

Lancashire County Pension Fund

Appendix A

**Pension Fund Committee
Responsible Investment Report**

30 June 2017

Title of Paper	Quarterly Report on Responsible Investment
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Appendices	Appendix 1: LCPF Reporting to the Principles of Responsible Investment 2017 Appendix 2: LCPF Statement of Compliance with the UK Stewardship Code

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 articulated within an Investment Strategy Statement which 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 preferred approach to RI encompasses four main areas of activity:

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

Responsibility for practical implementation of the Fund's approach to RI is devolved to Local Pensions Partnership Investments Ltd (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 January to 31st March 2017 plus insight on current and emerging issues.

3. Voting Globally

Through its investment in the LPP I Global Equities Fund (GEF) LCPF owns units in a pooled fund which invests in listed companies globally. Investors in the GEF delegate the control and exercise of shareholder voting to LPP I as part of arrangements which accommodate a pooled fund structure and associated ownership arrangements. This reflects that clients who hold units in the GEF are beneficial owners in common but do

not directly own underlying securities. LPP I exercises shareholder voting rights for the GEF centrally rather than delegating voting to individual asset managers. Decisions are taken in line with protecting the collective best interests of client pension funds as institutional investors.

To ensure shareholder voting rights are exercised effectively and consistently, LPP I employs an external provider of proxy voting and governance research services. Institutional Shareholder Services (ISS) provide voting recommendations in line with an agreed voting policy and oversee administration and vote execution on behalf LPP I.

ISS services operate through an online voting platform (ProxyExchange) which enables LPP I to evaluate pre-meeting research and analysis and review ISS voting recommendations in advance in order to decide whether to follow or depart from these. The platform also provides functionality to support monitoring, oversight and reporting on voting activities.

Voting headlines for the GEF in the first quarter of 2017 were as follows:

Total company meetings taking place	29	
Total resolutions (management and shareholder proposals)	525	
Total company proposals in the period	488	
Total shareholder proposals in the period	37	
Votes in line with Management recommendations	502	96%
Votes opposing Management recommendations	23	4%
Shareholder proposals supported by LPP I	6	16%

Proposals by Subject Matter

Elect directors / Board members	230
Agree management / Board remuneration	77
Generic meeting procedures (open, close, convene, adjourn)	53
Discharge the Board / management	33
Proposals relating to share capital	29
Auditors & Auditor remuneration	28
Dividends	15
Other (Miscellaneous)	12
Financial Statements and other Statutory Reports	11
	<u>488</u>

LPP I supported 6 shareholder resolutions in Q1. These were resolutions which reflected the rights of shareholders on themes we see regularly at company meetings:

- proxy access - resolutions seeking the ability (through a change in byelaw) for long-term shareowners to place alternative board candidates on the company's proxy card (ballot) in order for them to be voted on at the company's annual shareowner meeting;
- lobbying – resolutions requesting a more complete disclose of information on lobbying policy, activities, and payments.

At the AGM of Tyson Foods (largest American-owned processor and marketer of chicken, beef, and pork) LPP I voted in favour of three shareholder proposals as follows:

- the production of a report on the company's lobbying policies, procedures, expenditures, and oversight;

- a proposal to adopt a "proxy access" bylaw requiring Tyson to allow shareholders to nominate persons for election to the Board;
- a proposal to adopt and implement a water stewardship policy designed to reduce risks of water contamination at Tyson-owned facilities, its suppliers, and facilities under contract to Tyson.

The third proposal addressed exposure to environmental, reputational, and financial risks associated with water pollution from animal feed and byproducts and reflected that the company currently does not disclose specific policies, initiatives, or management oversight mechanisms the company has implemented to address effluent discharges and runoff from company-owned facilities, contract farmers, and suppliers.

A detailed report on Q1 voting activity for the GEF has been placed within the Members Reading Room for reference.

In due course LPP will begin to publish voting information for the GEF on its website. This reflects LPP's commitment to transparency under the principles of the UK Stewardship Code and is a move which will enable client funds and members of the public to begin accessing summary voting reports retrospectively online.

4. Engagement through Partnerships

As a responsible asset manager LPP I regularly participates in collaborations which represent the collective interests of institutional investors and seek to make progress on issues which impact shareholder value. Key partners 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).

