

Pensions Committee

9 December 2020

Report title	Responsible Investment Activities	
Originating service	Pension Services	
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Recommendation for decision:

The Committee is asked to note and approve:

1. Publication of the Fund's first stand-alone report prepared in line with recommendations from the Taskforce on Climate Related Financial Disclosure (TCFD) [Appendix C – To Follow].

Recommendations for noting:

The Committee is asked to note:

1. The Fund's engagement and voting activity for the three months ending 30 September 2020 [Appendices A and B].
2. The research and engagement activity undertaken by LAPFF as set out in the Quarterly Engagement Report, available on the LAPFF website: https://lapfforum.org/wp-content/uploads/2020/10/LAPFF_QER3_2020.pdf.
3. The voting and engagement activity of LGPS Central, as set out in the Quarterly Stewardship Report, available on the LGPS Central website: <https://www.lgpscentral.co.uk/wp-content/uploads/2020/11/LGPSC-Quarterly-Stewardship-Update-Q2-2020-21-1.pdf>

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.
- 2.2 In line with discussions at Pensions Committee at the September 2020 meeting and a focused training session on climate change, officers continue to work on reviewing the Fund's climate strategy noting that the goals set out in the Climate Framework and Strategy 2019-2023 have largely been achieved. In addition, since 2017 when the Taskforce on Climate Related Financial Disclosure (TCFD) recommendations were first published, the Fund has disclosed on an annual basis its approach to climate risk management within its annual report and accounts. Given the increasing emphasis on transparency and disclosure in this area and the Fund's leading approach, it has produced for publication an initial more detailed standalone report from this year.

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), EOS at Federated Hermes ('EOS' - via a contract held by LGPS Central Ltd, the Fund's investment pool operator), the Institutional Investors Group on Climate Change (IIGCC), Climate Action 100+ (CA 100+) and the UK Pension Fund Roundtable.
- 3.2 Through LAPFF, the Fund undertook 38 engagements with 27 companies during the quarter. Thirteen of the engagements addressed climate change issues, with the remaining engagements focussing on environmental risk, human rights and governance. The majority of engagements were conducted through dialogue with the Chairperson; six

engagements are currently categorised and change in process, whilst substantial and moderate improvements were documented in four engagements.

- 3.3 Through LGPS Central and its engagement provider, Hermes EOS, the Fund engaged with 258 companies during the quarter, covering 726 environmental, social and corporate governance issues and objectives. Most engagements were conducted through letter issuance or company meetings, and LGPS or EOS, met or wrote to the Chair or a member of senior management. An overview of this engagement activity is provided in Appendix A.
- 3.4 The ongoing global pandemic Covid-19 continues to cause disruption with potentially long-lasting repercussions for the economy and society as a whole, and the Fund continues to reflect and engage on the impact that this is having for companies and their stakeholders.

Climate Change

- 3.5 Climate change is an unavoidable issue for governments, corporates and consumers alike. The Fund continues to engage with its external managers over climate change. With the US having finally completing their withdrawal from the Paris Accord, the election of Joe Biden to the Presidency could see that overturned and a much more positive policy stance being adopted.
- 3.6 This quarter engagement has taken place on climate change through LAPFF (which both WMPF and LGPS Central are members). Thirteen climate change engagements with a range of companies were undertaken during the period with substantial improvements documented through engagement with ArcelorMittal and JS Sainsbury.
- 3.7 Engagement to date with ArcelorMittal has led to a 30% carbon emission reduction target for its European operations by 2030. ArcelorMittal issued a press release at the end of September announcing a group-wide target to be carbon neutral by 2050. Testing of technology to reach this goal will include a direct reduced iron – electric arc facility for carbon-free steelmaking to be up and running in Hamburg by 2023.
- 3.8 A meeting between LAPFF and the chair of a major food retailer provided detail underpinning the company's net zero by 2040 target, which included a discussion on scope 3 emissions such as incentivising the use of electric vehicle for deliveries and by customers. The meeting also covered the response to the pandemic including doubling the companies' on-line sales and a focus on employee engagement. Progress towards the plastic reduction goal of 50% by 2025 was explored in addition to management of deforestation.

