

THE NORTH EAST SCOTLAND PENSION FUND (NESPF)

Corporate Governance and Corporate Social Responsibility Policy

Introduction

The North East Scotland Pension Funds are administered by Aberdeen City Council within the Local Government Pension Scheme regulations.

There are two funds, the North East Scotland Pension Fund (NESPF) and the Aberdeen City Council Transport Fund (ACC Transport Fund). As at 31 March 2016 the value of the Funds' assets was £3.1bn and £86m respectively. (Both Funds will be referred to as NESPF within this document)

The Funds invests across all global markets with management carried out by a range of external asset managers.

The North East Scotland Pension Fund (NESPF) is aware of its fiduciary obligations to its members and scheme employers and seeks the best possible financial return on investments, whilst taking on no more than a suitable degree of risk.

Background

Whilst good corporate governance and good corporate social responsibility are two different things:

- Corporate Governance - refers to the mechanisms, processes and relations by which corporations are controlled and directed. Governance structures and principles identify the distribution of rights and responsibilities among different participants in the corporation and includes the rules and procedures for making decisions in corporate affairs.
- Corporate social responsibility - is a form of corporate self-regulation integrated into a business model. CSR policy functions as a self-regulatory mechanism whereby a business monitors and ensures its active compliance with the spirit of the law, ethical standards and national or international norms

Both have developed over the last two decades in response to legislative and stakeholder demands. NESPF has a long standing commitment to the support of good environmental, social and corporate governance within the companies in which we invest.

The companies in which NESPF invests vary significantly in their corporate governance and corporate social responsibility policies. NESPF supports the view that the willingness and ability of a company to adopt the highest standards of corporate governance and corporate social responsibility is increasingly important to its long-term growth.

Aims

Good corporate governance and good social and environmental practice can have a favourable effect on financial performance and improve investment returns to shareholders as well as society at large. Therefore, in order to protect and enhance the value of its investments, NESPF seeks to encourage the companies in which it invests:

- to operate to the highest standards of corporate governance
- to operate to the highest standards of corporate social responsibility

As a major long term shareholder, the main tools open to the NESPF to use its influence is by the responsible exercise of its voting power and active engagement on social and environmental factors with the companies in which it invests.

NESPF recognises that good corporate governance and good social and environmental practice will develop overtime and as such, will keep its approach to achieving its aims flexible.

The Fund's seeks to influence good practice in the following areas (but not limited to):

Environmental

- Climate change
- Sustainability

Social

- Diversify
- Human rights
- Consumer protection
- Supply chain management

Corporate governance

- Management structure
- Employee standards
- Accounting standards
- Executive compensation

Oversight

The Pension Committee is at all times responsible for the Fund's investments, including oversight of this policy and its implementation. Day to day responsibility for the implementation of this policy sits with the Director of Finance and dedicated staff within the Pension Fund Section. The Pensions Committee will review this policy annually, or in the event of a policy revision.

Risk

Fund Management

NESPF has a fiduciary duty to incorporate Environmental, Social and Corporate Governance (ESG) factors as an active and embedded principle of risk and return assessment in managing and determining its investment portfolio and ensuring that any managers appointed by the Funds are doing likewise. (1)

Companies that fail to adequately manage good governance and social and environmental risks may become vulnerable to higher operating costs, (including fines, lawsuits, damage to reputation) and subsequent loss of confidence to the detriment of all shareholders.

NESPF therefore has a duty to dedicate sufficient time and resource to monitoring the proper application of ESG factors in the approach our external fund managers take to investment and directly in the companies we invest in.

Investment Opportunities

There are some investment opportunities arising from environmental and social challenges which can be captured so long as they are aligned with the Fund's risk profile and investment strategy.

Positive Outcomes

In consideration of that risk and return profile NESPF engages with companies to:

- Improve the position of companies by increasing the prospects of them creating wealth for shareholders and interested parties by minimising business risks and maximising business opportunities.
- Address the risks to the Funds' assets that arise from poor governance.
- Recognised as good practice.
- Response to stakeholder interests

Implementation

This section describes NESPF approach to implementing our fiduciary duty.

Stewardship Code

NESPF has published its statement on compliance with the Stewardship Code which covers how investee companies are monitored, the investor's intervention strategy, voting policy and policy on Corporate Governance Code compliance as well as how stewardship interacts with the wider investment process.