LAPFF

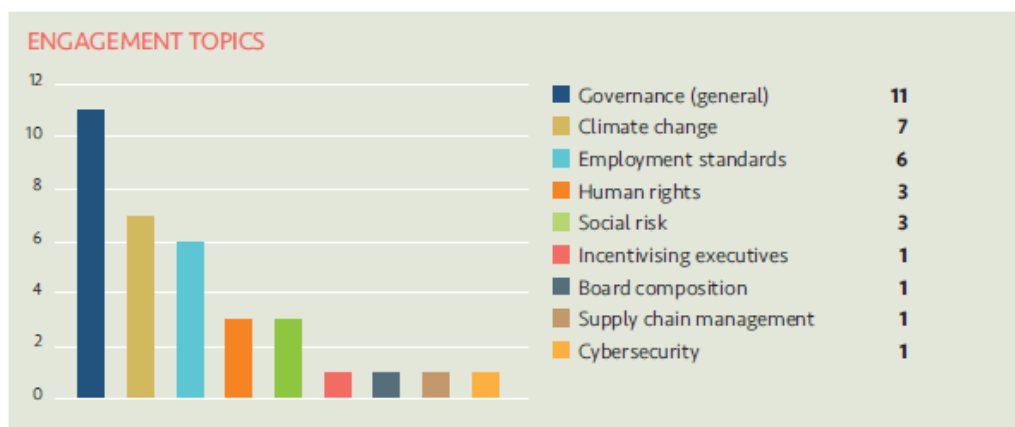
LAPFF has historically been LCPF's preferred engagement partner. The Forum exists to promote the specific investment interests of local authority pension funds as asset owners. 73 of the 89 LGPS funds are now members (with combined assets of over £200bn). LCPF has been a Forum member of long standing. On behalf of LCPF, LPP I attends LAPFF business meetings, seeks to influence debate, exercises the Fund's voting rights, drafts responses and feedback to consultations and identifies opportunities for participation in wider initiatives.

On a quarterly basis LAPFF provides Forum members with a summary of the engagement activities undertaken on their behalf.

A copy of LAPFF's Q1 2017 Engagement Report has been placed within the members reading room for reference.

Quantified across thematic topics, Q1 engagement activity by LAPFF was as follows:

Company Engagement



LAPFF's most recent quarterly Business Meeting took place on 11th April 2017 and was attended by the RI Manager. Headlines from the meeting included the following matters:

Forum Officers' Report

Following Durham Pension Fund's decision to join LAPFF the number of member funds now stands at 73 (82%). All 8 LGPS pools have funds which are members of LAPFF.

Details of "an offer" for LGPS pools to participate in LAPFF is under development and will be considered by the Executive before being presented to the membership later in the year.

Campaign on Reliable Accounts (Update)

LAPFF is working collaboratively on an initiative addressing the failure of companies to report in compliance with the Companies Act. The campaign contends that companies are agreeing dividends and other disbursements illegally due to not having figures within their accounts on distributable versus non-distributable reserves. At the Business Meeting members agreed to LAPFF writing to the Big 4 firms to highlight requirements placed specifically on auditors under Section 92 of the Companies Act which relies upon financial detail which is not currently being reported systematically.

Framework for a Climate Change Investment Policy

The Business Meeting received a proposed framework for a climate change investment policy intended to help Funds by guiding their approach to the risks and opportunities that may result from the impact of climate change. Forum members commented on the draft policy and the need for it to reflect the reality of their current position as well as aspirations for the future in order to be inclusive and realistic. In response to member dialogue on the draft, LAPFF has organised an event on climate change scheduled for 22 June 2017 at which funds will have the opportunity to share real world insight and help to influence the format of the final policy guidance. The RI Manager will participate and share insight on behalf of LCPF and LPFA.

Cyber Risk Engagement Proposal

The business meeting received a proposal for a collaborative engagement on cyber security working in partnership with the Principles of Responsible Investment. Members

supported LAPFF undertaking a focused, small scale direct engagement with companies where cyber risk is material. The engagement will aim to improve risk management from the Board's perspective and is to be targeted from a governance point of view. Cyber Risk is recognised as an area of technical complexity and Boards need to be fully aware of the risks this brings, and have the knowledge to proactively question management, and ensure the risks are being actively monitored across the organisation.

Approval Process for Issues-based Engagement

The meeting received a proposal formalising the process for member funds being able to make requests for LAPFF to undertake issues based engagement on subjects or issues they consider a priority.

