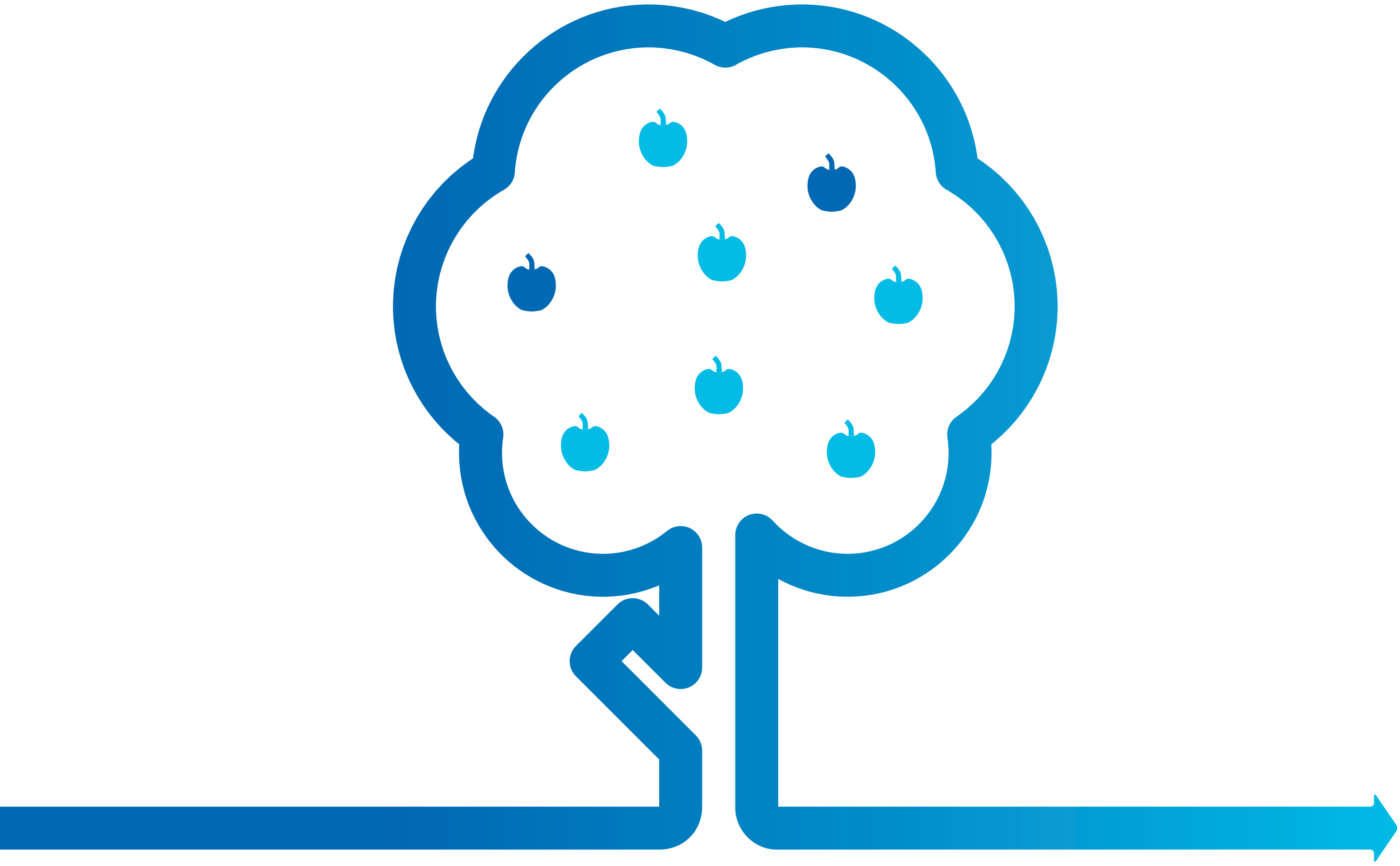
Responsible investment policy

February 2018



For people, not profit

the people's pension

Responsible investment

Trustee policy statement

Policy statement

Responsible investment is first and foremost about being responsible with our members' assets. "Responsible investment" as a term can cover issues that present a major opportunity – or a genuine threat to members' interests – which we should rightly look to identify, understand and evaluate. It is, however, a broad term that needs to be treated with care, and one where we must ensure our focus is on the interests of our members rather than external interests. Responsible investment in a pension scheme context involves taking a long-term perspective on delivering capital and income to members in retirement.

