

Annual Report on the Socially Responsible Investment Programme

1 April 2017 - 31 March 2018

This paper reports the annual findings of the Socially Responsible Investment (SRI) Programme to meet Trustee requirements in the Statement of Investment Principles. As part of its investment process, British Airways Pensions Investment Management Limited (BAPIML) is required to incorporate ongoing dialogue with the management of businesses in which it retains, or proposes to make, significant equity investments and, where appropriate, other forms of investments. This dialogue, 'responsibility discussion overlay' (RDO) allows BAPIML to raise environmental, social or governance (ESG) issues on behalf of the Trustees.

ESG issues are evaluated along with other factors to form a complete picture of the potential risks and returns of an investment. This framework allows BAPIML, on behalf of the Trustees, to engage with investee companies where they believe a change in company policy will enhance the long term returns for the Funds and is consistent with the overriding objective not to make or retain any investment likely to diminish the financial return on the Funds' investments.

1 Monitoring

BAPIML monitors proposals put forward for consideration at annual general meetings (AGM) and extraordinary general meetings (EGM) for environmental, social or ethical issues. These issues are voted on a case by case basis, recorded and submitted to the Investment Committee at least quarterly and are reported to Trustees and Scheme members annually under the SRI Programme. In addition, BAPIML annually screens investee companies' disclosure of key ESG criteria and identifies opportunities for engagement. Engagement activity under the RDO focused predominantly on annual results, strategy and governance issues during the year.

In the UK portfolio, BAPIML monitors investee company participation in community and ethical benchmarks and indices. UK holdings are checked for participation in the Business in the Community (BITC) Corporate Responsibility Index (CR Index), the Dow Jones Sustainability Indices (DJSI) and disclosure of carbon emissions data through participation in the CDP (formerly known as the Carbon Disclosure Project). There were 21 companies held by the Funds that neither participated in the above initiatives nor fell within the remit of the

indices due to the nature of their business. All companies had a statement in their report and accounts that adequately described their approach to SRI.

The ESG team have observed a growing trend of companies adopting the United Nations Sustainable Development Goals (UN SDGs) into their responsible investment strategies. The SDGs, agreed by all countries in the world, focus on three key areas, economic, social and environmental development, comprising 17 objectives and 169 underlying targets to be reached by 2030. Companies embedding SDGs into their responsible investment strategy are committed to moving towards more sustainable business practices, products and services. By implementing the SDG targets they are aligning with the Paris Climate Agreement's long term commitment to limit global average temperature increase to 2°C above pre-industrial levels and to undertake reductions of those targets in future. Research providers and brokers are using the framework of the SDGs, identifying company revenue segments and ESG metrics exposed to the SDGs, with some brokers now starting to analyse and provide bond style ratings for companies. BAPIML are exploring the benefits of using the SDGs to monitor investee company disclosure levels and their alignment with these goals.

2 Global Policy & Regulatory Changes

As of April 2018, 175 UN countries have so far ratified the Paris Agreement. The aim of the Paris Agreement is to strengthen the global response to the threat of climate change by keeping a global temperature rise well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5°C. In December 2018 all parties will have an opportunity to review their collective effort against the global goals prior to formally submitting their national contributions to the new agreement. This exercise will be repeated every five years. So far 168 parties have communicated their first nationally determined contributions to the UN framework convention on climate change.

There is still a level of uncertainty regarding Brexit and the EU ESG Disclosure Directive¹. Some of the proposed regulations may apply to the UK if they take effect during the post-Brexit transitional period, during which the Government will continue to apply EU law. The Government says it is committed to action on climate change which is framed by the Climate Change Act 2008, to reduce greenhouse gas (GHG) emissions by at least 80% from 1990 levels by 2050.

The House of Lords EU Energy and Environment Sub-Committee, in its Brexit: Environment and Climate Change report² highlighted key actions that will be needed to ensure environmental protections under EU Laws are not eroded because of Brexit. Environmental

¹ <https://www.iasplus.com/en-gb/news/2014/04/eu-parliament-esg-disclosure-directive>

² <https://publications.parliament.uk/pa/ld201617/ldselect/ldescom/109/10902.htm>

legislation in the UK is complex and extensive and there will be challenges to effectively maintain environmental protection through the Great Repeal Bill. The Great Repeal Bill will convert current EU law, including environmental and climate change law, into domestic law which will ensure a smooth and orderly transition on leaving the EU.

3 Analysis of Scheme Member Environmental and Social Enquiries

BAPIML monitors enquiries from members on environmental and social issues through the dedicated ESG email folder. Members are directed to the governance section of the member website and, where appropriate, responses are made to individual member enquiries. BAPIML received 23 enquiries, of which 19 were from Scheme members, on two climate change proposals and one ethical proposal put forward for consideration at the annual shareholder meetings of Exxon Mobil Corp, Facebook Inc, and Wells Fargo & Co.

