



ESG Engagement in Public Markets

Our Priorities, Objectives & Processes

2019



British Columbia Investment Management Corporation

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ABOUT BCI

British Columbia Investment Management Corporation (BCI) provides investment management services to British Columbia's public sector. Our role is to generate investment returns that will help our institutional clients build a financially secure future. With our global outlook, we seek investment opportunities that will meet our clients' risk and return requirements over time. This compels us to integrate long-term environmental, social, and governance (ESG) matters into our investment decisions and activities. We offer investment options across a range of asset classes: fixed income; mortgage; public and private equity; real estate; infrastructure; and renewable resource.

Background

As a responsible steward of our clients' assets, BCI takes share ownership rights and responsibilities seriously. As a large institutional investor, it is our responsibility to interact with and, where appropriate, challenge companies and market participants on their policies and activities.

Ownership also gives an investor the right to raise concerns and encourage positive changes. Therefore, BCI believes

- the power of share ownership lies in engagement, rather than divestment;
- we act in our clients' best financial interests; and
- we believe that companies that employ robust ESG practices are better positioned to generate long-term value for investors.

It is our fiduciary obligation to act in our clients' best financial interests to generate investment returns. Therefore, BCI aims to manage the long-term risks and opportunities that ESG matters present, both now and into the future. These risks may include stricter regulation, lawsuits, loss of consumer trust

and sales, damage to reputation, negative impact on credit rating, higher operational costs or even, in some circumstances, the loss of an ability to operate.

The engagement activities of BCI's Public Markets department are designed to help protect and increase the long-term returns of the funds we manage on behalf of our clients by actively raising a company's awareness of the importance of managing long-term ESG risks.

We believe that, when a company enhances its governance and operational practices to effectively address ESG performance, its risk profile, reputation and long-term ability to compete is improved, contributing to reliable long-term returns for our clients. BCI's engagement program for equity holdings is very well developed; we are now engaging as a bond holder as well. Engaging as a bondholder requires us to consider which ESG factors have the

WHAT IS ENGAGEMENT?

Engagement is having **constructive conversations with the public companies we are invested in** on environmental, social and governance (ESG) issues. In these conversations, we encourage companies to be transparent about their ESG risks and to adopt good corporate governance and operational practices. **We engage because we believe it improves companies' long-term performance** and is part of our role and responsibilities as stewards of our client's assets.



Our engagement approach is built on constructive communication that focuses on exploring specific issues in-depth, with both companies and influential standard-setting organizations.

greatest potential to translate into credit risks, the timing of our engagements, and the consistency of our expectations across the two asset classes.

Through respectful and encouraging dialogue, we seek to:

- ensure that companies understand their ESG risks and manage them effectively
- improve overall corporate disclosure of ESG policies and performance
- encourage the adoption of good corporate governance and operational practices
- minimize portfolio investment risk and increase long-term returns for our clients

This document should be read in tandem with BCI's **Proxy Voting Guidelines** document which provides details on the ESG principles and practices on which we frequently vote.

The UK Stewardship Code, and others like it, guide the interaction between investors and investee companies, and seek to improve the quality of engagement between companies and investors. One of the more instructive documents addressing the responsibility of shareholders is The International Corporate Governance Network's (ICGN) *Global Stewardship Principles*. This is useful for BCI as a global investor as it is meant to apply in all markets.

Our Engagement Priorities

CLIMATE CHANGE AND WATER, HUMAN RIGHTS, GOVERNANCE

BCI manages investment risks, and pursues activities that are expected to have the greatest material impact on our portfolio. Bearing in mind the size of the public markets portfolio (we are invested in more than 3,500 public companies) and our limited resources, BCI chooses to be selective, specific and pragmatic. Therefore, we establish and focus our efforts on our stated priorities.

The choice of priorities for our engagement program is based on our assessment of the following:

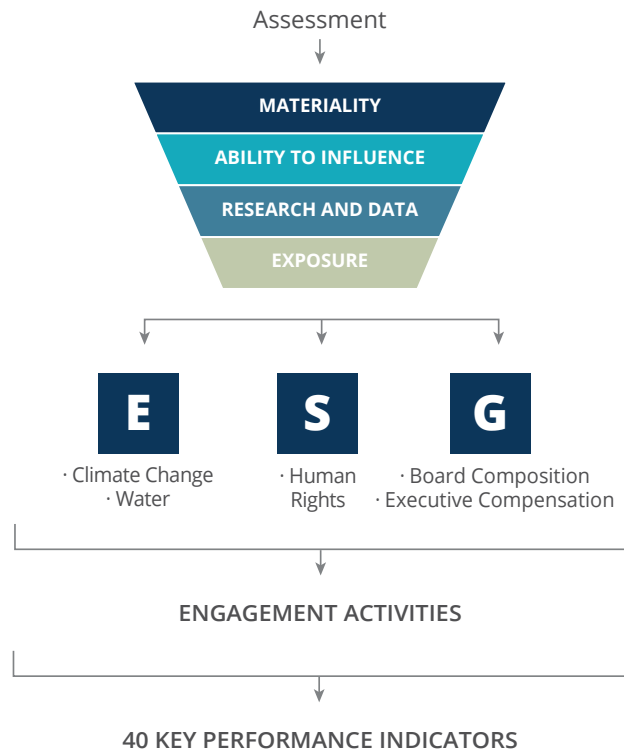
- **Materiality:** The companies BCI invests in face a variety of risks. We focus our efforts on ESG risks that are most significant or relevant to our investments and address those where we see the most positive outcome either in terms of mitigation or adding value.
- **Ability to Influence:** In order to maximize the effectiveness of engagement, we will tend to avoid allocating resources to addressing issues where there is little likelihood of success or where we are not able to have any influence. For example, while we do not support dual class share structures, there is little justification in engaging extensively on this issue due to the low likelihood that companies will voluntarily give up the control embedded in this structure. We will however explore opportunistic events to address these types of issues, such as including our views in comments to regulators or other standard setters. Our influence as a fixed income investor varies pre- or post-issuance, and whether the debt issue is public or private.
- **Research and Data:** BCI continually monitors expert sources of opinion, reviews academic research and gathers data to determine what emerging risks might be the most material

going forward.

- **Exposure:** We wish to engage on those issues that are most common or prevalent across our portfolio. This allows us to leverage research and have a wider impact. Therefore, we consider our country and sector level exposure when establishing our priorities.

Based on our criteria, we have chosen three areas that we consider to be long-term, widespread business challenges and therefore, a natural fit for an investor with an investment horizon that stretches forward many decades. These are: **climate change and water, human rights, and governance**. Other issues will be handled on a case-by-case basis as necessary to safeguard our clients' best financial interests. For example, we have recently engaged

OUR ENGAGEMENT PRIORITIES RESULT FROM THE ASSESSMENT PROCESS BELOW



companies on cyber security and data privacy.

We strive to be proactive with our engagement, though there may be times, usually when a major incident or news story comes to light, that we may reactively engage with affected companies.

While BCI maintains the operational responsibility for carrying out engagement activities, we consult our clients on material changes to our priorities and we remain accountable to them.

KEY PERFORMANCE INDICATORS

In addition to tracking progress and outcomes for specific engagements, BCI also tracks certain key performance indicators (KPIs) that evaluate our engagement program as a whole.

BCI collects and assesses data for more than 40 KPIs in seven categories. These indicators are closely aligned with our engagement priorities and the objectives outlined in the next section. We use multiple sources to create reliable datasets that, where possible, date back as far as 2011. The results illustrate the impact of our activities, and help us determine where we should focus our efforts going forward.

For example, we track the number of companies that respond to the CDP questionnaire and the average scores they receive. This helps us see how our activities are helping us achieve our objective to improve disclosure of climate-related information from public companies.

BCI KPI CATEGORIES



Climate Change Disclosure



Gender Diversity



Human Rights in Extractive Sectors



Executive Compensation in Canada



Sustainable Stock Exchanges



Board Independence in Japan



Water Related Disclosure

UNITED NATIONS SUSTAINABLE DEVELOPMENT GOALS

The United Nations Sustainable Development Goals (SDGs) are a collection of 17 global goals that cover a broad range of social and development issues including energy, sanitation, social justice and climate change. Together, the 17 SDGs and the 169 underlying targets represent a framework for sustainable development that has been agreed upon by all 193 UN member states; guiding the global community's sustainable development strategy from today until the year 2030.

The SDGs are becoming increasingly relevant to institutional investors who may use the framework to support their understanding of sustainability trends, to identify related risks and opportunities, and to measure their contribution to the SDGs. The UN Commission on Trade and Development estimates that US\$5-7 trillion in investment will be required to meet the SDGs by 2030. Since public sector resources are not sufficient, there is a growing expectation that companies and investors lend support.

BCI acknowledges the momentum around the SDGs as shown in the growing number of companies that include SDGs in their reporting, and the work of the Principles for Responsible Investment (PRI) in providing research and tools to investors for the SDGs. PRI intends to include questions about the SDGs in its annual reporting questionnaire for all its investor signatories.