Our policy is therefore to ensure that investment strategy is set in the interests of our members and being conscious of responsible investment issues where they are material to those interests. This means allocating governance time to their debate and consideration, as far as this is reasonably practicable. These issues are multi-faceted and require systematic, fact-based analysis. To enable us to make high quality decisions, the fact-finding and analysis is delegated to the Chief Investment Officer of B&CE and our independent investment advisers.

The Trustee has a standing Investment Committee to govern the investments of The People's Pension. This Committee includes consideration of responsible investment as a part of its terms of reference. A review of responsible investment has been commissioned by the Investment Committee with the Chief Investment Officer, for consideration in 2018.

Process

We see responsible investment as having three elements which are, as far as reasonably practicable, seeking to:

1. exclude companies from investment portfolios if they do not meet certain minimum ethical criteria, and/or proactively seeking out investments which are likely to have a positive impact outside of the company
2. shape portfolios to reflect environmental, social and governance (ESG) factors that could positively or adversely affect investment returns
3. engage with companies in an investment portfolio regarding issues believed to have a material impact (both positive and negative) on future returns.

Our policy is to give consideration to these three elements when setting and reviewing investment strategy and to consider appropriate actions. Where we assess that the impact of incorporating an investment approach into our portfolios is likely to be material to members' outcomes we consider its inclusion in our investment processes, either by seeking to exclude companies or reshape portfolios. Where we feel an issue should be raised, but that there is no clear path to altering our portfolios to benefit members, we will consider engagement with the relevant companies on these issues.

In deciding between these routes, we look to evaluate:

- the expected impact on investment returns and targeted outcomes for members
- the likelihood of the measures having a material impact on the issue in wider society
- the cost, transparency and investment merit of the available implemented investment processes
- the ongoing governance challenges of the structures concerned.

The significance of some factors is both scale and time dependant: certain actions cannot be implemented cost effectively until Scheme assets reach a certain size. This means that certain actions may not be appropriate to pursue, either now or in the foreseeable future. We therefore believe it is good governance to try, wherever reasonably practicable, to:

- ensure our research process can identify investment approaches which can have a positive material impact on both returns and, potentially, ESG issues
- review proposals addressing issues from the perspective of our members' interests and returns
- test and challenge such options before considering implementation, including commissioning further research where appropriate.

We expect these principles to remain, but recognise the approaches we develop and implement may be adjusted proportionately as The People's Pension grows and in response to market developments. Greater scale may enable us to devote resources to engagement or alternative investment approaches. We will review this policy annually and ensure that our latest thinking is available to members.

Current position and future plans

Passive investing

The People's Pension primarily invests through passively managed investment vehicles where our assets represent only a small proportion of the capital invested by the passive manager. The Scheme's Statement of Investment Principles explains the Principles by which we select and manage our investments.

Passive investing requires our managers to invest in line with indices and therefore passive managers are "forced buyers" of all/most stocks in the indices being tracked. However, we recognise the important role that we have, as a Trustee board, and the opportunity to influence positive ESG standards both through the voting on key policies and decisions at general meetings – and our manager's ability to engage with the boards on our behalf, as an asset owner, which we would influence and monitor. In addition, whilst we invest predominantly in a passive mandate, we are also exploring both how we can add more value and give ESG greater emphasis through the use of factor based investment by implementing tilts to exclude or overweight aspects of our passive portfolio in line with our clear principles.

The Chief Investment Officer has been asked to report on this issue in 2018. The principles underpinning this project are included in Appendix 1. The Chief Investment Officer has been asked to further consider each of our principles and recommend actions for consideration by the Investment Committee during 2018. This is set out in Appendix 4.

Our investment manager, State Street Global Advisors (SSGA) carries out the majority of our stewardship activity. We have established agreed ownership/voting principles with SSGA which are set out in Appendices 2 and 3 and will be reviewed by the Investment Committee, supported by the Chief Investment Officer and on the advice of the investment adviser, later in 2018.

We will increase the amount of stewardship activity we carry out directly over time and believe this can deliver enhanced value for money for cost-sensitive investors.

Appendix 1: Passive management – 2018 project

With passive management, our responsible investment policy is currently focused on the third approach, engagement with companies. We are, however, considering potential filters/constraints on portfolios to be evaluated in 2018 and the central principles being tested by this research are set out below.

The market perception is that consistently outperforming the market by taking active positions is very difficult to achieve. This means that any movement away from an index portfolio needs to be based on a significant degree of confidence that the movement is of financial value to a member's pension and this degree of confidence can be difficult to achieve.

