



COMPLIANCE WITH THE UK STEWARDSHIP CODE FOR INSTITUTIONAL INVESTORS JUNE 2019



West Midlands Pension Fund

INTRODUCTION

The West Midlands Pension Fund and West Midlands Integrated Transport Authority Pension Fund (together: 'the Fund') fully support the UK Stewardship Code ('the Code') and as part of their commitment to best practice seek to apply the principles in the Code to their investment activities.

The Code applies to both asset managers and asset owners. The Fund's adherence to and implementation of the Code is appropriate to the operating context of the Fund and the Fund's position within the investment chain. The West Midlands Pension Fund is one of the UK's largest pension funds, managing and administering the pension interests of our members and scheme employers. The Fund holds and manages a diversified portfolio of assets amounting to £16 billion (as at March 2019), targeting reliable growth over the long term, to deliver pensions for members in retirement.

Since April 2018, the Fund has undertaken stewardship activity both directly and through the LGPS Central investment pool. The Fund has transitioned a portion of its assets into pooled funds managed by LGPS Central Limited and now accesses proxy voting and engagement services through the company. The Company also complies with the Code and fully supports each of the seven principles.

This compliance statement is reviewed at least annually.

STEWARDSHIP OF THE FUND

The Fund defines the concept of stewardship in the same way as the Financial Reporting Council (FRC):

"Stewardship aims to promote the long-term success of companies in such a way that the ultimate providers of capital also prosper. For investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings."¹

In this compliance statement, the term 'responsible investment' (RI) refers to the Fund's programme of integrating financially material 'environmental, social and governance' (ESG) factors into the Fund's investment processes. 'ESG factors' may be referred to as 'responsible investment factors' throughout this document.

¹ <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.pdf> accessed June 2019

THE FUND'S POSITION ON IMPLEMENTING THE PRINCIPLES

Principle 1 – Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

The Fund fully follows this principle.

1.1 Overview

The Fund's approach to stewardship is set out in its *Responsible Investment Framework*, *Investment Strategy Statement* and *Voting Policies* which are available on the Fund's website². The Fund's approach to stewardship is tailored according to its role in the investment chain. Selected details of the Fund's approach to stewardship are provided below. This is expanded in greater detail in subsequent sections as appropriate to each of the seven principles of the UK Stewardship Code.

1.2 In Detail

1.2.1 Beliefs Underpinning the Fund's Approach to Stewardship

The Fund believes that effective management of financially material responsible investment risks should support the Fund's requirement to protect returns over the long term. With regard to climate change risks, the Fund recognises that the scale of the potential impacts is such that a proactive and precautionary approach is needed in order to address them. The Fund considers RI to be relevant to the performance of the entire Fund across asset classes.

Investee companies with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events. There is risk but also opportunity in holding companies that have weak governance of financially material ESG issues. Thus, the Fund prefers to adopt a policy of risk monitoring and engagement in order to positively influence company behaviour and enhance shareholder value, influence that would be lost through a divestment approach.

The Fund extends this principle of 'engagement for positive change' to the due diligence, appointment and monitoring of external fund managers who are at an early stage of developing its RI approach. The Fund believes that it will improve its effectiveness by acting collectively with other like-minded investors because it increases the likelihood that it will be heard by the company, fund manager or other relevant stakeholder compared with acting alone.

² For example, UK and Japanese Stewardship Codes

1.2.2 The Fund's Stewardship Objectives

The Fund aims to:

- 1 Be aware of and monitor financially material responsible investment issues in the context of investment and manager selection. Depending on the asset class and nature of the proposed mandate or vehicle, the Fund will monitor:
 - ESG issues in relation to internally managed investments (for example, equities, direct property);
 - the extent to which the external managers incorporate ESG issues into their investment processes; and
 - hold external managers to account for improvement in their ESG performance over a reasonable timeframe.
- 2 Make full use of its ownership rights, including voting and engagement activities. Either directly, collaboratively or through specialist service providers:
 - hold constructive dialogue with listed companies;
 - encourage the disclosure by companies of ESG issues; and
 - participate in the development of public policy on ESG issues.

1.2.3 Roles and Responsibilities for Stewardship at the Fund

Roles and responsibilities with respect to the discharge of stewardship activities are set out in the Fund's Responsible Investment Framework:

The Pensions Committee is at all times responsible for the Fund's investments, including oversight of the RI strategy and collaboration with other investors. Responsibility for oversight of the Fund's RI framework sits with the Director of Pensions and Assistant Director (Investments and Finance). Responsibility for the implementation of this framework sits with the Head of Investment. Implementation is supported by LGPS Central.

