BVV

FY 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.

In Q4 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 disproportionally 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[1] explaining how major food and pharmaceutical companies are overcoming the myriad challenges posed by AMR; and 2) releasing a podcast[2] to further raise awareness about AMR[3].

[1] Viewpoint – https://www.bmogam.com/wp-content/uploads/2020/11/esg-viewpoint-anitmicrobial-resistance-nov-2020.pdf
[2] Podcast – https://sustainabilityleaders.bmo.com/en/news-insights/sustainability-leaders/sustainable-finance/episode-27-preventing-the-antimicrobial-resistance-health-crisis/
[3] 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 disproportionally 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.

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.

In Q4 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.

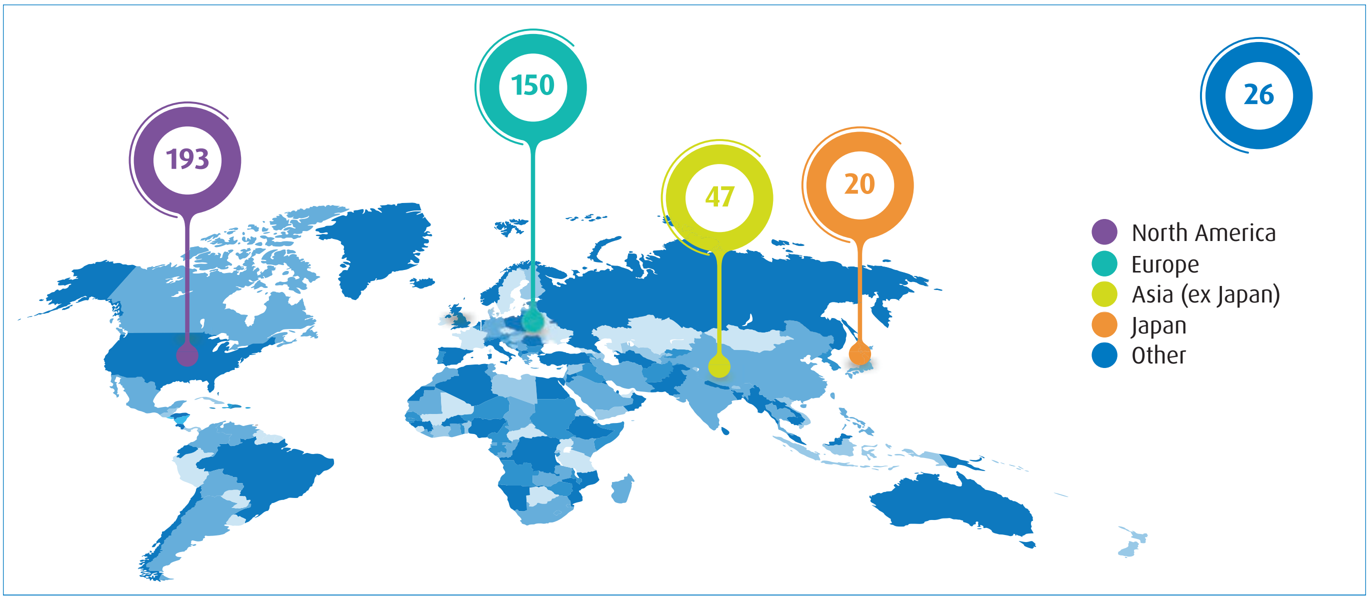
On the first proposal concerning 'ESG investing' products, the DOL shifted its focus in the final rule away from the term 'ESG' to the use of pecuniary and non-pecuniary factors. This has been interpreted as a victory by many, with the DOL conceding that ESG factors can in fact be pecuniary, in that 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.

