hard. However, the pre-meeting research and the company discussions have helped to clarify how companies might push back in these situations.

First, in reviewing company materials, it was evident that although defence companies often espouse the principle of stakeholder engagement, affected communities – such as the Yemeni population being bombed – are not included in the scope of stakeholders considered. This omission likely affects the decision-making about the impact of the products

"It is important for companies to recognise all those affected by the products they make and sell as important stakeholders. Without appropriate recognition, companies are unable to build a complete picture of the market and leave themselves exposed to unexpected changes in market dynamics."

Cllr Doug McMurdo
LAPFF Chair

YEMEN

and services these companies offer. In consideration of this likelihood, LAPFF pushed for companies to consider communities affected by these companies' products and services as stakeholders.

Second, different companies have different ways of contracting. For instance, BAE and Lockheed contract almost exclusively with governments. Boeing, however, has a much more robust commercial component. Consequently, Boeing arguably has more leverage in being able to push governments to comply with international human right standards. For example, in this situation, if a government client were to commission weapons that a company isn't comfortable with, or that are to be used for a purpose that a company isn't comfortable with, it would likely be easier for the company to ramp up its commercial production and refuse the government contract.

Third, a number of defence companies are looking at different defence options. For example, cyber security is an area of interest for defence contractors. This area might be considered non-traditional for defence companies, but there seems to be scope for these companies to develop this type of technology – both on a military and commercial basis – rather than continuing to focus exclusively on traditional weaponry. Some companies, like Lockheed, are also selling these services to government clients such as energy departments, not just the military services. Therefore, by developing client relationships with government departments other than the military, companies might be able to pull back when faced with dubious military contracts.

All of the defence companies reviewed for this engagement had values such as 'respect for life' and 'integrity'. It is hard to see how companies can uphold these values if they are trapped in contracts that, by definition, require them to betray these values. Therefore, LAPFF will continue to apply what it has learned so far in engaging with defence contractors to work with these companies to uphold not only their own values, but LAPFF's policies too. The engagements are not easy or straightforward, but at least now there appear to be ways to move the human rights agenda forward in a way that should produce more sustainable returns for LAPFF members, as well as other investors.

● Boeing has a joint direct attack munition contract and a wideband global satellite communication contract with the US Air Force, an MH-47G Block II Chinook (pictured below) contract with the US Army Special Operations, and an F/A-18 service life modification contract with the US Navy.

● The UK has suspended granting new export licenses for arms that might be used by the Saudi Arabia-led coalition in Yemen while it considers a landmark court ruling that found the government's decision-making processes were unlawful. The outcome of this litigation could have implications for BAE, and specifically the planned export to Saudi Arabia of 48 of its Eurofighter Typhoon jets worth £5 billion (top).

COMPANY ENGAGEMENT

GOVERNANCE RISK

Anti-Corruption Engagements Ramp Up

Along with Sarasin, Church Commissioners and Royal London Asset Management, LAPFF has been engaging with Glencore over concerns about corruption in the Democratic Republic of Congo. The issues raised during this engagement prompted the Forum to send engagement requests to four other companies embroiled in corruption probes – Shell, ENI, Petrobras and Total.

As with the Yemen engagement, there was doubt about whether the companies would be willing to discuss on-going corruption allegations. Shell wrote back re-stating the content of the company's annual report on the matter and batting back the meeting request. However, both ENI and Petrobras got back almost immediately to offer meetings. Total has also now agreed to a meeting.

To date, the meetings with Petrobras and ENI have taken place. It is interesting to note that Petrobras is still a partly state-owned enterprise, although the Brazilian President, Jair Bolsonaro, has stated he would like the Company to be privatised by 2022. ENI began life as a state-owned company but became public in 1992. Shell and Total are both public companies. Given the role of state parties in corruption cases, these distinctions might be highly relevant and will be explored in the remainder of the engagements.

