RESPONSIBLE INVESTMENT REPORT

2019

CCLA

GOOD INVESTMENT

Our purpose is to help our clients maximise their impact on society by harnessing the power of investment markets. This requires us to provide a supportive and stable environment for our staff and deliver trusted, responsibly managed and strongly performing products and services to organisations, irrespective of their size.

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INTRODUCTION FROM PETER HUGH SMITH

When CCLA was first launched in the late 1950s, its ethos of responsible investment was an entirely new one, confined to the fringes of the investment community. Back then, when we first started managing the funds of charities, churches and local authorities, we were one of the first to push beyond the notion of profitability alone in our investment decisions.

Over my career in the City, responsible investment has evolved to take centre stage in finance and I am delighted to see the catch-up. But there is still some way to go to build a sustainable financial industry that serves the long-term interest of its clients and society as a whole.

In my view, the responsible investment industry has become too focused on the short-term and has a poor track record in properly addressing systemic issues; climate change and ever-growing inequality, to name but two, threaten the viability of markets as well as the principles we hold dear as citizens.

It is important that we now stand up and do the right thing, rather than just saying it. As forerunners and leaders in this at CCLA we have a vital role to play.

In our third Responsible Investment Report we show how and why we are doing that. We not only set out what we have achieved in the past year, but show how we aim to be a positive force for change as we step up to the challenges of 2020.

This is far from being a 'nice to have' on top of what others might consider more serious investment management. We are convinced that tackling the issues of our day head-on as responsible investors is the only way to deliver strong, sustainable returns to our clients.

Peter Hugh Smith
Chief Executive, CCLA

Principles for Responsible Investment

The Principles for Responsible Investment (PRI) is the world's leading proponent of responsible investment, supported by the United Nations. It is backed by investors with over $80 trillion in assets. *

As a PRI signatory our responsible investment approach is assessed annually, and the full results are available on our website. In 2019, we were awarded an A+ grade for all of our assessed areas. This included our responsible investment 'Strategy and Governance', our approach to 'Active Ownership', and how we integrate environmental, social and governance (ESG) issues in listed equity and property investment.

This exceeds our responsible investment Key Performance Indicator which is to achieve an A in all areas.

**Source: PRI*

FACING UP TO THE 'TRAGEDY OF THE HORIZON'

As investors, we are primarily judged on the short-term financial returns that we deliver to our clients. But as time moves on, it has never been more apparent that our financial success depends upon us being a genuine force for positive change for the future.

It is almost five years since Mark Carney, the outgoing Bank of England governor, described climate change as the "tragedy of the horizon".

Addressing delegates at Lloyds of London, Carney predicted that climate change would become a defining issue for financial stability. But he warned that, as the full impact of excessive carbon emissions today will only become clear in the future, the true risk is not easily addressed in the time horizons used by most businesses and policymakers.

Without long-term thinking it is possible that we will not act until it is too late

Without long-term thinking it is possible that we will not act until it is too late.

As a new decade begins, forest fires and flash floods alongside vociferous environmental protests and continued political inaction are a warning that these are not empty words.

Unfortunately, climate change is not the only example of an environmental, social or governance (ESG) issue that threatens long-term financial performance and the viability of markets, although it is the most high profile. The recent annual World Economic Forum 'Global Risks Report', for instance, acts as a stark warning that issues including water shortages, social instability and cyber-attacks will, if unaddressed, impact the global economy and affect the delivery of strong and sustainable shareholder returns over the long-term.

While the largest investment industry players are now publicly acknowledging the importance of ESG challenges in headline-grabbing rhetoric, the world is still heading towards temperature rises far beyond the so-called 'safe' level. We also face heightened political risk from ever-widening global inequality.

However, much of the focus on responsible investment has been about the importance of integrating ESG factors into stock-picking or conducting polite engagement with companies. For us, this is symptomatic of the investment industry's inability to truly think about the long term and its lack of motivation to drive real change.

ESG integration is likely to help short to medium-term returns and noticeably alter portfolios. But our clients' non-profit endowments need to retain their real value for tens, if not hundreds, of years. Over this timespan any portfolio, no matter how strong on ESG metrics, is vulnerable to the impacts of social and environmental collapse.

For this reason, we believe that we have a duty to our clients to lead from the front and push the investment sector as whole towards action.

First and foremost we are lobbying policymakers for more ambitious regulation on managing climate change, as well as abandoning high-carbon assets incompatible with limiting global temperature rises.

We are asking our portfolio companies directly for targets on issues like modern slavery, that can creep under the radar as they focus on increased financial returns. And we are dedicating capital to investments that will noticeably deliver a real-world impact.

We are convinced that our actions will show how we are actively assuming our responsibility in resetting the world's current course and, in doing so, protecting the value of our clients' investments for the future.

TAKING ON BOARD ENVIRONMENTAL, SOCIAL AND GOVERNANCE FACTORS

Our responsible investment process is focused on preserving the long-term value of our clients' investment by delivering positive change. Nevertheless, we fully integrate ESG factors into our investment process, as this allows us to identify and control financial risks that are not often visible through the lens of conventional financial analysis. This predominantly means understanding the short, medium and long-term impacts of ESG factors.

We rate all companies' exposure and methods of managing ESG risk prior to both equity or debt purchases. This assessment is subsequently used to prevent companies with the highest levels of ESG risk entering our portfolios and sets our priorities for engagement.

Our assessment is based upon two factors. First, we rate companies' corporate governance standards and their wider behaviour.

This includes indicators such as the quality of accounting structures, board composition or whether internationally agreed behavioural norms have been violated, such as the United Nations Global Compact.

Over the short term this is likely to be a key indicator as to which companies could destroy shareholder value through, for example, poor management oversight —which is particularly important for key decisions like acquisitions— or an increased risk of litigation.

This is likely to be a key indicator as to which companies could destroy shareholder value

Second, we look at companies' approach to sustainability. By concentrating on issues such as climate change, public health or water use, for example, we are able to identify business models and industries whose value is at risk over the medium-long term by changing consumer preferences or regulation.

