



# Responsible Investment Framework 2018

March 2018

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## 1) Introduction

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### About This Document

This framework defines the commitment of West Midlands Pension Fund and West Midlands Integrated Transport Authority Pension Fund (together: 'the Fund') to responsible investment (RI). Its purpose is to detail the approach that Fund aims to follow in integrating environmental, social and governance (ESG) issues in its investments. It is considered supplementary to the Fund's *Investment Strategy Statement* and thus in alignment with its fiduciary duty. This framework has been developed in the context of relevant regulations, statutory guidance and the advice of the Law Commission.

The Pensions Committee is at all times responsible for the Fund's investments, including oversight of the RI strategy. Responsibility for oversight of the Fund's RI framework sits with the Director of Pensions. This policy applies to all members of the Pensions Committee and the Fund officers.

The Pensions Committee will review this policy at a minimum annually, or at such time as the Fund sees fit to revise its RI policies and procedures.

### LGPS Central

From April 2018 it is likely that a significant proportion of the Fund's RI activities will be executed on the Fund's behalf by LGPS Central Limited ("Central"). Central is the company established by the Fund and seven regional partners to operate collective investment vehicles through which the Fund may invest to save costs over the long term. Central is expected to have a leading approach to RI. Where this document refers to "fund management arrangements", this is defined to include arrangements with Central. Where this document refers to directly held assets, this does not refer to assets managed by Central.

### Definitions of Responsible Investment and Stewardship

The term 'responsible investment' refers to the integration of financially material environmental, social and corporate governance ("ESG") factors into investment processes. It has relevance both before and after the investment decision and is a core part of fiduciary duty. It is not simply a box-ticking exercise nor is it merely a matter of managing reputational risk. It is distinct from 'ethical investment', which is an approach in which the moral persuasions of an organisation take primacy over its investment considerations.

We define the concept of stewardship in the same way as the Financial Reporting Council (FRC), the organisation that oversees the UK Stewardship Code:

"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."

Please refer to the glossary for more definitions of terms.

## 2) Beliefs and Guiding Principles

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### RI Integration

The Fund believes that effective management of financially material RI risks should support the Fund's requirement to protect returns over the long term. The Fund considers RI to be relevant to the performance of the entire Fund across asset classes.

There are some investment opportunities arising from environmental and social challenges which can be captured so long as they are aligned with the Fund's investment objectives and strategy.

The Fund recognises the importance of taking 'proper advice' (as defined in the regulations) and of coming to investment decisions after adequate scrutiny of a robust evidence base.

### Engagement Versus Exclusion

Investee companies with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events. There is risk but also opportunity in holding companies that have weak governance of financially material RI issues. Thus, the Fund prefers to adopt a policy of risk monitoring and engagement in order to positively influence company behaviour and enhance shareholder value, influence that would be lost through a divestment approach. The Fund extends this principle of 'engagement for positive change' to the due diligence, appointment and monitoring of fund managers who are at an early stage of developing its RI approach.

The Fund believes that it will improve its effectiveness by acting collectively with other like-minded investors because it increases the likelihood that it will be heard by the company, fund manager or other relevant stakeholder compared with acting alone. The Fund recognises the need to operate at a market-wide level to promote improvements that will help it to deliver sustainable long-term growth.

## Remuneration, Fees and Incentives

Executive remuneration and investment management costs matter, particularly in low-return environments. Fee arrangements with fund managers and the remuneration policies of investee companies should be aligned with the Fund's long-term interests. The Fund recognises that it is part of its fiduciary duty to ensure that there is appropriate alignment.

## Climate Change<sup>1</sup>

Financial markets could be materially impacted by climate change and by the response of climate policy-makers. Responsible investors should proactively manage this risk factor through stewardship activities, using partnerships of like-minded investors where feasible.

## 3) In Practice

**Either directly or through fund management arrangements, the Fund aims to put its responsible investment beliefs into practice through actions taken both before the investment decision (which we refer to as the selection of investments) and after the investment decision (the stewardship of investments). The Fund aims to be transparent to its stakeholders through regular, high quality disclosure. These ambitions yield the Fund's three RI pillars: Selection, Stewardship and Transparency & Disclosure.**

### Selection

The Fund aims to be aware of and monitor financially material RI issues in the context of investment and manager selection. Depending on the asset class and nature of the proposed mandate or vehicle, the Fund will monitor:

- RI issues in relation to directly managed investments;
- the extent to which fund managers incorporate RI issues into their investment processes, with the expectation that managers' processes will improve over time. This is managed at the due diligence and appointment states as further explained below:

### Fund Manager Due Diligence

The Fund collects the following information from each manager before they are appointed where applicable to the asset class:

- Copy of their RI or stewardship policies (or equivalent) which articulates how RI factors, whether stemming from research, stewardship activities or other sources, are integrated into their investment process.

- Case studies or examples of where RI issues have influenced an investment decision.
- Information on the process for integrating any third party RI data into their company financial models, investment strategies and portfolio construction.
- Fee transparency and evidence of disclosure.
- RI reporting format.
- Whether they are a signatory of the UN-backed Principles for Responsible Investment (PRI) and UK (or other) Stewardship Code, copy of their PRI public report and annual assessment scores if applicable.