The Petrobras engagement centred around the Car Wash Investigation, a money laundering scandal that found that executives at Petrobras had accepted bribes in return for awarding contracts to construction firms. This outcome led to Petrobras' writing off US$2,527 million of capitalised costs for overpayment to contractors and suppliers

Objective: Ensure companies have made provisions for the potential liabilities associated with the corruption scandals. Ensure companies have updated internal mechanisms for finding and dealing with corruption across all levels of company operations.
Achieved: clarification gained on the extent of the corruption allegations and a the ultimate financial cost that might be incurred as a result of the litigation and the financial damage.
In Progress: dialogue on companies disclosing the extent to which ongoing corruption investigations are impacting profitability and growth.

"Companies leave themselves exposed to significant legal, financial and reputational risks if they fail to implement effective anti-corruption control mechanisms. The scandal at Petrobras outlines well the negative impact corruption scandals can have on shareholder value."

Cllr Rob Chapman - LAPFF Vice Chair

Operation Car Wash or 'Lava Jato' is an ongoing corruption investigation which initially started in 2008 involving Petrobras, politicians and construction companies.

COMPANY ENGAGEMENT

VOTING ALERTS

Sports Direct

LAPFF issued two voting alerts during the period under review. The first alert related to Sports Direct, a company that has recently faced the ire of investors after its latest results highlighted underwhelming performance as well as substantial unpaid taxes. These issues led to the company's primary auditor, Grant Thornton, announcing the intention to resign ahead of the company AGM. It is clear to LAPFF that although the Board has undergone significant change in recent years - improving independent oversight at Board level - the new directors have not held Mr Ashley to account, as evidenced by the company's continued spree of disparate retail aquistions. This acquisition strategy has raised significant concerns amoung investors. As a result, LAPFF recommended that member funds vote to oppose the entire board. Given the continued confusion with Grant Thornton and the controversy around Sports Direct's Belgian tax payments, LAPFF also recommended opposing the report and accounts, which are unlikely to give an accurate view of the business.

Ryanair

The second alert relates to Ryanair. LAPFF has requested that the company improve its governance practices for a number of years. Despite signing recognition agreements with a number of unions, Ryanair management still appears to struggle to work constructively with unions and staff to negotiate mutually beneficial terms and conditions of employment. With a board lacking in independence, LAPFF considers the board should be refreshed with a greater proportion of independent directors and skill sets appropriate to address and challenge the current company positions. On this basis, LAPFF recommended that members vote to oppose all board directors who are not independent.

ENGAGEMENT MEETINGS

Remuneration

As part of a wider investor discourse, LAPFF joined a call with Southern Company to discuss the implementation of compensation mechanism which links executive remuneration with climate factors. Southern Company is the second largest gas and electric utility company in the US and has recently set GHG reduction targets of 50% by 2030 (compared 2007 output) and 'low-to-no carbon emissions' by 2050. In support of this target, the company has also announced a new compensation metric that is tied to the carbon reduction goal.

The metric has both quantitative and qualitative components, ranging from adding zero-carbon megawatts and retiring coal to leadership in energy policy and R&D investment. The linking of GHG emissions to executive compensation is becoming more frequent across the energy sector, with Shell announcing similar metrics at the end of 2018.

Whilst the move has been welcomed by stakeholders, a number of concerns relating to Southern's remuneration mechanism were voiced at the meeting. These concerns raised three concerns about whether or not the proposed metrics can be considered effective in incentivising performance: (1) Southern has already announced GHG reductions of over 4,000 MW compared to the maximum award goal of 3,500 MW; (2) a net reduction in GHGs is not conditional upon achieving full vesting of the award as failure to reduce emission output can be offset by the generation of zero-carbon energy; and (3) the GHG reduction element of the award represents just 10% of the CEO's total opportunity under the long-term incentive.

LAPFF also asked the company if they would consider tying the GHG metric to the pay of other executive officers.