- 3.9 Climate change stewardship undertaken by LGPS Central Ltd continues to build on collaborations with the Climate Action 100+ initiative. During the quarter the LGPS Central's climate change engagement set comprised 148 companies with 183 engagements issues. There was engagement activity on 157 engagement issues and achievement of some or all engagement objectives on 73 occasions.

Climate Action 100 – specific engagements

- 3.10 Along with the LGPS Central and LAPFF, the Fund is proud to be a member of Climate Action 100+ (CA100+), a collaboration of 518 investor groups with \$47tn in assets. In September, letters went out to all CA100+ companies asking them to commit to a net-zero carbon emissions target by 2050 for their operations, products and services to end users. The letter also marks the start of a Benchmark Framework project that will allow evaluation of company progress on short-medium-and long-term trajectories to 2050, as well as scoring of companies within and across sectors. Using 30 indicators, the benchmark will provide comprehensive analysis on which companies are leading the transition to net-zero emissions, alongside a range of other indicators used by investors to inform investment and corporate engagement strategies.

Sustainable Food Systems

- 3.11 Global biodiversity targets for 2030 and 2050 will be agreed in 2021 and companies must be ready to deliver them. The financial materiality of biodiversity loss and ecosystem degradation to many sectors is apparent and can no longer be ignored as an inconvenient externality. There are also serious risks to the financial system and the global economy. Stewardship on these issues is a key means by which investors can ensure that companies recognise the importance of biodiversity and then take meaningful and concrete steps to protect it. Throughout the quarter the Fund has undertaken engagement under the Sustainable Food Systems umbrella through LAPFF and LGPS Central.
- 3.12 The impact of deforestation on climate change is a growing concern. Tropical forests play a crucial role in tackling climate change, protecting biodiversity and ensuring ecosystem services, all of which have an impact on economic development and the stability of well-functioning capital markets. During the last quarter, investors led by Storebrand (Norway) and BlueBay Asset Management (UK) formed an Investors Policy Dialogue on Deforestation (IPDD) initiative, of which LGPS Central is on the advisory panel. Last quarter the IPDD met with the Ambassador of the EU delegation in Brazil to outline the expectation that Brazilian authorities halt and reverse deforestation whilst allowing investors access data to monitor this progress.
- 3.13 Alongside the IPDD, 80 investors including LGPS Central have sent letters to three Brazilian meat processors, calling on the companies to better manage deforestation risks

and to provide full traceability across their entire cattle supply chain. Correspondingly, LAPFF held a meeting with another major food retailer to discuss how the company's meat supply chain might contribute to deforestation through its supplier. The soy, which is used to feed the cattle eventually purchased by the company as meat, is targeted by the campaign and has highlighted the complicated nature of commodity supply chains and the importance of conducting effective environmental and human rights due diligence on the entire supply chain, not just first or second tier suppliers.

Human Rights

- 3.14 The Fund supports the PRI view that human rights are universal and inherent to all human beings. Engagement provider EOS notes that every person around the world deserves to be treated with dignity and equality; we are all equally entitled to our human rights without discrimination. Human rights are a priority issue for investors as they underpin a company's wider corporate culture, business ethics and enterprise risk management. All these affect a company's reputation and the ability to create and preserve value over the long term.
- 3.15 The Fund has undertaken human rights engagement during the quarter through LAPFF and LGPS Central. The former undertook four human rights engagements during the quarter. During the quarter, LAPFF representatives joined a supply chain due diligence workshop hosted by the newly independent Workforce Disclosure Initiative. Attendees discussed what companies and investors can do to improve workplace standards at supplier facilities.
- 3.16 The Fund continues to support CCLA's FTSE 100 Mental Health Engagement initiative. Since inception in April 2020, responses acknowledging the problem of mental ill-health in the workplace have been received from 74 of the original 100 targeted companies, and steps have been put in place to begin to address this. Findings to-date highlight that 89% of respondents have an Employee Assistance Programme (EAP), or an equivalent, and have been signposting the resource throughout the Covid-19 crisis. More than half of the companies that responded offer specific, targeted mental health training for managers. Conversely, only ten companies said that they had relaxed or reviewed performance appraisals in light of the pandemic. In addition, whilst EAPs are widely offered, usage is rarely monitored.