1.2.4 Approach to Implementing and Monitoring Stewardship at External Managers

All new Investment Management Agreements (IMAs) include requirements to adhere to the UK's Stewardship Code, where applicable.

The Fund, supported by LGPS Central, undertakes annual reviews of the ESG approaches and practices of its external equity fund managers, including the extent of the manager's active stewardship of its investees. External equity fund managers are expected to demonstrate improving levels of the integration of ESG risks into investment decision making over time. Whilst equities – the Fund's largest single exposure by asset class – represents a natural focus point for managing ESG integration within external fund managers, the Fund endeavors to monitor the stewardship of external managers across all asset classes.

Pre-Appointment

The Fund collects the following information from each manager before they are appointed where applicable to the asset class:

- Copy of their ESG, active ownership policies or equivalent which articulates how ESG factors (stemming from research, active ownership activities or other sources) are integrated into their investment process.
- Case studies or examples of where ESG issues have influenced an investment decision.
- Information on the process for integrating any third party ESG data (for example, MSCI) into their company financial models, investment strategies and portfolio construction.
- RI reporting format.
- Whether they are a signatory of the UN-backed Principles for Responsible Investment (PRI) and Stewardship Code, copy of their PRI public report and annual assessment scores if applicable.

Post-Appointment

The Fund assesses the ESG capability of a fund manager as a factor within each of the people, process and performance categories. In its decision to appoint a fund manager, the Fund takes a balanced consideration of all relevant factors including ESG. However, the Fund will pay particular attention to adherence to relevant soft regulatory codes depending on the market in which it invests. In practice, this means the Fund is willing to hire a fund manager at an early stage of developing its RI approach so long as there is a demonstrable RI commitment and a willingness to improve in their approach over time. In alignment with our guiding principles on 'engagement versus exclusion', the Fund believes that there is added value in working with them to improve their approach.

Monitoring and Reporting

Each external fund manager is expected to report at agreed intervals to the Fund on how their RI activities are contributing to improved long-term risk-adjusted returns. Examples of information that can be provided in aid of this objective include but are not limited to the following:

- The evolution of how the manager integrates the consideration of ESG issues into its investment and active ownership activities.
- How investment and active ownership functions are combined to protect and/or enhance shareholder value.
- How the manager exercised the Fund's voting rights.
- Any outcomes arising from the manager's engagement with companies and their effectiveness.

Principle 2 – Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

The Fund fully follows this principle.

2.1 Overview

Declaration of conflict of interests is a standing agenda item at the start of all Pensions Committee meetings.

2.2 In Detail

2.2.1 Internally Managed Funds

The Fund has a conflicts of interests policy aligned with the expectations of the Financial Conduct Authority (FCA).

The FCA Handbook SYSC 10.1.3R states that a firm must take all reasonable steps to identify conflicts of interest between:

- a) the firm, including its managers, employees and appointed representatives (or where applicable, tied agents), or any person directly or indirectly linked to them by control, and a client of the firm; or
- b) one client of the firm and another client; that arise or may arise in the course of the firm providing any regulated activity or ancillary service.

The nature of the services provided by the authority may give rise to potential or actual conflicts of interests. We have put in place procedures to identify and manage potential and actual conflicts to ensure these do not adversely affect the interest of our customers and the Fund and that our actions are not influenced by interest which favour the authority, its employees or another party.

Conflicts of interests should be avoided, documented, managed and disclosed if they cannot be avoided.

Staff are provided with the Compliance Manual which sets out the types of conflicts that arise or may arise in their roles in addition to support from Compliance where there is any doubt whether there is a potential or actual conflict. All conflicts are recorded and stored by Compliance. Training is provided to all new employees and refresher training is compulsory on an annual basis.

2.2.2 Externally Managed Funds

The need to avoid conflicts of interest is also highlighted in the Fund's IMAs and contracts with external parties. Conflict of interest management forms part of the Fund's due diligence process before and after the appointment of external fund managers. The Fund obtains assurances that any potential conflicts are adequately managed, and this assurance is obtained on an annual basis following the appointment of an external manager.

Principle 3 – Institutional investors should monitor their investor companies.

The Fund fully follows this principle.

3.1 Overview

The Fund's arrangements are set out in its Responsible Investment Framework and its website³. Relevant information from the Responsible Investment Framework is presented below.