COMPANY ENGAGEMENT

AGM ATTENDANCE THE CLIMATE CRISIS: CLEAN ENERGY AND STRATEGIC RESILIENCE

National Grid

National Grid will be critical player in delivering the infrastructure needed to decarbonise the UK economy and meet government targets. LAPFF has therefore been engaging the company for a number of years to ensure it is managing the risks of a rapid transition. At this year's AGM, Cllr Glyn Carron welcomed the company's recent progress including its analysis on how net zero carbon emissions could potentially be achieved by 2050 and what this would mean for energy demand and use. Cllr Caron also congratulated the company for joining the Powering Past Coal Alliance, which had been a request at the last meeting with the company. Cllr Carron asked whether National Grid were confident they would be able to meet the new demands on the energy system and infrastructure if there was a rapid shift towards decarbonisation, not least regarding electrification of cars and heating of homes. The company outlined some of the challenges of moving away from certain types of fuel and initiatives they were undertaking with government on electric charging points.

"This initiative makes clear that mobilizing for the planet goes hand-in-hand with protecting our pensions, and we need these commitments now."

Scott F Stringer, New York City Comptroller

PROGRESS

- National Grid is planning to implement carbon pricing on all major investment decisions by 2020.

- LAPFF joins an international grouping of investors sending a Statement to over 30 global oil and gas companies, on methane management, disclosure, and the importance of strong U.S. federal methane regulation.

- Earlier this year LAPFF joined other Climate Majority Project coalition members calling on the 20 largest carbon emitting US utility companies to commit to achieving net-zero carbon emissions by 2050, and to make this commitment by September 2020. In late September both DTE Energy and NRG Energy made unambiguous commitments to net-zero carbon emissions by 2050.

- LAPFF also signed up to an investor statement on deforestation and forest fires in the Amazon. The statement called on companies to disclose and implement a commodity-specific no deforestation policy with quantifiable, time-bound commitments covering the entire supply chain. This statement, which was co-ordinated by the PRI, was issued in direct response to the escalating crisis of deforestation and forest fires in in Brazil and Bolivia during the period under review.

The largest steel-maker in the world, ArcelorMittal

LAPFF met with senior executives of ArcelorMittal in early July, following the publication of the company's first Climate Action report.

•**The commitment:** ArcelorMittal has committed to carbon neutrality in Europe by 2050 and to substantial reductions globally.

•**How the company plans to achieve it:** the Climate Action report has quite detailed low emission technology pathways, with the commercial time horizon for each set out.

•**Target setting:** the meeting had a strong focus on target setting, which ArcelorMittal aim to do in 2020, when the methodology for science-based targets for the steel industry is released. The current target is for an 8% carbon foot-print reduction by 2020, against a 2007 baseline.

•**Limitations:** Lakshmi Mittal, Arcelor-Mittal's joint chair, chief executive has been very clear on his view for the need for a green border tax to make implementation of many of the low carbon technologies commercially viable.

•**Focus for future engagement:** as with other Climate Action 100+ engagements, trade association memberships and target setting are key themes. Company participation in the Energy Transitions Commission, which had been a request at the AGM, has emphasised the view of the need to move to hydrogen technology using renewable energy. ArcelorMittal has already launched a new project in Hamburg to use hydrogen on an industrial scale for the direct reduction of iron ore in the steel production process.

SSAB – Swedish steel-making technology with virtually no carbon footprint

A joint investor call/webinar with the Swedish steelmaker, SSAB, provided useful context for understanding how companies are approaching the technological challenges of moving to low or net-zero carbon steel-making.

SSAB are working in partnership with a mining company (LKAB) and a utility (Vattenfall) on the Hybrit project. The Hybrit project is a hydrogen based process, with a byproduct of water instead of carbon dioxide. The partnership appears

COMPANY ENGAGEMENT

a crucial underpin to its success.