Responsible Financial Management

- 3.17 The Covid-19 pandemic, and the global response to it, poses a threat not only to global health, but to communities, economies and investments. The Principles for Responsible Investment (PRI) has stipulated that as long-term stewards of capital, investors can and should act now to help reduce harmful impacts. The Covid-19 crisis impacts all investors and their beneficiaries – regardless of holdings, strategy or role in the investment chain.

Responses to the crisis must therefore be predicated on the basis of systemic integrity and long-term universal returns being more important than relative company performance. The Fund reached out to its investment managers to obtain assurance on their management of Covid-19 and its impact on their business operations, which provided comfort on the effectiveness of managers in dealing with the crisis.

- 3.18 During the quarter LGPS Central undertook engagement with ten companies on eleven fair tax payment issues. The Pool expects continued scrutiny from investors and other stakeholders on responsible tax behaviour during the prolonged Covid-19 pandemic.
- 3.19 On behalf of LGPS Central, EOS at Federated Hermes engaged a European banking services company on various ESG issues including tax transparency and responsible tax behaviour. EOS requested a meeting with the Chair of the Board Sustainability Committee and agreed to provide views on a sustainable banking impact scorecard and the Company's latest tax transparency.
- 3.20 LGPS Central have continued to collaborate with five European investors to engage a selection of companies across vulnerable sectors. The investors have had several conversations with a US-domiciled software and services company regarding its approach to tax and how it defines and manages tax related risks. Despite the company establishing a Global Corporate Income Tax Matter Policy in the 2019, the investors are concerned about the potential use of tax havens and will continue engagement with the company.
- 3.21 LAPFF has responded to the Business, Energy and Industrial Strategy (BEIS) Select Committee Inquiry following up on its 2019 Future of Audit Inquiry. The Committee addressed progress on implementing the findings of the Competition and Markets Authority Review of the audit market, and the Kingsman Review into replacing the Financial Reporting Council. LAPFF was pleased with the direction of each of the reviews, however it was concerned with the slow progress in their implementation.

Voting Globally

- 3.22 The Fund's voting policies are currently executed by EOS via a contract held by LGPS Central Ltd, the Fund's asset pool company. The Fund has contributed to and endorses LGPS Central's Voting Principles.
- 3.23 The voting activity for the quarter across markets and issues can be found in Appendix B. During the period, the Fund voted at a total of 309 company meetings (3,842 resolutions) – 104 UK, 66 Europe, 29 North American, 55 Developed Asia, 10 Australasian and 45 in Emerging and Frontier Markets. At 149 meetings we recommended opposing one or more resolutions. The largest number of resolutions that were opposed concerned remuneration and board structure (usually voting against non-independent non-executive

directors where the Fund or its advisors do not see sufficient independent oversight on a company board).

Correspondence

- 3.24 Following the Supreme Court ruling on the case of the Palestine Solidarity Campaign (PSC) vs the Secretary of State for Housing, the Fund received correspondence from both a national campaign group (received in common with a number of other local authority pension schemes) and local representatives. The Wolverhampton Palestinian Solidarity Campaign raised queries regarding a number of companies that currently operate within Occupied Palestinian Territories (OPT) who were felt not to be adhering to the UN's guiding principles on Human Rights. The Fund's engagement partner LAPFF continues to progress engagement having communicated with a number of companies to convey concern on company involvement in the OPT/ Israel Territories and looking to further discussions with them over the coming months. The Committee will be kept updated on progress in this engagement.
- 3.25 As noted in the September Responsible Investment report, the Fund had received a number of communications from correspondence from individual members of the public in connection with climate change and calls for divestment. The Fund maintains its position that engagement rather than divestment continues to be a more effective long term approach and is able to point to the collaborative work it engages on with others to deliver success in ensuring companies to set carbon targets and to focus on managing their own climate risks. The Fund responded to all correspondents.