We believe, however, that there can be two valid reasons to consider moving away from this default position:

- because there is compelling evidence that a particular investment process (a method of making changes in our investment portfolios to react to the investment risks and opportunities arising from an issue) adds value to members' savings (net of additional costs) and/or
- because there would otherwise be a reputational issue for The People's Pension, reducing the trust members and society have in us to help members save appropriately for retirement.

In both cases, the investment process or issue will need to be deemed material enough by the Trustee to warrant moving away from the default position.

At our size of holding we would generally expect disinvestment to be less effective in addressing the issues we are concerned by, to add to investment costs and have the potential to reduce investment performance if too widely applied. We do believe, however, that this position should be researched. The research is being led by the Chief Investment Officer to evaluate the potential near-term exclusion of some companies that fail to meet certain criteria from our portfolios and pragmatic ways of shaping our portfolios.

Appendix 2: Passive management – engagement principles

We have created a list of principles which we will take into account when measuring our managers. We see ourselves as becoming an increasingly active owner influencing both companies themselves and the policies of the asset managers we use.

We are looking for managers who are prepared to:

Be transparent and accountable – for example by:

- engaging in dialogue, honest evaluation, continuous enhancement and increased transparency of their stewardship practices.

Enhance and evolve ESG practices in markets – for example by:

- applying higher voting standards where governance practices do not meet global investor expectations
- identifying clear engagement priorities that focus on sector, thematic and/or market specific issues
- collaborating with other investors when collective action is needed.

Develop long-term partnerships with companies and guide them through the evolution in ESG practices – for example by:

- engaging constructively with management/boards to effect change in investee companies
- publishing thought leadership papers to inform directors on changing ESG practices
- communicating clearly our expectations and vote rationale during engagement.

In addition, we will take into account whether our managers are signatories to the UNPRI and UK Stewardship code.

State Street Global Advisors

We have agreed with SSGA, the Scheme's core passive investment manager, that the building of relationships with the boards and management teams of investee companies and the monitoring of their performance is important in maximizing the long-term value of its clients' investments. On behalf of the Trustee, the Chief Investment Officer has evaluated – and will continue to evaluate – the breadth and capability of SSGA's function.

SSGA has a dedicated team of asset stewardship professionals who help it carry out its duties as a responsible investor. These duties include researching companies, identifying any issues and then engaging with them as necessary. Voting and engagement focuses on a range of themes including:

- Election of directors and boards
- Accounting and audit related issues
- Capital structure, reorganisation and mergers
- Compensation
- Environmental and social issues

As we invest in funds alongside other investors, we recognise that SSGA's prioritisation of issues for engagement and voting may not be the same as ours. As far as practicable, we go through a formal engagement process with SSGA every year to ensure that there is a good alignment of issues to prioritise over the coming year.

Monitoring and reporting on responsible investment

We receive, review and publish reports on:

- the voting activity of SSGA on our behalf
- the engagement activity of SSGA on our behalf.

In addition, part of our research at present is to research quantitative ESG scoring processes to understand our aggregate exposure to ESG risks. This will enable us to report on how elements of our investment approach reduce ESG risks relative to market averages.

We provide copies of this policy, our voting and our engagement records on our website.

Investment options

We recognise that some members will wish to access an investment fund which takes a stricter line and may exclude companies which we currently only engage with (rather than exclude). Our Ethical fund may be appropriate for members wishing to follow this route. This fund invests passively in the MSCI World ESG Universal Index which re-weights market cap weights based on ESG metrics as defined by MSCI's ESG research. It tilts away from free-float market capitalisation weights towards companies with a higher MSCI ESG rating and a positive ESG trend, while maintaining a broad and diversified investment universe.

APPENDIX 3: The People's Pension's proxy voting and engagement principles

When voting and engaging with companies in global markets, The People's Pension expects its managers, where reasonably practicable, to vote and engage in a way that protects and promotes good standards and practice and therefore the long-term economic value of our members' investments. Principally, we believe the primary responsibility of the board of directors of each of the underlying companies that our funds invest in, is to preserve and enhance shareholder value and protect shareholder interests.

These guidelines address our aspirations in relation to areas such as board structure, audit related issues, capital structure, remuneration, environmental, social and other governance related issues.

Directors and boards of investee companies

We believe that a well constituted board of directors, with a good balance of skills, expertise and independence, provides the foundations for a well governed investee company. Director independence, director succession planning, board diversity, evaluations and refreshment, and company governance practices are all useful measures of board quality. We expect our managers to vote for the election/re-election of directors on a case-by-case basis after considering the various factors.