BCI is early on the path to identifying our contribution to the achievement of the SDGs, but we recognize that there are certain areas where our engagement objectives and activities are aligned with the goals. These are indicated in this document.



Our Engagement Objectives



A. CLIMATE CHANGE AND WATER

Climate change is widely predicted to have large-scale economic impacts, both directly through flooding, drought and other extreme weather events, and indirectly through regulatory measures to limit greenhouse gas emissions and promote low carbon technologies.

Virtually every sector we invest in, (utilities, energy, insurance, tourism, property, transport, construction, retail and agriculture, for example) are likely to be affected. There is growing awareness that swift action is required to prevent staggering costs that will emerge in the face of inaction. In 2018, BCI adopted a *Climate Action Plan* which outlines our strategy for taking advantage of the opportunities and managing the risks of climate change on our investments. Engagement is a fundamental part of that strategy.

Most industries also face water risks, which can range from water quality and water quantity, to floods and/or droughts, particularly as the effects of climate change become more acute. In order to secure adequate water supplies, companies need to be sensitive to all water users by taking a regional perspective. This will avoid conflict with other users and provides operational reliability.

Given the predicted severity of climate change and the strategic importance of water, BCI will continue to focus efforts on this issue. Our objectives include:

- **Improve Disclosure:** In order to fully understand the risks, BCI requires disclosure. We are active members of both the CDP Climate Change and CDP Water programs and encourage companies to disclose using these frameworks in order to provide investors with comparable and relevant data on climate and water risks. We encourage company

disclosure that is aligned with the Task Force on Climate-related Financial Disclosures (TCFD).

- **Increase Efficiency:** Encouraging investment in research and development and emerging technologies to reduce carbon emissions while increasing efficiency to ensure the company's long-term competitive success.
- **Encourage goals and targets:** Efficient operators tend to be better operators so we encourage companies to use energy and water efficiently. Ideally, this is done by setting goals or targets with sound implementation plans.
- **Address regulatory risk:** Encouraging companies to prepare for increased regulatory scrutiny, including greenhouse gas regulation and stricter water permitting procedures.
- **Encourage stakeholder engagement:** Misusing water resources can have a direct impact on others, so we seek to understand how companies interact with local stakeholders to ensure water management plans are consistent with local needs and priorities.



Our KPIs related to this objective include:



CDP and CDP response rates; the average scores for those responses; the number of companies adopting targets for emissions reduction and water usage; companies using and internal price on carbon, implementing a water policy, and asking for related reporting from their suppliers .

CDP, formerly the Carbon Disclosure Project is a not-for-profit organization that maintains a comprehensive database of self-reported environmental data from companies all over the world.



B. HUMAN RIGHTS

Through the ratification of international human rights treaties, countries have committed to uphold their human rights obligations. However, the responsibility of corporations in the human rights sphere has been widely debated as the roles between government and private corporations have become more blurred over the years.

In the past few decades, globalization has allowed new opportunities for business in many areas of the world. Companies that pursue international growth and economic opportunities face the challenge of operating in various legal, political and social contexts. These challenges are particularly complex when companies operate in countries with weak regulatory environments, especially when the government is also a client or business partner of the company.

The overarching goal of our engagement on human rights is to urge companies to effectively address human rights risks associated with their activities and operations. We focus our efforts on high impact industries that are often most directly exposed, but also engage companies with significant risk in their supply chain. Through these efforts, BCI aims to:

- **Address risk:** It is important that we are able to determine that the company has a sound understanding of the various risks involved in its operations and manages those accordingly based on international best practice.
- **Assess policies and procedures:** Ensuring the company has established relevant policies and procedures required for managing the unique challenges of operating in high-risk areas, such as: poor employee safety culture, uncertain local rule of law, reputational risks and accusations of human rights violations.
- **Promote international standards:** We encourage companies to make an explicit commitment to respect human rights through

adoption of a human rights policy or endorsement of widely-accepted standards, such as the *UN Global Compact*, the *Voluntary Principles on Security and Human Rights*, or conventions of the International Labour Organization. We also encourage the adoption of the **UN Guiding Principles on Business and Human Rights**, which has become the authoritative standard for addressing adverse human rights impacts.



KPIs: We track companies' performance against Toward Sustainable Mining (TSM) indicators, assessments of human rights policies, community engagement practices and grievance mechanisms.