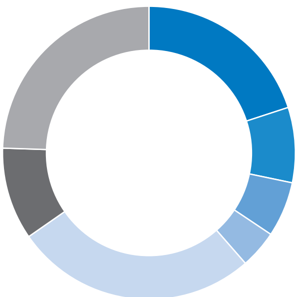
Companies engaged in 2020

Companies Engaged	Milestones achieved	Countries covered
436	217	38

Companies engaged by region

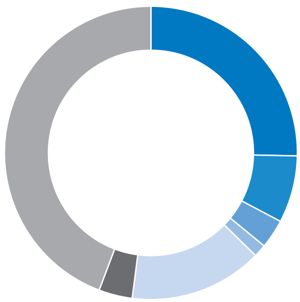


Companies engaged by issue **



Climate Change	283
Environmental Stewardship	117
Business Conduct	87
Human Rights	59
Labour Standards	380
Public Health	144
Corporate Governance	348

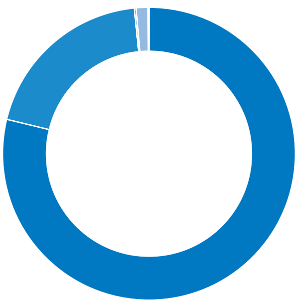
Milestones achieved by issue



Climate Change	55
Environmental Standards	16
Business Conduct	7
Human Rights	3
Labour Standards	32
Public Health	8
Corporate Governance	96

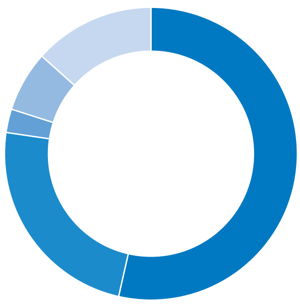
Share voting results ***

Company meetings voted	1652
Items voted	18219



For	78.7%
Against	19.6%
Abstain	0.2%
Withhold	1.3%
Do Not Vote	0.1%

Votes against and abstentions by category



Directors & Board	53.6%
Remuneration	23.8%
Capital Raising	2.6%
Shareholder Proposals	6.7%
Other	13.4%

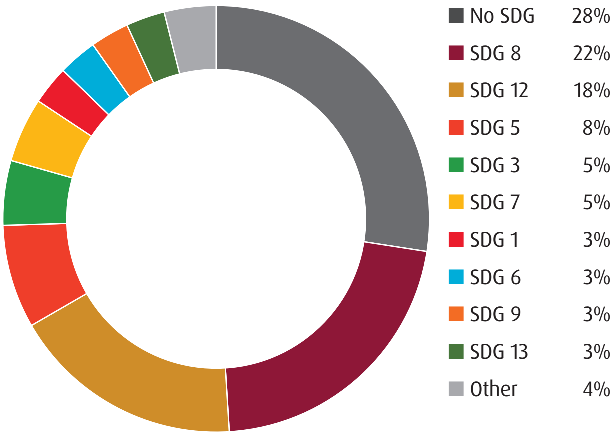
* ***reo***® is currently applied to £376.5bn/€420bn/$514bn/CA$656bn of assets as at 31 December 2020.
** Companies may have been engaged on more than one issue.
*** This report has been compiled using data supplied by a third-party electronic voting platform provider. The statistics exclude ballots 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)

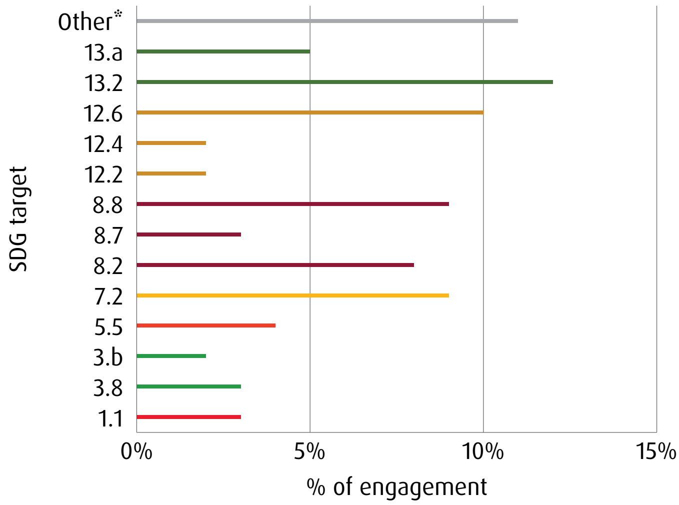
The 17 Sustainable Development Goals (SDGs) were developed by the UN and cross-industry stakeholders with a view to providing a roadmap towards a more sustainable world.