Voting Policy

NESPF votes where possible at all AGM's & EGM's for companies in which we directly invest. PIRC (Pensions & Investment Research Consultants Ltd) as the

1. The Scottish Local Government Pension Scheme – Scheme Advisory Board 24 June 2016 – Guidance on Fiduciary Duty

current service provider, provides voting advice to the pension fund. LAPFF (Local Authority Pension Fund Forum) also provide us with research including the receipt of regular alerts on FTSE 350 companies with serious corporate governance failings. Both sources of information are taken into account when making our voting decision. All Voting on behalf of our investments with external active Fund Managers is carried out In-house.

NESPF discloses its voting activity via the Pension Fund website on a quarterly basis at www.nespf.org.uk. Where investment is made via pooled vehicles details of the managers voting activity in respect of the underlying shares within the pooled vehicle is also monitored and also disclosed via the website

In the event that a stock is out on loan through a stock lending programme, NESPF will make a case by case base decision as to whether or not that stock should be recalled for voting purposes.

Fund Manager appointments and monitoring

NESPF assesses the ESG capability of a fund manager as a factor within each of the people, process and performance categories. In its decision to appoint a fund manager, NESPF takes a balanced consideration of all relevant factors including ESG.

Through regular reporting NESPF monitors the extent to which our external fund managers incorporate ESG issues in their investment processes, and hold those managers to account for improvement in their ESG performance.

Engagement

As stated above NESPF has a fiduciary duty to incorporate Environmental, Social and Corporate Governance (ESG) factors as an active and embedded principle of risk and return.

- Engagement versus screening

In considering its fiduciary duty NESPF seeks to adopt a policy of risk monitoring and engagement in order to positively influence company behaviour and enhance shareholder value, influence that would be lost through a dis-investment approach. NESPF extends this principle of engagement, to the due diligence, appointment and monitoring of external fund managers.

- Fund engagement is carried out through:

LAPFF

NESPF is an active member of the Local Authority Pension Fund Forum (LAPFF) whose aim is to maximise their influence as shareholders whilst promoting corporate social responsibility along with the highest standards of corporate governance and research. Details of LAPFF's activities can be found on their website at www.lapfforum.org

PRI

In becoming a signatory to the PRI, NESPF has publicly demonstrate its commitment to responsible investment and further places NESPF at the heart of a global community seeking to build a more sustainable financial system.

The PRI Initiative provides a high-level framework for integrating ESG issues into investment decision-making and ownership practices within the boundary of investors' fiduciary duties and offers a comprehensive range of tools and resources to support signatories.

Signatories have the opportunity to participate in more than 100 online and in-person events and webinars hosted by the Initiative around the world each year to network, collaborate and learn from their peers. This includes the annual signatory-only event, *PRI in Person*, which, like the Initiative as a whole, has an agenda designed to offer something for every signatory, regardless of their size, location, asset class focus, style of responsible investment or progress towards implementation. Details of UNPRI's activities can be found on their website at www.unpri.org

Shareholder Litigation

The Funds' recognises the importance of giving a clear shareholder view to companies, and this is best actioned if investors give a clear collective comment or view. As stated above NESPF is a member of LAPFF, Institutional Investors Group and PRI, taking an active part in working groups where appropriate. It will also join other shareholders in maximising shareholder value through class actions where appropriate.

Measuring the Funds' governance activity

The continued improvement in good environmental, social and governance practice by companies and the role of the Pension Fund in that improvement, can only be achieved through measurement of outcomes.

NESPF has therefore identified the following, as measures it is to achieve to demonstrate good governance of the assets it holds in a meaningful and measurable format.

Voting at company AGMs and EGMs

- Voting policy in place
- Votes cast in UK & Globally
- Regular reports to members
- Information available to interested parties
- Costs of voting known

Measurable outcomes

1. The Scottish Local Government Pension Scheme – Scheme Advisory Board 24 June 2016 – Guidance on Fiduciary Duty

- Percentage of votes cast
- Example of changed company behaviour linked to Fund's voting actions

Engagement

- Active support for LAPFF meetings with companies
- Support for PRI initiatives
- Meet Myners' requirements

Communication/Accountability

- Annual report details governance activity
- Information on website on governance
- Information on website on votes cast

The above policy statement and supporting documentation is reviewed on an ongoing basis by the Pension Committee.