

Pensions Committee

21 January 2020

Report title	Responsible Investment	
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 September 2019.
2. The issues discussed by LAPFF are set out in the Quarterly Engagement Report which is available on the LAPFF website: <http://www.lapfforum.org/publications/qrtly-engagement-reports/>.
3. The issues discussed in the LGPS Central Quarterly Stewardship Report which is available on the LGPS Central website: <https://www.lgpscentral.co.uk/wp-content/uploads/2019/03/LGPS-Central-Quarterly-Stewardship-Report-Third-quarter.pdf>
4. The new Stewardship Code which is currently under review by officers of the Fund with a view to updating its compliance statement.
5. Additional information in respect of Hanwha holdings.

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 Activities

Engagement through Partnerships

- 3.1 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 Ltd, the Fund's investment pool operator), Institutional Investors Group on Climate Change (IIGCC) and the UK Pension Fund Roundtable.
- 3.2 Through LAPFF, the Fund engaged with 108 companies during the quarter. Most engagements concerned climate change and human rights. Two engagements led to a substantial improvement with a further three showing moderate or small improvement. Most engagements were conducted by writing letters to the company concerned, but several 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/>
- 3.3 Through Hermes EOS, the Fund engaged with 232 portfolio companies during the quarter, covering 576 environmental, social and corporate governance issues. Hermes EOS' activities support delivery against the Fund's stewardship themes (see below) alongside a broader range of engagement themes including human rights. Further details of Hermes EOS' engagement along with voting activity can be found at Appendix A to this report.
- 3.4 The four stewardship themes the Fund has selected for the current 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

- 3.5 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.
- 3.6 Engagement has taken place through LAPFF (which both WMPF and LGPS Central Ltd are members). Earlier this year LAPFF joined other Climate Majority Project coalition members calling on the 20 largest carbon emitting US utility companies to commit to achieving net-zero carbon emissions by 2050, and to make this commitment by September 2020. In late September 2019 both DTE Energy and NRG Energy made unambiguous commitments to net-zero carbon emissions by 2050. LAPFF also signed up to an investor statement on deforestation and forest fires in the Amazon. The statement called on companies to disclose and implement a commodity-specific no deforestation policy with quantifiable, time-bound commitments covering the entire supply chain. This statement, which was co-ordinated by the PRI, was issued in direct response to the escalating crisis of deforestation and forest fires in Brazil and Bolivia during the period under review.
- 3.7 Climate change stewardship undertaken by LGPS Central Ltd continues to build on collaborations with the Climate Action 100+ Initiative (CA100+). During this quarter, CA100+ published its first Progress Report, which provides a review of how the oil and gas, utilities and mining and metal industries, amongst others, are progressing against the CA100+ goals around climate governance, reduction of emissions and climate disclosure. The report identifies that a handful of oil and gas majors, including Shell and Total, have developed initial investment plans to diversify their business and have set long-term intensity targets to reduce their emissions.

Single Use Plastics

- 3.8 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 13 companies over concerns with plastic pollution and single-use plastics. Attention was focused upon UK drinks providers, for example Co-op and Iceland, making the transition to a circular economy and the development of innovative and reusable packaging solution.
- 3.9 This quarter LGPS Central have embarked upon two key initiatives to help improve standards across the plastic value chain. Firstly, the Plastic Pellet Pollution project aims to establish a new industry standard for plastic pellet management within natural waterways and the ocean. The project is reliant upon broad stakeholder collaboration including investors, government, corporates and non-governmental organisations. Secondly, LGPS Central have signed a petition from investors to the Marine Stewardship Council (MSC) on “ghost gear” – namely marine debris and plastic pollution. The petition stressed that inclusion of ghost gear in MSC’s certification standards is

necessary to ensure that MSC's program is highly relevant to fundamental environmental, food security and safety needs.