Unless they are able to keep pace with the changing world, we believe that many companies and investors will be left with assets, such as fossil fuel reserves, that become little more than worthless.

ADDRESSING POOR CORPORATE GOVERNANCE

Robust corporate governance has long been central to evaluating our clients' investments, given the risk to shareholder value of an oversight failure. We need look no further than the arrest of former Nissan chief executive Carlos Ghosn and allegations of money-laundering at Swedbank for recent examples of how unforeseeable crises can suddenly explode.

Mindful of this, we have strengthened our approach. Until now, we had used high-quality data provided by a third party to track corporate governance. But, having increasingly questioned its performance on key issues, we have developed our own in-house rating system. The new tool has boosted our ability to identify and avoid dedicating capital to companies whose corporate governance is poor.

Through the rating tool we take into account conventional factors, such as board structure, ownership, and accounting but also less commonly analysed features, such as the competence of executives and staff. Whilst obvious, this is a feature of corporate governance that is so often overlooked. Assessing the ability of leaders is tricky, but distinguishing properly between them helps us identify companies that could, over time, trip themselves up.

Aside from this we continue to push for improvements in our portfolio stocks, from actively using our votes at all firms to focus on key issues at specific companies.

One example is UK-listed RWS Holdings, a provider of intellectual property and life science language services. Our concerns relate to the composition of the Nomination Committee, responsible for evaluating prospective senior roles and thereby its ability to plan for succession. We are still in discussions with RWS and will reconsider continued investment based on progress.

We have wielded our shareholder votes to take on excessive and inappropriate executive pay, an issue of longstanding and deep concern to our clients. We were delighted to see a drop in the average FTSE 100 chief executives' pay during the year* and a rise in the number of votes against remuneration policies at US companies**after a long campaign in which, at times, a lack of progress led us to question the effectiveness of our own approach.

We take into account conventional factors, such as board structure, ownership, and accounting but also less commonly analysed features, such as the competence of executives and staff

We continue to work with shareholder voting bodies to tackle other themes which impact the preservation of value.

We are targeting directors of nomination committees to promote women, particularly for the purposes of management succession. While we welcome evidence that firms are promoting women to more board posts, that does little to redress gender imbalance in the long term.

We did not support the re-election of 16 Nomination Committee Chairs due to concerns about a lack of board level gender diversity

Evidence suggests there is no shortage of talented professional women, but rather a cultural and communicative difficulty in appealing to them and fostering their progress from lower corporate ranks. If companies do not start to focus in on this differently, the gender imbalance will persist. Failing to address it properly is not only unfair, but is a wasted opportunity as well as a potential source of talent loss.

In the same vein, we are using our votes to take on companies whose executive pensions are far out of sync with those of their own staff. This hampers corporate ability to attract talent and furthers inequality amongst employees, causing potential recruiting and retention problems for the longer term.

*Source: *Chartered Institute of Personnel and Development (CIPD) **Institutional Shareholder Services (ISS)*

Our corporate governance integration policy

Poor corporate governance poses a substantial risk to the long-term performance of companies. For this reason, we have developed a process that includes bespoke quantitative and qualitative analysis to identify and remove companies with weak governance from our portfolio. This operates as follows:

1. Corporate governance analysis must be conducted on all prospective equity investments and fixed interest counterparties prior to purchase. This means we review ratings with CCLA's bespoke governance rating tool and complete rigorous qualitative analysis.

2. Companies rated with a high governance risk, or who do not have appropriate independent auditors or who have received a qualified audit report do not qualify for any CCLA portfolio. To meet our requirements these would need permission from the Chief Investment Officer and the Head of Ethical and Responsible Investment.

3. To be approved, the relevant investment analyst must demonstrate why a 'high risk' rating' – or the auditors' qualification - is incorrect or not of concern. This normally requires detailed qualitative analysis, fact-finding discussions with the company and ongoing, target-based engagement.

4. Should an existing holding's rating decrease to a 'high risk', a full governance review is required and a decision on continued investment is required within one week.

5. A review of high governance risk companies and the portfolio structure by governance rating are a standing agenda item at CCLA's twice-yearly Ethical and Responsible Investment Committee.

Corporate governance and our portfolio

We adopt a rigorous process to identify and remove companies with high governance risk from our investment universe, so our portfolios are biased against companies with low corporate governance ratings.

As of the 31st December 2019, we held seven companies whose corporate governance had been specifically approved by the Chief Investment Officer and Head of Responsible Investment as follows:

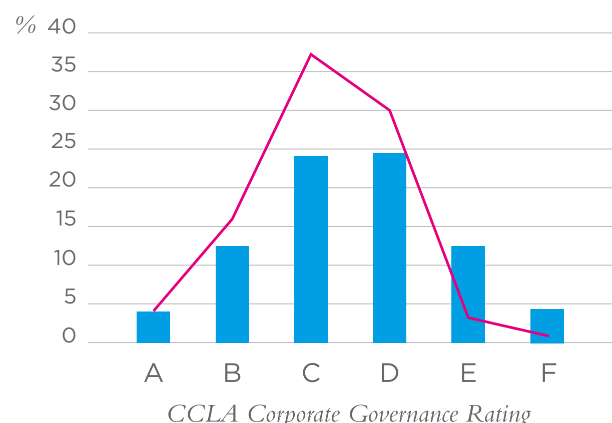
- **Network International, Heineken, Remy Cointreau** and **LVMH** have an unconventional governance structure due to strong family holdings. Whilst this can act as a governance red flag, upon review we were satisfied that the companies had high-quality management teams, a strong track record of delivering value for minority shareholders, and a long-term view driven by an inter-generational perspective.
- **Alphabet**, who have developed an unconventional governance structure to protect themselves from the short-term nature of Wall Street investors.
- **Tencent**, who due to Chinese law prohibiting direct investment from overseas investors, adopt the Variable Interest Entity (VIE) principle that allows overseas investors to own the right to revenue streams from the company rather than the direct assets. To reassure shareholders, Tencent have appointed a high-quality board and, unlike other Hong Kong-listed technology companies, have never used the VIE structure to disenfranchise minority shareholders.
- **RWS**, a UK-based translation company where the founder retains a strong shareholding. We are currently engaging with the company on the composition of its Nomination Committee and will re-consider our continued investment if this is not productive.

