

# Pensions Committee

24 March 2021

<b>Report title</b>	Responsible Investment Activities	
<b>Originating service</b>	Pension Services	
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## Recommendation for decision:

The Pensions Committee is recommended to:

1. Approve the Responsible Investment Framework March 2021 (Appendix A).

## Recommendations for noting:

The Pensions Committee is asked to note:

1. The Fund's engagement and voting activity for the three months ending 31 December 2021 (Appendices B and C).
2. The issues discussed by LAPFF are set out in the Quarterly Engagement Report which is available on the LAPFF website: [https://lapfforum.org/wp-content/uploads/2021/01/LAPFF\\_QER4\\_2020\\_final.pdf](https://lapfforum.org/wp-content/uploads/2021/01/LAPFF_QER4_2020_final.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, stewardship, and transparency and 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 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 Principles for Responsible Investment (PRI).
- 3.2 Through LAPFF, the Fund undertook 172 engagements with 145 companies during the quarter. Ninety-nine of the engagements targeted human rights issues, fifty nine raised climate change concerns, with the remaining engagements focussing on a mix of environmental risk, human rights, and governance issues. Most engagements were conducted through dialogue with Executive Directors or CEOs; three engagements are currently categorised as change in process, whilst substantial and moderate improvements were documented in three engagements.

Through LGPS Central and EOS, the Fund has been closely monitoring the developing engagement activity in support of responsible financial management, with focus on the banking sector and company response to social needs highlighted by the pandemic. Topical issues such as fair tax payment and coronavirus vaccine distribution have come to the fore as attention turns to global recovery. LGPS Central are in the process of preparing an annual review of engagement activity and progress which will be reported to the Committee in June.

- 3.3 The ongoing global COVID-19 pandemic 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*

- 3.4 With the UN's COP26 meeting set to take place in November 2021, this is a critical year for both corporate and policy makers in accelerating action towards the goals of the Paris Agreement - to limit global warming to well below 2, preferably to 1.5 degrees Celsius, compared to pre-industrial levels. The focus is now on the UK and the contribution that local authority pension funds and other institutional investors can make to help decarbonise the economy in a way that protects beneficiaries and secures just transition to net zero.
- 3.5 Following a primary proposal in August 2020, the Department for Work and Pensions published a secondary draft of climate risk reporting and governance regulations for occupational pension funds in January 2021<sup>1</sup>. The consultation on the proposed rules comes after the Chancellor in November announced plans to roll out mandatory climate reporting requirements across the UK economy by 2025, with a significant proportion in place by 2023. The Fund provided responses to both phases of the consultation and will review how these changes influence LGPS regulations as and when these are published by MHCLG.
- 3.6 This quarter, fifty-nine climate change engagements were undertaken by LAPFF. Change in progress has been recognised through engagement with ArcelorMittal. LAPFF pushed ArcelorMittal to set group-wide net zero targets and the company has now set an interim target of 20% reduction in scope 3 emissions by 2030. LAPFF similarly met with Standard Chartered who has since committed to net-zero emissions across its global properties by 2030. For scope, in regard to 3 emissions (which relate to indirect emissions occurring in a company's value chain), the company is now working with clients to measure, monitor and reduce emissions to ensure alignment of the portfolio with the Paris goals.
- 3.7 During 2020, LAPFF called on the UK Government to ban sales of all new petrol and diesel cars by 2025. The Government has confirmed that it will ban the sales by 2030, representing a significant outcome in terms of carbon reduction impact. When questioned on its approach to fleet electrification, BMW assured LAPFF that it was ready to meet the rise in demand for electric vehicles and that its own operations will be carbon neutral by 2022.
- 3.8 Through CA100+ the Fund engaged 39 oil and gas companies during 2020. BP set a new ambition to become a net-zero emissions company by 2050 for scope 1, 2 and 3 with a 50% cut in the carbon intensity of products it sells by 2050 or sooner. It also became the first oil major to announce that it will cut production 40% by 2030. Shell set a new long-term ambition to reduce the net carbon footprint of its energy products by 65% by 2050, and by around 30% by 2035. To reach overall net-zero emissions, Shell intends to pivot towards serving customers that are aligned with its net-zero ambitions.

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<sup>1</sup> <https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes-response-and-consultation-on-regulations>

- 3.9 During 2020, the Fund also engaged 23 mining and metal and 14 consumer product companies via CA100+. BHP made a significant enhancement in its approach to improve real-time disclosure on misalignment and escalation. The company also set a medium-term target to reduce operational emissions by 30% by 2030. Unilever announced it would achieve net-zero emissions from all its products by 2039. It intends to establish a 1 billion Climate and Nature Fund to invest in projects such as reforestation, carbon sequestration and conservation.