There has been much interest in Hybrit from other steel companies, and almost all major steel companies in Europe have launched similar initiatives. Currently, there is a projected 20-30% increase in cost for this steel, but with renewable electricity costs dropping over time, and the EU emissions trading scheme costs for carbon emissions rising, SSAB has concluded that in future, steel from this process will be able to compete in the market with traditionally made steel. In the interim, SSAB considers customers will be willing to pay a premium for low to zero carbon steel. Ultimately, SSAB is aiming for carbon-neutral production by 2045 in line with the national target for Sweden.

Centrica plans to exit oil and gas exploration and production

Following on from a meeting with Centrica's new Chair, Charles Berry, in May, LAPFF participated in an investor meeting/webinar with Centrica executives which provided the opportunity to not only hear about changes to the company's strategy, but also to probe further into the context for Centrica's target setting.

Centrica plans to exit oil and gas production, including selling its stake in Cuadrilla which operates fracking operations in Lancashire. This move supports a strategic focus on customers, which is mirrored by its target setting for carbon reduction. Customer emissions represent 90% of total company emissions, and the target is to reduce the use of gas and electricity by customers by 25% by 2030, with a goal of net zero by 2050.

For many companies, customer emissions are much larger than their direct and operational emissions, so investors keep a keen eye on target setting in this area, as an indication that boards are addressing this primary carbon reduction challenge. BHP has been notable amongst the diversified miners in this regard, announcing in July that it will set and disclose goals in 2020 to tackle emissions from customers that use its iron ore and coking coal for steelmaking and other products.

Carmakers in the US

LAPFF alongside other investors has been engaging both Ford and General Motors (GM) on their approach to climate change, which became more pressing with the US administration planning a roll-back on fuel efficiency standards. LAPFF and other investors were initially calling on companies to engage with the federal government but also with California. The Forum had previously written to the companies to continue to work with California on agreed standards to reduce greenhouse gas emissions regardless of the federal approach. GM responded to a separate correspondence from the investor coalition outlining their investment in electric vehicles and stating that they were encouraging a negotiated national solution. However, there was a more positive response from Ford alongside BMW, Volkswagen and Honda who have agreed a deal with California on fuel efficiency standards. The Forum wrote to those companies thanking them for their agreement to voluntarily comply with California's rules while also calling on GM to follow suit. This agreement is a major win for the Forum and will potentially have significant environmental and economic benefits for all stakeholders.

SOCIAL RISK ENGAGEMENTS DIVERSITY

Aveva Group

LAPFF has identified the technology sector as having particularly low levels of women represented on company boards and therefore has focused diversity engagements in this sector. As part of this engagement strand, the Forum spoke with the Philip Aiken (pictured), chair of UK-based technology company Aveva, to gain a better understanding of how Aveva is tackling management of diversity throughout the company as well as any target setting on gender diversity in particular. Mr Aiken provided a clear outline of measures the company was taking in recruiting and retaining women in Aveva's workforce and the approach to boardroom appointments, with the latest appointments split equally between men and women. Further improvement in board level diversity is unlikely in the short-term, with no board appointments imminent, leaving the company still falling short of 30% female board representation mark.

COLLABORATIVE ENGAGEMENTS

Methane: regulatory oversight

Four oil and gas majors have come out publicly in support of federal methane regulation (Shell, BP, Exxon Mobil and Equinor) with Shell's statement being the strongest. Despite this, the Trump Administration is seeking to remove methane from regulatory oversight. LAPFF has supported an Investor Statement which asks a range of these 'non-renewable' companies to speak out publicly on the need to maintain both the federal regulation of methane and the US Environmental Protection Agency (EPA)'s 'Endangerment Finding'. This finding dates from 2009 and requires the EPA to take action under the Clean Air Act to curb emissions of carbon dioxide, methane and other greenhouse gases which would endanger 'the public health and welfare of current and future generations'. The Investor Statement is also being sent to a number of US Electric Power companies on the risk posed to downstream companies including Dominion, Duke, Xcel, Exelon, Southern and NRG. LAPFF has also written to the National Grid Chair with the Statement as the company has significant operations in the US distributing electricity and natural gas.