### Fund Manager Appointments

The Fund assesses the RI capability of a fund manager as a factor within each of the people, process and performance categories. In its decision to appoint a fund manager, the Fund takes a balanced consideration of all relevant factors including RI. However, the Fund will pay particular attention to adherence to relevant soft regulatory codes<sup>2</sup> depending on the market in which it invests.

In practice, this means the Fund is willing to hire a fund manager at an early stage of developing its RI approach so long as there is a demonstrable RI commitment and a willingness to improve in their approach over time.

In alignment with our guiding principles on 'engagement versus exclusion', the Fund believes that there is added value in working with them to improve their approach.

### LGPS Central

LGPS Central will begin to manage assets on the Fund's behalf from April 2018. Central will operate an investment process that integrates RI factors alongside "traditional" factors, as detailed in Central's *Responsible Investment and Engagement Framework*. RI integration is expected to feature in the investment process for all major asset classes invested in by Central, whether the investments are managed internally or externally.

### Stewardship

The Fund aims to make full use of its stewardship rights, including voting and engagement activities. From April 2018 this will be executed on the Fund's behalf by LGPS Central for certain investments.

<sup>1</sup> By highlighting climate change, rather than other RI risk factors, we are not asserting that climate risk has, for all assets, greater economic significance than other factors. Our motivation for referring specifically to climate change risk derives from our recognition that it is a risk factor of particular importance to a number of stakeholders, and we have communicated our investment beliefs about climate change for reasons of transparency.

<sup>2</sup> For example, UK and Japanese Stewardship Codes

## Company Engagement

The Fund's approach includes bottom-up engagement – which targets improvements on specific issues at individual companies – and top-down engagement – which identifies particular themes of long-term economic significance and of relevance for stakeholders. The Fund will, either directly, collaboratively or through specialist service providers or fund management arrangements:

- hold constructive dialogue with investee companies;
- encourage the disclosure by companies of RI issues;
- participate in the development of public policy on RI issues; and
- disclose and maintain a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of the Fund's beneficiaries first.

## Fund Manager Monitoring

Each fund manager is expected to report<sup>3</sup> at agreed intervals to the Fund on how their RI activities are contributing to improved long-term risk-adjusted returns. Examples of information that can be provided in aid of this objective include but are not limited to the following:

- The evolution of how the manager integrates the consideration of RI issues into its investment and stewardship activities.
- How investment and stewardship functions are combined to protect and/or enhance value.
- Any outcomes arising from the manager's engagement with companies and their effectiveness.

## Industry Engagement

In collaboration with other like-minded investors, the Fund may engage with public policy makers, regulators, trade bodies, indexes and other players in the financial markets to further support the Fund's fiduciary responsibilities. The Fund considers these initiatives on a case-by-case basis.

## Shareholder Litigation

The Fund is eligible to participate in certain individual and class action securities litigation. Securities litigation may be used as an escalation technique within an engagement process. There are a number of litigation options available when a company has violated securities laws that result in losses to the Fund.

For US-based claims, the options would be to:

- remain in the class action and file proof of claim through our claims administrator;

- participate as a lead plaintiff in a class action; or
- opt out and file a private action.

For non-US based claims, the options would be to join an existing group action or file a group action as a lead plaintiff.

The Fund takes a case-by-case approach in determining whether or not to join a class action but considers factors such as:

- advantages and disadvantages of the Fund becoming actively involved;
- relative size of the Fund's potential losses compared to other organisations;
- likelihood of success; and
- whether the Fund is fully indemnified against costs, expenses, counterclaims and any other losses.

## Voting

The Fund uses its voting rights to support the long term economic interests of its stakeholders and to ensure boards of directors are accountable to shareholders. The Fund expects UK companies to adhere to the UK Corporate Governance Code on a comply or explain basis. Further, the Fund has a bespoke UK voting policy (available on the Fund's website<sup>4</sup>), which aims to deal with issues that are either not covered by the Code, require greater emphasis or are specifically left open for shareholders to resolve with company boards.

The Fund expects companies outside the UK to adhere to international voting principles, recognising local application and development.

Where practical<sup>5</sup>, the Fund aims to vote in every single market in which it invests. In the interests of sending a consistent signal to investee companies, the Fund has decided to use a third party provider for analysis of governance issues and executing its proxy voting rights across all markets in which it invests. These arrangements are reviewed on a regular basis.

## Securities Lending Programme

The Fund has an active securities lending programme. To ensure that the Fund is able to vote all its shares at important meetings has worked with service providers to establish procedures to restrict lending for certain stocks and recall shares in advance of shareholder votes. The Fund monitors the meetings and proportion of the securities on loan, and will restrict and/or recall lent stock in select circumstances.

<sup>3</sup> Refers to either formal written reporting and to informal verbal communications, which can be regular and/or ad-hoc in frequency.