During the year, four companies that would otherwise have entered our portfolio were rejected due to poor corporate governance. These included US-listed luxury goods company **Estée Lauder** where, despite a history of value creation, we were concerned that the share structure disenfranchised minority shareholders and there were insufficient protections from the controlling family on the board. This will be reviewed over time.

Our approach to integrating corporate governance meaningfully alters the composition of our portfolios.

This chart compares the governance rating of companies within CCLA's COIF Charities Ethical Investment Fund with the MSCI All Countries World Investible Markets Index

Source: CCLA



Our proxy voting record

As part of our active ownership programme, CCLA aims to vote at all public meetings held by our investee companies.

Our approach to voting is designed to promote best-practice corporate governance, tie in with our wider stewardship priorities and reflect our clients' values. For this reason, we take a strong position on excessive and poorly-aligned executive remuneration proposals, gender diversity in company leadership and environmental sustainability.

As demonstrated in the charts below we target our dissenting votes on the re-election of relevant directors. For instance, we vote against the Chair of the Remuneration Committee where we have concerns about executive pay plans, the Chair of the Nomination Committee if the company has a poor approach to gender diversity and the Chair if the business is not adequately addressing climate-related risk.

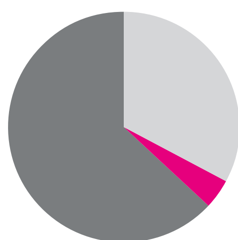
Credit: David Simonds & The Economist.

To increase the impact of our votes we write to all companies prior to the meeting about our plans. Particular focus is placed on any resolution where we do not propose to support management and provide an overview of our concerns.

During the year we voted on 2,678 resolutions at 195 meetings held by 170 companies.

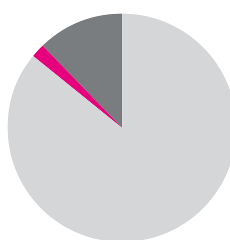
We did not back the re-election of 54 Remuneration Committee Chairs who had overseen inappropriate executive pay proposals

Our voting record



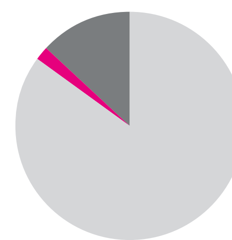
ALL EXECUTIVE REMUNERATION VOTES

- For 33%
- Abstain 4%
- Against 63%



DIRECTOR ELECTIONS

- For 86%
- Abstain 2%
- Against 12%



ALL VOTES

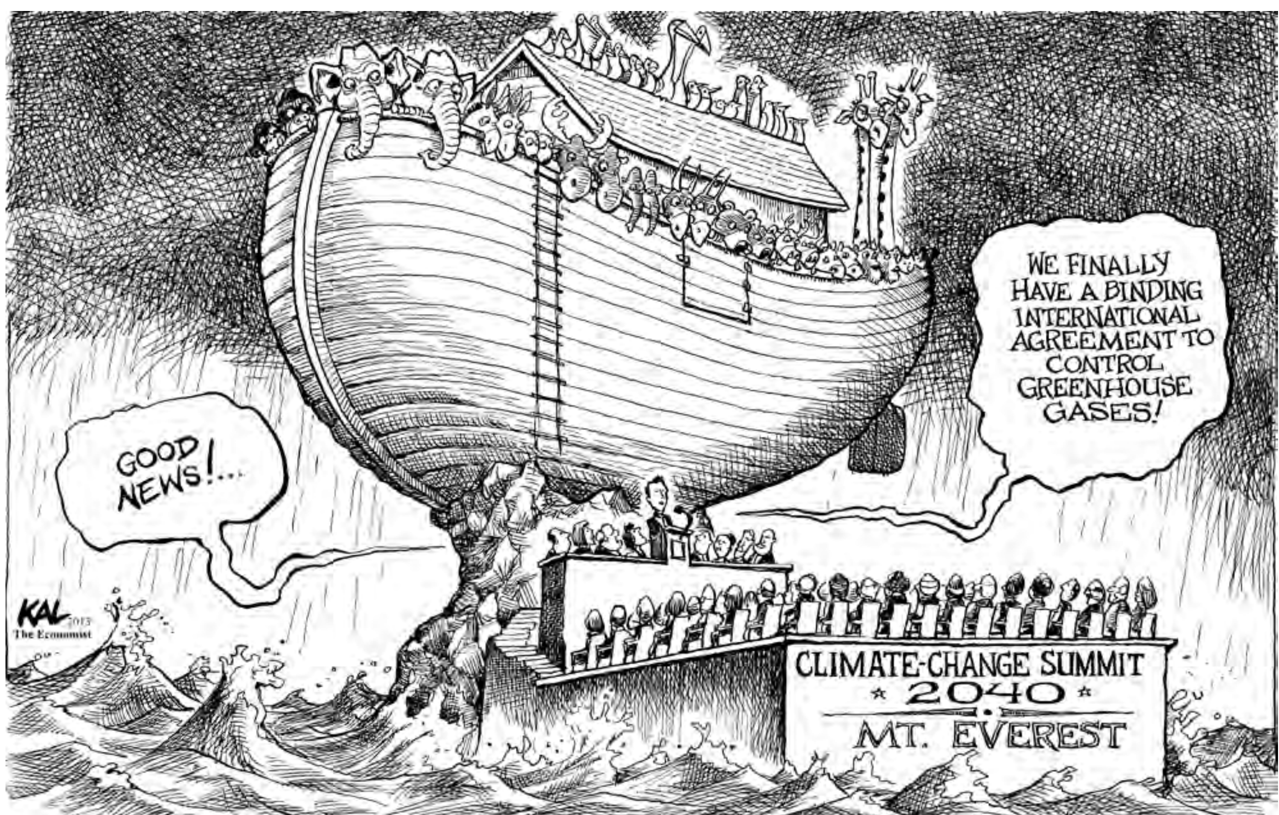
- For 86%
- Abstain 2%
- Against 13%

Source: CCLA

Addressing controversies

In addition to our work on corporate governance we routinely analyse companies' ongoing behaviour. This identifies whether any of our holdings have faced substantiated allegations of non-conformance with the UN Global Compact. This relates to labour standards, human rights, threats to biodiversity and other important environmental and social issues.