Technology and Disruptive Industries

- 3.10 With technology dominating daily lives, the need for good governance has led to significant opportunities for institutional investors. The quarter's Hermes EOS stewardship report contains a significant focus on human rights risks caused by big data, digitalisation and Artificial Intelligence. The Fund, alongside LGPS Central Ltd, has joined a collaborative engagement initiative led by the New Zealand Crown-owned investors aiming for social media companies (Facebook, Twitter and Alphabet) to strengthen controls around the live streaming and distribution of objectionable content. All three companies have begun communicating with the investor initiative. Facebook, for example, has committed to leading from the front and is obtaining footage from UK and US international firearms training programmes in order to help detect and prevent the streaming of objectionable content, such as the shootings that took place in Christchurch in March 2019.

Tax Transparency and Fair Tax Treatment

- 3.11 Tax transparency and fair tax is one of the key stewardship themes for the year. The avoidance of tax by some large multinationals has attracted a great deal of criticism, and small businesses shouldering a heavier tax burden have struggled to compete. Instead, more companies are now taking a long-term view that investment in the community and the society in which they operate by paying taxes will ultimately lead to greater prosperity for the business too. For example, UK energy supplier SSE has obtained the Fair Tax Mark independent accreditation for now 'paying the right amount of tax, in the right place at the right time'.
- 3.12 During the quarter the Fund's stewardship provider Hermes EOS engaged with six companies on our behalf, with efforts focused upon tax policy and transparency in the banking sector. Poor tax-related conduct has occurred in the bank industry in relation to client servicing. In response to this, Hermes EOS sent its expectations on tax policy, governance and transparency to a focus list of 10 banks. After an initial assessment of tax policies and reporting at these companies, Hermes EOS investigated the unreported areas of tax practice and pressed the banks on their controls for tax-related conduct across the company.

Human Rights

- 3.13 Pensions Committee were keen to emphasise that they would like to see a focus on Human Rights as part of the broader responsible investment approach. Whilst not a specific engagement theme for the current financial year, human rights remains a key focus for engagement by the Fund on an ongoing basis. An overview of the topic was provided to trustees at the November joint Pensions Board and Committee members training day and is addressed here in more detail.

- 3.14 Human rights include civil, political, economic, and social and cultural rights, such as the right to life, the right to freedom of association or the right to health. The [United Nations Office on Drugs and Crime](#) defines human trafficking as recruitment by threat, use of force, or other forms of coercion and deception for the purpose of exploitation. Although no publicly traded companies intentionally support human trafficking, they can become unintentionally complicit by inadequately overseeing their supply chains. To combat this, companies must remain vigilant with regards to their suppliers' hiring policies and practices to avoid and discourage these conditions in the workplace.
- 3.15 Increased public attention to the global crisis of modern slavery which now affects more than 40 million people worldwide has driven companies to take formal and public stances against forced and child labour. Of the companies with human rights policies, 67% explicitly forbid both forced and child labour. Among the companies with formal human rights policies, only three-quarters have basic systems, such as employee training or grievance mechanisms in place to manage and promote human rights. Far fewer, just 15% of this group, conduct human rights impact assessments in addition to basic systems.
- 3.16 The International Labour Organisation states that there are 40 million modern slaves globally and 25 million in forced labour. It is estimated that 71 of the UKs leading retailers, 77% believe that there was a likelihood of modern slavery occurring in their supply chains. UK figures put modern slavery cases between 10,000 to 13,000 per year, with the projected direct cost in the UK for each individual victim of modern slavery as £328,000. Adopting the UN Guiding Principles on Business and Human Rights is one of the most effective strategies for ensuring both meaningful commitment and implementation of human rights protections. Released in 2015, the UN Guiding Principles Reporting Framework is the first comprehensive guidance for companies to report on human rights issues.
- 3.17 Through Hermes EOS, the Fund engaged with 16 companies on human rights issues during the quarter. Attention was focused upon supply chain engagement, including the technology sector. As an example, over a six-year period, Hermes EOS engaged Hon Hai, Apple's largest supplier, following reports of exploitative working conditions and workers committing suicide. Hermes EOS raised concerns with the chair at the AGM and requested that the company progress with its worker health and well-being programme. Following this engagement, Hon Hai has taken the positive step of publishing a human capital management strategy, but Hermes EOS will continue to engage with the company.

Voting Globally

- 3.18 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.

- 3.19 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 242 company meetings – 91 UK, 33 European, 33 North American, 38 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 1345 resolutions where the Fund either voted against or abstained. 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.