Towards Sustainable Mining (TSM) is the Mining Association of Canada's (MAC) commitment to responsible mining. It is a set of tools and indicators to drive performance and ensure that key mining risks are managed responsibly at our members' facilities. Adhering to the principles of TSM, our members demonstrate leadership by:

- Engaging with communities
- Driving world-leading environmental practices
- Committing to the safety and health of employees and surrounding communities

Source: mining.ca/towards-sustainable-mining



C. GOVERNANCE: BOARD COMPOSITION, & EXECUTIVE COMPENSATION

BCI believes good corporate governance is essential for effective company management. A company's board of directors is crucial because directors are responsible for long-term strategy and for ensuring the company has systems in place to effectively assess and manage risk, including environmental and social risks. Therefore, constructing a board with a diverse mix of skills, backgrounds and experience is critical to achieving this, and BCI sees board composition as the most important element of our engagement activities. We have high expectations and standards for board directors. We expect directors to oversee management, be aware of all risks, and to protect the interests of shareholders, and when we believe such oversight has been lacking, we hold directors accountable through our voting. We encourage boards to adopt and implement policies and practices that appropriately address corporate responsibility matters that are relevant to their business.

Due in part to our efforts on the board election process in Canada, investors now have annual elections for directors, the disclosure of detailed vote results, and the adoption of majority voting policies. Such progress on the elections process now allows us to devote more time to assessing directors individually and examining the make-up of the board to assess if the right mix of skills, experience, independence and diversity exists.

Next to the election of directors, BCI spends the most time analyzing executive compensation programs. These programs must be aligned with the strategic priorities of the company and ensure that a pay for performance link exists. In many markets, companies must give investors an opportunity to support or not support the overall compensation design (say on pay). This is a positive communication vehicle for investors and we strive to offer companies feedback when we choose not to support their compensation program.

With respect to governance, BCI's engagement objectives include:

- **Encouraging board refreshment:** A balance of both experienced board directors and newer directors that will offer fresh insights
- **Improving diversity:** Increasing levels of diversity on boards to bring forward different perspectives and opinions
- **Aligning pay with performance:** Seek to align the interests of management with the interests of shareholders through compensation arrangements that are linked to the achievement of long-term company success and do not incentivize excessive risk-taking. Executive compensation should be clearly disclosed, reasonable, have a strong link to long-term shareholder value, and minimizes potential "pay for failure" components. We also work to encourage adoption of say on pay where it is not mandated.

Organizations such as the Asian Corporate Governance Association (ACGA), the International Corporate Governance Network (ICGN), and the Council of Institutional Investors (CII) also play a key role as respected advocates for governance reform, and therefore, our participation in these networks is an efficient use of resources.



KPIs: We measure the impact of our governance related engagements by tracking progress made in female representation on corporate boards, director independence levels in Japan, and the number of companies in Canada that have voluntarily adopted an advisory vote on executive compensation ("Say on Pay").

Our Engagement Process

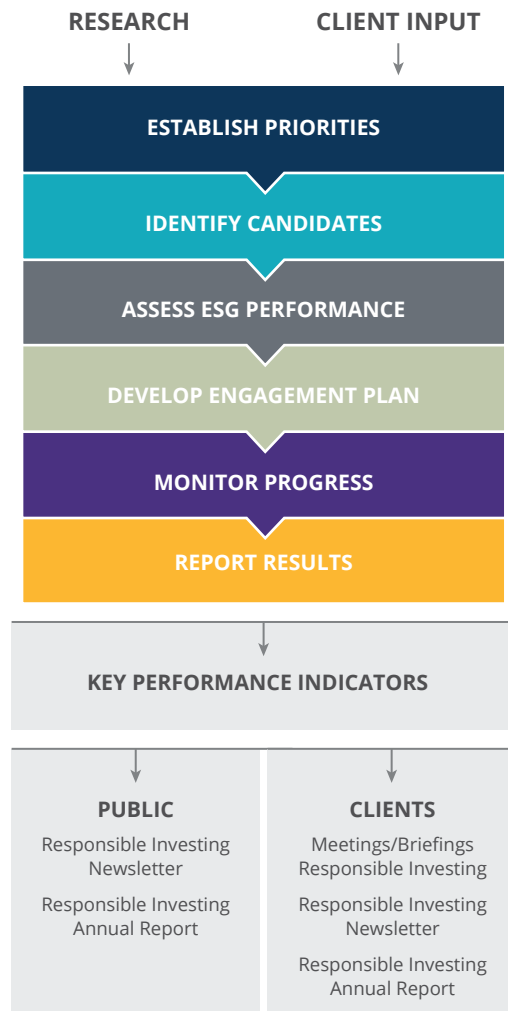
With these broad priorities and objectives established, BCI takes a systematic approach to deciding which companies we seek to engage with and what changes we wish to achieve. While the framework below has been established, BCI also continually evaluates further engagement opportunities based on timely news events, possibilities to join our peers, or sectoral risks that may come to light but were not anticipated. Structure and accountability are important, but we also must be flexible enough to capitalize on event-driven opportunities.

