New Zealand Superannuation Fund

Q1 2021

The purpose of the ***reo***® (responsible engagement overlay) * service is to engage with companies held in portfolios with a view to promoting the adoption of better environmental, social and governance (ESG) practices. The ***reo***® approach focuses on enhancing long-term investment performance by making companies more commercially successful through safer, cleaner, and more accountable operations that are better positioned to deal with ESG risks and opportunities.

Engagement in review

In the past 12 months net zero firmly entered the mainstream. Global net-zero commitments doubled and commitments by companies more than tripled arrived within the past year, signalling a remarkable embrace of the concept by policymakers and businesses. While net-zero pledges are critically important steps to combat climate change, we acknowledge that much more is needed.

As per a recent analysis by PwC, only around 8% of the world's largest companies represented by the Global Fortune 500 have committed to become net zero as of February 2021. Moreover, surveys indicate that just 10% of net-zero companies have set interim science-based emissions targets. In its inaugural Net-Zero Company Benchmark, which assesses the world's largest corporate greenhouse gas emitters on their progress in their transition to net zero, the Climate Action 100+ initiative found that none of the focus companies that have announced net-zero ambitions have fully disclosed strategies to achieve such goals. Likewise, none have committed to aligning future capital expenditure with the goal of limiting temperature rise to 1.5 degrees Celsius.

Climate strategies get a vote

Proxy voting

First advocated by activist investor Sir Christopher Hohn and later supported by the former governor of the Bank of England Mark Carney, investors and high emitting companies are keenly discussing the prospect of the "Say on Climate" mechanism, which requires boards to seek regular shareholder approvals on their decarbonisation strategies at AGMs.

Whilst this certainly helps shareholders get more clarity on the ambition and accountability of the board on decarbonisation, we also see this as a great opportunity for high emitters to garner long-term shareholder support once they begin the decarbonisation journey. This journey wouldn't be straightforward for most companies, as in many occasions we have already witnessed how the 2050 decarbonisation ambition is fundamentally reshaping business strategies with uncertainty about the future energy system and market dynamics. We expect the implied regular investor engagement required to maintain the level of support on the "Say on Climate" proposals and the feedback collected in this process to help companies balance different shareholder expectations and, in return, improve shareholder loyalty to the company throughout the journey.

The coal mine that became a political hot potato

Public policy engagement

We supported the Institutional Investors Group on Climate Change (IIGCC) letter to the British Prime Minister Boris Johnson asking for a timetable for the phase-out of all coal developments in the UK. The letter notes that the opening of a coal mine in northwest England will have a notable impact on the UK's legally binding carbon budgets and commits the UK to emissions from coking coal, for which there may be no domestic use after 2035. The letter also refers to the UK's expected leadership on climate change as host of COP26 later this year. The government has since taken on responsibility for any future decisions on the mine's opening after having previously chosen not to intervene, but first awaits an independent inquiry in the approval process and underlying climate data.

Towards a sustainable agricultural policy for the European Union

Public policy engagement

As part of our engagement on driving sustainable food systems, we joined several investors in sending a letter to the European Commission advocating for strong incentives in the Common Agricultural Policy (CAP) to support the transformation towards sustainable agriculture. Specifically, the letter called for ensuring incentives for Member States and farmers promote efforts to combat climate change and environmental impact and internalise the carbon footprint of currently subsidised commodities such as red meat.

The economics of biodiversity

Engagement tool

The Dasgupta Review, an independent study commissioned by the UK Treasury, was published in February 2021, providing an in-depth study of the economics of biodiversity. It described a devastating impact on nature from our current economic system and systematic failures of institutions to address the damage. It recommends an integration of the value of nature's good and services into accounting systems and a rebalancing of the economy to ensure demand on nature does not exceed its sustainable supply. Thirdly, it calls for institutions, especially finance and education, to transform to support these measures. We will use the findings of the report to inform corporate engagement on valuing ecosystem services and assets as part of company biodiversity strategies.

