

Pensions Committee

19 June 2019

Report title	Responsible Investment Activities	
Originating service	Pension Services	
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Recommendations for decision:

The Committee is recommended to approve:

1. The Fund's updated Responsible Investment Framework
2. The Fund's updated Voting Principles (UK)
3. The Fund's updated statement of Compliance with the UK Stewardship Code for Institutional Investors

Recommendations for noting:

The Committee is asked to note:

1. The Fund's voting and LAPFF's engagement activity for the three months ending 31 December 2018, including Appendix D.
2. The issues discussed in the LGPS Central Quarterly Stewardship Report which is available on the LGPS Central website:
<https://www.lgpscentral.co.uk/responsibleinvestment/>
3. The issues discussed by LAPFF are set in the Quarterly Engagement Report which is available on the LAPFF website:
<http://www.lapfforum.org/publications/qrtly-engagement-reports/>

1.0 Purpose

- 1.1 To update the Pensions Committee on the work undertaken in relation to responsible investment activities since the last Pensions Committee meeting.

2.0 Background

- 2.1 The Fund has a longstanding policy of supporting good corporate governance in the companies in which it invests. The Fund will also challenge companies who do not meet either the standards set by their peers or reasonable expectations as measured by best practice. The Fund's approach is part of its overall investment management arrangements and its active responsible investment framework. There are three main pillars to the framework: **selection** (of assets), **stewardship** (of assets), and **transparency & disclosure**.

3.0 Responsible Investment Framework and Statements

- 3.1 The Committee regularly reviews (in some cases annually) and approves the various framework and policy documents to ensure any necessary changes e.g. regulatory and changes in approach are incorporated. On this occasion, all three documents include minor amendments and a refresh of commentary rather than any fundamental changes. The documents for consideration and approval at this Committee comprise:

- Responsible Investment Framework
- Voting Principles
- Stewardship Code

- 3.2 Responsible Investment (RI) Framework: - The Responsible Investment Framework has seen a number of updates since last being approved by this Committee on 17 March 2018. This includes aligning the Fund's investment beliefs with the Investment Strategy Statement that was approved by Committee on 27 March 2019:

- Effective management of financially material ESG risks including climate change risks should support the Fund's requirement to protect returns over the long term.
- Investee companies with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events.
- There are some investment opportunities arising from environmental and social challenges which can be captured so long as they are aligned with the Fund's investment objectives and strategy.
- Responsible investment should be integrated into the investment process.
- The Fund will manage responsible investment factors through engagement rather than exclusions.

In addition, reference to the Fund's Climate Risk Strategy and Framework approved on 27 March 2019 enhancing earlier commentary on the Fund's approach to climate change. The references to LGPS Central Ltd have also been amended to reflect the fact that the company is now operational and that it has already developed a leading

approach to Responsible Investment and supporting Partner Funds including WMPF in the implementation of Fund RI policy both through fund management arrangements and under advisory agreements with the Fund. The Fund's top engagement themes for 2019/20, based on financial significance and resonance with broader Fund stakeholders, have also been incorporated as set out below:

- Climate Change – ongoing consideration of potential risks as the pace of policy and evidence for rapid reaction continues to grow
- Single-use plastics – how companies are responding to pollution risks and preparing for the policy and customer changes which could significantly impact their business model
- Technology and disruptive industries risk – considering the potential social, governance and environment costs of new technology, changing consumer behaviour and mis-use, with the potential for global technology stocks (and the wider markets they drive to suffer material set-backs
- Tax transparency and fair tax payment – increasing transparency, tax practices and the impact of aggressive tax strategies on long-term shareholder value

The Committee are asked to approve the Responsible Investment Framework 2019, included at appendix A, following consideration of its contents.

