

Lancashire County Pension Fund

Appendix A

**Pension Fund Committee
Responsible Investment Report**

2 December 2016

Title of Paper	Quarterly Report on Responsible Investment
Lead Officer:	Frances Deakin Responsible Investment Officer Local Pensions Partnership Investments Ltd
Appendices	Appendix 1: LAPFF Quarter 3 Engagement Report Appendix 2: Extract from Guidance on Preparing an ISS Appendix 3: LPP I Responsible Investment Policy

1. Executive Summary

This report provides members of the Pension Fund Committee of Lancashire County Pension Fund (LCPF) with a quarterly update on Responsible Investment (RI) matters.

2. Introduction

The Fund's approach to RI has been expressed within its Statement of Investment Principles (SIP) and confirms that the objective of RI is to decrease investor risk, improve risk-adjusted returns and assist the Fund's adherence to the UK Stewardship Code.

The Fund's approach to RI encompasses four main areas of activity:

- Voting Globally
- Engagement through Partnerships
- Shareholder Litigation
- Active Investing

Responsibility for the practical implementation of the Fund's approach to RI is devolved to LPP I as LCPF's provider of investment management services. The report which follows provides the committee with an update on RI activity during the period 1st July to 30th September 2016 plus insight on current and emerging issues.

3. Voting Globally

LCPF owns shares in listed companies across the globe. The Fund employs an external provider of proxy voting and governance services to ensure effective and consistent use of the voting rights attached to these assets. Pensions and Investment Research Consultants Ltd (PIRC) analyse and apply voting guidelines to the resolutions at every

shareholder meeting the Fund is entitled to attend and oversee the process of vote execution.

PIRC provide quarterly reports which include a summary of votes cast in the period and the outcome of voting (where known). A copy of the most recent report covering the period from 1st July to 30th September 2016 has been placed within the Members Reading Room for reference.

During the third quarter of 2016 the Fund's interests spanned 20 shareholder meetings (17 AGM, 3 EGM) incorporating 271 separate resolutions. The tables below summarise the spread of voting within Q3:

Location	Meetings Voted	
UK & BRITISH OVERSEAS	4	20%
EUROPE & GLOBAL EU	5	25%
USA & CANADA	3	15%
ASIA	4	20%
AUSTRALIA & NEW ZEALAND	3	15%
REST OF THE WORLD	1	5%
TOTAL	20	100%

Vote	No. of Resolutions	% of Resolutions
For	162	60%
Oppose	86	32%
Abstain	20	7%
Withhold	1	0%
Non-Voting	2	1%
Total	271	100%

There were no cases where the Fund was entitled to vote but did not submit a ballot. The 2 resolutions reported as non-voting were at ASX LTD and related to reports presented for information where there was no requirement for shareholders to give approval.

PIRC apply a voting policy on LCPF's behalf which reflects Corporate Governance best practice and opposes or abstains where resolutions are judged not to be in the long term best interests of shareholders. The Fund supported more than half (60%) of the resolutions tabled in the quarter; opposition voting concentrated upon the following matters:

- CEO and Chairman of the Board responsibilities being combined in a single role;
- the appointment of NEDs known to be fulfilling multiple other directorships;
- Non-Executive Director (NED) nominees lacking independence through their length of tenure or other conflicts of interest;
- Re-election of the Chair of the Nomination Committee where there are no targets for board diversity including gender diversity;
- executive remuneration arrangements lacking adequate checks on excessive pay levels and/or performance measures clearly aligned with shareholder interests;
- remuneration arrangements which grant share options to NEDs (and risk

- compromising their independence);
- the re-appointment of auditors where long standing relationships or non-audit fee levels potentially compromise objectivity, or where the company has not disclosed the terms of the audit fee or the length of tenure;

There were only 2 shareholder resolutions within the third quarter, both of which were supported by the Fund as follows:

J.M. Smucker Company AGM - Renewable Energy Sourcing Report

JM Smucker Company manufactures and markets food products on a worldwide basis. The Company's principal products include peanut butter, fruit spreads, baking mixes and ready-to-spread frostings, flour and baking ingredients, juices and beverages, syrups, pickles and condiments.

The shareholder resolution requested a public report by January 2017 analysing how the Company can increase its renewable energy sourcing and/or production. The Proposer argued that by setting goals to source renewable energy, the Company would demonstrate a proactive approach to reducing exposure to volatile energy prices; enhancing U.S. energy security; creating jobs in the United States; enhancing the Company's reputation; achieving its greenhouse gas (GHG) reduction targets; and meeting the global need for cleaner energy.