Our continuing work on living wages

Engagement update

An important element of our living wage engagement has been the work of collaborative initiatives we are part of. To celebrate our one-year anniversary of being members of the Platform Living Wage Financials (PLWF), we hosted the initiative's plenary meeting for the first time and invited a representative from the UN PRI to speak about developments around the EU Social Taxonomy. The PLWF working groups are now working on streamlining assessment methodologies for retail, garment and apparel, agriculture and food companies, all in preparation for the company assessments in the fall.

We also have ongoing dialogues on fair wages, freedom of association, employee engagement and enhanced transparency (i.e. participation in the Workforce Disclosure Initiative) with a number of companies in North America. Overall there is limited progress to report.

US update - What a difference a quarter makes

Regulatory update

This quarter we attended the spring conference of the US Council of Institutional Investors (CII), albeit virtually for the second year. We received updates on the current US regulatory agenda, as well as investor engagement campaigns in advance of the forthcoming US proxy season. We also contributed to the work of the CII's Corporate Governance Advisory Committee, providing feedback to the CII board on its campaigns and priorities.

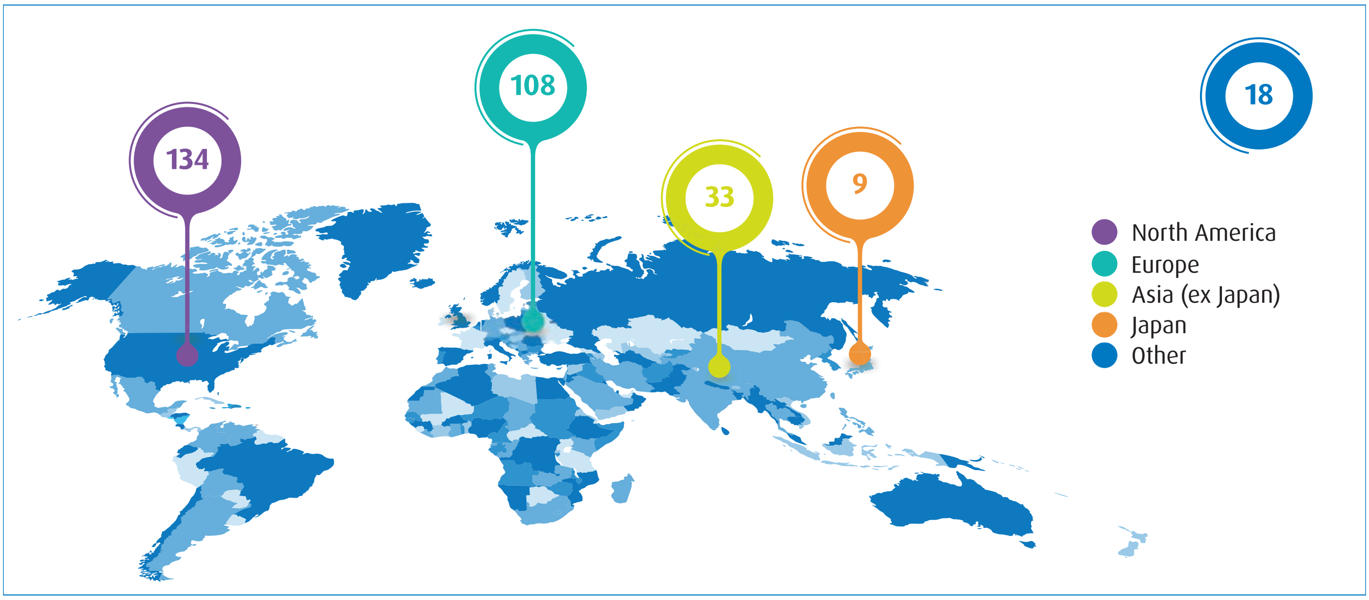
In contrast to the last few years, there was a renewed sense of optimism at the conference over the regulatory outlook in the US market since the Biden Administration came into power. In turn this has led to changes to the leadership and overall agenda at the SEC, which has spoken much more positively regarding the responsible investment industry and using proxy voting to promote better ESG performance. By means of example, they appointed a new role of climate czar and have encouraged companies to better disclose climate-related risks to investors.