<sup>4</sup> <http://www.wmpfonline.com/article/5693/Voting-Globally>

<sup>5</sup> Issues such as power of attorney or share blocking in certain markets may prevent the Fund's ability to do so

## Climate Change Stewardship<sup>6</sup>

The Fund, either directly, through partnerships or fund management arrangements, aims to:

- encourage improvement in the level of disclosure by companies of material climate change risks through collaborative initiatives, for example via our affiliations with LAPFF, CDP, and the Institutional Investors Group on Climate Change (IIGCC);
- support – and where applicable co-file – reasonable shareholder proposals to disclose/justify a company’s approach to climate change risk;
- review its fund managers to understand their approach to incorporating climate change considerations and encourage improvements in identifying and assessing the potential impact of climate change;
- contribute to public policy with regard to climate change as it relates to investment considerations through participation with organisations such as the IIGCC. In support of this aim, the Fund is a signatory to the Global Investor Statement on Climate Change<sup>7</sup>;
- increase awareness of climate change as it applies to investment decision making through participation in relevant industry forums and collaborative initiatives;
- keep up to date on the latest research and thinking on the financial materiality and interconnectedness of climate change within and across asset classes;
- use and encourage adoption of the Transition Pathway Initiative’s (TPI) toolkit for climate change management and performance; and
- disclose using the framework recommended by the Taskforce on Climate-related Financial Disclosures (TCFD), which is recognised as best practice.

## Memberships and Affiliations

### Local Authority Pension Fund Forum

The Fund is a founding member of the Local Authority Pension Fund Forum (LAPFF) and the Fund’s Director of Pensions is currently LAPFF’s Honorary Treasurer. LAPFF is the UK’s leading collaborative shareholder engagement group encompassing more than 70 local authority pension funds from across the country with combined assets of around £200 billion. The Fund is an active participant in LAPFF’s engagement programs. Membership of LAPFF provides the Fund with:

- independent research and advice on the RI risks of companies to inform further stakeholder engagement;
- advice on the governance practices of companies; and
- a forum to engage with companies to improve governance practices.

## Other Initiatives

The Fund is currently a signatory to the UN-backed Principles for Responsible Investment and is a member signatory of the CDP. The Fund is presently a member of Institutional Investors Group on Climate Change (IIGCC), the Pensions and Lifetime Savings Association (PLSA), Transition Pathway Initiative (TPI) and the 30% Club Investor Group. Memberships are reviewed on a regular basis.

## Transparency & Disclosure

The Fund aims to keep its beneficiaries aware of its RI activities through:

- making its RI policy documents public, eg. voting policies, RI policy;
- providing a summary of the Fund’s RI activities, including voting activity<sup>8</sup>, in the annual report ;
- providing a summary of the Fund’s RI activities in the quarterly reports to the Fund’s Pensions Committee;
- publishing aggregate voting and company engagement statistics on a quarterly basis;
- disclosing the outcomes of its voting decisions on a vote-by-vote basis; and
- disclose the Fund’s approach to managing climate change risk using the TCFD framework.

## 4) Appendix: Glossary of Terms

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### Responsible Investment

The integration of environmental, social and corporate governance (ESG) considerations into investment management processes and stewardship practices in the belief that these factors can have an impact on financial performance. The Fund also supports the PRI’s definition of responsible investment which can be found here: <http://www.unpri.org/introducing-responsible-investment>

### ESG

Environmental, social and governance factors which may impact on company performance and therefore investment returns. Examples include resource management and pollution prevention, climate change impacts, labour management, product integrity, executive compensation, board independence and audit function.

### Governance

The process and principles by which a company or organisation undertakes its business. For the Fund, governance includes how it undertakes both its operational and investment responsibilities on behalf of its members.

<sup>6</sup> Please refer to the previous footnote regarding climate change risk

<sup>7</sup> <http://www.iigcc.org/publications/publication/2014-global-investor-statement-on-climate-change>

<sup>8</sup> In line with Regulation 57 of the 2013 Regulations.

**Stewardship**

Refers to the responsibility of the Fund to participate, where appropriate, in the governance decision-making of companies in which it invests by way of voting and by engagement with company management, either directly or via its fund managers. It also recognises the relevance of engaging with regulatory bodies and other market players to support policies that promote long-term sustainable growth.

**Fund**

West Midlands Pension Fund and West Midlands Integrated Transport Authority Pension Fund

**Pensions Committee**

Body established by City of Wolverhampton Council (the administering authority) in charge of the management of the administration of benefits and strategic management of the Fund's assets, which has representation from the seven West Midlands metropolitan district councils and local trade unions.

**Pensions Board**

The role of the Pensions Board is to assist in the good governance of the scheme through the monitoring of Fund performance and adherence to statutory duties. The Board consists of six employer and six member representatives consisting of five employer (officer) and five member (trade union) representatives together with two City of Wolverhampton councilors (one sitting as an employer representative and one as a member representative). The Pensions Board is not a decision-making body, nor does it hold a scrutiny function; its role is to assist in the compliance with scheme rules. The Fund's policies, including the ISS and the RI Framework, are reviewed annually by the Pensions Board.

**Social Investments**

Investments that deliver social impact as well as a financial return are often described as "social investments".

The Fund considers opportunities in social investments alongside other opportunities and will assess their relative merits on fundamental grounds and with reference to suitability of fit for the Fund.

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