

# Pensions Committee

22 March 2017

<b>Report title</b>	Responsible Investment Activities	
<b>Originating service</b>	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 31 December 2016, including Appendix 1.
2. The issues discussed by LAPFF are set in the Quarterly Engagement Report which is available on their website:  
[http://www.lapfforum.org/Publications/engagement/files/Q4\\_2016\\_QER\\_FINAL.pdf](http://www.lapfforum.org/Publications/engagement/files/Q4_2016_QER_FINAL.pdf)
3. The update provided on the recent engagement activities with Hanwha Corporation and Motorola Solutions.
4. The Fund's revised Stewardship Code Compliance Statement and the award by the FRC of Tier 1 status in relation to the Fund's Compliance Statement.
5. Other activity undertaken to ensure the Fund continues to develop and support its approach to Responsible Investment.
6. The Fund's updated UK Stewardship Code Compliance Statement, available on the Fund's website: <http://www.wmpfonline.com/CHttpHandler.ashx?id=4650&p=0>

## 1.0 Purpose

- 1.1 To update the Pensions Committee on the work undertaken by the Investment team regarding their responsible investment activities between the period 01 October to 31 December 2016.

## 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 policy. There are three main areas of responsible investment that we focus on: **voting globally**, **engagement through partnerships** and **shareholder litigation**.

## 3.0 Responsible Investment Activities

### *Voting Globally*

- 3.1 The Fund currently has its own bespoke UK voting policy which our voting provider, Pensions and Investments Research Consultants Ltd (PIRC), executes on the Fund's behalf. However, the Fund follows the voting advice of PIRC for European, US, Japanese and Pacific region company meetings. The bespoke UK voting policy is reviewed annually, and the 2017 review is expected to be undertaken in the coming months.
- 3.2 The voting activity for the quarter across markets and issues can be found in Appendix 1. During the period the Fund voted at a total of 269 company meetings – 47 UK, 32 European, 44 North American, 11 Japanese, 46 Asia (excluding Japan), 80 Australasian and 9 in the rest of the world. During this period there were 15 meetings where the Fund supported all the resolutions put forward by companies. Approximately 35.7% of the resolutions were not supported by the Fund. The largest number of resolutions that were opposed related to the independence of directors, annual reports that failed to meet best practice and executive pay schemes.
- 3.3 In line with the terms of best practice outlined by the Financial Reporting Council, the fund now discloses its voting activity on a vote-by-vote basis. The information is available through the Fund's website.
- 3.4 At the Sports Direct EGM on 5th January 2017 the Fund voted against the re-election of Sports Direct Chair Keith Hellawell, who has overseen a troubled time for Sports Direct both financially and reputationally. Despite significant opposition, Mike Ashley (Sports Direct CEO and 55% majority shareholder) forced through the re-election of Mr Hellawell. Through the Local Authority Pension Fund Forum (LAPFF), the Fund continues to engage with Sports Direct.

### *Engagement through Partnerships*

- 3.5 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 program is implemented through the Fund's membership of the Local Authority Pension Fund Forum (LAPFF). The mission statement of LAPFF is "to promote the investment interests of local authority pension funds and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest, commensurate with statutory regulations". LAPFF has a current membership of 72 public sector pension funds in the UK with combined assets of over £175 billion.
- 3.6 Through LAPFF, the Fund engaged with twelve companies during the quarter. Most engagements concerned Governance issues. Rio Tinto, BP and National Grid were engaged on their preparedness for climate change risk. A summary of LAPFF's engagement activities for the quarter are provided alongside the voting activity report in Appendix 1. The issues are set out in the Quarterly Engagement Report which is available on LAPFF's website:  
[http://www.lapfforum.org/Publications/engagement/files/Q4\\_2016\\_QER\\_FINAL.pdf](http://www.lapfforum.org/Publications/engagement/files/Q4_2016_QER_FINAL.pdf)
- 3.7 Through the United Nations' Principles for Responsible Investment (PRI), the Fund is currently a support investor to two engagement topics, each of which concerns a number of holdings. One topic is water scarcity risk in the supply chains of food & beverage and apparel companies. Water scarcity and potential supply shocks are financially material risks for businesses whose value chains depend on soft commodities. A second topic is human rights risks in companies involved in the extractives sector. In this sector, a failure to manage human rights risks can lead to a loss of license to operate, facilities closures and a diminution of revenue.
- 3.8 Through a collaboration of European pension funds, the Fund is a participant in an engagement with one of its investees on the adequacy of succession planning for a key individual.