Alongside this, we saw the U.S. Department of Labor (DOL) issue a non-enforcement notification regarding its two anti-ESG rules that came into force in the last few days of the Trump Administration. Although these rules are still legally binding, and therefore cannot be outright dismissed, it will give some comfort that the DOL will not investigate or overly-scrutinise investors on the ESG investing and proxy voting activities.

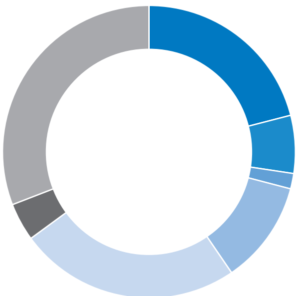
Companies engaged this quarter

Companies Engaged	Milestones achieved	Countries covered
302	97	34

Companies engaged by region

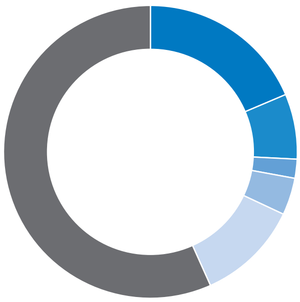


Companies engaged by issue **



Climate Change	164
Environmental Standards	50
Business Conduct	13
Human Rights	89
Labour Standards	191
Public Health	33
Corporate Governance	241

Milestones achieved by issue



Climate Change	18
Environmental Standards	7
Human Rights	2
Labour Standards	4
Public Health	11
Corporate Governance	55

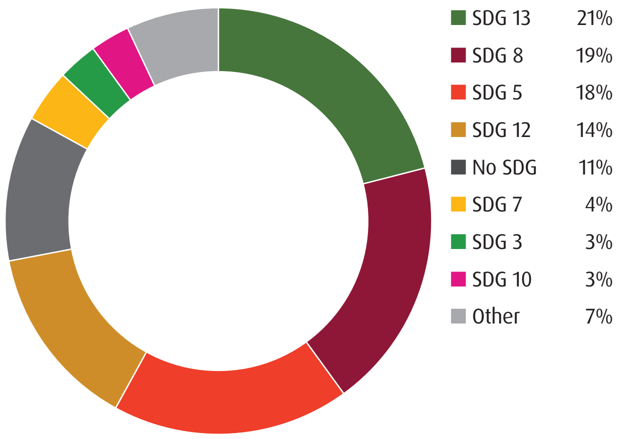
* ***reo***® is currently applied to £271bn / €303bn / US$370bn / CAD$433bn* as at 31 December 2020.
** Companies may have been engaged on more than one issue.
*** This report has been compiled using data supplied by a third-party electronic voting platform provider. The statistics exclude ballots with zero shares and re-registration meetings. Meetings/ballots/proposals are not considered voted if: ballots have been rejected by voting intermediaries (e.g. where necessary documentation (such as Powers of Attorney, beneficial owner confirmation, etc.) was not in place); instructed as "Do not vote" (e.g. in share-blocking markets); or left uninstructed. Past performance should not be seen as an indication of future performance. Stock market and currency movements mean the value of, and income from, investments in the Fund are not guaranteed. They can go down as well as up and you may not get back the amount you invest.

Engagements and Sustainable Development Goals (SDGs)

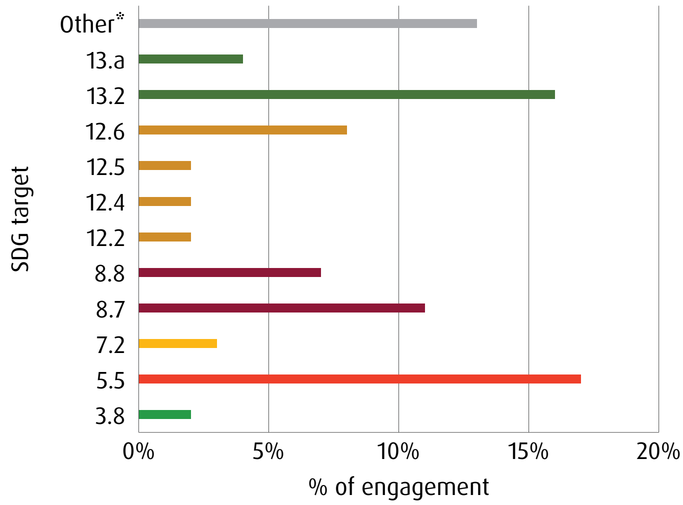
The 17 Sustainable Development Goals (SDGs) were developed by the UN and cross-industry stakeholders with a view to providing a roadmap towards a more sustainable world.