- 3.3 Voting Principles: - The voting principles have been updated to reflect the inclusion of WMITA PF within the voting principles. The Voting Principles apply to all assets where the West Midlands as asset owner has voting rights and where voting rights are executed by external managers on behalf of the Fund, the Fund has reviewed and is satisfied with the voting policies of those managers. The principles have been further updated to incorporate the inclusion of LGPS Central Ltd who are now the key external provider of investment management services for WMPF. The Committee are asked to approve the updated Voting Principles 2019, included at appendix B.
- 3.4 Stewardship Code: - Both WMPF and WMITA PF fully support the UK Stewardship Code as part of best practice in being good stewards of capital and responsible asset owners. The background to the Code and its principles can be found on the Financial Reporting Council (FRC) website: <https://www.frc.org.uk/investors/uk-stewardship-code>. The main changes to the Fund's Stewardship Code adherence statement reflect the incorporation of LGPS Central Ltd since going live in April 2018, reflecting the fact that a considerable amount of the Fund's assets are now managed directly through LGPS Central Ltd sub-funds. It should be noted that the company has also signed up to the Stewardship Code and fully supports the 7 principles of the Code. Changes in the Fund's officer structure have been incorporated as the Fund no longer has a dedicated RI Officer, instead the implementation of the Code will sit with the Head of Investments and be supported by LGPS Central Ltd, with oversight by the Director of Pensions and Assistant Director, Investments and Finance. Reference to the Fund's engagement and voting provider is also included but no longer specifically names the provider. The FRC have further undertaken a consultation exercise to help frame a new Stewardship Code, expected to be published in the summer of 2019. Any changes to the Code itself, will be reviewed and a further updated compliance statement provided to reflect changes required at a

future Committee meeting. The Committee are asked to approve the updated compliance statement with the UK Stewardship Code for Institutional Investors 2019, included at appendix C.

4.0 Responsible Investment Activities

Engagement through Partnerships

- 4.1 The Fund's strategy is to engage with its investee companies and other key stakeholders through partnerships and on its own. The Fund aims to protect and increase shareholder value by engaging on a range of financially material ESG investment factors. A significant part of the Fund's engagement programme is implemented through partnerships including the Principles for Responsible Investment (PRI), the Local Authority Pension Fund Forum (LAPFF), Hermes EOS (via a contract held by LGPS Central, the Fund's asset pool), Institutional Investors Group on Climate Change (IIGCC) and the UK Pension Fund Roundtable.
- 4.2 Through LAPFF, the Fund engaged with 104 companies during the quarter. Most engagements concerned the use of plastics, and climate change. Five engagements led to a small improvement. Most engagements were conducted by writing letters to the company concerned. A summary of LAPFF's engagement activities for the quarter are provided alongside the voting activity report in Appendix D. The issues are set out in the Quarterly Engagement Report which is available on LAPFF's website:
<http://www.lapfforum.org/publications/qrtly-engagement-reports/>
- 4.3 Through Hermes EOS, the Fund engaged 350 portfolio companies during the quarter, covering 777 environmental, social and corporate governance issues. Hermes EOS' activities support delivery against the Fund's stewardship themes, which are currently climate change, cyber security and diversity. Further details of Hermes EOS' engagement activity is found in the background paper as provided within this report.
- 4.4 The Fund's stewardship themes for 2018/19 were climate change, cyber security and diversity. These themes have been selected because they have both financial relevance and resonance with the Fund's stakeholders. The Fund is, primarily through partnerships, engaging with companies, fund managers and other relevant organisations, and using its voting rights to drive change and signal the importance of these issues to institutional investors. Progress on each theme is reported to the Pensions Committee on a quarterly basis.

Climate Change

- 4.5 The Fund has continued its proactive programme of climate change stewardship, primarily by leveraging its strategic partnerships including LAPFF, LGPS Central, Hermes EOS, the Transition Pathway Initiative, the Climate Action 100+ Initiative, and the Institutional Investor Group on Climate Change.