During the year we have engaged with Novartis, a Swiss pharmaceutical company, following allegations it bribed 10 top politicians in Greece to gain access to the country's market and fix prices. We have been pleased with the new management team's emphasis on business ethics and will continue to monitor progress.



Credit: Kevin KAL Kallaugher, The Economist, Kaltoons.com

Corporate governance stewardship

RWS

Engagement performance: ■

Board governance and succession planning

As an Alternative Investment Market listed company, RWS implements The Quoted Companies Alliance Corporate Governance Code (the QCA Code) rather than the UK Governance Code. Chairman Andrew Brode leads and chairs the board in an executive capacity and is a controlling shareholder. During the period, he decided to step down from the audit committee to satisfy recommended corporate governance best practice. However, the lack of clear succession plan remains a focus for our engagement with the company.

LVMH

Engagement performance: ■

Audit committee independence

We remain concerned about the level of independence on the company's Audit Committee. We are encouraging the company to provide balance by appointing another suitably qualified independent director to the committee. Engagement is ongoing.

N.B. As an active manager we are constantly working on updating our portfolios to ensure that they meet the needs of our clients. This means that we may not currently hold all of the companies that we have engaged with during the year.

Novartis

Engagement performance: ■

Non-compliance with the UN global compact

Novartis faced allegations of bribery to gain access to the Greek market. We have engaged with the company and are pleased with the new management's team's response. We will continue to monitor progress.

ENGAGEMENT KEY

We are pleased with progress against our current engagement aims: ■

Some progress: ■

No or limited response to engagement: ■

PROTECTING VALUE BY PROTECTING THE ENVIRONMENT

From wildfires in the Amazon and Australia to the ever more imaginative use of recycled plastic, environmental concerns are increasingly material to the performance of companies. For this reason, during the year we have continued our work to accelerate the transition to net-zero greenhouse gas emissions and increase the resilience of our portfolios against prospective future legislation and the physical implications of climate change.

We also expanded our engagement work to address issues such as the so-called plastics economy and the problems associated with lost and discarded fishing equipment.

The impact of the transition to a low-carbon economy is already beginning to affect the value of the most climate-sensitive companies. With this in mind, we have continued to work towards reducing exposure to assets that will be weakened by the inevitable transition to a net zero economy, and we continue to manage our portfolios towards a low-carbon footprint.

With the right leadership, we believe it is still possible for diversified oil and gas businesses to adapt their businesses to align with the goals of the Paris Climate Agreement. However, we have taken the step of divesting our two remaining oil and gas holdings in the COIF Charities Ethical Fund in order to give our clients a 'fossil free'* choice. In our other funds, we are carefully assessing the approach to protecting shareholder value during the inevitable phasing out of the fossil fuel industry.

We remain focused on managing our clients' portfolios to protect their value in the short-term. Nevertheless, we believe that a failure to tackle global warming poses a much greater overall risk to the value of investments and indeed economies.

In our view, despite increased public focus on environmental sustainability, the current rate of corporate and government policy action is insufficient to avoid significant temperature rises and its consequences. These include mass forced migration and increased extreme weather events. This threatens all companies' valuations as well as the viability of economic markets.

As stewards of our clients' investments we, therefore, believe that it is our responsibility to actively push for increased global climate action.

We will advance our work further in 2020, as we do not believe the current policy position is sufficient; it will not limit temperature rises two degrees Celsius above pre-industrial levels (let alone pursue an ambition to limit this to 1.5 degrees)**.

We believe that it is our responsibility to actively push for increased global climate action

With Britain due to host the COP 26 United Nations Climate Change Summit in Glasgow in November, we have a unique opportunity to press policymakers for legislation which demands coherent goals for a sustainable future. This is essential for our environment to support economic activity safely and sustainably.

In 2019 we also continued our work as a leading member of the Climate Action 100+ initiative, supported by investors with over $40 trillion dollars in assets under management. On behalf of this initiative we co-led engagement with mining firm Rio Tinto and U.S. electrical utility Duke Energy.

The scope and speed of corporate and government climate policy action is not enough

We also took part in productive dialogues with Royal Dutch Shell, Total, SSE, National Grid and NextEra Energy and we are working with insurance holdings about their exposure to extreme weather risks.

Whilst we continue to build dialogue with individual companies, this year we increased our engagement with public policymakers in other ways. This included supporting the British government in developing the Powering Past Coal Finance Principles, speaking at the United Nations Framework Convention on Climate Change COP 25 Conference and supporting the annual Investor Statement produced by the Institutional Investors Group on Climate Change, which called on policy makers to step up their climate action.

**The Fund does not invest in companies that generate more than 10% of their revenue from the extraction and/or refining of fossil fuels*

***Source: Climate Action Tracker*

Our climate change and investment policy

To help us manage climate change risks and opportunities, we have established an investment policy which commits CCLA to:

1. Advocate effective global action against climate change. This includes dialogue with public policymakers and engagement with companies in our portfolio.

2. Conduct an annual review of sectors and companies most affected by climate change and the transition to a low-carbon economy to inform our asset selection process.

3. Re-evaluate the value of oil and gas businesses based upon our projections for declining future demand. This makes fossil fuel businesses less attractive within our investment model.