### *Sustainable Food Systems*

- 3.10 As a founding member of the 'Valuing Water Finance Task Force<sup>2</sup>', LAPFF attended the second meeting in November. Task Force members discussed the importance of highlighting the link between water resources and climate change as well as the need for a solution-orientated approach. Members discussed how best to encourage asset allocation to the future of water security. Ultimately, the methodologies of both the cost of inaction and the shadow price on water were identified as a potentially meaningful way of undertaking financial materiality assessments.
- 3.11 The UN's landmark 2019 global assessment report on biodiversity and ecosystem services identified a major decline in biodiversity at a level unprecedented in human history, with extinction rates accelerating. In 2021, countries are expected to agree on a post- 2020 framework for biodiversity at the Convention on Biological Diversity COP 15. Like the Paris Agreement for climate change, the targets will be delivered by countries and companies.
- 3.12 Consumption of plastic has increased 20-fold in the last 50 years and is set to triple again by 2050, yet only 14% is recycled. Simultaneously, microplastics threaten to contaminate all living organisms, with unknown health consequences. EOS have published a white paper 'Investor Expectations for Plastic Challenges<sup>3</sup>' to help address this escalating problem. Over the long term, EOS deem that plastics must either be removed altogether, reused, or recycled in a closed loop.

### *Human Rights*

- 3.13 In 2020, along with other LGPS Funds, the Fund reported that it had been approached by both pro-Israeli and pro-Palestinian groups about investments in the Israeli-Palestinian territories. Consequently, LAPFF cross-referenced the companies of interest with a UN list of companies raising concerns based on their operations in this area to determine a preliminary list of companies with which to engage on this issue. The first engagements have taken place with three of the seventeen companies approached on this issue, calling for the companies to prepare human rights impact assessments. So far, there has been pushback on two fronts from all three companies, one citing existing legal requirements in place to protect. LAPFF will continue to engage with the companies approached and Pensions Committee will be kept updated on the progress of this engagement.

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<sup>2</sup> <https://www.ceres.org/valuing-water-finance-task-force>

<sup>3</sup> <https://www.hermes-investment.com/uki/eos-insight/eos/investor-expectations-for-global-plastics-challenges/>

- 3.14 Part of LAPFF's strategy to make progress on the previously reported Tailings Dam safety has been to meet company chairs to explain the Forum's perspective on the importance of speaking meaningfully with affected communities. The Forum has managed to speak to the chairs of Vale and BHP but is yet to meet with the chairs of AngloAmerican and Glencore on this issue. These engagements fit within the continuing collaborative efforts between investors through another Church of England-led initiative on engagement with Indigenous communities. Over 70 letters were sent to mining companies globally to request improved disclosure on stakeholder engagement and governance. The results are now being collected to determine next steps.
- 3.15 The Fund continues to engage social media companies through its collaboration with the NZ Superfund. As a direct response to a specific governance-level request by the Superfund, Facebook has updated the charter of its Audit & Risk Oversight Committee to explicitly include review of content-related risks that violate its policies, and it will move not just to monitor or mitigate such abuse, but to prevent it. Facebook noted its appreciation of the Superfund's constructive dialogue. Alphabet has also recently strengthened the mandate of its Audit committee to explicitly include oversight of civil and human rights-related risks. The Superfund hopes that Twitter will follow suit.

#### *Responsible Financial Management*

- 3.16 Executive remuneration continues to be a topical issue and, against the backdrop of the coronavirus pandemic, decisions on how to reward executives have been thrown into sharp focus. During the quarter, EOS looked for appropriate reductions to salaries and incentive pay and for boards to use their judgement to ensure executives were not being unduly insulated from the impacts of the crisis where others were not. EOS opposed pay proposals where they did not believe appropriate adjustments had already been made, such as at JPMorgan Chase & Co, Disney and Delta Airlines.
- 3.17 EOS has continued to make the case for switching to simpler pay schemes based on long-term time-restricted stock, as the crisis exposed the limitations of schemes reliant on stock options or 'performance-based' schemes for which boards struggled to set meaningful targets. Underpinning this, EOS has applied its normal voting policy guidelines that seek to address excessive pay and problematic pay structures around the world.
- 3.18 EOS has been engaging with Tesco since 2014. Following recent correspondence with Tesco's board, EOS were pleased with the changes made to the company's culture and processes, particularly for financial reporting and audit, risk management and enhanced transparency. EOS was satisfied with the effectiveness of the company's response to the coronavirus pandemic; improved risk management processes enabled a quick operational response, whilst the company's culture enabled swift decision-making.