- 4.6 Engagement has taken place through Climate Action 100+ with Chevron Corporation with an initiative seeking “that Chevron issue a report... on how it can reduce its carbon footprint in alignment with greenhouse gas reductions necessary to achieve the Paris Agreement’s goal of maintaining global warming well below 2 degrees Celsius.”
- 4.7 Engagement has also taken place with Exxon Mobil, through Climate Action 100+ calling on Exxon Mobil to publicly disclose its lobbying activities. While ExxonMobil publicly supports the Paris agreement, and has donated to campaigns to introduce a carbon tax, it also supports trade associations and lobbying groups whose climate policies conflict with Exxon Mobil’s, and whose activities undermine progressive regulatory efforts to correct market failures including GHG emissions. Disclosure (and action) on lobbying activities is one of the aims of the Climate Action 100+ initiative, of which WMPF and LGPS Central Ltd are members. We have achieved significant successes on lobbying (for example, at Royal Dutch Shell, Rio Tinto, and other UKlisted extractive companies), and are calling on Exxon Mobil to rise to the same standard.
- 4.8 On the Fund’s behalf LGPS Central Ltd has engaged Rio Tinto as part of the Climate Action 100+ initiative, meeting the Chair, CEO, and other executives. The company has been very responsive to engagement, and has taken a number of steps to position the business to benefit from a transition to a lower carbon economy. This includes the sale of the thermal coal businesses, target-setting for scopes 1 and 2 GHG emissions, transparency over lobbying activities, and moving the management of climate risk from the Environmental and Legacy Management Team to the Strategy Team.
- 4.9 The Transition Pathway Initiative (TPI) is one of the Fund’s strategic partners for engaging companies on climate risk management. Headed by a steering group of asset owners, TPI is powered by climate change experts at the London School of Economics, and the data provider FTSERussell.

Cyber Security

- 4.10 As noted at the previous Committee meeting the PRI-led group engagement on cyber security and data protection has found a number of respondents to be reluctant to divulge information to shareholders and particularly in the public domain. US companies in particular were reluctant to grant the group access to board members to discuss cyber security. However, the Fund will continue to engage through external partners on these issues to provide assurance that the board has accountability for cyber risks, a clear line of sight as to the systems for managing this risk, and that there is due regard for cyber expertise and experience within the directors put forward for (re-)election to the board.

Diversity

- 4.11 The Fund continues to engage through its partnerships on the issues around diversity and specifically targeting companies with low levels of diversity on company Boards and pressing them to produce action plans setting out how they are responding to the challenge of increasing diversity and reporting on pay gaps across their workforce.

- 4.12 The Committee were appraised at the last meeting of an engagement with Millennium & Copthorne through the 30% Club, following which the company announced the appointment of a female to the Board as a non-executive director.

Voting Globally

- 4.13 The Fund's voting policies are currently executed by Hermes EOS via a contract held by LGPS Central, the Fund's asset pool. The Fund has contributed to and endorses LGPS Central's Voting Principles.
- 4.14 The voting activity for the quarter across markets and issues can be found in Appendix D. During the period, the Fund voted at a total of 390 company meetings – 49 UK, 69 European, 45 North American, 187 Developed Asia, 1 Australasian and 39 in Emerging and Frontier Markets. During this period there were 199 meetings where the Fund supported all the resolutions put forward by companies. Approximately 10% of the resolutions were not supported by the Fund. The largest number of resolutions that were opposed concerned the re-election of directors (usually voting against non-independent non-executive directors where the Fund or its advisors do not see sufficient independent oversight on a company board) and remuneration.