4.0 Climate Change Update and Taskforce on Climate Related Financial Disclosure (TCFD) Reporting

Climate Strategy

- 4.1 Climate change, and the risks and opportunities it presents to the Fund as a long-term investor has been a key consideration for a number of years. The Fund recognises that action on climate change requires commitment by all parties on a worldwide scale and as a global investor the Fund has a key role to play in promoting and leading transition to a low carbon economy. The Fund recognises the scale of the challenge and actions required, not just by investors but more broadly by companies and consumers. Furthermore, the Fund believes collaboration with like-minded investors on climate change is essential in driving change and therefore has and continues to be active participants in selected collaborative initiatives where supportive of our stewardship aims.
- 4.2 The development of the Fund's approach to climate change continues to be an area of focused activity and following on from discussions at the September 2020 Committee meeting and the focused training session in October, officers continue to work on a

review of the climate framework and strategy. The Climate Change Framework and Strategy (2019-2023) agreed by Pensions Committee in March 2019 set out a number of ambitions. Significant progress has been made against those ambitions two years into the Framework and Strategy, and in recognition of the increase in pace of global action required, it is appropriate to review what has been delivered, with an outline of the Fund's strategic actions on Climate Change set out at a high-level below:

- Measurement of climate and observation of climate risks and opportunities – The Fund has revisited climate risk analysis under a range of scenarios and has shown improvement against those scenarios (see TCFD report). The Fund has engaged with a range of advisers to incorporate climate change into the advice it receives. It is however, recognised that at this time, measurement of climate risk is an inexact science and the Fund is supportive of measures to ensure improved data collection, for example through the Transition Pathway Initiative (TPI).
- Reflecting climate change priorities in asset allocation – The Fund has reflected the importance of climate change within its investment beliefs and includes within the Fund's Investment Strategy and Funding Statements. The Fund set some clear ambitions to have 10-15% of the Fund invested in low carbon and sustainable investments and has already achieved this ambition with its investments in the Climate Factor Fund and Global Sustainable Equities, along with renewable infrastructure investments. The Fund also sought to reduce its exposure to pure-play thermal coal producers and again has met this ambition.
- Ensuring that climate change is incorporated into the Fund's selection and due diligence processes – Climate risk factors for major asset classes are incorporated into the decision-making process when considering new investments. For example, the Fund was instrumental in the development of the LGPS Central Ltd Climate Factor Fund and developed a Global sustainable equity framework open to the pool, to enable access to a range of dedicated strategies, including those which target development sustainable solutions and technology to support transition to a low carbon economy.
- Maintaining purposeful stewardship in relation of climate change – Climate change continues to be one of the Fund's four key engagement themes and has also been adopted by the Fund's investment pool provider. Through its collaborative and partnership arrangements, the Fund campaigns for greater awareness, transparency, disclosure and action on climate change. Engagement and voting are undertaken by LGPS Central Ltd's appointed voting and engagement provider Hermes EOS.

- Providing transparency and disclosure in relation to climate change – The Fund has reported against the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations since they were introduced in 2017 and following review, the Fund is enhancing reporting with a standalone disclosure report this year. As noted above voting on behalf of the Fund is undertaken by Hermes EOS through LGPS Central Ltd and where appropriate they will pre-declare voting intentions on shareholder resolutions e.g. Barclays.

4.3 Nearly two years in to the Fund's four year Climate Change Framework and Strategy, the ambitions it set out in 2019 have largely been delivered, recognising that climate change is a fast evolving space and it is appropriate to revisit those ambitions to update the Climate Framework and Strategy which is in development for Pensions Committee, March 2021.