The Powering Past Coal Alliance

The government department for Business, Energy and Industrial strategy (BEIS) is working to develop Finance Principles for the UK and Canadian government-led 'Powering Past Coal Alliance'. The PPCA Finance Principles are covered in the government's new Green Finance Strategy.

LAPFF has signed up to be a partner to the 'Powering Past Coal Alliance'. This decision is in line with LAPFF policy that there should be no new investment in coal. This position will be made public in New York in late September as part of UN Climate Action Summit (pre)meetings. There will be further opportunities for

COMPANY ENGAGEMENT

LAPFF members to join PPCA through to and including COP26 in late 2020.

US Corporate Lobbying positions

Companies have significant influence on climate and energy policies and LAPFF has concerns, shared by other investors, about lobbying activities that are inconsistent with addressing the risks posed by climate change.

LAPFF, through its CERES membership, has therefore joined other signatories to an investor letter to 55 US companies to share expectations on the topic of corporate lobbying on climate change and to request information about how each company ensures that its lobbying activities are consistent with the goals of the Paris Agreement on climate change. Some members wishing to take a more active approach have taken up the opportunity to file or co-file resolutions to US companies that have been identified with significant federal and state lobbying expenditures and that lack or have poor disclosure on trade association memberships.

POLICY ENGAGEMENTS

Reliable accounts updates

There have been few developments in this area since the last Quarterly Engagement Report, other than the fact that the new Chair of the Audit, Reporting and Governance Authority (ARGA) has been announced as Simon Dingemans.

Further to the penalties on Tesco plc, following accounting irregularities in 2014, LAPFF has again approached the Financial Conduct Authority (FCA) and a meeting between the LAPFF Chair and the FCA is pending. LAPFF made the point that the system the FCA had used, compensating one class of shareholder at the cost of another, was disadvantageous to long-term shareholders.

As part of an investor group led by Sarasin & Partners LLP, LAPFF attended a meeting with PwC about the extent to which auditors are able to provide assurance that companies are accounting for material climate risks. The concern is whether audit committees, as well as the auditors themselves, are able to ensure that a company's financial statements convey a true and fair view of the businesses financial performance if climate considerations are not adequately disclosed. The balance sheets of oil and gas companies (now classified as 'non-renewables') are particularly at risk of potential overstatement given the increase in risk of asset depreciation consequent to changes in government policies, technological advances and public opinion amongst other factors. PwC acknowledged the role of the auditor in reporting climate risks. It became apparent during the discussion that the primary obstruction to consistency in reporting climate risks originates from the judgement auditors make around whether financial statements that do not outline climate change as a material risk remain compliant with reporting requirements.

Investing in a Just Transition to a Net Zero Economy – What needs to change?

Changes to secure investment in the Just Transition were discussed at the Liberal Democrat, Conservative and Labour conferences. Organised by the Smith Institute, the meetings provided a platform for LAPFF to set out what these changes should be. Both the LAPFF Chair, Cllr Doug McMurdo and Vice-chair, Cllr Rob Chapman identified that partnership is critical to the success of the Just Transition. So a core recommendation from LAPFF was that the UK government should establish a Just Transition Commission, along the lines of the Scottish Commission, to bring public and private sectors together.

A consensus from the Liberal Democrat meeting was that there needed to be much more certainty around environmental regulation and policy to support the move to a net zero economy in a just way. The regulatory environment was also central to discussions at the Conservative fringe meeting with a call for greater cross government collaboration and a dedicated cabinet minister and governmental department. At the Labour meeting, there was agreement that the target of net zero emissions by 2030 achieved in a 'just' way was ambitious and that there should be focus on making as much progress in the short term as possible.