In principle, we believe independent directors are crucial to good corporate governance and help management establish sound corporate governance policies and practices. A sufficiently independent board will most effectively monitor management and perform oversight functions necessary to protect shareholder interests. Further, we expect boards of FTSE-350 listed companies wherever reasonably practicable to have at least one female board member.

The People's Pension's broad criteria for director independence in UK companies include factors such as:

- participation in related-party transactions and other business relations with the company
- employment history with company
- excessive tenure and a preponderance of long-tenured directors
- relations with controlling shareholders
- family ties with any of the company's advisers, directors or senior employees
- if the company classifies the director as non-independent.

Audit related issues

Companies should have robust internal audit and internal control systems designed for the effective management of any potential and emerging risks to company operations and strategy. The responsibility for setting out an internal audit function lies with the audit committee, which should include, where possible, independent non-executive directors.

Appointment of external auditors

The People's Pension believes that a company's auditor is an essential feature of an effective and transparent system of external supervision, and that shareholders should be given the opportunity to vote on their appointment or re-appointment at the annual meeting.

Managers should consider voting against members of the audit committee if they have concerns with audit related issues or if the level of non-audit fees to audit fees is significant. In certain circumstances, managers should consider auditor tenure when evaluating the audit process.

Shareholder rights and capital related issues

Share issuances

The ability to raise capital is critical for companies to carry out strategy, grow, and achieve returns above their cost of capital. The approval of capital raising activities is fundamental to shareholders' ability to monitor the amounts of proceeds and to ensure capital is deployed efficiently. The People's Pension supports capital increases that have sound business reasons and are not excessive relative to a company's existing capital base.

Share repurchase programs

The People's Pension generally supports a proposal to repurchase shares, other than cases where the issuer does not clearly state the business purpose for the program, a definitive number of shares to be repurchased, specify the range of premium/discount to market price at which a company can repurchase shares, and the timeframe for the repurchase. Managers should consider voting against share re-purchase if any of these criteria are not adequately satisfied or for requests that allow share repurchases during a takeover period.

Dividends

The People's Pension generally supports dividend payouts that constitute 30% or more of net income. Managers may vote against dividend payouts if the dividend payout ratio has been consistently below 30% without adequate explanation, or, the payout is excessive given the company's financial position. Payments that are significantly out of line with previous dividend payments will be reviewed on a case by case basis. Particular attention will be paid to cases where the payment may damage the company's long term financial health.

Mergers and acquisitions

Company mergers or reorganisations often involve proposals relating to reincorporation, restructurings, mergers, liquidations, and other major changes to the corporation. We would generally expect managers to support proposals that are in the best interests of the shareholders, demonstrated by enhancing share value or improving the effectiveness of the company's operations. In general, we would expect managers not to support provisions that are not viewed as economically sound or are thought to be destructive to shareholders' rights.

We would generally expect managers to support transactions that maximize shareholder value. Some relevant considerations include, but are not limited to, the following:

- offer premium
- strategic rationale
- board oversight of the process for the recommended transaction, including, director and/or management conflicts of interest
- offers made at a premium and where there are no other higher bidders
- offers in which the secondary market price is substantially lower than the net asset value.

Anti-takeover measures

The People's Pension opposes anti-takeover defences such as authorities for the board when subject to a hostile takeover to issue warrants convertible into shares to existing shareholders.

Remuneration

Executive pay

Despite the differences among the types of plans and awards possible, The People's Pension has a simple underlying philosophy—there should be a direct relationship between remuneration and company performance over the long term.

Shareholders should have the opportunity to assess whether pay structures and levels are aligned with business performance, including profit growth, balance sheet strength and risk management, and sustainable long-term shareholder value growth. When assessing remuneration policies and reports, we generally expect managers to have regard to factors such as adequate disclosure of different remuneration elements, absolute and relative pay levels, peer selection and benchmarking, the mix of long-term and short-term incentives, alignment of pay structures with shareholder interests as well as with corporate strategy and performance.

Equity incentives plans

The People's Pension may not support proposals on equity-based incentive plans where insufficient information is provided on matters such as grant limits, performance metrics, performance and vesting periods and overall dilution. The People's Pension does not generally support options under such plans being issued at a discount to market price or plans that allow for re-testing of performance metrics.

Non-executive director pay

Authorities seeking shareholder approval for non-executive directors' fees are generally not controversial. The People's Pension generally supports resolutions regarding directors' fees unless disclosure is poor and we are unable to determine whether they are excessive relative to fees paid by other companies in the same country or industry. Where possible, managers should evaluate on a company-by-company basis any non-cash or performance related pay to non-executive directors.