4. Assess fossil fuel and electrical utility businesses against the decarbonization requirements set by the Paris Climate Change Agreement* prior to purchase. This has two consequences:

   a. We will not invest in companies that generate more than 5% of their returns from the extraction of coal or oil from oil sands

   b. Businesses that are not currently aligned require the approval of the Chief Investment Officer and the Head of Ethical and Responsible Investment prior to purchase. Holdings are subject to ongoing productive engagement

5. Assess and manage the risk posed by the exposure of other companies to climate-sensitive assets, including those within the finance industry.

6. Continue to manage a maximum carbon footprint for our portfolios. This currently prevents our equity portfolios from having a carbon footprint higher than the MSCI World Index.

7. Invest in companies and funds, such as renewable energy infrastructure and battery technology, that deliver a substantial environmental benefit.

As climate change is a financially material issue, CCLA's Chief Investment Officer is accountable for the implementation of the Climate Change and Investment Policy.

**This is defined as the Nationally Determined Contributions (NDCs) that were the contributions that each government set, as part of the Paris Agreement, for meeting the world's climate needs. Whilst we do not consider these to be adequate to address the climate challenge, the NDCs are our current base-case for expected climate public policy.*

Climate change and our portfolio

All CCLA portfolios take into account our climate change and investment policy.

Our three flagship Multi-asset Investment Funds* have a 'Weighted Average Carbon Intensity' below 86.4 tons of carbon dioxide per million dollars sales (tCO_2e/$m sales)**. This compares favourably to the MSCI World Index, a proxy for the world's investment markets, footprint of 166.6. The carbon footprints of all of our funds are available on request.

Whilst we remain vigilant about the pace of change at Royal Dutch Shell and Total (our two remaining holdings in the oil and gas industry) we believe that all companies within our portfolio are currently aligned, or capable of aligning, with the decarbonisation pathway set as part of the Paris Agreement.

In addition to controlling climate-related risk, we seek out companies which meet our risk and return criteria and are actively strengthening the green economy. These include renewable energy companies, forestry and low carbon infrastructure. As of the end of December 2019 approximately 6% of our Multi-Asset Investment Funds were dedicated to companies that are wholly focused on these types of activities.***

**The CBF Church of England Investment Fund, the COIF Charities Investment Fund and the COIF Charities Ethical Investment Fund*
***Source: MSCI, due to data availability this only covers 82.8% of the Fund's portfolio. This only includes Scope One and Two emissions (the direct and indirect emissions associated with the production of the company's products)*
****Source: CCLA*

About the Powering Past Coal Alliance finance principles

Led by the United Kingdom and Canadian governments, the Powering Past Coal Alliance is a global alliance of national and sub-national governments, businesses and organisations working to move away from unabated coal power generation. Coal-fired power generation is the most carbon-intensive method of producing electricity and the initiative commits countries in the Organisation of Economic Cooperation and Development and the European Union to phase it out of their energy mix by 2030 and other countries by 2050. It has now been signed by 33 national governments and 27 sub-national governments, including 10 US States.

CCLA's role in developing and promoting the Powering Past Coal Finance Principles was recognized in the UK government's Green Finance Strategy. The Finance Principles commit investors to take significant steps to help phase out coal generation assets. As part of this work, our Chief Investment Officer James Bevan, and our Climate Stewardship Director Helen Wildsmith, spoke at the November 2019 UN Framework Convention on Climate Change Conference.

More information on the Powering Past Coal Alliance is available at: www.poweringpastcoal.org

Tackling problem waste

We are a founding signatory of the PRI plastics working group. This United Nations initiative, which consists of 29 global investors representing US $5.9 trillion in assets, has focused on building an understanding of plastics from a global and holistic perspective.

We know that with increasing production and use, as well as poor end-of-life management, there are many environmental and economic risks associated with plastics pollution. Through the PRI plastics working group we have collaborated with other investors and published two reports.

The first titled 'Plastics: the challenges and possible solutions' gives an overview of the global plastics supply chain, equipping investors with the information they need to understand plastics as a systemic issue.

The second report, 'Risks and opportunities along the plastics value chain', raises awareness of the range of risks and opportunities associated with plastics.

The group has also worked with the Ellen MacArthur Foundation to establish a number of best practice measures that companies can adopt. The next stage for the coalition will be to collaboratively engage with companies to encourage them to improve their standards on plastics management.

Our work over the year also included direct company engagement. We spoke with Heineken about their global sustainability strategy, encouraging the company to set time-bound targets for recycled packaging content in a dialogue we expect to continue.

As part of a collaboration with the Investor Forum, we also encouraged the British Retail Consortium (BRC) to introduce a new standard for the management of plastic micro-pellets so they are less likely to leak into the environment.

In addition to this, we are part of a coalition of investors that have encouraged the Marine Stewardship Council (MSC) to introduce a new approach to managing 'Ghost Gear', discarded fishing equipment that causes large loss of marine life.

Climate stewardship

We prioritize all carbon-intensive businesses for engagement on climate risk. Unless otherwise noted, this engagement follows the priorities established by the Climate Action 100+ initiative. Over the past year we have achieved the following progress.

Chevron

Engagement performance: ■

Extractives industry

Chevron disclosed information to shareholders about their climate change approach and joined the oil and gas climate initiative. However we remained concerned about Chevron's approach and, as we are reducing our weight in the oil and gas industry, divested our holding in April 2019 at the time of the unsuccessful bid for Anadarko.

Royal Dutch Shell

Engagement performance: ■

Extractives industry

The company remains receptive and has taken a number of steps, such as incorporating metrics related to the transition to a low-carbon economy into their executive remuneration. Whilst it is ahead of some of its competitors in addressing climate change we remain concerned about the pace of change in the industry as a whole.

Total

Engagement performance: ■

Extractives industry

Total is considered a leader in the oil and gas industry due to early plans to diversify its business and set long-term emissions intensity goals. However, we remain concerned about the pace of change in the industry as a whole.

Rio Tinto

Engagement performance: ■

Extractives industry

Rio Tinto has undertaken a detailed review in order to set new emissions' reduction targets for the 2020s, alongside innovative steel and aluminum partnerships. This builds on their previous decision to exit thermal coal.