UK Pension Fund Responsible Investment Roundtable

This collaborative group involves some of the largest pension funds in the UK and is a forum for investors to work together on responsible investment matters as part of regularly sharing insight and resources. Attention focusses on issues identified as priorities by group members, an approach which enables funds to collaborate informally with one another by agreement. In addition themes arise on which a larger group of investors may agree to collaborate formally in order to exert collective joint influence as responsible asset owners.

During the last quarter attention has focussed on a joint engagement with large asset management firms who did not support climate resilience resolutions consistently during the 2016 proxy voting season. LPP participated in a joint engagement which focussed on clarifying how managers integrate environmental, social and governance considerations into voting practices and the extent to which they are using engagement to encourage companies into greater disclosure on how they are planning for the impact climate change on their business future.

Transition Pathway Initiative

LPP has become a named supporter of the Transition Pathway Initiative (TPI). The TPI is an asset owner-led initiative resourced by the London School of Economics and the Grantham Institute which is designed to define what the transition to low carbon looks like for companies in high-impact sectors such as oil and gas, mining and electricity generation.

The TPI

- Evaluates and tracks the quality of companies' management of their greenhouse gas emissions and of risks and opportunities related to the low-carbon transition;
- Evaluates how companies' future carbon performance would compare to the international targets and national pledges made as part of the Paris Agreement;
- Publishes the results of this analysis through an online tool.

At its launch on 11th January 2017 the TPI published Management Quality Assessments for 20 large companies in the oil and gas sector and 20 large companies in the electricity utilities sector. By the end of 2017 MQ and Carbon Performance assessments will have been produced for between 120 and 150 companies, with coverage and scope due to be extended further in 2018. Companies are categorised into one of five levels based on an assessment of the information they disclose which must be in the public domain.

LPP has committed to using the Toolkit to inform its approach to engagement on climate change. The toolkit is available at the following link.
<http://www.lse.ac.uk/GranthamInstitute/tpi/the-toolkit/>

5. Shareholder Litigation

Shareholder litigation offers a route for recovering financial losses where asset values have been diminished as a result of financial misconduct. Activity forms part of seeking to hold companies to account for the quality of their corporate governance arrangements and their protection of investor interests.

LPP I has recently employed Institutional Protection Services (IPS) as an external provider of litigation monitoring services to ensure shareholder litigation cases affecting securities owned by the GEF are known about, claims are filed in a timely way and progress is monitored and followed up with Claims Administrators. In addition, IPS will monitor cases relating to shares held by LCPF in the period before the Fund pooled its listed equity investments from November 2016. Litigation can arise quite some time after shareholdings have been sold and monitoring new cases and referring back to historic holdings records to establish rights of ownership is an ongoing task.

IPS provide LPP I with monitoring information on a quarterly basis detailing the number of cases investigated. The monitoring report for Q1 2017 was the first to provide information on cases identified for LCPF holdings (legacy assets). The figures reflect that a long backward look has been undertaken as part of service take on by IPS. The number of cases in Q1 is not representative of the ordinary volume of new cases arising within a single quarter:

Total cases identified where LCPF had holdings within the class period	47
Claims confirmed and filed on behalf of LCPF	7
Claims potentially identified but subject to further review	5
Confirmation of no entitlement to join a class action	35

6. Active Investing

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

The Pensions Regulator - New Investment Guidance for DB Schemes

In March 2017 the Pensions Regulator released new Investment Guidance for the Trustees of defined benefit pension schemes which is available from the Regulator's website <http://www.thepensionsregulator.gov.uk/guidance/db-investment.aspx>. The guidance provides assistance in meeting standards set out in Code of Practice 3 (The Defined Benefit Funding Code) and provides practical information and illustrative examples across six sections;

- Governance;
- Investing to Fund DB;
- Matching Assets;

- Growth Assets;
- Implementation and Monitoring.

Governance includes a sub-section on Investment Stewardship in which trustees are encouraged to consider how and by whom the ownership rights associated with their investments are being exercised.

Investing to Fund DB includes subsections relating to stewardship and responsible investment themes which the Committee may find useful, particularly those on developing investment beliefs, the consideration of financial and non-financial factors, sustainability, setting an appropriate investment strategy, understanding investment risks and monitoring.