We use the detailed underlying SDG targets to frame company engagement objectives, where relevant, as well as to articulate the positive societal and environmental impacts of engagement. Engagements are systematically captured at a target level, to enable greater accuracy and achieve higher impact.

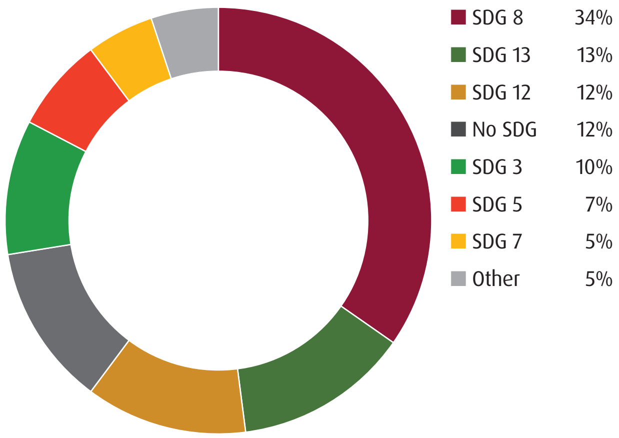
Engagement: SDG level



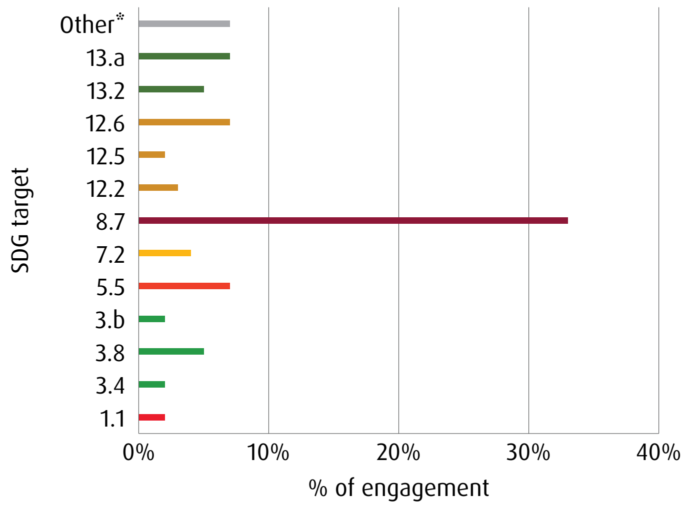
Engagement: SDG target level



Milestone: SDG level



Milestone: SDG target level



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

Engagement case studies

Company: Canadian National Railway Co	Country: Canada	Sector: Industrials
Priority Company: -	ESG Risk Rating:	Response to engagement: Good
Theme: Corporate Governance	Issue: Board Independence	

Background

Canadian National Railway ("CN") runs Canada's largest railway network, spanning from coast to coast and across the U.S. border to the Gulf Coast. Despite being a prominent member of the main index in Canada, certain aspects of the company's board structure made it an outlier. We identified concerns over the company's board and key committees as five of their 12 board directors had been on the board long enough for their tenure to potentially compromise their independence. Although tenure limits were in place, these did not apply to those directors already long tenured who had been made exempt.

Action

We engaged CN on board refreshment, director tenure and committee independence for several years, including speaking with management and the board on several occasions. During this time CN had implemented certain minor changes by removing long tenured directors from the compensation committee and reducing the number of committee members from ten to six. While we were pleased that these effectively improved the committee's independence and ability to effectively formulate and implement executive compensation plans, it did not address our wider concerns about overall board renewal. Our concerns led us to withhold support from several directors at the 2018, 2019 and 2020 Annual General Meetings.

Verdict

In February 2020, CN Railway announced updates to its Board Governance policies, amongst other developments, which we discussed with the company during a meeting. In particular, they confirmed that all directors are now subject to a 14-year tenure limit by removing the current grandfathering provision and that the retirement age for directors was lowered. Removing this provision means that all five of the long-tenured directors we had concerns around will be stepping down from the board at the 2021 AGM.