There were 11 member enquiries from Scheme members with reference to the voting of item 12 at Exxon Mobil Corp’s annual meeting, which took place on 31 May 2017. The proposal asked the company to annually assess and report on the long term impacts of public climate change policies, particularly those policies aimed at reaching the globally agreed upon 2°C target. ExxonMobil provides climate change disclosure in its Outlook on Energy, in its 2016 Energy and Carbon Summary and in their report Energy and Carbon - Managing the Risks. Despite this extensive disclosure, ExxonMobil has not provided investors with a thorough assessment of the impact of climate change law and regulation on the company’s operations in line with a 2°C scenario and the effect this will have on the company’s products and services.

BAPIML are supportive of proposals that encourage the assessment and disclosure of the impact of climate change laws and regulation, in line with a 2°C scenario. As the proposal allowed investors to better understand how ExxonMobil mitigates climate change regulatory risks, BAPIML voted in favour of item 12 on the meeting agenda. This is the second consecutive year that BAPIML voted in favour of this proposal.

At the annual meeting of Wells Fargo & Co, a proposal asking the US bank to adopt a policy on the rights of indigenous peoples was presented to shareholders, resulting in five enquiries from members. The shareholder campaign cites Wells Fargo financing of companies building the Dakota Access Pipeline (DAPL), which has drawn attention for its environmental impact, and treaty rights³ protecting water sources and sacred land of the

³ Treaties - a series of mid-19th century treaties between the United States and the Great Sioux Nation collectively known as the Fort Laramie Treaties – are enshrined in the US constitution as the supreme law of the land.

Standing Rock Sioux reservation. BAPIML recognise that Wells Fargo is aligned with internationally recognised standards and initiatives on indigenous rights. The DAPL project was evaluated and reported in line with the Equator Principles⁴ (a minimum standard for due diligence and monitoring to support responsible risk decision making) by an independent engineer and deemed compliant. Wells Fargo has developed an indigenous people's statement to help guide its decision-making process for projects that may impact Native American, Native Alaskan or other indigenous communities.

However, it was not clear how the requirements and objectives of those policies and commitments were met regarding the funding of the DAPL project, as the engineer's report was not disclosed. In addition, the bank had not divulged how they managed related risks regarding the rights of indigenous peoples throughout the lifetime of the DAPL project. The passing of this proposal would give shareholders greater clarity on how the company manages or plans to manage future related risks, therefore BAPIML voted in favour of proposal 10, contrary to management.

BAPIML received three-member enquiries regarding item seven on the agenda of Facebook Inc's annual meeting agenda to adopt an independent chair to the board. Primarily this was a governance issue; the board was not classed as independent, had no formal nomination committee in place and the existing chairman is CEO and co-founder of the company. There have been several scandals regarding the data leak of user profiles and data protection breaches by a third party, as well as ethical concerns over alleged misuse of user data for political purpose, fake news, disinformation which was not managed effectively and transparently, causing considerable reputational damage.

The primary responsibility of the board should be to protect the interests of shareholders. In addition, the board is responsible for overseeing management and instilling accountability. A conflict of interest may arise with the combined role of CEO and chairman, which may weaken the governance structure of the board, and impact shareholder value. To balance the existing leadership of the board and improve governance and accountability of Facebook, the board needs independent oversight. The non-binding proposal would not require an immediate change to the board leadership structure, therefore, BAPIML supported resolution seven and withheld a vote for the election of the combined Chair and CEO.

⁴ <http://equator-principles.com/#>

4 Analysis of Global Environmental and Social Proposals

BAPIML monitors the environmental, social and ethical practice of investee companies through statements in report and accounts, corporate responsibility statements on websites and as part of the corporate governance programme. BAPIML records all environmental, social and ethical issues, including climate change proposals which are subject to a vote at AGM and EGM's. The Pensions and Lifetime Savings Association (PLSA) UK Corporate Governance Code Guidelines and Institutional Shareholder Services (ISS) recommendations are used in conjunction with BAPIML's own research, to assist in decision making on environmental, social or ethical proposals, on a case by case basis.

In the year under review, BAPIML voted on 89 environmental or social proposals submitted to shareholder meetings, a decrease from 108 proposals last year. There were 13 management and 73 shareholder proposals across all regions.

Environmental/Social Proposals submitted to Annual/Extraordinary Meeting Agenda's April 2017 - March 2018	
Proposals	Action
11	In favour, in line with management and ISS
23	In favour, contrary to management, in line with ISS
49	Against, in line with management and ISS
1	Abstained, in line with ISS, no management recommendation

In the UK there were five environmental or social proposals submitted to annual meetings. BAPIML voted in favour of two management proposals, one to approve a sustainability report and one management proposal to omit the name of an auditor from published documents. There were three shareholder proposals at the AGM of one company, two proposals requesting the company to, amongst other things, set and publish targets for reducing GHG emissions, and one to review the public policy advocacy on climate change and energy, which were voted against, in line with management. There was a slight decline from two shareholder proposals voted at annual meetings in Europe to just one on board gender diversity.