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.

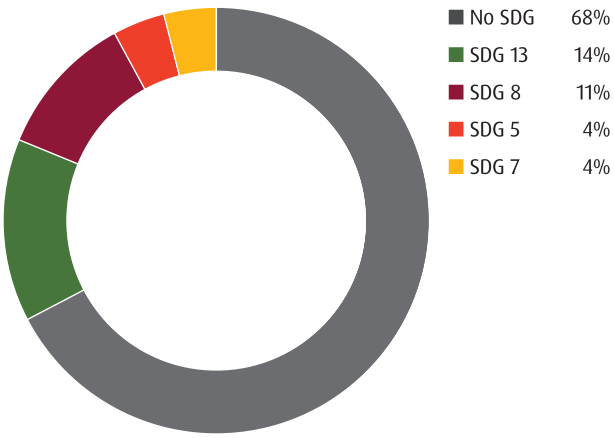
Engagement: SDG level



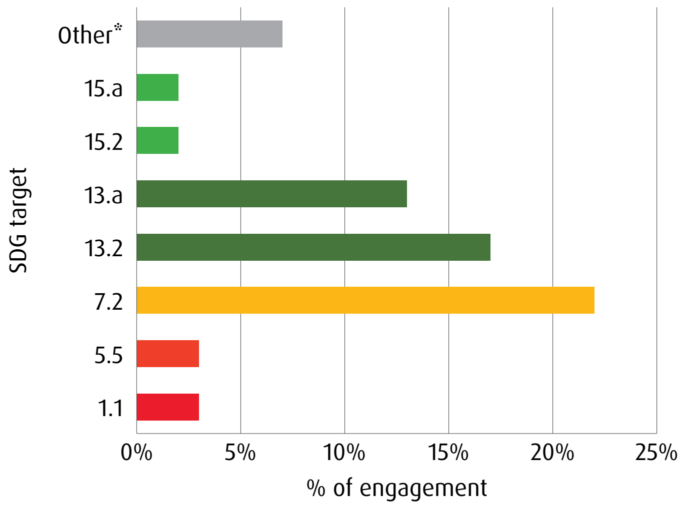
Engagement: SDG target level



Milestone: SDG level



Milestone: SDG target level



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

Engagement case studies

Company: Hoya Corp	Country: Japan	Sector: Health Care
Priority Company: -	ESG Risk Rating: ORANGE	Response to engagement: Adequate
Theme: Labour Standards	Issue: Labour Standards	
SDG: 8 DECENT WORK AND ECONOMIC GROWTH 8.7		

Background

Hoya is a global med-tech company headquartered in Tokyo, Japan. The company manufactures eyeglasses, medical endoscopes, intraocular lenses, optical lenses, and key components for semiconductor devices, among other products. Hoya's revenue growth has recently been strong, and the company plans to ramp-up production in Vietnam in order to meet increased demand for its products. We are aware that Modern Slavery risks in Vietnam are comparatively high, therefore action needs to be taken to protect against potential financial, legal, operational, and reputational damage.