For equity holdings, the Fund uses the Local Authority Pension Fund Forum (LAPFF) as its primary engagement partner. The Fund is also supported by LGPS Central's engagement partner, Hermes EOS. Where an engagement platform is not available, the Fund will engage with its investees directly, or in collaboration with the PRI or other groups of like-minded investors. The Fund does not typically seek to become an insider in any of its quoted equity investments.

The Fund and LGPS Central hold external fund managers to account for their engagement approach as part of routine monitoring activities.

3.2 In Detail

3.2.1 Compliance with the UK Corporate Governance Code

The Fund expects UK companies to adhere to the UK Corporate Governance Code on a comply or explain basis. Further, the Fund has bespoke UK corporate governance guidelines which are available on its website, which aim to deal with issues that are either not covered by the Code, require greater emphasis or are specifically left open for shareholders to resolve with company boards. The Fund expects companies outside the UK to adhere to international voting principles, recognising local application and development.

3.2.2 Understanding and Disclosure of ESG Risks

The Fund expects companies to manage and disclose its environmental and social risks to the extent required for an understanding of the development, position and performance of the company. In alignment with the Association of British Insurers' position, there are aspects of environmental and social reporting on which the Fund places particular value given their relevance across all sectors, its holistic approach to risk management, and the view that owners should not micro-manage companies.

This is narrative reporting which:

- sets ESG risks in the context of the whole range of risks and opportunities facing the company;
- contains a forward-looking perspective; and
- describes the actions of the board in mitigating these risks.

³ <http://www.wmpfonline.com/article/5708/Engagement-Through-Partnerships>

In terms of the specific environmental and social issues to focus upon, the Fund prefers to take a case-by-case, sector-based approach. Our approach on climate change risk is detailed below.

The Fund aims to engage in purposeful stewardship.

Working with our partners, we will develop an Annual Climate Stewardship Plan. This will set clear goals of engagement with companies, fund managers, policy-makers, and other organisations of influence. We will use stewardship techniques to manage the risks and opportunities within our investment portfolio, focusing on the risks and opportunities of greatest magnitude.

Our monitoring and stewardship of climate-related risks and opportunities will extend to our funding risk and employer covenant monitoring.

We will collaborate with like-minded investors where possible and we will be active participants in selected collaborative initiatives where supportive of our stewardship aims.

We will make full use of our voting rights and will co-file or support climate-related shareholder resolutions.

Principle 4 – Institutional investors should establish clear guidelines as to when and how they will escalate their activities as a method of protecting and enhancing shareholder value.

The Fund fully follows this principle.

4.1 Overview

The Fund recognises that ‘escalating activity’ is most effective when carried out as a group; hence when necessary and typically in partnership, the Fund will escalate an engagement with directly held investee companies to protect and enhance shareholder value. Where an engagement platform is not available, the Fund will act alone to escalate engagements with its investees directly, or will enter into collaboration with the PRI or other groups of like-minded investors.

The Fund holds its external fund managers to account for their engagement approach as part of its monitoring activities, which includes any escalating activity.

4.2 In Detail

4.2.1 Issues and Escalation

The Fund, either on its own or in collaboration, engages with companies on a range of issues including governance, climate change, employment standards, tax practices, board composition, human rights, employment practices and human capital management, social risk, reputational risk.

Unsatisfactory corporate responses lead to escalation, as agreed by the appropriate investment officers at the Fund, LGPS Central or, where engagement has been conducted through LAPFF, the LAPFF Executive.

Examples of how the Fund, LGPS Central or LAPFF might escalate include:

- letter issuance;
- alert issuance;
- meetings with the management or the directors of an investee;
- attendance and raising questions at company AGM;
- collaborative engagement with other organisations, including the 30% club, UNPRI, the CDP, EITI, INCR;
- shareholder resolutions (normally only after a sustained period of engagement); and
- legal action.

4.2.2 Measuring Success

Assessments of success are measured according to the degree of a company's response to the engagement exercise. Where an engagement has been executed through LAPFF, each company response is given one of seven qualitative assessment scores (ranging from 'Dialogue Continuing' to 'Substantial Improvement') and all information is collated and reported by LAPFF. Other data collected include the seniority of the position engaged on each issue and the format of the engagement. Where an engagement has been conducted directly by the Fund or LGPS Central, qualitative assessments of the success of the engagement to date are made and reported to the Pensions Committee on a quarterly basis, for as long as the engagement takes to conclude. The statuses of collaborative engagements (including with LAPFF) are also reported to the Pensions Committee on a quarterly basis.