The Board recommended that shareholders oppose the resolution, arguing that the Company has recently issued its sixth corporate responsibility report which included, among other matters, a discussion of the Company's renewable energy investments. The Company has made investments in solar arrays and methane turbines at the Company's natural foods campus in Chico, California and the Board argued that the proposal would result in unnecessary and duplicative reporting, and was not in the best interests of the Company and its shareholders.

LCPF supported the resolution on the basis that the company has not set goals or targets for its development of renewable energy sourcing.

Results: For: 27.0%, Abstain: 5.1%, Oppose/Withhold: 67.9%.

Nike Inc. AGM - Report on Political Contributions

Nike is a multinational corporation which designs, develops, manufactures and markets footwear, apparel, equipment, accessories and services.

The shareholder resolution requested that the Company provide a report, updated semi-annually, which discloses

- 1) Nike's policies and procedures for making direct or indirect contributions to the political campaigns of candidate for public office, or for attempting to influence the general public with respect to an election or referendum.
- 2) any monetary and non-monetary contributions made (direct and indirect) including:
 - a. The identity of the recipient as well as the amount paid to each; and
 - b. The title(s) of person(s) at Nike responsible for decision-making.

The Proposer argued that current gaps in reporting keep shareholders in the dark and expose Nike to reputational and business risks that could threaten shareholder value. It was argued that Nike's current policy regarding political spending has a number of significant gaps, public data does not provide a complete picture and Nike does not report on the most important avenue of hidden corporate money into politics: payments to trade associations.

The Board recommended that shareholders vote against the proposal because more disclosure than the Company already provides is not in their best interests.

The resolution was supported by LCPF on the basis that it is important companies protect their reputation by open and transparent reporting which avoids any suspicion that shareholders' funds are being used in an inappropriate way or to gain undue influence. Results: For: 26.5%, Abstain: 7.0%, Oppose/Withhold: 66.5%

Shareholder voting forms part of a wider programme of ownership activity through which LPP I (on behalf of LCPF) seeks to have a positive influence in favour of well-run companies whose business conduct and interests align with generating long term value for shareholders.

4. Engagement through Partnerships

The Fund understands the value of engagement activities which attempt to raise specific issues of concern and reinforce the lines taken within shareholder voting. The Fund's approach recognises the benefit of partnerships and collaborations which offer greater potential reach and impact than acting alone. LPP I participates in a number of collaborations which represent the collective interests of institutional investors and seek to make progress on issues which impact shareholder value. Key groups include the Local Authority Pensions Fund Forum (LAPFF) the Pensions and Lifetime Savings Association (PLSA) the Principles of Responsible Investment (PRI) and the Institutional Investor Group on Climate Change (IIGCC).

LCPF's principal engagement partner is LAPFF which exists to represent the specific investment interests of local authority pension funds as asset owners. 71 of the 89 LGPS funds are now LAPFF members. On a quarterly basis LAPFF provides member funds with a summary of the engagement activities undertaken on their behalf. A copy of LAPFF's Q3 2016 engagement report is attached at **Appendix 1**. Highlights from the report which covers the period from 1 July to 30 September 2016 include the following:

- the launch of "Engaging for a Low Carbon Transition" a joint report from LAPFF and the Carbon Tracker Initiative which provides practical support for investors engaging with companies on their preparedness for a 2°C world;
- AGM attendance at Sports Direct, SSE, Sainsbury, BT, British Land, Vodafone, National Grid and Vedanta;
- Media attention for LAPFF's campaign on reliable accounting and the critical stance being taken to the response of the Financial Reporting Council;
- Direct engagements with 21 companies across a range of themes;
- Engagement on climate change with National Grid, BP and Anglo American in addition to a continuing participation within the broader "Aiming for A" Coalition.

The LAPFF Engagement Report includes detailed information on engagement activities within the quarter which are quantified across thematic topics as follows:

Engagement Topic	Number of Engagements by LAPFF	
Governance (general)	11	23%
Board composition	8	17%
Climate change	7	15%
Employment standards	5	10%
Remuneration	5	10%

Human rights	5	10%
Other	3	6%
Environmental risk	2	4%
Supply chain management	1	2%
Campaign (general)	1	2%
	48	100%

LPP I represents LCPF as a member of the Forum by attending LAPFF business meetings, exercising the Fund's voting rights, drafting responses and feedback to consultations and identifying opportunities for participation.