Action

We arranged a call with an Investor Relations representative at Hoya, who is also a member of the company's ESG Committee, which was established in 2019. We flagged that the company's policies to combat Modern Slavery will be scrutinised more closely by stakeholders as production in Vietnam increases. We asked Hoya to review and strengthen its Modern Slavery statement to reflect the higher risks facing the company. We explained that BMO Global Asset Management is a signatory to KnowTheChain, a resource for companies and investors to understand and address Modern Slavery risks in their global supply chains. We highlighted that in KnowTheChain's 2018 Information & Communications Technology Benchmark, Hoya is ranked 30 out of 40 companies. The company representative informed us that Hoya wants to strive to improve its ranking. We analysed why the company scored relatively poorly, and shared the opportunities for improvement identified by KnowTheChain with Hoya. We were encouraged to learn that the information we provided will be shared with the company's ESG Committee.

Verdict

Our dialogue with Hoya about Modern Slavery has been constructive. It is positive that the company recognises that enhanced disclosure about policies and practices to address Modern Slavery risks is needed, and we think that the methodology underpinning KnowTheChain's Information & Communications Technology Benchmark provides Hoya with valuable guidance on the key areas where action may be required. We look forward to closer collaboration with the company as it improves transparency on Modern Slavery and other material ESG risks.

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: GlaxoSmithKline PLC	Country: United Kingdom	Sector: Health Care
Priority Company: -	ESG Risk Rating:	Response to engagement: Good
Theme: Corporate Governance	Issue: Executive Remuneration	

Background

GlaxoSmithKline plc (GSK) is a British multinational pharmaceutical company. It has historically received negative attention due to its approach to executive remuneration. This is mainly due to the remuneration committee having to align executive pay to that of GSK's global peers, most of which are large US pharmaceutical companies that are used to setting high pay levels. The company is seeking to renew its tri-annual remuneration policy that will set the parameters of executive pay for the next three years. The current policy received a high level of shareholder support back in 2017.

Action

We participated in the annual ESG investor meeting at which changes to the remuneration policy were discussed. Following this meeting we were consulted individually, which we took advantage of to provide feedback to the remuneration committee. The details set out in the consultation document included a pension contribution above what we are willing to accept. We have been engaging with company requesting that serving executives have their pension contribution level reduced to a maximum of 15% of base salary, which is generally much closer to the contribution level of the wider workforce. In addition, we raised concerns regarding the proposed increase to long-term incentives. These factors led us to explain to the committee that we would not be supporting the upcoming policy without a reduction in the pension contribution. We were relieved to be informed by the company that the pension contribution level had been reconsidered. By 2023, this will now be brought down to 7% of salary, the same as the company offers to its ordinary employees. Whilst this is not an immediate decrease, it is acceptable from our perspective.

Verdict

UK listed companies have been under increasing pressure to reduce pension contributions for serving directors. This has been partially driven by the UK's Investment Association, which we are members of. While many companies have dug their heels in by not reducing contributions, many others have, including large companies such as HSBC. This is an area of executive pay that we feel is particularly hard to justify from a fairness perspective. The high contributions are partly a legacy issue of the switch from generous defined benefit to defined contribution pension schemes. Like proposed increase in long-term incentives, we are concerned this could lead to extremely high award levels. However, considering the reduction in pension contribution and other positive changes, the remuneration committee has moved sufficiently at this point to receive a satisfactory level of support at the AGM.

Engagement case studies

Company: Eni SpA	Country: Italy	Sector: Energy
Priority Company: -	ESG Risk Rating:	Response to engagement: Good
Theme: Climate Change	Issue: Low carbon energy transition	
SDG: 7.2		

Background

In March of this year, the Italian oil and gas giant Eni published its long-term emissions reduction and energy transition strategy. With this ambitious programme, the company joined the group of leading oil majors, most of them European, that have developed and published a clear pathway for their businesses in the context of the transition to a low carbon economy. The strategy, which indicates Eni's oil and gas production will peak in 2025, includes carbon reduction targets for its own operations as well as for its oil and gas products. The company plans to achieve a net-zero carbon footprint for operational (scope 1 and 2) emissions by 2040, and reduce the carbon intensity of its energy products by 80% by 2050. The strategy also includes significant investments in renewable energy.