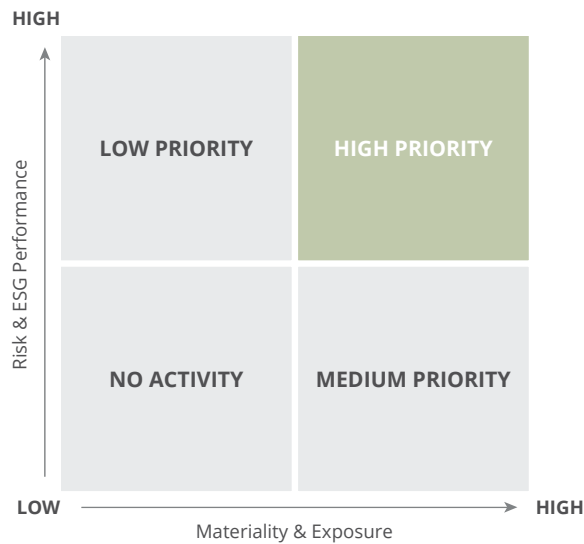
A. ANNUAL PORTFOLIO ASSESSMENT

Our first step is to consider our portfolio. BCI invests in thousands of publicly-traded companies and it would simply not be feasible or effective to try to engage each company. Therefore, it is important that we understand which companies we are most exposed to from a market value perspective. This exposure is determined by annually assessing our largest holdings to identify potential candidates for engagement.

B. ESG PERFORMANCE ASSESSMENT OF LARGEST HOLDINGS

Using a variety of external data sources, BCI formulates a high level ESG performance assessment of our largest holdings (by market value) in order to rank companies and issues. Our engagement efforts will be most constructive when they are focused on those companies presenting significant ESG risks. This research effort allows us to narrow our engagement list down to a reasonable level that is appropriate for the resources we have available.





This process of prioritization is illustrated by the Figure above. Companies that BCI's clients are heavily exposed to and create elevated ESG risk are those that will receive the highest priority for engagement. Conversely, those with less financial exposure and lower ESG risk will receive low priority. The end result is a list of companies that we believe are the highest priorities for engagement, based on their ESG risks, our assessment of their current ESG performance, and our financial exposure.

C. ENGAGEMENT PLANNING AND MONITORING

With a focused list of companies to engage, it is useful to set some broad engagement objectives which can then be measured after a reasonable time period to assess the effectiveness of our efforts. Once an engagement has begun, it may continue for several years, but BCI actively monitors progress.

Depending on our specific objectives, the nature of the risk, and materiality of the issue, we will plan an engagement approach that is the most appropriate. BCI engages on ESG risks in four primary ways:

1. Voting in an informed manner at the shareholder meetings of the thousands of companies within our investment portfolios.

2. Corresponding and directly meeting with company management and board directors.
3. Exchanging information, pooling resources and collaborating with like-minded investors. BCI is a member of the Asian Corporate Governance Association (ACGA), the International Corporate Governance Network (ICGN), the Pension Investment Association of Canada (PIAC), and Council of Institutional Investors (CII), and is a signatory to the CDP and the Principles for Responsible Investment (PRI). We also support the Task Force for Climate Related Financial Disclosures (TCFD) and have signed the ESG in Credit Ratings Statement.
4. Engaging with government, policy makers, regulatory and standard-setting bodies, and industry associations.

There may also be times when BCI will explore filing or co-filing a shareholder proposal, although this tool will be used sparingly and in situations when other methods of engagement have not been effective. The right to file a shareholder proposal or to vote at the annual meeting is not available to us as bondholders.

D. REPORTING

BCI is committed to being transparent and has a number of ways to report back to clients, as well as the public. Our reporting initiatives include annually publishing three Responsible Investing Newsletters and a Responsible Investing Annual Report. We also disclose our proxy voting decisions and rationale for when we vote against a proxy, ahead of a publicly-traded company's annual general meeting. The searchable database, available on our website, also provides an account of our voting history. Our engagement KPIs have been included in our RI Annual report and are provided to clients on an annual basis.

As a PRI signatory, BCI participates in the annual PRI survey that assesses our responsible investing practices across our asset classes in line with the six principles.

Summary

BCI is confident that our engagement approach is effective and appropriate to mitigate ESG risk in our clients' portfolios. We approach engagement in a constructive way and make the most of the resources at our disposal.

BCI strives to be transparent in our approach and results relating to our engagement activities. More information is available on our website at **BCI.ca**.





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