Risk management

The People's Pension believes that risk management is a key function of the board of any investee company, which is responsible for setting the overall risk appetite of that company and for providing oversight on the risk management process established by senior executives at the company. Where possible, The People's Pension expects companies to disclose how the board provides oversight on its risk management system and to identify key risks facing the company. Boards should also review existing and emerging risks as they can change with a changing political and economic landscape, or as companies diversify or expand their operations into new areas.

Environmental and social issues

The People's Pension considers the financial and economic implications of environmental and social issues first and foremost. In their public reporting, we expect companies to disclose wherever practicable information on relevant management tools and material environmental and social performance metrics. We support efforts by companies to try to demonstrate how sustainability fits into their overall strategy, operations and business activities. As far as practicable, managers should evaluate these risks and shareholder proposals relating to them on an issuer by issuer basis, understanding that environmental and social risks can vary widely depending on company industry, its operations, and geographic footprint. Managers should also consider taking action against the re-election of members of the board if they have serious concerns over ESG practices and the company has not been responsive to shareholder concerns.

Appendix 4: Chief Investment Officer's review project (2018)

- In 2018, the Chief Investment Officer will report back on their findings in this area to enable the Trustee Board to further consider its policy in relation to investee companies. This will consider three core areas:
- the impact of a company's practices and products on the environment
- the impact of a company's practices and products on society
- the Governance of a company.

The Chief Investment Officer has been asked to work with the Trustee's investment adviser to review and provide evidence to support the principles set out in the draft policy (appendix 5), which is expected to be considered by the Investment Committee in May 2018.

Appendix 5: draft policy wording

Taking account of environmental, social and governance factors is an intrinsic part of our investment and engagement processes, as reflected in our ESG belief:

Investment decisions should reflect Environmental, Social and Corporate Governance (ESG) considerations	Incorporating ESG factors in our investment not only has the potential to influence change in corporate behaviour, it also has the potential to generate positive returns over the long term.

Investments within pension schemes are long term in nature and factors such as poor corporate governance or unsustainable business practices, together with other long-term risk factors such as climate change, can have significant detrimental impact on returns. We therefore believe that it is our responsibility to manage our investments to deliver a positive contribution to society and future generations where this does not affect returns negatively.

We believe that:

- a company's **environmental actions** can signal:
  - operational efficiency: higher or lower costs
  - environmental liability: reduced or enhanced
  - revenue sources: opportunities or threats.
- a company's **social behaviors** can signal:
  - human capital: effective or ineffective management of people
  - product/service safety: Reduced or enhanced financial and reputational risks
  - customer base: expanding or declining.
- a company's **governance practices** can signal:
  - decision-making: shareholder value enhanced or reduced
  - controls: Reduced risk from reputation damage or weak financial
  - management: better or worse performance from reaction to and implementation of change.

The ESG issues we focus on

The particular issues we are focussed on at present, and the actions we may consider taking in relation to them are detailed in the table below.

Issue	Description	Activity (where reasonably practicable)	Rationale
Environmental issues			
Climate change	Carbon footprint and reserves, exposure to climate change effects, exposure to the transition to a low-carbon economy	Researching as an investment factor Engaging with companies	Seeking compelling evidence that specific investment approaches offer material performance improvements
Social issues			
Landmines and cluster munitions	Companies manufacturing weapons banned by the UN Global compact	Exclusion from all our portfolios	Material reputational issue Immaterial financial impact – small number of investments excluded
Asbestos mining	Companies extracting and processing asbestos	Exclusion from all our portfolios	Material reputational issue Immaterial financial impact – small number of investments excluded
Gender diversity	Balance of genders by level of seniority	Researching as an investment factor Engaging with companies	Seeking compelling evidence that specific investment approaches offer material performance improvements
Pay inequality	Distribution of pay by level of seniority	Researching as an investment factor Engaging with companies	Seeking compelling evidence that specific investment approaches offer material performance improvements
Governance issues			
Board Diversity	Composition of board appointments and decision-making	Researching as an investment factor Engaging with companies	Seeking compelling evidence that specific investment approaches offer material performance improvements

Where an ESG issue is being researched as an investment factor we are looking to decide:

- whether a quantitative investment process (reliant on data and analysis) can reduce exposure to the issue and improve risk and return for members
- whether the subtleties of the issue mean that a quantitative process cannot (or does not presently) improve the investment characteristics of a portfolio.

If an issue can be addressed with a quantitative process, we would see this as a candidate for investment.

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