LAPFF's most recent quarterly Business Meeting took place on 18th October 2016 and was attended by the LPP I Responsible Investment Officer. Headlines from the meeting included the following matters:

- LAPFF Constitution and Membership

Comments received from member Funds following LAPFF's offer to give Observer Membership status to the emerging LGPS pools are to be discussed at a LAPFF strategy meeting in November where other issues relating to Pools and LAPFF membership including fees will also be considered.

LPP has communicated its position to LAPFF on the offer made to pools explaining that the RI Officer will need to continue to attend LAPFF Business meetings and other LAPFF events in order to directly represent clients (LCPF and LPFA) and will need to be able to exercise their voting rights and participate in decision-making on their behalf, something which is not currently envisaged under the observer status offered to pools.

A revised LAPFF constitution is under consideration by the LAPFF Executive and will be put to the AGM in January 2017. Changes will include narrative which strengthens and clarifies the approach to diversity.

- All Party Parliamentary Group (APPG) on Local Government Pensions

LAPFF's role in relation to the All Party Parliamentary Group (APPG) on Local Government Pensions has been clarified following questions raised by Member Funds. It has been confirmed that LAPFF cannot command and control the APPG (which is the creation of Parliament) but can feed ideas into its work plan and use the opportunity provided by the APPG to communicate issues and concerns through to Parliament. APPG meetings are open and member funds who wish to attend are welcome to send representatives to meetings (which take place at the House of Commons). LAPFF will issue press releases and forward these to Forum members by way of update after each APPG meeting.

- LAPFF response to DCLG Guidance on LGPS Investment Strategy Statements

LAPFF has welcomed the new Guidance and specifically the re-statement of the central role of Administering Authorities as the repositories of fiduciary responsibility for LGPS funds. The Forum will be seeking further dialogue with DCLG on the precise meaning of "inappropriate pensions policies" and on the Secretary of State's powers of direction.

The requirement for Administering Authorities to publish Investment Strategy Statements (ISS) which must include their approach to stewardship is discussed in greater detail below within the section on Active Investing.

- Transition Pathway Initiative (TPI)

The business meeting received a presentation on the TPI from LAPFF Executive Member Faith Ward of the Environment Agency Pension Fund (EAPF). TPI is a joint initiative from the Church of England Commissioners, EAPF, and the London School of Economics Grantham Institute to create a practical analytical tool which will help investors understand where companies sit on the transition pathway to a low carbon economy (and their competence to navigate the transition). The tool will be web-based, free for investors to use and will provide information to increase insight and facilitate activity in line with each investor's approach to RI. At the Business meeting members gave their agreement to LAPFF becoming a named supporter of the TPI, attending the launch, using the tool as part of its engagements efforts and publicising the tool to members once operational.

The LPPI RI Officer was already aware of the TPI through separate dialogue with the two Funds who are developing it and LPP I will be a named supporter of TPI in its own right. This will involve being positively associated with the initiative, supporting its goals and committing to using the tool once it is available. The TPI tool will help to inform the development of analysis which seeks better insight into how companies within the Global Equities Pool are currently placed and their plans for future development.

5. Shareholder Litigation

Litigation offers a route for recovering financial losses where asset values have been diminished as a result of financial misconduct.

On LCPF's behalf, LPP I maintains an up to date understanding of prospective shareholder litigations in which the Fund potentially has an interest. Monitoring services are provided at no cost by two US law firms - Barrack, Rodos and Bacine (BR&B) and Robbins Geller Rudman and Dowd (RGRD) which ensure prospective actions are known about, the fund's interest (level of loss) is quantified and information is available as a basis for making a decision on the most appropriate course of action given the risks, costs, benefits and deadlines involved in each case.

LPP I monitors developing litigation cases to ensure the Fund is made aware of those where it has sustained losses and is appraised about opt-in, opt-out or independent legal action where this might offer a premium recovery compared with the default approach of participating collectively in class actions.