Duke Energy

Engagement performance: ■

Electrical utilities

Duke Energy is one of CCLA's most carbon-intensive holdings. Although the US-listed utility retains a significant coal-fired power generation portfolio, our engagement continues to be productive. The company has updated its carbon emissions reduction targets to include a 50% reduction in greenhouse gas emissions by 2030 and to be 'net zero' by 2050. We will continue to closely monitor progress, including in relation to coal phase out.

National Grid
Engagement performance: ■
Electrical utilities

We are pleased with National Grid's response to CCLA engagement, although our holding was sold on investment grounds in December 2019.

NextEra Energy
Engagement performance: ■
Electrical utilities

NextEra is a relatively new CCLA holding. The company has responded well to initial CCLA engagement and, with a portfolio focused on low-carbon generation assets, is well placed for the low-carbon transition. Future engagement will focus on encouraging the phase-out of their only coal-fired asset by 2030.

SSE
Engagement performance: ■
Electrical utilities

During the year SSE announced that they will exit coal-fired power generation by March 2020. We moved to include issues relating to the Just Transition, a framework to protect workers during the transition to a low-carbon economy, into the engagement. Our holding was sold in December on investment grounds.

Beazley
Engagement performance: ■
Financial services

Beazley confirmed the climate change scenarios and stress tests that they use to assess and manage their exposure to climate-related risk. This met our demands and concluded the engagement.

Direct Line Insurance
Engagement performance: ■
Financial services

Direct Line detailed their exposure and process for managing climate-related risks. This included the development of proprietary models and re-insurance. This met our expectations and concluded the engagement.

We will pick up engagement with our other holdings in the insurance and financial services industries in 2020.

Improving standards across the UK market

We recognise that addressing climate change will take action across the market as a whole, so we have once again engaged with UK-listed companies that have not achieved a 'B' grade on CDP (formerly the Carbon Disclosure Project) Climate Change Ranks.

A 'B' grade requires companies to take steps such as establishing good governance practices related to the management of greenhouse gas emissions and link this to strategy. They then have to set and meet long-term ambitious emissions reduction targets. During the year we engaged with 64 FTSE350 constituent companies, of which 22 improved their CDP score after our dialogue.

This work is conducted on behalf of the Church Investors Group, to whom we act as Secretariat.

22 companies improved their CDP Climate Score after CCLA-led engagement

Environmental waste stewardship

Duke Energy
Engagement performance: ■
Environmental management

Duke Energy has long faced criticism on how it uses ash basins, a form of landfill, to prevent coal ash from entering the environment. Following longstanding engagement, the company has agreed a plan to permanently close all remaining ash basins in an environmentally-sensitive manner.

Heineken
Engagement performance: ■
Product packaging

Unlike its peers, the company has not set group-wide time-bound targets for reducing the weight of its packaging materials, increasing recycled content or reclaiming used packaging materials. The company are developing targets which we expect to be disclosed to investors in 2020.

Honeywell International
Engagement performance: ■
Air quality

Honeywell is yet to disclose specific targets for ensuring air quality. Whilst an initial response has been received, we are yet to achieve our engagement goal.

INVESTING WITH PEOPLE AND COMMUNITIES IN MIND

Most investors have traditionally struggled to consider people-related issues above and beyond their focus on increased financial returns. However, with increased calls for capitalism to contribute to long-term social goals, the question of how we help develop and protect thriving communities is increasingly pressing.

This is not just a question of ethics but, moreover, a matter of maintaining our license to operate. Growing inequality has led to political instability and unhappiness with capitalism itself. The 2020 Edelman Survey, which has measured public trust globally for 20 years, found that 53 percent of Britons now believe that capitalism does more harm than good.

With that in mind companies are waking up to the need for real, measurable action to contribute something to society or, at the very least, not cause harm.

As a responsible investor, we have long sought to integrate impacts on people and communities into our investment process. This work ranges from avoiding producers of goods that cause harm, like tobacco, or those with poor human rights records, to advocating change on other issues that really matter, such as inequality.

But we recognise that more needs to be done. As a genuinely long-term investor, we feel we have a natural role to spur a reluctant investment industry towards a new era of stakeholder capitalism. For this reason, we launched two new major engagement initiatives during the year.

The question of how we can help develop and protect thriving communities is increasingly pressing

The first focusses on helping firms develop policies to protect their employees' mental health and wellbeing. To do so we brought together senior representatives from Public Health England, mental health charity Mind and other leading thinkers on the issue to create an ambitious but achievable set of expectations for businesses. It is early days as yet, but our initial findings re-affirm our long-held view that companies who look after staff health benefit from improved motivation, productivity and ideas.

The second brings the UK investment industry together to make a meaningful contribution to ending modern slavery in company supply chains. The initiative launched at the London Stock Exchange in November and has three lines of attack:

1. We are working with politicians and the Home Office to push for tougher modern slavery legislation.

2. Action has been hampered by a lack of information, so we are working with data providers for the investment industry to identify exposure and rate companies' response to modern slavery.

3. We are leading direct engagement with companies in the hospitality industry who have large and complicated supply chains spanning high risk areas such as agriculture, construction and domestic service.

As testament to the power of our network, the programme has already received support from investors with over £1.3 trillion of assets under management.

Both initiatives supplement our existing corporate engagement that seeks to address issues that are specific to the companies in which we invest.

A form of capitalism that truly respects people and communities may still be a distant prospect for the investment industry, but we are committed to playing our part in making it happen.

CCLA's modern slavery programme has already received support from investors with over £1.3 trillion of assets under management

Promoting workplace wellbeing

Poor mental health is not a new phenomenon but, until relatively recently, it was largely a hidden one as most sufferers fear the stigma of public disclosure. This is especially true in the workplace, where affected staff often feel unable to step forward due to fear of adverse consequences, lost opportunities and isolation.