### *Update on Cluster Munitions Engagement*

- 3.9 WMPF continues to work with LAPFF on allegations of cluster munitions production at Hanwha Corp. This follows successful engagements on the same topic with Lockheed Martin, Singapore Technologies, Textron and Alliant Techsystems. The Fund has, through meetings of the Executive and through follow up emails to LAPFF's research and engagement provider, written to LAPFF to ask that LAPFF continue to engage with Hanwha Corp. A decision is expected following the confirmation of LAPFF's 2017/18 workplan – including plans and budgets for engagement topics – which concludes in

early March 2017. An update will be provided to the Pensions Committee at the meeting following LAPFF's decision. Although the amount invested in Hanwha Corp (held via a passive equity fund), represents less than 0.01% of the Fund's total AUM, the Fund remains committed to encouraging LAPFF to address the issue through continued engagement with Hanwha.

#### *Update on Engagement into Human Rights in the Occupied Palestinian Territories*

3.10 WMPF continues to work with LAPFF on allegations of Motorola Solutions having business activities in Israel without having implemented the UN Guiding Principles on Human Rights. This follows successful engagements on the same topic in 2015-16 with Caterpillar, Hewlett-Packard, Veolia and G4S, which were prompted by an approach in 2014 by a group known as the Wolverhampton Palestine Solidarity Campaign (WPSC). UN Resolution 2334 – passed in December 2016 – describes Israel's settlement activity as being without legal validity, and calls upon UN Member States to distinguish between the State of Israel and the Occupied Palestinian Territories (OPTs). The legal ramifications of this UN Resolution for companies – as opposed to UN Member States – are not clear and if companies choose to report on the issue, it will not be evident until the next financial reporting cycle. The Fund has, through meetings of the LAPFF Executive and through follow up emails to LAPFF's research and engagement provider, encouraged LAPFF to engage with Motorola Solutions on human rights risk and its alleged involvement in Israel and the OPTs. A decision by LAPFF on whether to pursue engagement with Motorola Solutions is expected following the confirmation of LAPFF's 2017/18 workplan, which will be completed in early March 2017. An update will be provided to the Pensions Committee at the meeting following LAPFF's decision. Although the amount invested in Motorola Solutions (held via a passive equity fund), represents less than 0.01% of the Fund's total AUM, the Fund remains committed to encouraging LAPFF to address the issue through continued engagement with Motorola.

#### *Shareholder Litigation*

- 3.11 As mentioned above, the pursuit of litigation against investee companies forms part of the Fund's Responsible Investment Framework. The fund partakes in shareholder litigation activities where it thinks monies can be recouped on behalf of the fund's members and where there is no risk of cost or penalty to the fund. Litigation is not considered unless the costs and benefits are known.
- 3.12 The Fund, via its appointed representatives Stewarts Law (SL) has agreed a settlement with RBS relating to the Fund's purchase of a rights issue by RBS in 2008. The Fund is expected to receive payment in 2017Q1. RBS has issued a press statement relating to the finalised settlement. SL will continue to provide monthly updates on the matter.
- 3.13 Following the issues Volkswagen (VW) faced with the emissions testing of its US diesel cars, the Fund became a registered claimant in litigation filed against VW and Porsche in Germany. VW had already admitted to fault in the emissions scandal before the fund became a registered claimant. WMPF is joined by thousands of investors seeking to recover losses in the German courts. The case is ongoing.

### *LAPFF Contract*

3.14 LAPFF has a contract with PIRC Ltd for the provision by PIRC of research and engagement services (“the LAPFF contract”). As reported at the December meeting of the Pensions Committee, the then-current LAPFF contract was up for renewal as of 31 May 2017 and, as the City of Wolverhampton Council manage the financial administration of LAPFF, the Fund was responsible for managing the re-tender process. The LAPFF Executive had endorsed the use of the LGPS National Framework for Stewardship Advisory Services (subject to a successful launch), in order to complete the re-tender project in the most efficient and cost-effective fashion. The Framework was launched on Monday 14 November, and the invitation to tender was sent to the suppliers listed on the Framework on the same date. Unfortunately there was an insufficient response to the invitation to tender and consequently an insufficient level of competition ensued. For reasons of efficiency, and noting the 31 May 2017 contract expiry date, the LAPFF Executive decided to abandon the existing tendering process, to extend PIRC Ltd’s existing contract until 31 May 2020, and to re-start the tendering process in due course.