It is notable that within the section on financial and non-financial factors the Regulator has clarified that where trustees think environmental, social and governance (ESG) factors or ethical issues are financially material, they should be taken into account when making investment decisions. Also of note are several practical which reference Funds who identify that climate risk has the potential to significantly affect the value of investments and wish to reflect this within their beliefs, strategies and approaches. Whilst the examples are theoretical rather than real world, the emphasis being given to climate change risk (through these reoccurring references) is interesting and new.

Manager monitoring includes examples which reference the approach to Responsible Investment and the actions taken to incorporate environmental, social and governance (ESG) issues into investment analysis and decision-making. The following suggestions are included for reporting requirements relating to stewardship;

- any ESG events / issues and any material changes to the ESG risks and opportunities in the portfolio;
- voting activity summary;
- engagement summary.

Principles of Responsible Investment – reflections on the 2017 reporting process

Since the Committee last met the Fund has formally reported against the Principles of Responsible Investment (PRI) for the first time. LCPF became a PRI signatory in March 2015 but has not reported against the framework previously (there being a grace period for the first 12 months of being a signatory). The annual reporting deadline is 31 March.

Annual reporting is undertaken entirely online. Responses have to be given to a detailed array of indicators designed to capture the Fund's overall approach and specific efforts and activities undertaken during the previous 12 months.

The document at **Appendix 1** is the Fund's full Transparency Report for 2017 which is the ultimate output of the reporting process.

Transparency Reports for each signatory are made publicly available from the PRI website following the assessment of annual reporting submissions. Each signatory will receive a confidential Assessment Report which confirms the PRI's scoring of their efforts against an underlying assessment methodology and their position relative to their peer group. We are advised by the PRI that this is likely to happen during June 2017.

This first experience of reporting has shown the process to be very detailed and to consume considerable time and effort. Explaining underlying contractual and procedural arrangements and providing detail on specific examples of activity is especially onerous

first time around but dedicating adequate time is essential as the Transparency Report which is made public is a composite of responses to more than 60 individual indicators.

Some specific learning points have arisen from the experience of working through the detailed reporting framework. One of the greatest difficulties was in clearly defining a demarcation between LCPF as an asset owner signatory and LPP as a provider who fits the PRI's definition of a fiduciary manager. It is LCPF rather than LPP which is the PRI signatory, but there are currently limited places in which the Fund formally sets out RI requirements and how they inform what is required of LPP in terms of stewardship activity and monitoring against this. For example the Fund's Statement of Investment Principles (SIP) which contained a level of detail on the Fund's preferred approach to RI was superseded by an Investment Strategy Statement in October 2016 which lacked this detail. Similarly, the timing of the redrafting of the Fund's statement of compliance with the UK Stewardship Code meant it could not be referred to in detail within the 2017 return.

PRI signatories are not aiming for compliance with a single formulaic approach. Arrangements must meet signatory needs and deliver processes matched to their underlying purpose and local investment beliefs. The PRI recognises that signatories will be at varying stages and will follow different methods for seeking to evolve their approach. Continuing to make progress is the core requirement. Consideration of the ways LCPF could seek to demonstrate it has defined its RI beliefs, set out expectations of LPP and is monitoring and holding LPP to account for delivery against these standards is a potentially fruitful way to demonstrate further progress over the next 12 months and something the Fund may wish to explore.

Statement of Compliance with the UK Stewardship Code

An updated statement of compliance with the UK Stewardship Code has been drafted for the Fund and submitted to the Financial Reporting Council for assessment. The need for an updated statement was twofold;

- to reflect the practical and regulatory changes which have accompanied the establishment of the Local Pensions Partnership and the transition to assets under pooled management arrangements;
- as part of the introduction of "tiering" by the FRC in 2016 to encourage greater detail and transparency of disclosure.

Under the FRC's new approach, signatories to the Code are tiered according to the quality of their disclosure against the seven principles of the Code and supporting guidance. Asset owner statements are categorised into one of two tiers, Tier 1 (high quality with transparent disclosure) or Tier 2 (satisfactory, improved transparency warranted).

A copy of the Fund's new statement of compliance appears at **Appendix 2**.

The Chair of the Pension Fund Committee approved the statement for submission to the FRC under the urgent business procedure after members of the Lancashire Local Pension Board had been given the opportunity to provide comments on an initial draft. The Committee will be advised about the outcome of the tiering decision once this has been communicated by the FRC. On the completion of the assessment process the Fund's new statement will be published on the FRC website and LCPF will be re-instated as a signatory to the Code.