

Pensions Board

22 October 2019

Report title	Investment Update	
Originating service	Pension Services	
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Recommendation for noting:

The Board is asked to note:

1. The update on investment related matters including responsible investment and investment pooling.

1.0 Purpose and background

- 1.1 This report provides an update on investment related matters including the ongoing development of LGPS Central Investment Pool and the Fund's responsible investment activities.
- 1.2 LGPS Central Ltd ("the Company") is a jointly owned investment management company established by West Midlands Pension Fund and seven Partner Funds to deliver investment pooling for the LGPS Central pool in accordance with the criteria laid down by the Secretary of State. The Company obtained FCA authorisation of the operator and Authorised Contractual Scheme (ACS) in January and February 2018 respectively and formally launched in April 2018. The business case for the pool is focused on securing longer term investment cost savings and supporting delivery of Partner Funds' strategic investment objectives.
- 1.3 Investments products and services to Partner Funds are being developed, supported and overseen by the governance structures established within the Company and across the wider investment pool. The Shareholder Forum and Joint Committee each meet at least twice annually with the Shareholder Forum considering shareholder related matters such as the company's strategic business plan, annual budget and annual report and accounts. The Joint Committee is focused very much on client deliverables of investment pooling, together with governance and oversight of pooling arrangements.
- 1.4 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**.
- 1.5 The Responsible Investment Framework and other relevant RI policy documents are reviewed and approved annually by the Pensions Committee.

2.0 LGPS Central Investment Pool Sub-Fund Development and Asset Transition

- 2.1 As previously reported to the Board, since launch and over the next 2-3 years, a range of internally and externally managed sub-funds are being developed and launched for liquid (e.g. equities and bonds) and alternative more-illiquid asset classes (e.g. private equity, property, infrastructure).
- 2.2 WMPF works closely with LGPS Central Ltd and its Partner Funds to agree sub-fund product development, a protocol for which has now been established to deliver the investment products that Partner Funds need to meet their strategic requirements, pooling objectives for return and cost savings and broader strategic objectives including responsible investment. The product development protocol also provides Partner Funds with the opportunity to undertake due diligence of the process and products as they progress along the development pipeline and gain the necessary assurance to transition assets across to LGPS Central Ltd.

- 2.3 Review of the first transition of the Fund's internally managed equity assets in April 2018, with total asset value of £5.2 billion, has now been completed by internal audit and has received substantial assurance. The Fund has since made further investments with LGPS Central Ltd which include both active global equities and a commitment to private equity.
- 2.4 The Fund's Investment Advisory Panel, comprising external advisers, the Director of Pensions and Assistant Director (Investment and Finance), continue to review investment in sub-funds as they are developed taking into account the strategic fit for WMPF. The Pensions Committee are kept updated on product development and are asked to re-confirm delegations to transition assets as appropriate to these emerging sub-funds.
- 2.5 LGPS Central has launched an Emerging Market Equities sub-fund which WMPF will allocate to in due course. Other sub-funds currently in the launch process include, Corporate Bonds and a Climate Factor-Based Fund, with the latter due to launch in early October. The new Climate Factor Fund aligns with the Fund's investment beliefs and will help the Fund to meet objectives set in the Climate Change Strategy and Framework agreed in March 2019.
- 2.6 The product development pipeline continues to evolve and be reviewed as strategic priorities and opportunities develop.

3.0 LGPS Central Investment Pool Governance

- 3.1 As previously reported to the Board, the governance arrangements for the LGPS Central pool include a Shareholder Forum (as the group of "owner" representatives) and the Joint Committee (focused on investment matters and client-side). The Joint Committee has invited a trade union representative to join the Committee and is waiting for a nomination from the TUC. A representative from the West Midlands' Pension Committee is currently attending on an informal basis. The Practitioners Advisory Forum, PAF (officer group) support both groups and act as a liaison with the Company.
- 3.2 The Shareholder last met in February 2019 and are next due to meet in November 2019.
- 3.3 The Joint Committee will meet in December to receive an update on workstreams from the Practitioners Advisory Forum (including finance, investment, client and governance oversight and responsible investment), along with the risk and audit assurance framework, and delivery and performance updates.
- 3.4 The Board were previously advised of draft guidance issued by Ministry of Housing, Communities and Local Government (MHCLG), noting, the emphasis on the Pool governance and oversight. It is understood that a formal consultation is due to be issued but is now not expected until the late autumn.
- 3.5 LGPS Central Limited's own governance arrangements include an Investment Committee, Executive Committee and oversight from the Non-Executives through the company board and sub committees (Remuneration and Audit and Compliance). The Company also sought and obtained permission from Shareholders to recruit for an additional non-executive director and the recruitment for that post is currently underway.