Engagement case studies

Company: Compass Group PLC	Country: United Kingdom	Sector: Consumer Discretionary
Priority Company: -	ESG Risk Rating:	Response to engagement: Good
Theme: Public Health	Issue: Product Quality and Safety	
SDG: 2.1		

Background

Compass Group was perhaps the largest FTSE 100 company that very few people had heard of until January 2021 when the company's subsidiary, Chartwells, was accused of profiteering off a government contract to deliver free school meal parcels to disadvantaged children across the UK. Photos of the inadequate provisions in the parcels quickly circulated on social media. Many questioned the value of the meagre rations and accused the company of pocketing the difference. The media coverage gained momentum when the Prime Minister labelled the quality of some food parcels as 'sub-standard' following calls for an urgent and comprehensive review. This is not the first time Compass has faced negative media attention. In 2007 the nutritional value of their 'turkey-twizzler' offering in school canteens was questioned and 2013 the company was embroiled in the horse-meat scandal. Concerns relating to Compass Group's quality control measures have come to the fore once again.

Action

We reached out to the company following the media reports to better understand the allegations and discuss potential action plans. Senior managers explained that due to the unplanned nature of the national lockdown, the company was forced to pivot operations overnight to deliver food parcels, which had led to quality and quantity issues. In the wake of the scandal, Compass implemented measures, including providing examples of adequate parcel provisions for staff to reference, requiring photographic evidence of parcel contents to be sent to head office and increasing sourcing from the UK to avoid further supply chain delays. This response provided some comfort that management acted swiftly to tackle the situation and limit the risk of reoccurrence. We also attended the annual general meeting 3 weeks after the scandal broke to ask senior management and the board for an update on the implementation of enhanced quality assurance procedures across all locations. The CEO was able to confirm that appropriate corrective actions had been taken.

Verdict

The company was able to assuage our concerns regarding allegations of profiteering, but we cannot ignore the negative light that has been cast on its approach to quality management or the increased attention to the supply of government-sponsored meals to schools. In light of past scandals, stakeholders may continue to question Compass' framework of quality assurance. That said, we appreciate the responsiveness to engagement and the swift action taken to rectify issues. Additionally, the company has highlighted its broader responsibility to improve the nutritional value of school meal provisions. We will continue to monitor their efforts and will be holding future discussions on these topics going forward.

Engagement case studies

Company: Haier Smart Home Co Ltd	Country: China	Sector: Consumer Discretionary
Priority Company: -	ESG Risk Rating:	Response to engagement: Good
Theme: Corporate Governance	Issue: ESG Oversight	
SDG: 16.6		

Background

Haier Smart Home ("Haier") recently went through a merger with its sister company Haier Electronics to enhance managerial and operational efficiency in order to better compete with other big home appliance makers. As it now has a more complex supply chain and a global market outreach, managing its environmental and social impacts will prove to be a bigger challenge. A recent example is the alleged use of forced labour in its supply chain as reported by the Australian Strategic Policy Institute. We believe that the ESG risk profile Haier has would warrant a better ESG governance structure to ensure the underlying issues are dealt with in a strategic way.

Action

We had a meeting with both Haier Smart Home and Haier Electronics to share our expectations on the post-merger corporate governance structure, including the board's overall independence, the composition of individual committees and board members' expertise. We also had a deep discussion about its internal ESG governance structure and its response to the alleged use of forced labour in its supply chain. The company is aware of the growingly complex and sizeable supply chain, which it has a strategy to further simplify in the near term. The company also talked us through the forced labour issue in its Chinese supply chain, which is a politically sensitive subject. The company has clarified their policy over forced labour and will continue to assess its exposure in the future. In March 2021, after our meeting, the company tabled a proposal at its general meeting to create an ESG committee at board level. It is a specific working body established to evaluate the company's working progress on ESG risk management, and to formulate its long-term ESG vision, goals and strategies.