### *UK Stewardship Code*

- 3.15 Members of the Pensions Committee will recall that the Fund is a signatory to the UK Stewardship Code, a set of seven principles requiring fiduciaries to take a proactive approach to responsible investment, especially through voting, engagement and transparent reporting. Signing the Code is set to become common practice for LGPS following pooling. The Department for Communities and Local Government (DCLG) has, in its “Guidance on Preparing and Maintaining an Investment Strategy Statement”, stated that “administering authorities should become signatories to the Code and state how they implement the seven principles and guidance of the Code”.
- 3.16 The Fund has been recognised by the Financial Reporting Council (FRC) for its stewardship activities and has been awarded Tier 1 status for its revised UK Stewardship Code Compliance Statement, which is hosted on the Fund’s website. Noting the DCLG’s guidance on the UK Stewardship Code, the award of Tier 1 status ensures West Midlands Pension Fund is compliance-ready going into pooling.

### *Responsible Investment Integration*

3.17 The Fund continued its programme of integrating Responsible Investment practices in internally and externally managed funds. For internally managed funds, this has expanded beyond voting and engaging to involvement in the development of investment cases. Where possible buy opportunities are identified, the Responsible Investment Officer has worked with the fund manager on financially material RI risks associated with the investment thesis. For externally managed funds, this has involved face-to-face meetings with active equity fund managers, passive equity fund managers and corporate

bond fund managers. Responsible Investment is also a criterion in the due diligence processes for new private equity fund arrangements; one meeting with a private equity manager was held during the quarter in review. The Responsible Investment Officer has worked with the Chief Investment Officer on Mandate and Process documentation for the investment arrangements pertaining to passive equities and private equity, with other asset classes to follow. This ensures that adequate procedures and processes are hard-wired into the management of the Fund.

### *Other Activities*

- 3.18 The Fund's Responsible Investment Officer attended the AGM of the Institutional Investors Group on Climate Change (IIGCC), of which the Fund is a member. New Chairman Peter Jensen (from the Danish pension fund PKA) will replace outgoing Chairman Donald MacDonald. The IIGCC was praised for policy influence, notably: (a) its role in the Paris Climate Agreement at COP 21 in December 2015 and (b) its role in influencing the UK Government to adopt a 5<sup>th</sup> Carbon Budget and to continue to mandate UK-listed companies to disclose GHG data, and providing evidence to the UK Parliament's Energy Committee inquiry into Investor Confidence in the UK Energy Sector.
- 3.19 Since early 2016 the Fund has been part of the Transition Pathway Initiative (TPI), a tool to rate the adequacy of companies' responses to climate change risk. TPI launched at the London Stock Exchange on 11<sup>th</sup> January 2017 and the Fund will consider using the tool in its Responsible Investment activities. TPI is supported by investors with collectively £2tn in AUM, including some of the largest pension funds in the world.
- 3.20 The "Fiduciary Duty in the 21<sup>st</sup> Century" statement ("the statement") calls on investors to act with due care, skill and diligence, to avoid conflicts of interest, and to take account of environmental, social and governance (ESG) issues, in their investment processes and decision-making. Many financial institutions from around the globe – including 21 from the UK – have signed the statement. Since the Fund already commits to the statement's three pledges in other documented commitments (e.g. WMPF's RI Framework, Statement of Investment Principles, UK Stewardship Code Compliance Statement), the Fund has signed the statement as well.
- 3.21 Following a commission by Mark Carney, as Chair of the Financial Stability Board (FSB), Michael Bloomberg delivered preliminary findings of the so-called "Taskforce on Climate-related Financial Disclosures" (TCFD). Responding to the TCFD's consultation, the Fund welcomed the FSB's recommendations, which seek to improve transparency and disclosure on financially material climate risk.
- 3.22 Several officers and elected members of the Fund attended the LAPFF annual conference in December 2016. The conference contained an interesting array of speakers and topics. There was a particular focus on corporate governance issues, especially executive remuneration.

#### **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**

6.1 This report contains no direct legal implications.

#### **7.0 Equalities implications**

7.1 This report contains no equal opportunities implications.

#### **8.0 Environmental implications**

8.1 Environmental implications are addressed through the Fund's corporate governance policy.

#### **9.0 Human resources implications**

9.1 This report contains no direct human resources implications.

#### **10.0 Corporate landlord implications**

10.1 This report contains no direct corporate landlord implications.

#### **11.0 Schedule of background papers**

11.1 LAPFF Quarterly Engagement Report October to December 2016:  
[http://www.lapfforum.org/Publications/engagement/files/Q4\\_2016\\_QER\\_FINAL.pdf](http://www.lapfforum.org/Publications/engagement/files/Q4_2016_QER_FINAL.pdf)

11.2 West Midlands Pension Fund UK Stewardship Code Compliance Statement, December 2016: <http://www.wmpfonline.com/CHttpHandler.ashx?id=4650&p=0>

#### **12.0 Schedule of Appendices**

12.1 Appendix 1 (Voting and Engagement Activity)