Apart from its human facets, it is also a significant issue for corporate performance. In the UK alone, long-term mental health problems drive 300,000 people from their jobs per year* and the problem erases up to 4.5 percent of the annual value of the economy**.

At the level of individual companies, research conducted by Oxford Economics found that the loss of an employee earning £25,000 annually or more has an average financial impact of £30,614. This is particularly pertinent as poor mental health is cited as the reason one-in-four people in the UK leave their jobs.

The British government went some way to increasing public awareness and know-how in its 2017 "Thriving at Work" report.

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Taking that as our foundation and combining it with the mental health expertise of our client base and a specialist advisory committee, we have developed a set of markers and met with 10 financial services and pharmaceutical sector firms to assess their progress.

This is new turf for most corporates, so there are few established success indicators. But two measures that experts use are the percentage of staff actively using employee assistance programmes (EAP) and the number of days' absence for mental health reasons. This may appear counter-intuitive, but given that one-in-four people suffer from a diagnosed mental health issue, low EAP usage suggests that a company has not succeeded in establishing trust with those who need it. Usage statistics at those we met ranged from 1% to 18%.

Neither can businesses escape the difficult issue of how staff roles themselves impact mental health. Whilst leaders, like pharmaceutical company Roche, force line managers to annually produce a written assessment of risks associated with each new and existing role, the default in finance and pharmacy is still a 'macho', fast-paced atmosphere in which work is omnipresent day and night.

In our experience, once managers can talk about sensitive subjects and encourage staff to open up, they can offer safety to staff who may be struggling and a practical course of action. Employees, in turn, benefit from evidence their firm is invested in them, the certainty of knowing their wellbeing is taken seriously and having a safe haven in times of stress.

Whilst pockets of best practice exist, there is much work to be done. One large UK financial services company has yet to develop a structured approach to employee wellbeing and does not offer line managers training on this important subject. We have targeted them for increased engagement, as we believe this will hamper productivity and their ability to deliver sustainable returns.

Over the next year, we will also be seeking to bring together representatives of the investment industry to increase awareness about mental health, and will report back on our progress.

** Source: Thriving at Work*
*** Source: OECD*

Integrating social issues into our investment selection process

How companies treat their workforces, customers and the communities that live around their operations can have a material impact upon their performance. Furthermore, we recognise that some products made by listed companies are banned by international treaties or have wholly negative impacts upon human health.

For these reasons, we implement the following process in the management of all our clients' assets:

We use data from an external provider to identify and avoid investing in any company that is involved in the production of land mines, cluster munitions or chemical or biological weapons systems.

We will not invest in tobacco manufacturers, as identified by our external data provider.

Prior to purchase, we assess prospective investments against varied social criteria. We look at the impacts of products, labour standards, health and safety, people-management, community relations, responsible marketing, data privacy and corruption. This analysis can lead us to alter our investment hypothesis, prioritize ongoing, target-led, engagement or even remove the company from our investment universe altogether.

In addition, we expect our portfolio businesses to have adopted rigorous policies and processes on human rights.

Why we're asking companies to 'find, fix and prevent' modern slavery

The International Labour Organisation estimates that there are over 25 million modern slaves in the world, despite being outlawed in Britain for more than 130 years. That means there are more people living in a state of slavery than there were at the height of the transatlantic slave trade.

This human tragedy has huge repercussions for businesses. When surveyed anonymously by the Ashridge Hult Business School, 77% of UK retailers said they thought that modern slavery existed somewhere in their supply chain. We believe the problem goes far beyond that.

Under the UK Modern Slavery Act (2015) companies that derive more than £36m in the UK must produce an annual statement detailing the steps that they have taken to address modern slavery in their supply chain. However, not all FTSE100 companies meet the Act's minimum standards* and very few businesses report on the effectiveness of their actions against slavery. For this reason, we have worked with partners including the UN-backed Principles of Responsible Investment, the Investment Association, the University of Nottingham's Rights Lab, and the Business and Human Rights Resource Centre to launch 'Find It, Fix It, Prevent It'.

Initially, the project will target detailed engagement with companies in the hospitality industry, lobby government for better regulation, and work with ESG data providers to develop readily available data on corporate responses to modern slavery.

As a first step we co-ordinated and submitted a response to the UK government's Transparency in the Supply Chain Consultation, supported by investors with more than £2.4 trillion in assets under management. We have asked for legislation obliging companies to meet Home Office best practice guidance, and asked the government to explore mandatory human rights' due diligence. This would mean companies must consider the environmental and human rights implications of any new project.

** Source: Business and Human Rights Resource Centre*

Modern Slavery Act
2015

STEWARDSHIP REPORT

Auto Trader

Engagement progress: ■

Data protection

We have made initial contact with the company, but are yet to begin significant engagement.

Beazley

Engagement progress: ■

Data protection

We met with the company and were reassured that processes went significantly beyond the details that were currently available publicly. We will continue to encourage further disclosure.

Direct Line Insurance

Engagement progress: ■

Data protection

Direct Line provided significant extra information regarding their approach to data privacy. We will continue to encourage the company to disclose further.

Fidelity National

Engagement progress: ■

Human capital management

We were concerned that the company had no publicly available policy covering performance appraisals or mechanisms that allowed employees to raise grievances. Whilst Fidelity National provided further information regarding their approach to diversity and rewarding their staff they have yet to fully assuage our concerns and we continue to engage.

Nasdaq

Engagement progress: ■

Data privacy

Company provided a comprehensive response to engagement with 7 senior members of staff, including the General Counsel, joining the meeting. Nasdaq agreed to publicly disclose more information about their approach.

Stryker

Engagement progress: ■

Product health & safety

Like many healthcare technology companies, Stryker have faced a number of product recalls. We have commenced engagement, seeking greater confidence in their approach to supplier auditing and quality control.

US Bancorp

Engagement progress: ■

Data privacy

We engaged with US Bancorp to see how customer data is used, how that is communicated to clients and how data privacy controls are audited. The company assuaged our concerns, and we will continue to push for further public disclosure.

