

Pensions Committee

25 September 2019

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

The Committee is asked to note:

1. The Fund's voting and LAPFF's engagement activity for the three months ending 30 June 2019.
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 (typically annually) and approves the various framework and policy documents to ensure any necessary changes e.g. regulatory and changes in approach are incorporated. At its meeting on 27 June three key policy documents were reviewed and approved following updates:

- Responsible Investment Framework
- Voting Principles
- Stewardship Code

The Committee further approved the Fund's top engagement themes for 2019/20, based on financial significance and resonance with broader Fund stakeholders, as per 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

In addition, the Committee were keen to emphasise that they would also like to see a focus on Human Rights as part of their broader responsible investment approach.

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 62 companies during the quarter. Most engagements concerned climate change and Board Composition. Four engagements led to a substantial improvement with a further five showing moderate improvement. Most engagements were conducted by writing letters to the company concerned, but a number of this quarter's engagement activities also took place through meetings. 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 with 449 portfolio companies during the quarter, covering 1,039 environmental, social and corporate governance issues. Hermes EOS' activities support delivery against the Fund's stewardship themes as set out above alongside a broader range of engagement themes including human rights. Further details of Hermes EOS' engagement along with voting activity can be found Appendix A to this report.
- 4.4 As noted above the key themes for this financial year are climate change, single use plastics, technology disruption and tax transparency and highlights of this quarter's engagement activities are set out below:

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+ (which both WMPF and LGPS Central Ltd are members) and partner organisations with Centrica with a meeting taking place with the new chair of Centrica plc, Charles Berry. The meeting articulated an ambition for Centrica to show its long-term vision for decarbonisation, particularly of heat, and that it is committed to net-zero. It was considered Centrica could articulate its policy stance more strongly, points noted by the Chair.

- 4.7 Climate change continues to be identified by business leaders among the top five global risks, with the potential to impact investment returns over the long-term and we are pleased to see that one of our key partners LGPS Central is looking to continue the focus on climate change for the current financial year following discussions with WMPF and other Partner Funds on keep stewardship themes for areas of focus. Stewardship provider Hermes EOS as part of role in the Climate Action 100+ (CA100+) initiative spoke at the AGMs of Anglo American, Centrica, BP, Volkswagen and Daimler to challenge companies on their management of climate-related issues, their disclosure in line with the Task Force on Climate-related Financial Disclosures and their alignment with the Paris Agreement.
- 4.8 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 FTSE Russell. It recently issued an update on the state of transition report which assesses how the world's largest and highest CO2 emitting public companies are transitioning to a lower carbon economy. Positively, a large proportion of companies assessed now acknowledge climate change as a business issue and are building some capacity to manage the low carbon transition. The report points to a correlation between management quality and carbon performance in that companies scoring well on quality are likely to be better performing in terms of the carbon response.

Single Use Plastics

- 4.9 As a new theme for this financial year, the Fund is very conscious of the damage that single use plastics has on the environment and is keen to engage alongside partners in highlighting the risks that single use plastics pose to longer term financial returns. Stewardship provider Hermes EOS engaged seven companies over concerns with single-use plastics and plastic pollution during the quarter in review. During the fourth quarter of 2018-19, Hermes EOS reported on some positive developments among corporates who are finding solutions to cutting plastic waste or finding alternatives to plastics. In the UK market, Co-op and Iceland have backed a mandatory deposit return scheme on plastic bottles and have trialled this in some locations. Further to this Tesco is trialling in-store deposit return machines for plastic bottles and a pilot scheme allowing customers to bring their own containers when buying meat, fish and cheese from counters.

Technology and Disruptive Industries

- 4.10 With technology dominating daily lives, the need for focus on ensuring good governance and controls in this area are all too obvious, not least because technology companies have come to dominate many public equity indices around the globe. This has led to not only significant opportunities for institutional investors, but also increasingly the realisation around the risks in the portfolios including cyber security (one of the Fund's previous stewardship themes); data privacy; content management; loss of autonomy and consumer manipulation. This quarter's Hermes stewardship report contains a significant focus on Artificial Intelligence and suggests a failure by social media companies to

manage risks adequately has triggered big fines for some and is prompting regulators to look at the sector closely, with a view to imposing tighter controls.

- 4.11 The Fund is looking to engage with social media companies over the risks posed by the business models operated by the companies and the governance arrangements for the management of data privacy and content management. Engagement is taking place through Hermes with Facebook on a number of material governance and business model issues, in light of the furore around how its platform works. In addition, the Fund alongside LGPS Central Ltd has looked to join a collaboration of international investors to engage with social media companies. The objective of the engagement is to convince the social media companies (Facebook, Alphabet and Twitter) to strengthen controls to prevent the live streaming and distribution of objectionable content, such as the shootings that took place in Christchurch on Friday 15 March 2019.

Tax Transparency and Fair Tax Treatment

- 4.12 Tax transparency and fair tax is one of the key stewardship themes for the year. To echo LGPS Central comments, corporate taxes play an important role in funding public goods and services and they support the health of societies in which businesses operate and rely on to carry out their activities. When taxes are paid fairly, it ensures a level playing field for businesses and overall stable markets. Whether companies are paying the right amount of tax can be a complex question. However, whether a company is transparent on how tax is determined and on its governance around tax and tax risk, is more straightforward and it is something we want to encourage.
- 4.13 During the quarter stewardship provider Hermes EOS engaged with eight companies on our behalf on tax transparency. In these engagements Hermes EOS has encouraged companies to enhance disclosure by developing a clear narrative on how they have implemented their tax policy in the reporting year. Pressure on the fair tax treatment is starting to pay dividends, witness Starbucks announced in June this year that its tax contribution to its European (and London) based companies increased to a higher effective rate than the local level of corporation tax.