Action

We have actively engaged with Eni for over a decade, both individually and collaboratively, about its management of climate change risks and opportunities and its positioning for the energy transition. Specifically, we have asked for programmes and targets to reduce greenhouse gas emissions, including carbon and methane; use and disclosure of carbon pricing and scenario planning; better climate-related reporting; and development of long-term incentive plans that take into account business risks and opportunities associated with the energy transition. We have also asked for transparency on its lobbying activities, review of its membership in industry organisations, and robust CAPEX programmes that are aligned with the long-term goals of the Paris Climate Agreement. The company has responded positively to investor engagement as evidenced by the various strategic measures it has taken to transform the business for the long-term.

Verdict

We support the development and publication of Eni's climate strategy and its 30-year roadmap, which includes tangible objectives such as a gas-to-oil mix of 85% and renewable energy capacity of at least 55GW. It also addresses significant issues such as gas flaring, fugitive methane emissions, and carbon capture and utilisation. We particularly welcome the rolling 4-year plans to implement interim steps in the strategy. These shorter-term objectives will enable us to monitor progress and urge for additional steps if necessary. Overall, we are confident this strategy will allow Eni to better manage the risks and opportunities related to the energy transition. We will continue our engagement with the company, including on linking the climate roadmap to remuneration plans and implications for capital investment plans.

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: ANTA Sports Products Ltd	Country: China	Sector: Consumer Discretionary
Priority Company: ✔	ESG Risk Rating: ORANGE	Response to engagement: Good
Theme: Corporate Governance	Issue: Board effectiveness	

Background

Anta Sports has steadily grown into a household name in China. The sportswear manufacturer, which has seen its sales increase by over 4x in just five years, recently took over Finland's Amer Sports in its way to become a global player. Despite such significant growth and ambitions, the composition of the board had barely changed since the company was listed in 2007. Up until 2019, executive directors occupied six of the board's nine seats and no new independent directors had joined the board. We did not have specific concerns over any of the directors; however, we had concerns about the ability of the board to effectively oversee the conduct of the business and supervise management. Particularly as Ding Shizhong, the founder, chairman and CEO, and his family own over 60% of shares in the company.

Action

We have engaged with the company several times since 2017, including a 1-on-1 meeting in Hong Kong, to discuss a number of material ESG issues, including board composition and effectiveness. We acknowledged the role the board had played in helping make Anta Sports a success, whilst encouraging it place the topic of board composition and refreshment high on its agenda. Specifically, we asked that the balance of the board be improved by appointing additional non-executive independent directors and incorporating diversity considerations into director selection and appointment processes. At the 2019 AGM, the board requested shareholders to approve the appointment of two new independent directors to serve as board members and members of the audit committee. We welcomed this move, which will bring fresh perspectives, help improve the balance of the board, and improve the board's ability to oversee management.

Verdict

The appointment of two independent directors is significant; however, gaps remain in relation to our expectations of a what a well-balanced board should look like. There are more executive than non-executive directors and all directors are men. We will continue to engage for these gaps to be addressed, while taking into account that Anta is in many aspects a thriving family business. As such, the journey to achieving better governance can be, and in many cases should be, slow and gradual. Our message will highlight the importance of improving the balance of the board in a way that augments the attributes that have enabled Anta to thrive and that fits with its culture. In addition to engaging on governance issues, we will continue engagement on labour standards and human rights issues in the supply chain. The company lags its international peers when it comes to managing and monitoring these risks.

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

Engagement case studies

Company: Facebook Inc	Country: United States	Sector: Information Technology
Priority Company: -	ESG Risk Rating:	Response to engagement: Poor
Theme: Human Rights	Issue: Content moderation	

Background

As a social media platform with more than 2.5 billion monthly active users, the equivalent to one in three of the world's population, the content that Facebook hosts can have unprecedented levels of influence. Following the Cambridge Analytica scandal that broke in 2018, there has been growing distrust over the company's role in society and concerns with spreading disinformation on its platforms and its messaging service WhatsApp. In a recent report that the company commissioned it admitted that it had failed to keep its platform from being used to "foment division and incite offline violence" contributing to the Rohingya genocide in Myanmar in 2017. More recently it has enabled the live-streaming of terrorist attacks such as the Christchurch shootings last year. This is all in the context of poor corporate governance and company culture that shields its founder and CEO Mark Zuckerberg from accountability to minority shareholders and broader society.