Stewardship Code Update

- 3.20 The Fund has been a signatory of the UK Stewardship Code ('the Code') since its inception in 2012. The Fund defines the concept of stewardship in the same way as the 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.
- 3.21 The FRC has now published an updated Code which came into effect from 1 January 2020. The Code⁹ represents a new best practice standard for both asset owners and asset managers alike. The new guidelines require that Funds who want to remain or become signatories of the Code must publish a Stewardship Report, demonstrating compliance with the 12 principles of the Code by 31 March 2021. The Code will also be used in conjunction with forthcoming guidance to be issued by the Scheme Advisory Board, as a basis for reviewing and strengthening the Fund's approach to responsible investment activity. The Fund will be working in conjunction with LGSPC Ltd to update the Fund's current Code by March 2020. A more detailed review of the new Code and the work done to meet its requirements will be provided in the March 2020 committee report.

Scheme Advisory Board Guidance

- 3.22 In November 2019 the National LGPS Scheme Advisory Board issued a consultation on the first phase of new guidance in relation to Responsible Investment. Recognising the growing interest in responsible investment across the LGPS and wider pensions industry and noting recent changes from DWP regarding trustees' response, policies and action in addressing financially material risks such as climate change, the draft guidance looks to set out key definitions considers fiduciary duty and recognises for the LGPS that there are a range of stakeholders including local taxpayers to consider. The consultation document relates to part 1 guidance which aims to assist decision makers identify parameters for applying a responsible investment approach in the context of applicable regulations and guidance. Responses to the consultation are required by 11 January and examples of successful policy application are also invited to inform development of a further stage of guidance. Part 2 of the guidance is expected to provide more of a toolkit to demonstrate the range of ways administering authorities' responsible investment policies can be integrated into the investment strategy. The Scheme Advisory Board is

aiming to prepare working draft of the second part of guidance by mid-February and then will then consult.

Correspondence

- 3.23 As reported in September, the Fund received correspondence from the Coventry Peace and Justice Group regarding holdings in Hanwha companies. 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. The residual holding of this stock within an external managed portfolio has now been sold following further planned restructuring of the Fund's global equity holdings. The Fund retains exposure to three other Hanwha companies, namely Hanwha Chemical; Hanwha Techwin and Hanwha Life. Additional research undertaken by officers confirmed there was no evidence exposure to cluster munitions in the other companies and indeed in some areas the Fund is gaining positive exposure to things such as solar energy, which support the Fund's wider climate change policy. The Fund will continue to review investments on a case-by-case basis and is considering the concerns raised in the context of the next review of the responsible investment framework, due March 2020.
- 3.24 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 to contracting and engagement with affected communities. 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.
- 3.25 The Fund continues to receive correspondence on its exposure to fossil fuels and the potential for divestment of holdings in companies exposed to oil and gas. This included correspondence from Walsall Borough Council and Birmingham City Council as well as correspondence from individual scheme members, all heightened by growing public awareness of climate change including extinction rebellion protests. The Fund has a climate change policy framework and has set proactive targets for moving a significant proportion (10-15%) of its assets to low carbon or sustainable equity mandates by 2023, a target which it expects to achieve earlier, having already transitioned 10% of the portfolio to a low carbon factor fund (early October) and plans to transition 5% of its assets to a sustainable equity mandate early in the new year. The Fund will also be updating analysis of portfolio exposure to climate change risk and will report back to Committee in due course on the outcome of this work.

4.0 Financial implications

4.1 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.

5.0 Legal implications

5.1 This report contains no direct legal implications.

6.0 Equalities implications

6.1 This report contains no equal opportunities implications.

7.0 Environmental implications

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

8.0 Human resources implications

8.1 This report contains no direct human resources implications.

9.0 Corporate landlord implications

9.1 This report contains no direct corporate landlord implications.

10.0 Schedule of background papers

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

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

10.3 Hermes EOS Engagement Report, Q3, 2019:
<https://www.hermes-investment.com/ukw/wp-content/uploads/2019/10/hermes-eos-public-engagement-report-q3-2019.pdf>

11.0 Schedule of appendices

11.1 Appendix A – WMPF Voting and Engagement Activity.