Principle 5 – Institutional investors should be willing to act collectively with other investors where appropriate.

The Fund fully follows this principle.

5.1 Overview

The Fund believes that collaboration with other investors on ESG issues allows the Fund to increase its impact when engaging with companies, fund managers, regulatory bodies and other stakeholders. The Fund will, however, act alone on corporate engagement where relevant.

The Fund actively works with other asset owners, fund managers, and other organisations to promote responsible investment. These include but are not limited to LAPFF, the UN-backed Principles for Responsible Investment and the Institutional Investors Group on Climate Change (IIGCC), Transition Pathway Initiative (TPI), 30% Club Investor Group, Pensions & Lifetime Savings Association (PLSA) and UK Sustainable Investment Forum (UKSIF). The Fund seeks to work collectively on engagement whenever its aims are supported by like-minded investors and where it is felt that collaborative action is more likely to result in a positive outcome.

5.2 In Detail

The Fund uses various engagement platforms to maximise its influence as an active owner in collaboration with other like-minded investors. The Fund's primary engagement partnerships are highlighted below.

5.2.1 Local Authority Pension Fund Forum

The Fund is a founding member of the Local Authority Pension Fund Forum (LAPFF) and the Fund's Director of Pensions is the Honorary Treasurer. LAPFF is the UK's leading collaborative shareholder engagement group encompassing over 80 local authority pension funds and investment pools from across the country with combined assets of over £230 billion. The Fund is an active participant in LAPFF's engagement programs. Membership of LAPFF provides the Fund with:

- independent research and advice on the ESG risks of companies to inform further stakeholder engagement;
- advice on the governance practices of companies;
- a forum to engage with companies to improve governance practices; and
- proxy voting advice on proxy voting for annual general meetings.

5.2.2 UN-backed Principles for Responsible Investment

The Fund signed the Principles for Responsible Investment (PRI) in 2011. The PRI is a set of six aspirational principles designed to encourage and assist investors integrate ESG into their investment processes. The Fund is an active participant in the PRI's engagement program. The Fund considers the following criteria amongst others in determining its participation in PRI-related initiatives:

- Initiative is in alignment with the Fund's RI policy.
- The ESG issue or company of concern is considered to be particularly material to the Fund.
- Certain impediments (eg, geographic) make investor collaboration the preferred option.

5.2.3 Industry Engagement

In collaboration with other like-minded investors, the Fund may engage with public policy makers, regulators, trade bodies, indices and other players in the financial markets to achieve the aim of promoting sustainable growth. The Fund considers these initiatives on a case-by-case basis.

5.2.4 Roles and Responsibilities

The Pensions Committee is at all times responsible for the Fund's investments, including oversight of the RI strategy and collaboration with other investors. Responsibility for oversight of the Fund's RI framework sits with the Director of Pensions and Assistant Director (Investments and Finance). Responsibility for the implementation of this framework sits with the Head of Investment, supported by LGPS Central.

Principle 6 – Institutional investors should be willing to act collectively with other investors where appropriate.

The Fund fully follows this principle.

6.1 Overview

The Fund's voting approach and associated policies can be found in full on the Fund's website⁴. Further details are provided below. The Fund releases a report summarising its voting activities on a quarterly basis, details of which can be found on the Fund's website. The Fund also discloses its voting activity on a vote-by-vote basis, via an online portal. Voting reports are also presented to the Pensions Committee on a quarterly basis.

6.2 In Detail

6.2.1 Voting Globally

Where practical, the Fund aims to vote in every single market in which it invests. In the interests of sending a consistent signal to investee companies, the Fund has decided to use a third party provider for analysis of governance issues and executing its proxy voting rights across all markets in which it invests.

Further details of the fund's Voting Policy and current guidelines are set out in the Responsible Investment Framework and Voting Principles available on the Fund website.

The Fund currently uses a proxy voting agency, appointed by LGPS Central Limited for analysis of governance issues and executing its proxy voting rights across all markets in which it invests. The Fund has its own detailed West Midlands UK Voting Policy which aims to deal with issues that are either not covered by the UK Corporate Governance Code, require greater emphasis or are specifically left open for shareholders to resolve with company boards. For the remaining markets in which we invest, we currently endorse the proxy voting providers International Shareholder Voting Principles.

The Fund is committed to transparency with respect to its voting activity. To that end, the Fund discloses its voting activities on a vote-by-vote basis via its website.