Action

In early 2019 we met with the company to discuss its proposals to introduce a 'Content Oversight Board' ('COB') as part of its broader operation to better moderate its platform. We noted at the time that the company seemed to be undertaking an open and extensive consultation with a wide range of stakeholders on how the COB should operate in practice. However, given that Facebook CEO Mark Zuckerberg said that the COB would launch in early 2019, we were surprised to see how little they had in place at the time of consultation. In our formal response we expressed overall support but pushed for the publication of a transparency report that should also cover other areas of their content moderation programme so that investors and other stakeholders can actively monitor progress. In addition to this, we joined and have been assisting in the work of an investor coalition looking to engage Facebook, Alphabet and Twitter on introducing better moderation of livestreams on their respective platforms.

Verdict

In 2020 the company published a draft charter for the COB, detailing its decision-making and public reporting processes. We are particularly pleased that the COB will operate independently from Facebook itself, including having its own dedicated staff, and that its decisions will be binding on the company. At the same time, its roll-out remains too slow, with no one expected to be appointed until the summer. There seems to have been no change in remit with the actual board of directors, who we consider should be ultimately be responsible. Like other social media companies, there continues to be few clear lines of accountability on content moderation, insufficient resources to tackle the issue and little public reporting. For this reason, we co-signed an open letter by 100 global investors released in the anniversary of the Christchurch shootings asking these companies to do more.

Engagement case studies

Company: Taiwan Semiconductor Manufacturing Co Ltd	Country: Taiwan	Sector: Information Technology
Priority Company: -	ESG Risk Rating: GREEN	Response to engagement: Adequate
Theme: Corporate Governance	Issue: Board independence and effectiveness	

Background

Taiwan Semiconductor Manufacturing ('TSMC') is the largest and perhaps the most influential and technologically advanced chipmaker in the world. The company is widely admired given its robust track record of growth, managerial and margin discipline and investment returns. Such track record, as well as good transparency, protection of shareholders' rights and business conduct are all indicators of good governance practices. However, our analysis of the composition of the board yielded some concerns about its effectiveness. These included failure to disclose a succession plan, critically important given exposure to key-person risk related to the founder and executive chairman, as well as the presence of a number of long-tenured and likely very influential non-executive directors serving on key board committees. We were concerned they might have become too close with the executive chairman, potentially affecting their ability to discharge their oversight role.

Action

We travelled to TSMC's headquarters in Taipei in 2016 to meet with the company and engage on succession and board entrenchment issues. Specifically, we asked for the development and disclosure of a succession plan for the chairman, appointment of new independent directors (INEDs), reshuffle of the audit committee, and implementation of a board performance evaluation programme. The company acknowledged our concerns and informed us (but kept details under wrap) that it had a plan to ensure the orderly succession of the executive chairman. As for the rest of our asks, TSMC was not very receptive to them. It argued that its strong operating performance and myriad of awards for best corporate governance should be proof enough of the strength of the board. We left the meeting not feeling very hopeful that change would come swiftly. However, in the time since that meeting the company has acted on some of our advice.

Verdict

Morris Chang, the widely revered founder and executive chairman announced his retirement in 2018, and the company's co-chief executives formed a dual leadership team to succeed him – one became the sole chief executive and the other the executive chairman. We recognise that from a governance perspective this change is not considered best practice. However, given how closely linked the success of TSMC was to Mr Chang, the change in leadership as it happened was arguably necessary to retain top talent and avoid rattling customers and investors. Other changes include the appointment of two new INEDs and a corporate governance officer, and establishing clear procedures and criteria for the nomination and evaluation of candidates for directors.

