

CITY OF  
WOLVERHAMPTON  
COUNCIL

# Pensions Board

21 January 2020

<b>Report title</b>	Investment Governance	
<b>Originating service</b>	Pension Services	
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## Recommendation for noting:

The Board is recommended to note:

1. The update on investment governance 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 Financial Conduct Authority (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**.

## 2.0 Investment Strategy

- 2.1 The Fund is currently undergoing a review of its Investment Strategy in conjunction with the triennial Actuarial Valuation which will be incorporated into the Investment Strategy Statement due for consideration by the Pensions Committee in March 2020. This is being developed along with the investment risk management framework to enable the Fund to meet its longer-term funding and investment objectives. The Board will be kept updated of progress and changes to the Investment Strategy Statement will be discussed with the Board in April.

## 3.0 LGPS Central Investment Pool Sub-Fund Development and Asset Transition

- 3.1 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).

- 3.2 WMPF works closely with LGPS Central Ltd and 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.
- 3.3 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.
- 3.4 Following approvals by Pensions Committee WMPF has transitioned assets into LGPS Central Ltd ACS passive equity sub-funds, active external global equities sub-fund and the climate factor fund launched in early October. The Fund also made commitments to LGPS Central Ltd's first private equity sub-fund which was set up under a Scottish Limited Liability Partnership following approval by shareholders for the new vehicle. In aggregate the Fund has approximately £6.5bn or around 40% of assets under management directly invested in LGPS Central Ltd sub-funds, helping demonstrate compliance with statutory guidance on LGPS Investment Pooling.
- 3.5 LGPS Central has launched an Emerging Market Equities sub-fund which WMPF anticipates allocating to in due course. The Corporate Bond sub-fund is scheduled for formal launch in February and the Fund is in the process of transferring assets to this sub-fund. As noted above the Fund also transitioned assets across to the new Climate Factor-Based Factor Fund in early October which aligned 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.
- 3.6 The product development pipeline continues to evolve and be reviewed as strategic priorities and opportunities develop and the Fund works closely with its Partner Funds and LGPS Central Ltd to ensure that suitable products become available to meet the Fund's broader strategic objectives.

#### **4.0 LGPS Central Investment Pool Governance**

- 4.1 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.
- 4.2 The Shareholder Forum last met in November 2019 and are next due to meet in February 2020 to agree the LGPS Central Strategic Business Plan and Budget for 2020-2021.

- 4.3 The Joint Committee was due to meet in December, but due to the General Election taking place this has now moved to February 2020 and will 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.
- 4.4 The Board were previously advised of draft guidance issued by MHCLG, noting in particular, the emphasis on the Pool governance and oversight. It is understood that a formal consultation is due to be issued but was postponed from the Autumn and we are awaiting a further update from Government as to when this updated guidance will be issued.
- 4.5 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 with a formal announcement on the appointment expected in January 2020.
- 4.6 The Internal Audit Working Group which covers all Partner Funds undertook 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 February. In addition, an Investment audit is due to commence shortly and again the results of this audit will be presented to the Joint Committee in due course.

## **5.0 LGPS Central Ltd Investment Reporting and Oversight**

- 5.1 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.
- 5.2 The Fund reviews performance of these sub-funds on a quarterly basis internally as well as actively participating in the Practitioner Advisory Forum Investment Working Group review of quarterly performance with LGPS Central Ltd.

## **6.0 Responsible Investment**

- 6.1 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.
- 6.2 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).

- 6.3 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.
- 6.4 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/>
- 6.5 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 in the appendix to the Pensions Committee Responsible Investment Report.
- 6.6 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.
- 6.7 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/2019/11/2019-11\\_QSR\\_v8.pdf](https://www.lgpscentral.co.uk/wp-content/uploads/2019/11/2019-11_QSR_v8.pdf)
- 6.8 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."
- 6.9 The FRC has now published an updated Code which came into effect from 1 January 2020. The Code 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 to Pensions Board at its next meeting.

- 6.10 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. It is recognised that capacity to invest in responsible investment is likely to be different depending on scale. The Scheme Advisory Board are issuing guidance for consultation in two phases, with both expected to be available before the Scheme year-end.
- 6.11 As noted above the Fund will be reviewing its compliance with the updated Stewardship Code and will be providing an updated Statement of Compliance to Pensions Committee for its meeting in March. In addition, the Fund will be undertaking a review of its Responsible Investment Framework including any new themes being proposed along with a review of its voting policy.

## **7.0 CMA Review**

- 7.1 The CMA (Competition Markets Authority) published its report on the market investigation into Investment Consultants in December 2018, issuing an Order in June placing new obligations on service providers and pension schemes with regard to Fiduciary Management and Investment Consultancy Services. Consultation in June confirmed the requirement to set strategic objectives for providers of Investment Consultancy Services. The Fund has now set strategic objectives for investment consultancy services with its range of external advisers.

## **8.0 Financial implications**

- 8.1 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.
- 8.2 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.
- 8.3 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.

## **9.0 Legal implications**

- 9.1 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.
- 9.2 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 in 2020.

## **10.0 Equalities implications**

- 10.1 There are no direct equalities implications.

## **11.0 Environmental implications**

- 11.1 There are no direct environmental implications.

## **12.0 Human resources implications**

- 12.1 There are no direct human resources implications.

## **13.0 Corporate landlord implications**

- 13.1 There are no direct corporate landlord implications.

## **14.0 Schedule of background papers**

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

## **15.0 Schedule of appendices**

- 15.1 None.