Human Rights

- 4.14 Whilst not a specific engagement theme for the current financial year, human rights remain a key focus for engagement by the Fund on an ongoing basis. One of the key themes for this quarter's engagement report from stewardship provider Hermes EOS is about human rights in the supply chain. To quote from their report, it is estimated by the International Labour Organisation that there are 40m modern slaves globally and 25m in forced labour. It is estimated that 71 of the UK's leading retailers 77% believe that there was a likelihood of modern slavery occurring in their supply chains.

- 4.15 It is estimated that direct cost in the UK for each individual victim of modern slavery is £328,000. UK figures put cases between 10,000 to 13,000 per year. The UK government is currently running a consultation on Transparency in the Supply Chain <https://www.gov.uk/government/consultations/transparency-in-supply-chains> both the Fund and LGPS Central Ltd are responding to the consultation supporting,
- Mandatory reporting on the six areas currently highlighted by the Modern Slavery Act
 - Actions to improve company reporting on the efficacy of their efforts to tackle modern slavery
 - Extending the mandatory reporting requirement to the public sector Providing greater clarity on which organisations are covered by the Transparency in the Supply Chain provision.
- 4.16 Recent engagement activity undertaken by Hermes EOS engagement on this topic is with US home improvement supplies retailer Home Depot, and its approach to managing prison and forced labour risks in the lower tiers of its supply chain.
- 4.17 The Committee were appraised at previous meetings of engagement with Millennium & Copthorne through the 30% Club, this follows on from a long period of engagement with the company dating back to 2017. The Fund had previously tried to engage the Board and management of the UK listed hotels chain on a range of issues from accounting to Board diversity and strategy. The Fund had previously rejected a bid from the majority shareholder on the basis that the bid significantly undervalued the company. Since December 2017 engagement continued, with meeting and writing to the company, as well as using voting rights to further initial engagement aims and to hold the independent board to account. This delivered a positive outcome when a revised offer was tendered during the quarter in review, valuing the shares 24% higher than the initial possible offer in 2017. This experience in this engagement reinforces conviction in taking a long-term approach, and adds to our belief in the importance of high-quality, independent boards of directors.

Voting Globally

- 4.18 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.
- 4.19 The voting activity for the quarter across markets and issues can be found in Appendix A. During the period, the Fund voted at a total of 449 company meetings – 82 UK, 82 European, 179 North American, 67 Developed Asia, 2 Australasian and 37 in Emerging and Frontier Markets. During this period there were 510 meetings where the Fund supported all the resolutions put forward by companies. There were 3,460 resolutions where the Fund either voted against or abstained from. 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.

Correspondence

- 4.20 During September 2019, the Fund received correspondence from Coventry Peace and Justice Group regarding holdings in Hanwha companies. Long serving members of the Pensions Committee will recall that the Fund, following a long period of engagement with Hanwha Corporation over the manufacture of cluster munitions, took the decision to divest from holding in the Corporation recognising that engagement on this occasion was proving ineffectual. The Fund had previously engaged with a number of organisations through LAPFF in 2014 and achieved effective change in practice on this issue. The recommendation before Committee in December 2017 was to de-select Hanwha Corporation from the Fund's internal passive equity portfolio which was subsequently carried out within the first quarter of 2018. In April 2018, the internal portfolio transitioned to the Fund's investment pool company, LGPS Central Ltd, and there remains no exposure to Hanwha Corporation in that portfolio.
- 4.21 Where the Fund uses external passive investment managers, it does not have the ability to divest individual investments in the same manner, as holdings often form part of larger pooled investment portfolios. Through legacy externally managed portfolios, the Fund has had a small residual holding in Hanwha Corporation. These portfolios are in the process of being wound down and will shortly be completely removed as restructuring on the Fund's equity portfolio is completed.
- 4.22 The recommendation to the Pensions Committee in December 2017 followed detailed consideration of potential financial implications including transition costs. De-selection has been conducted in response to non-financial considerations but cognisant of potential financial detriment and timed to mitigate adverse impact on the Fund.
- 4.23 For clarity and completeness, there are other Hanwha companies held within the Fund's passive equity portfolios. This includes Hanwha Life Insurance, Hanwha Chemicals and Hanwha Techwin. On review in 2017 and more recently since then, we have found no evidence that these companies are involved in arms manufacture or sales, or controversial weapons manufacture or sale and as such they remain within the portfolio. We note that this position is common amongst other investors who have taken a similar decision in relation to Hanwha Corporation i.e. to divest in the Corporation shares only but retain exposure to other Hanwha companies.
- 4.24 Companies within the portfolio holdings are considered on an individual and case by case basis, as potential issues emerge, with wider drivers for change also coming from the Fund's thematic base engagement and engagement with policy makers, noting the greater impact which can be achieved from wider and collaborative engagement. Committee are aware of the Law Commission's guidance on fiduciary duty and the balance on considerations on investments.
- 4.25 As the Committee will appreciate the Fund continues to monitor the activity of the companies it invests in through a broader engagement programme and in line with its Responsible Investment Framework. The Fund continues to believe that engagement is the appropriate way to bring about change in its investee companies. It believes that

divestment will ultimately restrict the Fund's ability to make investment decisions which could impact on the financial returns that it needs to meet the costs of delivering pensions to its scheme members which could impact on the costs borne by its employer base which includes local authority tax raising bodies.

4.26 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 had written to the company to begin an engagement dialogue and the Company has engaged with this request. 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 Voting and Engagement Activity