Verdict

Whilst the post-merger integration will take time for the combined company to be fully efficient, we believe that it has taken the right steps on both its ESG governance reform and specifically on responding to the forced labour issue. The internal control team we spoke to is knowledgeable about shareholders' expectations on environmental and social sustainability. As the company has been very open to our engagement, we think the new ESG committee will be a key asset for us to leverage our influence and to motivate the company to enhance its management of other material ESG issues.

ESG Risk Rating: Rating of a company's ESG risk exposure and risk management compared to industry peers. Source: MSCI ESG Research Inc.

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

Engagement case studies

Company: Johnson & Johnson	Country: United States	Sector: Health Care
Priority Company: -	ESG Risk Rating:	Response to engagement: Adequate
Theme: Public Health	Issue: Access to Healthcare and Product Quality and Safety	
SDG: 3.8		

Background

In recent years, Johnson & Johnson (J&J) has suffered financial and reputational damage as a result of high-profile incidents, including lawsuits in the United States related to talcum powder and opioids. In order to restore trust, the company has increased transparency on these and a range of other material ESG issues and the frequency of its dialogue with investors. Against this backdrop, we have ramped up our engagement with J&J, focusing on the risks and opportunities associated with access to medicine and product quality and safety.

Action

Leveraging J&J's increased openness, we have had twelve engagements with the company since January 2019. While we prefer one-to-one dialogue, we recognise that collaborative engagement has provided us with additional insights into key topics, most notably access to medicine. We note that J&J ranked third in the 2021 Access to Medicine Index, partly thanks to its large R&D pipeline with multiple projects targeting public health needs in developing markets. We have asked the company to consider establishing access plans for all of its late-stage R&D projects, and in a meeting in March 2021 we discussed the impact of COVID-19 on its HIV initiatives in Africa. Regarding product quality and safety, our dialogue with J&J has shone a spotlight on the relationship between this highly material issue and responsible business conduct, as well as the role of the Board in providing effective risk management oversight. It is positive that the company's risk management process has become more centralised, which should reduce the likelihood of controversies going forward. In addition, in October 2020 – in response to investor pressure and a shareholder proposal we voted in favour of – the company published a Board report on the oversight of risks related to opioids.

Verdict

Although the shadow of major controversies still hangs over J&J, we find reasons to be optimistic about its current trajectory. The company's strengthened approach to risk management in conjunction with an ambitious and clearly articulated access to medicine strategy should help it to decrease the frequency of litigation and improve its reputation. As J&J ramps up its COVID-19 vaccine rollout, we plan to continue regular engagement with the company, because further scandals could fuel public distrust and – crucially – vaccine hesitancy. Our focus areas will be: enabling equitable global access to the J&J COVID-19 vaccine; and chemical safety, an issue which stakeholders are increasingly concerned about.

Engagement case studies

Company: Tyson Foods Inc	Country: United States	Sector: Consumer Staples
Priority Company: -	ESG Risk Rating:	Response to engagement: Poor
Theme: Human Rights	Issue: Human Rights Due Diligence	
SDG: 8.8		

Background

The meatpacking industry proved to be particularly susceptible to coronavirus infections because of the nature of the work: intense physical labour, conducted indoors at close proximity to other workers. Meat-processing plants around the world became COVID-19 infection hotspots. In the US, the rapid growth of confirmed COVID-19 cases in rural counties with 20 percent or more employment in meatpacking drew attention to the role of the industry in the pandemic. Tyson Foods, one of the largest in the industry and one with significant presence in rural America, has seen over 10% of its workforce contract COVID-19. This has contributed to plant shutdowns, production delays, and reduced productivity.

Action

We joined other investors in engaging executives at Tyson Foods to discuss concerns regarding the company's response to the pandemic. Management described in detail measures taken, some of which went above and beyond voluntary industry guidelines, to protect the health and safety of workers and communities in the vicinity of its plants. Measures included setting up ongoing, data-driven testing of workers on-site; implementing robust tracing mechanisms; working with outside health experts; and expanding its health services staff, including appointing a chief medical officer. In the absence of mandatory COVID-19 safety regulations, we welcomed Tyson's strategic and scientific approach to addressing the risks to its workers and its business. At the same time, we noted the absence of a sufficiently robust approach to human rights due diligence and how that might have helped delay the response to the pandemic and, in the process, allowed for Tyson to have the highest rate of COVID-19 infections in the industry.