The Fund produces a summary report on a quarterly basis, which is disclosed on the Fund's website and is reported to the Pensions Committee.

6.2.2 Securities Lending Programme

The Fund has an active securities lending programme. To ensure that the Fund is able to vote all its shares at important meetings has worked with service providers to establish procedures to restrict lending for certain stocks and recall shares in advance of shareholder votes. The Fund monitors the meetings and proportion of the securities on loan, and will restrict and/or recall lent stock in select circumstances.

⁴ <http://www.wmpfonline.com/article/5693/Voting-Globally>

Principle 7 – Institutional investors should report periodically on their stewardship and voting activities.

The Fund fully follows this principle.

7.1 Overview

The Fund's website provides information on its responsible investment commitments and evidence of implementation of its stewardship responsibilities. Reports are taken quarterly to Pensions Committee on responsible investment activities⁵.

A section in the Annual Report is devoted to reporting on the Fund's responsible investment activity, including an annual summary of its voting and engagement activity⁶. The Fund also discloses its voting activity on a vote-by-vote basis, via an online portal.

7.2 In Detail

7.2.1 External Reporting

Voting

The Fund is committed to transparency with respect to its voting activity. To that end, the Fund discloses its voting activities on a vote-by-vote basis.

The Fund releases a report on its voting activities on a quarterly basis and this is also disclosed on the Fund's website⁷. The quarterly voting report is provided to the Pensions Committee.

Engagement

The engagement activities of the Fund are disclosed via the collective bodies through which the Fund executes its corporate engagement activities (notably LGPSC Central, LAPFF and the PRI) as well as via the Fund's Annual Report and Accounts which is available on the Fund's website. Data on engagement themes, status/success of each engagement and the engagement format used are reported to show the effectiveness of each engagement.

7.2.2 Internal Reporting

Data on engagement and voting are reported to the Pensions Committee on a quarterly basis. The Pensions Committee is made aware of the extent of the Fund's voting through the quarter, the way in which the fund has voted and the extent to which the fund has supported the company's resolutions.

The Pensions Committee is made aware of new and ongoing engagement activities either undertaken by the Fund or by the Fund's engagement partners. Engagement themes are reported to the Pensions Committee each quarter until their conclusion.

⁵ <http://www.wmpfonline.com/article/5062/Member-Engagement>

⁶ <http://www.wmpfonline.com/annualreports>

⁷ <http://www.wmpfonline.com/article/5693/Voting-Globally>

7.2.3 Accreditation and Credentials

LGPS Central

From April 2018, Fund assets have started to transition into the LGPS investment pool, LGPS Central Limited. The pool company LGPS Central Limited ("Central"), established by the Fund and seven regional partners to operate collective investment vehicles through which the Fund may invest, has developed a leading approach to RI and supports Partner Funds in the execution of their individual RI policies. RI integration features in the investment process for all major asset classes, a suite of RI policies are in place together with a supporting engagement provider and regular monitoring and reporting.

Central supports the Fund in implementation of RI policy both through fund management arrangements and in an advisory capacity, supplementing and building on the collective action of the Fund and its own partnerships.

LAPFF

The Local Authority Pension Fund Forum (LAPFF) is the UK's leading collaborative shareholder engagement group. Formed in 1990, LAPFF brings together over 80 LGPS funds and investment pools from across the country with combined assets of over £230 billion. The Forum provides a unique opportunity for Britain's local authority pension funds to discuss investment issues and shareholder engagement. PIRC Ltd. is currently the research and engagement partner to LAPFF. PIRC has been awarded 'Tier 1' status by the FRC⁸ for PIRC's stewardship activities and implementation of the Stewardship Code and is signed up to the Best Practice Principles for Proxy Advisers⁹. PIRC is regulated by the Financial Conduct Authority.

Contacting West Midlands Pension Fund

For queries relating to the Fund's compliance with the UK Stewardship Code, including queries from other investors relating to collaborative stewardship, please contact responsibleinvestment@wolverhampton.gov.uk

For general queries, please contact pensionfundenquiries@wolverhampton.gov.uk

⁸ <https://www.frc.org.uk/Our-Work/Corporate-Governance-Reporting/Corporate-governance/UK-Stewardship-Code/UK-Stewardship-Code-statements/Service-Providers.aspx>

⁹ <http://pirc.co.uk/about-us-1/files/PIRC%20Best%20Practice%20Principles%202014.pdf>

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