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: Vistra Corp	Country: United States	Sector: Utilities
Priority Company: -	ESG Risk Rating:	Response to engagement:
Theme: Climate Change	Issue: Energy Transition	
SDG: 13.2		

Background

Vistra is one of the largest electric utilities in the US, with high greenhouse gas emissions compared to peers as a result of its coal fleet, which currently makes up almost 30% of its capacity. The company only listed in 2017; its assets have come from predecessor firms TXU, Luminant and Dynegy. Its high carbon intensity makes it subject to significant climate risk.

Action

We have engaged with the company since 2018, initially 1-to-1 and then as co-lead of the Climate Action 100+ group. From a starting point of having only very rudimentary sustainability reporting, the company has made significant progress. We had multiple interactions with management asking for a more ambitious climate policy, including a net zero 2050 target; setting out a schedule for coal retirements; and conducting scenario analysis. The engagement has been constructive in tone, and the company showed awareness that they were lagging their US peers in sustainability reporting and strategy. In August, as part of the Climate Action 100+ group, we were able to put these questions directly to the CEO and CFO and were impressed with their responses. The CEO was clear that he saw the future of the company as being part of the energy transition, and articulated clear views on the pathway to get there and potential obstacles, including the urgent need for better energy storage. At the company's investor event in September they announced a raft of new policies and initiatives in line with our engagement asks, including a 2050 net zero target; a stronger 2030 target; decommissioning dates for a further seven of their coal plants; and new projects in renewable energy and storage. They also published their first Climate Report, which includes detail on positions the company has taken to support more ambitious climate policies, and references to the Just Transition agenda and measures to support communities in areas of coal closure.

Verdict

Vistra remains a company with significant climate risk exposure, with some coal plants still scheduled to run for many years to come, and a continued reliance on natural gas. We would also like to see further improvements in disclosure, for instance by reporting historical and future carbon intensity data, and a meaningful link to remuneration. But the recent announcements represent a major step forward, bringing Vistra in line with other major US electric utilities also committed to a net zero 2050 business model.

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

Engagement case studies

Company: General Motors Co	Country: United States	Sector: Consumer Discretionary
Priority Company: ✔	ESG Risk Rating:	Response to engagement: Adequate
Theme: Labour Standards	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.

Engagement case studies

Company: Vistry Group PLC	Country: United Kingdom	Sector: Consumer Discretionary
Priority Company: -	ESG Risk Rating:	Response to engagement:
Theme: Corporate Governance	Issue: COVID Response & Executive Remuneration	

Background

Vistry Group plc (Vistry) was formed following the acquisition of Linden Homes by Bovis Homes in early 2020. Bovis had suffered significant reputation damage in 2017 and 2018 due to issues around the quality of the homes they built. The company has moved on from these issues under the leadership of a new CEO and has now achieved 5-star rating from the NHBC, an external quality assurance organisation. As was the case for many UK companies in the spring of 2020, Vistry cancelled the dividend payment due to concerns over the unfolding COVID pandemic. Fortunately, the housing sector faired reasonably well through the lockdowns in the UK and the company has now managed to make shareholders whole by issuing additional shares during the summer to replace the dividend payment and has paid back all government aid. In addition, during the lockdown, all employees that were furloughed have been paid 100% of their wages and the executives took a voluntary pay cut equivalent to 20% of their base salary.

Action

We held a call with the board chair and the chair of the remuneration committee to discuss executive remuneration and the company's response to COVID. Vistry received a high level of dissent at the 2020 AGM as a result of a salary increase to the CFO. An update was provided on how the committee has sought to engage investors on the issue. We also spoke about a proposal for the executives to be paid the base salary forfeited during lockdown on the basis that investors, employees and the government had all been made whole in terms of potential losses as set out above. Around one-third of FTSE350 companies cut board pay during this period. This is the first company we have spoken to proposing to reimburse executives.