Further information about the full range of EOS engagement activity is summarised in their quarterly engagement report included as a background paper to this report

### *Voting Globally*

- 3.19 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.
- 3.20 An overview of the engagement and voting activity for the quarter across markets and issues can be found in Appendices B and C. During the period, the Fund voted at a total of 331 company meetings (2,523 resolutions) – 62 UK, 73 Europe, 37 North American, 40 Developed Asia, 91 Australasian and 28 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*

- 3.21 The Fund continues to receive correspondence from individual members of the public, and more established divestment groups in connection with climate change and calls for divestment. In February, the Fund received advanced notice of a proposed publication by Friends of the Earth in relation to our investment in coal, oil and gas companies. The Fund raised directly with the report authors some misstatement of information which has resulted in the overstating of the exposure to these industries within our investments and sought rectification of the data prior to publication. 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 encouraging companies to set carbon targets and to focus on managing their own climate risks. The Fund continues to respond to all correspondents.

### *Leadership and policy development*

- 3.22 The IIGCC Net Zero Investment Framework was launched on 10 March. This aims to provide a comprehensive set of recommended actions, metrics and methodologies to enable both asset owners and asset managers to maximise the contribution they can make to decarbonisation of the global economy in tackling climate change. It provides an important tool to support alignment with net zero and is one output from the Paris Aligned Investor Initiative (PAII) that the West Midlands Pension Fund, along with LGPS Central, has contributed to since 2019. The Fund continues to support PAII and development of framework implementation through two working groups.
- 3.23 At time of writing, the Fund is awaiting publication of the first company scorecards from the Climate Action 100+ Net-Zero Company Benchmark. The benchmark framework developed in collaboration with signatory investors and leading climate research and data NGOs incorporates ten disclosure indicators to assess company alignment with key commitments. This, together with the IIGCC framework will inform a review of the Fund's Climate Change Framework and Strategy over 2021/22.

3.24 As part of a developing workstream on Equality, Diversity and Inclusion (EDI) the Fund is working in collaboration with other investors to engage with its investment managers to understand developing practice and action to improve EDI within the pension and asset management community. Progress will be reported to Committee as this develops.

#### **4.0 Responsible Investment Framework March 2021**

4.1 The Fund's Responsible Investment Framework sets out the approach the Fund takes to integrate environmental, social and governance (ESG) considerations into its investment strategy and implementation. Supplementing and aligned with the investment beliefs set in the Investment Strategy Statement, the Framework outlines three pillars of Fund action on selection; active stewardship through engagement and voting; and transparency and disclosure.

4.2 The Framework was last reviewed and updated in June 2020, to incorporate four updated engagement themes over the three years to 2023. Review in 2021 has focused on routine review and refresh of the policy document as part of an annual programme, to capture any associated changes and/or developments and keep the framework document up to date.

4.3 Key changes to the updated Framework enclosed in Appendix A include:

- specific reference to the Fund's support for increasing regulation and guidance for UK pension schemes to assess, manage and publish action on Climate Change;
- reference to the action the Fund is taking to disclose its climate risk assessment;
- reference to standards adopted by LGPS Central to ensure RI-integration with the products the Company creates; and
- specific reference to the Fund's work to promote diversity and inclusion.

4.4 The changes all aim to clarify and provide greater commentary on the Fund's developing approach and the Committee are invited to approve the 2021 Framework with these additions.

#### **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 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 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 LAPFF Quarterly Engagement Report:

[https://lapfforum.org/wp-content/uploads/2021/01/LAPFF\\_QER4\\_2020\\_final.pdf](https://lapfforum.org/wp-content/uploads/2021/01/LAPFF_QER4_2020_final.pdf)

11.2 Federated Hermes EOS Public Engagement Report:

[Public Engagement Report Q3 2020 - UK Institutional \(hermes-investment.com\)](https://www.hermes-investment.com/public-engagement-report-q3-2020-uk-institutional)

## **12.0 Schedule of appendices**

12.1 Appendix A – Responsible Investment Framework March 2021.

12.2 Appendix B – WMPF Engagement Activity.

12.3 Appendix C - WMPF Voting Activity.