RESPONSIBLE PROPERTY INVESTMENT

Amid more frequent extreme weather, increased tenant expectations and more progressive regulation, the delivery of successful property investment strategy has become more complex in recent years.

A failure to address climate change means erratic weather, such as flooding, will pose a significant challenge to property valuations. Our work to address global warming and other sustainability issues is a positive way in which we can help preserve the value of our clients' property investment assets. This makes our portfolio more resilient by selecting assets that are likely to preserve their value over the long-term and reduces the portfolio's environmental footprint.

Due to the unique characteristics of real estate investing we also implement a specific approach to responsible investment in property.

Whilst it is easy to think of sustainable property investing as building new, energy efficient facilities, we have consciously avoided flashy investment options. Such buildings can cost more to run, and depreciation is higher. Instead, our strategy has been to identify underrated assets, often in good locations, and upgrade their environmental and social attributes and performance and, in so doing, their value.

Our responsible property investment continues long after we have purchased an asset. We have an ongoing process of tenant engagement to improve sustainability and, when buildings fall vacant, we seize on the opportunity to implement improvements. This includes installing more energy-efficient air-conditioning, modern lighting systems with motion sensor activation and sustainable waste and water management.

We believe that a failure to address climate change means erratic weather, such as flooding, will pose a significant challenge to property valuations

Another key part of our approach to property investment is staying ahead of prospective regulation and legislation.

From April 2023 landlords will not be able to rent out any property that has an Environmental Performance Certificate Rating below 'E'. This marks the second stage in implementing the UK's Minimum Energy and Efficiency Standard, which has already begun to have a significant impact on the value of the worst performing property assets.

Whilst we have taken steps to ensure that our portfolios will meet the new requirements, we believe that this is only the first step from regulators. The built environment accounts for 34% of the UK's Greenhouse Gas emissions* and, given the UK government's target of 'net zero' greenhouse gas emissions by 2050, we are expecting significant further regulation in the medium term.

For this reason, we have overhauled our portfolio to reduce our average lease to four to five years versus a typical investment industry property portfolio with an average lease of seven to eight years. This means we have ample time to ready our buildings for the transition to a 'net zero' economy.

We also want to be a good member of the community. For this reason, during the year we wrote to every local authority where we owned a property for any feedback that they might have on our asset management.

Our approach to responsible investment in property is still progressing, but we believe that an integrated approach is likely to help us deliver outperformance over the long term.

Our responsible property investment policy

We believe that ESG factors will impact the future profitability of property assets. As a consequence, our responsible property investment policy applies to the selection, management and refurbishment of all property assets under our stewardship.

Prior to any purchase we consider:

- Environmental risk issues that may manifest as liabilities, for example contaminated land, flood risk, presence of hazardous substances etc
- Environmental audit scores and risk assessments, including energy use, water consumption, greenhouse gas emissions and waste management
- Social factors, such as the availability of public transport and the facilities available for tenants
- The ability to drive improvements through refurbishment

In addition, we review all elements of the transaction to avoid issues related to corruption and bribery.

Where we have concerns, we alter the valuation that we are willing to pay for the property, develop an action plan for future refurbishments or, in extremis, abandon the proposed investment.

Once we have purchased a property, we seek to be an active owner and if we see potential value we refurbish to improve environmental and social performance.

We appoint managing agents to look after our properties on a day-to-day basis. As part of this work they are tasked with:

- Monitoring and setting targets for the reduction of energy use, water consumption, waste and CO2 emissions
- Procuring energy from renewable sources
- Conducting pro-active occupier engagement, including tenant surveys, covering a variety of ESG factors, at least every two years
- Minimizing health and safety incidents
- Monitoring of any environmental risks identified on purchase

In order to implement this policy our third-party property manager reports regularly on progress against the targets we have established.

Incoporating climate risk in property selection

A key part of our property investment process is to understand the extent to which properties will be impacted by environmental, social and governance risks, as the worst-positioned properties are likely to be penalized.

One of the major ESG factors in property investment is flooding, associated with the increased frequency of extreme weather which climate change will bring. Although we frequently turn down investment opportunities due to potential flooding, we recently acquired a hotel property in a potential flood area in Bath as we believe this to be a very desirable location for tourists.

During the initial evaluation we identified the risk. Then we looked at the building design and construction to check it had the right levels of defence and flood-proof design features. In addition, we discounted the price we were prepared to pay to account for contingencies.

During the due diligence process, we pinpointed further concerns and held discussions with the vendor and the tenant. Through this we were able to agree a programme of improvement works, and a corresponding price reduction. Moreover, to further manage the risk over the medium term, we reached agreement with the water authority to manage riverbank maintenance and dredging to lower flooding risk. We believe that this will help protect the value of an attractive property asset.

Improving the performance of our property portfolio

Through our active ownership programme we seek to increase the environmental and social performance of our property portfolios.

During the year, we undertook a number of specific projects. At the Iceni Centre in Warwick, for instance, we installed significant extra cycle parking to meet growing demand and installed a number of electrical vehicle charge points. We also completed a number of energy efficiency improvements at Salmon Retail Park, Hereford. This included the installation of LED street lighting that will not only reduce our energy consumption but also provide cost savings.

In regard to environmental management, we pay particular attention to the performance of the twelve properties that make up the majority of the value of our portfolios.

In these properties we saw reductions in like-for-like electricity and gas use over the year*. Like many property portfolios we do not have access to the environmental performance data for all of our assets. For this reason, we are seeking to expand our coverage through 'green clauses' in our tenants' leases. We made good progress on this during the year and, when possible, will expand our environmental targets to cover more of our Funds.

*Source: *BNP Paribas Real Estate Services*

ABOUT CCLA

We manage investments for charities, religious organisations and the public sector. This is all we do.

Founded in 1958, we aim to deliver strong long-term returns and have unmatched experience in providing ethical and responsible investment. We are independently owned by our clients with over £10 billion in assets under management.

CCLA

BECAUSE GOOD IS BETTER

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All data correct as at 31 December 2019.

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