A copy of the report received from BR&B summarising litigation monitoring during Q3 2016 has been placed within the Members Reading Room for reference. The report confirms that LCPF had losses in only 1 of 63 new cases filed with Federal or State Courts in the US. Details of the Fund's losses in relation to a prospective class action against Stericycle Inc. (a US company providing medical waste recycling) have been considered and it has been confirmed that Fund's interests are well served by monitoring the progress of the case and submitting a claim within the filing deadline. There was only one new non-US case in which the Fund had interests in the period (Toshiba Corp) but it has been clarified that the Fund would have no claim for damages having sold its shares long before fraud was revealed in 2015. No distributions

were received in quarter 3 in respect of the Funds share of recovered losses from settled cases.

6. Active Investing

This section of the RI report is dedicated to updating the Committee on key developments within stewardship and RI and interpreting these within the context of the Fund's responsibilities and interests.

- New LGPS Investment Regulations and Guidance

Since the last meeting of the Committee the Government has published replacement LGPS Investment Regulations which facilitate investment pooling. The new Regulations came into force on 1st November 2016 and contain the requirement for Administering Authorities to formulate and publish an Investment Strategy Statement which includes: 7 (2) e - the authority's policy on how social, environmental, and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; 7 (2) f – the authority's policy on the exercise of the rights (including voting rights) attaching to investments.

Within its "Local Government Pension Scheme: Guidance on Preparing and Maintaining an Investment Strategy Statement" DCLG has further clarified requirements under paragraphs 7 (2) e and 7 (2) and this section of the Guidance is re-produced at Appendix 2.

The surprise contained within the guidance is confirmation that schemes may take purely non-financial considerations into account provided that doing so does not involve significant risk of financial detriment. This is not a reference to it being permissible to consider ESG factors (which are now being referred to as financially material to investment performance) but an additional concession which opens the door to policies which pursue specific social outcomes and impacts in line with themes prioritised by scheme members. The ability to forgo some of the financial return on investment in order to generate social impact is qualified by the need for there to be no risk of significant financial detriment from doing so – a form of words which is clearly open to different interpretations of the term "significant".

This is an extra concession which was unanticipated and appears to be in response to the substantial concerns expressed at the original consultation's embargoing of any policies of divestment and exclusion which run contrary to UK Foreign and/or defence policy. These embargoes remain unchanged within the final guidance, but are now balanced by the sanction given for pursuing other routes to positive social impact.

The new guidance implies that a decision to target specific social impacts is not in conflict with fulfilling the underlying fiduciary duty to maximise risk adjusted returns so long as the Administering Authority has reason to believe scheme members share the concern for social impact and so long as financial return remains the predominant objective. Discretion over how and whether to pursue social impact resides with each individual Fund and is something which will need careful consideration within the context of pooling. There is an obvious conflict between an imperative for achieving cost savings which relies on investment arrangements which operate at a pool level and leverage

economies of scale and the development of a demand for investment arrangements which implement Fund-specific preferences for social outcomes.

Any requirement for investment arrangements which restrict the investment universe in order to achieve a defined social impact will add cost for all Funds participating in a pool because they will require assets to be disaggregated in order to apply specific products. This will immediately lose the benefit of scale that pooling ultimately aims for.

The Committee will need to consider whether the power to pursue social impacts is something it wishes to utilise. This is a consideration which would likely benefit from discussion with pooling partners as part of seeking to agree a collegiate approach. The best starting point may be to identify any outcomes of importance to the Committee (and likely to be shared by Fund beneficiaries) which will not be met via the investment arrangements and approach in place by LPP I. The Committee's efforts will be assisted by reviewing the LPP I Responsible Investment Policy which explains the arrangements in place to deliver against commitments under the Principles of Responsible Investment and the UK Stewardship Code.

- LPP I Responsible Investment Policy

An RI Policy has been developed and approved by the LPP I Board which explains the key beliefs informing LPP I's stewardship practices. The Policy gives insight into the standards of stewardship clients can expect from LPP I and explains how fiduciary responsibilities are being addressed within the services provided. The Policy is attached at Appendix 3.

The LPPI RI Policy meets a number of requirements simultaneously. It provides a reference point for internal investment staff (as context for the processes they operate and the standards required of them) and is a guide to the approach and standards deliverable by external partners which supports the process of manager selection and ongoing monitoring.

The Policy provides the LPP Stewardship Committee with a framework for monitoring RI activities and outcomes on an ongoing basis. By articulating beliefs, translating these into practice and expressing clear statements of intent, the policy prompts the consideration of priorities, the targeting of resources and the development of plans and targets as part of monitoring progress and providing reporting to the LPP I Board, to pension fund clients, and to regulators and other stakeholders as required.