Verdict

Given its size and the industry it operates in, Tyson's human rights impacts require heightened due diligence and enhanced disclosure. However, the company has not acted on investors' requests for management to report on measures to identify, assess, mitigate and remedy such impacts. This has become even more urgent given the company's poor response to protect workers during the pandemic. We, therefore, decided to co-file a shareholder proposal asking for enhanced human rights reporting at this year's AGM. The proposal received 78.7% support from independent investors , a remarkable level of support that we are hopeful will lead Tyson to prepare and publish a human rights due diligence report.

Appendix

SDG	Target	Target Summary
SDG1	1.1	Eradicate poverty and ensure a living wage for all
SDG2	2.1	End hunger and ensure access to safe and nutritious food
SDG3	3.3	End AIDS, TB, malaria and other water-borne and communicable diseases
SDG3	3.4	Reduce mortality from non-communicable diseases and promote mental health
SDG3	3.5	Increase the prevention and treatment of substance abuse
SDG3	3.8	Access to medicines and health-care
SDG3	3.9	Reduce deaths and illnesses from pollution and contamination
SDG3	3.b	Support research into vaccines and medicines for diseases primarily in developing countries
SDG4	4.6	Increase youth and adult literacy and numeracy rates
SDG5	5.1	End all forms of discrimination against women and girls
SDG5	5.2	Eliminate all forms of violence against women
SDG5	5.5	Ensure full equality of opportunity for women, including at leadership levels
SDG5	5.c	Leverage enforceable legislation
SDG6	6.1	Achieve universal access to safe & affordable drinking water
SDG6	6.3	Improve water quality by reducing pollution
SDG6	6.4	Increase water-use efficiency to address water scarcity
SDG7	7.1	Ensure universal access to modern energy services
SDG7	7.2	Substantially increase the global share of renewable energy
SDG7	7.3	Double the global rate of improvement in energy efficiency
SDG8	8.2	Achieve greater productivity through innovation.
SDG8	8.3	Promote development-oriented policies
SDG8	8.5	Achieve full and productive employment for all
SDG8	8.7	Eradicate forced labour, modern slavery & human trafficking
SDG8	8.8	Protect and promote safe working environments for all workers
SDG9	9.1	Develop resilient and sustainable infrastructure
SDG9	9.4	Upgrade and retrofit industries to increase sustainability
SDG10	10.1	Achieve a higher rate of income growth for the bottom 40%
SDG10	10.2	Empower and promote inclusivity for all
SDG10	10.4	Adopt policies to progressively achieve greater equality
SDG10	10.7	Facilitate safe migration through managed policies
SDG10	10.a	Implement the WTO's special rights provisions
SDG11	11.1	Ensure universal access to safe and affordable housing
SDG11	11.2	Provide access to safe and affordable transport systems
SDG11	11.4	Strengthen efforts to safeguard the world's natural heritage

Appendix (continued)

SDG	Target	Target Summary
SDG11	11.6	Reduce the negative environmental externalities of cities
SDG12	12.2	Sustainably manage and make efficient use of natural resources
SDG12	12.4	Manage chemical usage and waste throughout their life cycle
SDG12	12.5	Reduce waste through prevention, reduction, recycling and reuse
SDG12	12.6	Encourage companies to adopt sustainable practices and enhance ESG reporting
SDG13	13.1	Strengthen adaptive capacity to climate-related events
SDG13	13.2	Integrate climate change plans into policies and strategies
SDG13	13.a	Address climate change mitigation for developing countries
SDG14	14.1	Prevent and reduce marine pollution of all kinds
SDG15	15.1	Ensure sustainable usage of terrestrial freshwater ecosystems
SDG15	15.2	Promote the implementation of sustainable management of forests
SDG15	15.5	Take urgent action to reduce degradation of natural habitats
SDG15	15.8	Reduce impact of invasive species on land and water ecosystems
SDG16	16.5	Reduce corruption and bribery in all their forms
SDG16	16.b	Promote non-discrimination laws for sustainable development