MEDIA COVERAGE

Pension fund anger at Sports Direct's Mike Ashley: 'There's a problem here'
Yahoo! Finance, 11 September 2019
A third of Sports Direct investors vote against re-electing Mike Ashley
The Guardian, 11 September 2019
Sports Direct in race against time to find new auditor
Financial Times, 11 September 2019
Sports Direct shares recover some losses
The BBC News, 29 July 2019
Results debacle hits Sports Direct shares
The Times, 30 July 2019
Investors urge cement makers to cut emissions
Financial Times, 21 July 2019
Super Fund corrals $13trn for livestreaming action
Newsroom, 20 August 2019
Germany and Slovakia head list of new Alliance members at UN Climate Action Summit
Powering Past Coal Alliance, 22 September 2019
Inside view: How to be an effective steward of assets
Funds Europe Magazine, 25 September 2019

NETWORKS AND EVENTS

ClientEarth 'Climate Change and the Law' Seminar - This event explored how to use the existing legal framework to better encourage companies to report both on their climate change impacts and on how they will be affected by climate change.

LAPFF attended the launch of the FAIRR Protein Producer Index. The Index benchmarks the largest global meat, dairy and aquaculture producers using environmental, social and governance risk factors in line with the Sustainable Development Goals.

> The processing of 70 billion animals for human consumption annually is responsible for 14% of the world's greenhouse gas emissions.
> *Jeremy Coller - Coller FAIRR Protein Producer Index*

COMPANY PROGRESS REPORT

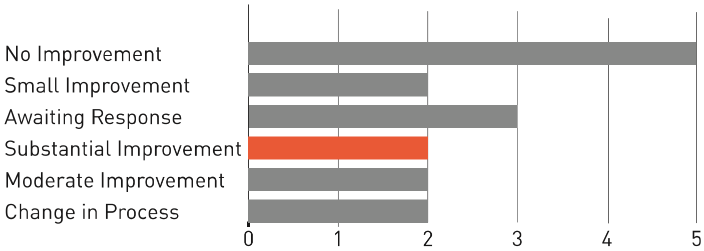
108 Company engagements over the quarter including the following meetings, voting alert submissions and filing of shareholder resolutions

Company	Activity	Topic	Outcome
ARCELORMITTAL SA	Meeting	Climate Change	Change in Process
BAE SYSTEMS PLC	Meeting	Human Rights	No Improvement
CENTRICA PLC	Meeting	Climate Change	Substantial Improvement
GENERAL MOTORS COMPANY	Meeting	Environmental Risk	Small improvement
GLENCORE PLC	Meeting	Audit Practices	Small Improvement
NATIONAL GRID PLC	AGM	Climate Change	Substantial Improvement
PETROBRAS-PETROLEO BRASILIERO	Meeting	Reputational Risk	Moderate Improvement
RYANAIR HOLDINGS PLC	Alert Issued	Governance (General)	
SOUTHERN COMPANY	Meeting	Climate Change	Change in Process
SPORTS DIRECT INTERNATIONAL PLC	Alert Issued	Governance (General)	
WALT DISNEY	Resolution filed	Climate Change	Dialogue

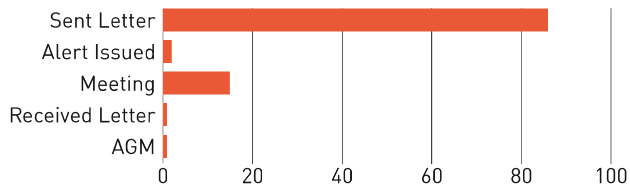
SUBSTANTIAL IMPROVEMENTS: Centrica plans to exit oil and gas production, including selling its stake in Cuadrilla which operates fracking operations in Lancashire. **National Grid** is joining the Powering Past Coal Alliance, which had been a request at the last meeting with the company.