There were 11 environmental or social proposals presented by management in Emerging Markets, a decrease from 19 proposals last year. There were six proposals to approve the re-election and remuneration of the Social & Ethics Committee members and one proposal to present the Social & Ethics Committee report. There was one proposal to approve a change in the age limit of the executive officers and one to approve social contributions. In

addition, there were two proposals to issue shares for cash for Black Economic Empowerment (BEE) purposes and to approve financial assistance for the purchase of subscriptions for its shares to a BEE Entity.

In Asia, there were five proposals to approve contingent resolutions on climate risk disclosure and transition planning, two on short-lived climate pollutants and one on human rights reporting.

In Japan, 12 shareholder proposals were filed at investee company meetings, down from 29 proposals last year. There were seven anti-nuclear proposals and five proposals to amend articles. These covered issues such as the establishment of a system to review corporate social responsibility, the addition of provisions on recruitment and offer of senior positions to women returning to work from maternity leave and the prohibition of discriminatory treatment of activist investors. There were also two amendments proposed to add provisions on priority grid access for renewable energy and to establish a committee on cost calculation of each electric power source.

The number of shareholder proposals submitted to the agenda of US investee companies continues to increase year on year, from 44 to 55 proposals this year. The most prevalent were 23 environmental issues of which 14 were climate-change-related shareholder proposals at investee company meetings. A number of proposals were withdrawn prior to the meeting following a commitment by the companies to enhance their disclosure on climate change.

There were nine proposals on improving diversity: one to increase diversity of senior management and board of directors and one to disclose the percentage of females at each percentile of compensation, five proposals on gender pay gap and two on the preparation of an employment diversity report and report on diversity policies.

Five proposals were submitted by shareholders on human rights, two resolutions to establish a board committee on human rights and two proposals to participate in the Organisation for Economic Co-operation and Development (OECD) mediation for human rights violations. A proposal to adopt a policy regarding prison labour was also presented. Five shareholder proposals to adopt Holy Land principles and related report on weapon sales to Israel were submitted, which were featured in BAPIML's previous reports.

5 Developments at Portfolio Companies

In the UK, a binding resolution was presented at the AGM of an oil and gas producer requesting the company to, amongst other things, set and publish targets for reducing GHG emissions in line with the aim of achieving the 2°C target, and to publish scope 3 GHG reduction targets. The company provides a high level of GHG information, broadly in line with industry standards and responded to the 2015 shareholder resolution BAPIML

supported on increased disclosure of climate change and the energy transition. The company appears to be listening to shareholder concerns and is continuing to improve reporting and disclosure of scope one and two objectives and targets, therefore BAPIML voted against the resolution, in line with management.

A climate change proposal to review the public policy advocacy, whether direct or indirect (e.g. through trade bodies) on climate change and energy was presented at the AGMs of a dual listed mining and materials company. The company has made a commitment to review its trade body associations and publish a list of material differences between trade associations and BHP's policies through an independent third party. As most of the details raised by the proponents were addressed and the company committed to publishing the trade body review by the end of the year, support for the proposal was not warranted.

At the AGMs of three US food producers and retailers, a proposal was put forward requesting the board to issue a report assessing the environmental impact of continued use of non-recyclable packaging. All three companies have made progress towards improving packaging, reducing and recycling waste. The companies have signed up to initiatives encouraging consumers to switch to reusable bags and have increased their use of reusable containers. However, none of the companies provide information on the environmental impact of its non-recyclable packaging or targets to phase out these types of packaging.

A report providing information on current packaging reduction and recycling programs, as well as an assessment on the reputational, operational and financial risks involved at all three companies, would provide greater clarity on how companies manage and mitigate risks associated with post-consumer packaging waste. A vote for the proposal at all three companies was warranted.

On the agenda of a US integrated oils company, in addition to voting in favour for the company to report on impacts of climate change policies, BAPIML also voted in favour of a shareholder proposal for the company to report on its monitoring and management of methane emissions from its operations. This relates to the company's actions, beyond regulatory requirements, to minimise leakage from hydraulic fracturing operations and to include information on leak detection, methane emission rates and methane emissions reduction targets.

The same proposal was presented at the AGM of another US integrated oils company, to report on the impact of climate change policies. The proponents requested an assessment of the impact of climate change law and regulation on the company's operations in line with a 2°C scenario, and the effect this will have on the company's products and services. The proposal was withdrawn from the agenda prior to the AGM following a commitment by the company to report.

BAPIML voted in favour of two proposals at the AGM of a South African property loan company. The proposals related to the issue of shares for cash for BEE purposes and the

approval of financial assistance for the purchase of subscriptions for its shares to a BEE Entity. BEE is an explicit government social economic policy aimed at redressing past economic imbalances. Moreover, BEE is seen as an important policy tool to broaden the economic base of the country, with the purpose of stimulating economic growth, job creation and eradication of poverty.

BAPIML implements policies and reports directly to Trustees, with updates being provided to members on the website on an annual basis. This information can be found on www.mybapension.com.

CG & SRI Specialist
11 September 2018