Framework and Strategy for Managing the risks and opportunities presented by climate change

- 4.15 The Committee will recall that at its meeting on 12 December 2018, a set of beliefs about climate change, and its relevance for the Fund, were discussed, noted and endorsed. These have been taken as the basis for developing a framework that sets out the Fund's approach to managing the risks and opportunities presented by climate change. The Committee approved on 27 March 2019 at its meeting the Fund's *Framework and strategy for managing the risks and opportunities presented by climate change*, which describes the Fund's proposed plan to address climate change over the coming four-year period (2019-2023). The Framework and strategy were based on five principles:
- **Integration:** connecting to and supporting the Fund's Investment Strategy Statement and Risk Register
 - **Informed:** that the best available evidence is used to inform the framework and strategy, which support the Fund's fiduciary duty to pay pensions
 - **High Ambition:** the Fund recognises its status as a large UK asset owner and seeks to establish a leadership position in matters of climate change management
 - **Actionable:** the framework and strategy are drafted in terms that describe clear actions such that progress can be observed and reviewed
 - **Holistic:** recognition that the scope of the pension fund's climate risk is broader than just its investment function, and far broader than just its investment in fossil fuel producers.

- 4.16 To assist with delivering on the framework and strategy, the Fund will utilise a series of selected partners who we believe provide the best available resourcing for our “Strategic Actions”. Consistent with the Fund’s belief that collaboration is vital for the mitigation of climate-related risks, we will collaborate with our Partner Funds and with LGPS Central Limited in the delivery against the framework and strategy.
- 4.17 The Fund has received correspondence from scheme members and from non-scheme member stakeholders regarding climate change as a financial issue, and as an ethical issue. The Fund is fully aware of the regulations and statutory guidance relating to matters of responsible investment, and Committee members receive regular training on this subject. The draft framework has been shared with employers who have engaged with the Fund on this issue.

Correspondence

- 4.18 During February 2019, the Fund received correspondence from Unison seeking support of Pension Funds globally on increasing transparency on tax payments on the basis that greater transparency will enable better investment decisions and protect long-term returns. Hermes EOS on behalf of the Fund and LGPS Central Ltd engages on tax transparency via its theme of *Conduct, Culture and Ethics* stating: “We support industry initiatives that, for example, press governments to amend tax regulations to restrict opportunities to shift profits offshore and to increase country-by-country reporting”. As noted above the Fund has adopted tax transparency and fair tax payments as one of its key themes for 2019/20 and Members will be kept updated of progress on this theme throughout the year.
- 4.19 As previously advised, the Committee has received correspondence in relation to the Fund’s investment in a Coventry-based company, Lockheed Martin and its involvement in the arms trade in Yemen. The Fund has reached out to LAPFF to consider direct engagement with the Company to better understand its approach and relationship with Leidos. LAPFF has written to the company to begin an engagement dialogue but had not received a response at the time of writing. The Committee will be updated as this dialogue progresses.

5.0 Financial implications

- 5.1 The promotion of good corporate governance amongst companies in which the Fund invests is complementary to the Fund’s objective of maximising financial returns, as it is widely believed that good corporate governance improves shareholder value in the long term.

6.0 Legal implications

- 6.1 This report contains no direct legal implications.

7.0 Equalities implications

7.1 This report contains no equal opportunities implications.

8.0 Environmental implications

8.1 Environmental implications are addressed through the Fund's Responsible Investment Framework.

9.0 Human resources implications

9.1 This report contains no direct human resources implications.

10.0 Corporate landlord implications

10.1 This report contains no direct corporate landlord implications.

11.0 Schedule of background papers

11.1 LGPS Central Quarterly Stewardship Report:
<https://www.lgpscentral.co.uk/responsibleinvestment/>

11.2 LAPFF Quarterly Engagement Report:
<http://www.lapfforum.org/publications/qrtly-engagement-reports/>

11.3 Hermes EOS Engagement Report, Q1, 2019:
<https://www.hermes-investment.com/ukw/wp-content/uploads/2019/04/public-engagement-report-q1-2019.pdf>

12.0 Schedule of Appendices

12.1 Appendix A: WMPF Responsible Investment Framework 2019

12.2 Appendix B: WMPF Voting Principles 2019

12.3 Appendix C: WMPF Compliance with the UK Stewardship Code for Institutional Investors 2019

12.4 Appendix D: (WMPF Voting and Engagement Activity)