ENGAGEMENT DATA

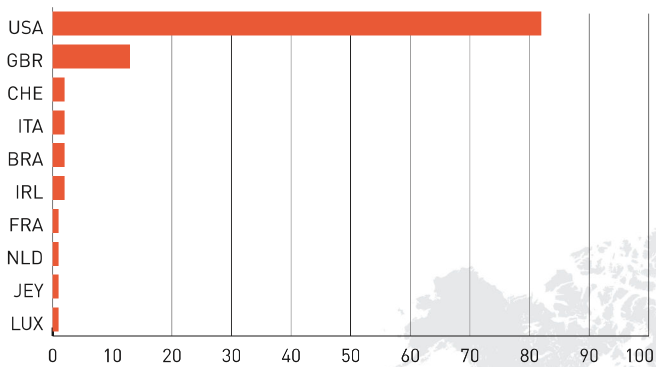
MEETING ENGAGEMENT OUTCOMES



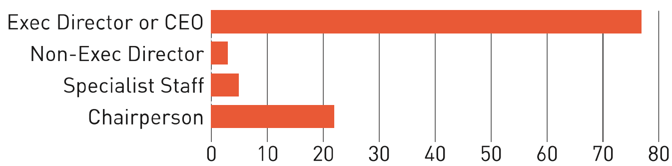
ACTIVITY



COMPANY DOMICILES



POSITIONS ENGAGED



ENGAGEMENT RE YEMEN

The reputational damage facing local authority funds as a result of holding Aerospace and Defence companies has been outlined.

LOCAL AUTHORITY PENSION FUND FORUM MEMBERS

Avon Pension Fund
Barking and Dagenham Pension Fund
Barnet Pension Fund
Bedfordshire Pension Fund
Border to Coast Pensions Partnership
Brunel Pensions Partnership
Cambridgeshire Pension Fund
Camden Pension Fund
Cardiff & Glamorgan Pension Fund
Cheshire Pension Fund
City of London Corporation Pension Fund
Clwyd Pension Fund (Flintshire CC)
Cornwall Pension Fund
Croydon Pension Fund
Cumbria Pension Fund
Derbyshire Pension Fund
Devon Pension Fund
Dorset Pension Fund
Durham Pension Fund
Dyfed Pension Fund
Ealing Pension Fund
East Riding Pension Fund
East Sussex Pension Fund
Enfield Pension Fund
Environment Agency Pension Fund
Falkirk Pension Fund
Gloucestershire Pension Fund
Greater Gwent Pension Fund
Greater Manchester Pension Fund
Greenwich Pension Fund
Gwynedd Pension Fund
Hackney Pension Fund
Hammersmith and Fulham Pension Fund
Haringey Pension Fund
Harrow Pension Fund
Havering Pension Fund
Hertfordshire Pension Fund
Hounslow Pension Fund
Islington Pension Fund
Kingston upon Thames Pension Fund
Lambeth Pension Fund
Lancashire County Pension Fund
Leicestershire Pension Fund
Lewisham Pension Fund
LGPS Central
Lincolnshire Pension Fund
London CIV
London Pension Fund Authority
Lothian Pension Fund
Merseyside Pension Fund
Merton Pension Fund
Newham Pension Fund
Norfolk Pension Fund
North East Scotland Pension Fund
North Yorkshire Pension Fund
Northern LGPS
Northamptonshire Pension Fund
Northumberland Pension Fund
Nottinghamshire Pension Fund
Oxfordshire Pension Fund
Powys Pension Fund
Redbridge Pension Fund
Rhondda Cynon Taf Pension Fund
Shropshire Pension Fund
Somerset Pension Fund
South Yorkshire Pension Authority
Southwark Pension Fund
Staffordshire Pension Fund
Strathclyde Pension Fund
Suffolk Pension Fund
Surrey Pension Fund
Sutton Pension Fund
Swansea Pension Fund
Teesside Pension Fund
Tower Hamlets Pension Fund
Tyne and Wear Pension Fund
Wales Pension Partnership
Waltham Forest Pension Fund
Wandsworth Borough Council Pension Fund
Warwickshire Pension Fund
West Midlands ITA Pension Fund
West Midlands Pension Fund
West Yorkshire Pension Fund•
Westminster Pension Fund
Wiltshire Pension Fund
Worcestershire Pension Fund