4.4 The Fund has already committed to align itself to the Paris Agreement whose

“central aim is to strengthen the global response to the threat of climate change by keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius”

A consensus which has emerged since the Fund's Strategy and Framework was developed in 2019 is the view that meeting the goals of Paris will require transition to a “net zero” economy by the middle of the century. There remains debate amongst commentators, policy makers and industries as to the definition of net zero and the Fund is actively supporting work being undertaken by the IIGCC on the development of a Net Zero Investment Framework, to inform further development of the Fund's strategic objectives in response to climate change.

4.5 As the Committee are aware, the Fund continues to adopt engagement rather than divestment, viewing this as the most appropriate response to climate change. As a large scale investor the Fund is of necessity invested across a diversified range of assets and recent efforts on engagement have provided evidence that certainly across a range of companies this is starting to have an impact in their approach to climate change, the Fund alongside other investors will continue to pursue greater steps to ensure these companies hold good on those commitments and to move at greater speed to deliver the climate transition with a reallocation of capital to climate friendly investments.

Taskforce on Climate-related Financial Disclosures

4.6 An initial assessment of the Fund's investment portfolio-wide exposure to climate-related risks was undertaken in 2017. This aligned with the publication of the TCFD recommendations on climate disclosure and the Fund was one of the first pension

schemes to report against those recommendations and has continued to do so annually. Disclosing and setting out in a transparent way the actions we are taking and reporting against the TCFD recommendations enable the Fund to lead and demonstrate its commitment in climate change, particularly in what is a fast-evolving space. The Fund therefore proposes in the interests of transparency and fuller disclosure to publish a separate standalone TCFD report this year and going forwards, recognising that this is the first of such more detailed disclosures and work will be ongoing to further enhance reporting going forwards.

4.7 TCFD recommendations have four key elements for disclosure, namely:

- Governance - The organisation's governance and how it oversees climate-related risks and opportunities
- Strategy - The actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning
- Risk Management - The processes used by the organisation to identify, assess and manage climate-related risks.
- Metrics and Targets - The metrics and targets used to assess and manage relevant climate-related risks and opportunities

The Fund supports the TCFD recommendations as the leading framework to describe and communicate the steps the Fund is taking to manage climate-related risks and incorporate climate risk management into investment processes.

4.8 The standalone report for 2020 is contained in Appendix C. The Committee are invited to approve the report for publication.

4.9 Earlier in the summer the Department for Work and Pensions published a consultation on climate change disclosure which sought views on whether reporting against TCFD recommendations on climate change should become mandatory for Pensions Funds over a period of time reflecting the scale of a scheme's assets. Whilst this consultation was aimed at private sector schemes and would not apply to the LGPS, the Fund given its support for TCFD since the outset submitted a response to the consultation to broadly support the recommendation for greater transparency and disclosure. Subsequently the government has confirmed that the UK will become the first country in the world to make TCFD-aligned disclosures fully mandatory across the economy by 2025. In terms of Pension Funds this will start in 2021 for the largest occupational pension schemes, i.e. those over £5bn. Consultation on changes to LGPS Regulations and guidance are expected early 2021.

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 The report contains no direct legal implications.

7.0 Equalities implications

7.1 The report contains no direct equalities 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 The report contains no direct human resources implications.

10.0 Corporate landlord implications

10.1 The 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/wp-content/uploads/2020/08/LGPS-Central-Quarterly-Stewardship-Update-Q1-2020-21.pdf>.

11.2 LAPFF Quarterly Engagement Report: <https://lapfforum.org/publications/category/quarterly-engagement-reports/>

12.0 Schedule of appendices

12.1 Appendix A – WMPF Engagement Activity

12.2 Appendix B – WMPF Voting Activity

12.3 Appendix C - Taskforce for Climate-related Financial Disclosure (TCFD) report 2020 –
To Follow.