3.6 The Internal Audit Working Group which covers all Partner Funds is currently undertaking a governance audit of LGPS Central Investment pool, incorporating both the governance and oversight arrangements of Partner Funds and also the Company. The results of this audit work are expected to be presented to the Joint Committee in December. In addition, an Investment audit is due to commence towards the end of the calendar year and early into next year and again the results of this audit will be presented to the Joint Committee.

4.0 Responsible Investment

4.1 The Fund's strategy continues to be 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 Limited, the pool operator company), Institutional Investors Group on Climate Change (IIGCC) and the UK Pension Fund Roundtable.

4.2 The Fund's engagement activity is monitored and reported to the Pensions Committee on a quarterly basis. Engagement activity includes a number of direct company engagements, on a range of themes, voting activity and working in partnership with other institutional investors to consider shareholder resolutions. Activity and progress are included in published reports from LGPS Central Limited and the Local Authority Pension Fund Forum (LAPFF).

4.3 As previously discussed the stewardship themes for engagement for the Fund for the current financial year are: Climate Change; Single-use plastics; Technology and Disruptive Industries; Tax Transparency and fair tax payment. Whilst not a specific theme for the year, the Pensions Committee were also keen that there was a focus on Human Rights and the Fund has also commenced more detailed reporting on this additional theme for Pensions Committee in addition to the previously agreed themes.

4.4 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/qtrly-engagement-reports/>

4.5 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 within the Appendices to the main Pensions Committee Responsible Investment Committee Report:
<https://wolverhamptonintranet.moderngov.co.uk/ieListDocuments.aspx?CId=186&MIId=11794&Ver=4>

4.6 The Fund responds to all correspondence received directly from pension scheme members, campaign groups or via members of Pensions Committee. From time-to-time the Fund will issue statements to confirm its approach and work undertaking in relation to specific issues or concerns raised. Correspondence is discussed at each Pension Committee meeting.

5.0 Client reporting

5.1 The Investment Team at LGPS Central Ltd are providing Funds with quarterly strategy updates along with broader market and training information. Quarterly stewardship reports covering engagement and voting are also being provided to Partner Funds as well as being accessible on the Company website, the latest quarter can be found at:

<https://www.lgpscentral.co.uk/wp-content/uploads/2019/03/LGPS-Central-Quarterly-Stewardship-Report-Third-quarter.pdf>

5.2 Monthly and Quarterly reporting on the LGPS Central Ltd sub-funds is being provided and the client oversight and governance group is working closely with the Company to further develop these reports to ensure that they will meet the reporting requirements of Partner Funds as the range of products and assets under management grows.

5.3 In July 2019, the pool held a Responsible Investor information day to which all Pension Committee and Pension Board members across the Central region were invited. This covered a range of topical issues and was well attended and received by attendees.

6.0 Financial implications

6.1 The costs of the LGPS Central pool and the Fund's share of these are including within the Fund's annual budget and reported within the Fund's Annual Report and Accounts.

6.2 CIPFA guidance on the Pension Fund Annual Reports requires all Pension Funds to fully disclose progress on transition of assets, performance and costs in relation to both the ongoing management of the Pool and transition, thereby providing high levels of transparency on the implementation of investment pooling and the delivery against the business case.

6.3 MHCLG continues to monitor progress of all the investment pools on a regular basis with the latest update supplied in September 2019. This reaffirmed that the LGPS Central Pool remained on target to deliver the planned savings in the timescales set out in the original business plan.

7.0 Legal implications

7.1 The requirement to pool fund investments is a requirement of law, failure to work collaboratively and meet the Government's criteria and timetable for delivery may result in Government intervention.

7.2 MHCLG issued updated draft statutory guidance relating to investment pooling for informal consultation in January 2019. This was to update and replace the original statutory guidance issued in 2015. Both the Fund and LGPS Central Ltd have provided responses to the

consultation and MHCLG and currently expected to issue a formal consultation later this year.

8.0 Equalities implications

8.1 There are no direct equalities implications

9.0 Environmental implications

9.1 There are no direct environmental implications

10.0 Human resources implications

10.1 There are no direct human resources implications

11.0 Corporate landlord implications

11.1 There are no direct Corporate landlord implications

12.0 Schedule of background papers

12.1 Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016
<http://www.legislation.gov.uk/ukxi/2016/946/contents/made>

13.0 Schedule of appendices

13.1 None