Verdict

Over the past few years, our view on the cultural transformation undertaken by the management team is positive. We appreciate the transparent process undertaken by the board in consulting shareholders on the reimbursement. Whilst over 130 FTSE350 companies cut executive pay in one form or another, very few will be in Vistry's position of having made whole all affected stakeholders. Given the specifics of this case, we are supportive of the proposals. However, it is our view that the executives should be the last party to be made whole - for the vast majority of companies that cancelled the dividend payment, this will not be possible.

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: Sempra Energy	Country: United States	Sector: Utilities
Priority Company: ✔	ESG Risk Rating:	Response to engagement:
Theme: Climate Change	Issue: Wildfire resilience	
SDG: 13.1		

Background

The increasingly intense wildfires in the western United States in recent years have had devastating effects on human life, property and the environment. Electric utilities are in the front line, with some of the worst fires having been caused by sparks from electric grid infrastructure. For example, PG&E Corp. this year pleaded guilty to 84 counts of manslaughter resulting from the 2018 Camp Fire, which was triggered by its equipment. It had also filed for bankruptcy protection in 2019, faced with tens of billions in potential fines.

Action

We have engaged with Californian utilities PG&E, Southern California Edison (owned by Edison International) and San Diego Gas & Electric (owned by Sempra Energy) to better understand their wildfire mitigation plans, including how they are assessing the increased potential severity of risk as climate change causes further rises in temperature. All three companies are investing heavily in three key areas: grid hardening (upgrading power poles and lines); vegetation management around electricity infrastructure; and improved monitoring systems. Linked to monitoring, all have also adopted proactive power shutdowns at times of particularly high fire risk. This has been controversial, as residents have been left without power for prolonged periods of time. Our call with Sempra Energy revealed a proactive approach dating back well before the recent spate of wildfires. The company hired a meteorologist in 2009, and now has a team which includes a former San Diego fire chief. It demonstrated over our video call its risk tool, which includes data from 220 weather stations, and on 500,000 trees. The tool allows it to calculate a Fire Potential Index to flag high risk levels, and to predict the course of any fire given a starting point. It is also working with the Californian authorities and with academics on future climate modelling.

Verdict

Companies across sectors which are subject to weather-related risks need to consider in a systematic way how these may evolve as climate change accelerates. Undertaking this analysis may mean hiring in expertise, or working with external experts, to understand how risks are likely to change, and the range of uncertainty around projections. Within the utilities sector, wildfire risk is likely to spread to areas which had not previously experienced it – the 2020 US wildfire season, for instance, affected the state of Oregon much more than in recent years. Historical risk is no longer a reliable guide to future risk, and companies like Sempra that recognise this early and invest now can improve their chances of avoiding much more costly consequences later.

Engagement case studies

Company: Wolters Kluwer NV	Country: Netherlands	Sector: Industrials
Priority Company: -	ESG Risk Rating:	Response to engagement:
Theme: Corporate Governance	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	3.3	End AIDS, TB, malaria and other water-borne and communicable diseases
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
SDG3	3.9	Reduce deaths and illnesses from pollution and contamination
SDG3	3.b	Support research into vaccines and medicines for diseases primarily in developing countries
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	6.1	Achieve universal access to safe & affordable drinking water
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
SDG7	7.3	Double the global rate of improvement in energy efficiency
SDG8	8.2	Achieve greater productivity through innovation.
SDG8	8.3	Promote development-oriented policies
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	11.4	Strengthen efforts to safeguard the world's natural heritage
SDG11	11.5	Reduce social and economic losses caused by disasters
SDG11	11.6	Reduce the negative environmental externalities of cities
SDG12	12.2	Sustainably manage and make efficient use of natural resources

Appendix (continued)

SDG	Target	Target Summary
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	13.1	Strengthen adaptive capacity to climate-related events
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
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