

## **Pension Fund Committee**

Meeting to be held on Friday, 30 November 2018

Electoral Division affected: None;
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### **Report of the Responsible Investment Working Group.**

(Appendices 'A', and 'B' refer)

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#### **Executive Summary**

This report sets out the recommendations of the Responsible Investment Working Group in relation to a revised Responsible Investment Policy, proposed actions for the future development/implementation of that Policy and responses to four issues referred to the Working Group by the Committee.

The report also seeks the views of the Committee on a proposal from the London Pension Fund Authority to establish a joint Working Group on responsible investment.

#### **Recommendations**

The Committee is asked to

1. Agree not to proceed with the draft Climate Change Policy as presented to the meeting on the 23<sup>rd</sup> March 2018 and instead approve the revised Responsible Investment Policy set out at Appendix 'A' to this report.
2. Consider the responses of the Working Group in relation to the five action points to develop the Responsible Investment Policy and agree a new Action Plan (set out at Appendix 'B') for the future development/implementation of the revised Responsible Investment Policy referred to in 1 above.
3. Note the responses of the Working Group regarding the four issues referred to it by the Pension Fund Committee on the 8<sup>th</sup> June 2018 and 14<sup>th</sup> September, 2018, as set out in the report.
4. Consider the proposal from the London Pension Fund Authority to establish a joint Working Group on responsible investment on the basis set out in the report.

## Background and Advice

On the [23<sup>rd</sup> March 2018](#) the Pension Fund Committee considered a report on a draft Responsible Investment Policy and Climate Change Policy. After considering the report the Committee approved an amended Responsible Investment Policy and referred the draft Climate Change Policy (which included an Action Plan for the future development of that policy) back to the Working Group for further consideration.

Since then the Working Group have met with the Head of Fund, the Governance and Risk Officer and the Responsible Investment Manager from the Local Pensions Partnership on the 5<sup>th</sup> June 2018 and 11<sup>th</sup> October 2018 to consider the draft Climate Change Policy together with other issues referred to it by the Committee. The Working Group have also had discussions with representatives of the London Pension Fund Authority (LPFA) regarding a proposed joint Working Group on responsible investment.

### 1. Climate Change Policy/revised Responsible Investment Policy

When developing the initial draft Climate Change Policy the Working Group had sought to take account of LAPFF guidance and produce a policy that was aligned with that of the LPFA. However, having reconsidered the draft policy the Working Group recognised that the LPFA was in a different position to the LCPF as it had to take into account the views of the Mayor of London on issues such as Climate Change. Furthermore, having reviewed the LAPFF Climate Change Investment Policy the Group concluded that in some respects LCPF were ahead of the LAPFF Policy.

In view of the above the Working Group considered there was no need for a separate Climate Change Policy and acknowledged that the majority of the text in the draft was included within the 'Climate Change' section of the Responsible Investment Policy which had been approved by the Pension Fund Committee in March 2018. Therefore, it was agreed that the reference to 'stranded assets' and the paragraph which began 'LCPF expects ...' should be incorporated into the Climate Change section of the Responsible Investment Policy and that a separate Action Plan for the future development of that policy produced.

The Working Group did consider whether 'climate value at risk' or 'stranded assets' was the most appropriate term to use in the Policy and decided that the former was a technical term rather than common parlance and was more restrictive than 'stranded assets'. Therefore, it was agreed that as 'stranded assets' should remain in the 'Climate Change' section of the Responsible Investment Policy, but with the word 'including' being added before 'via' so as not to narrow application of the definition.

It was also agreed that the following paragraph in section 4 d) of the approved Responsible Investment Policy should be removed as it was not considered relevant *'Finally, LCPF does not have any strategic asset allocations in specific areas in relation to RI and ESG. This is reviewed to ensure it is still appropriate by the Investment Panel on a 12 monthly basis'*.

All of the recommended amendments are highlighted in the revised Responsible Investment Policy set out at **Appendix 'A'** to this report.

At the Working Group on the 11<sup>th</sup> October 2018 the Governance and Risk Officer confirmed that the Investment Strategy had been reviewed in light of the agreed Responsible Investment Policy and the Independent Advisers to the Pension Fund Committee had advised against carrying out any strategic asset allocation changes or disinvestment.

## **2. Action Plan for the future development/implementation of the revised Responsible Investment Policy.**

The draft Climate Change Policy presented to the Pension Fund Committee on the 23<sup>rd</sup> March 2018 included an Action Plan for the future development of that policy.

Having decided to incorporate some elements of the draft Climate Change policy into a revised Responsible Investment Policy the Working Group re-examined the Action Plan and at the meeting in June 2018 agreed 5 new actions points for consideration. The conclusions of the Working Group with regard to the 5 action points are set out below together with a proposed new Action Plan (**Appendix 'B'** to this report) for the future development and implementation of the revised Responsible Investment Policy.

### **Action Point 1 - Instruct LPP to undertake a full audit of LCPF holdings in order to identify those investments which include positive ESG or RI exposures and not just those which are considered Non ESG RI, such as tobacco and alcohol.**

As a full audit of LCPF holdings was a considerable undertaking the Working Group was provided with an initial detailed analysis of the Listed Equities Portfolio, comprising an overview with more detail on specific investments in Annexes. In considering the information the Working Group recognised the benefit of having up to date information available and acknowledged that when expressed as a percentage of the total LCPF Fund listed equity energy companies equated to only 0.7% and extractive fossil fuel companies to less than 0.5% of the current portfolio.

With regard to the utilities sector (which including the provision of water, gas and electricity) it was noted that expressed as a percentage of the total Fund Utilities companies represented 1.1% of the portfolio. Whilst holdings in listed renewable energy companies were relatively small at £3.7m it was recognised that the Fund's main interests in renewable energy were included in the Infrastructure portfolio.

The Working Group agreed that the information regarding the Listed Equity portfolio) be referred to the Pension Fund Committee on the 30<sup>th</sup> November 2018 for consideration and, subject to the approval of the Committee, that similar reports on the Infrastructure, Private Equity and Credit portfolios be presented to future meetings in order to broaden the coverage of information available to the Committee.

Note – A report on the analysis of the Listed Equities portfolio is presented in Part II of the agenda in accordance with Paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972 as it contains information which relates to the financial or business affairs of any particular person (including the authority).

**Action Point 2 - Instruct LPP to consider the implications of LCPF setting a target to reduce LCPF exposure to fossil fuels from 4.8% to as near as zero as possible, including a) The practicality of LPPI implementing such a target, any potential challenges and how they can be overcome and b) The implications of the use of tolerance levels for individual investments.**

The Working Group recognised that the 4.8% figure referred to in the Action Point had been taken from an externally produced report and that such reports could present an inaccurate position as they were often based on limited information that was available publicly.

Having considered the up to date information on the current exposure to fossil fuels within the Listed Equities portfolio the Working Group acknowledged that the current exposure for the LCPF was lower than expected and was less than other Funds. It was also suggested that rather than setting targets the Committee should monitor the direction of travel for the Fund's exposure to fossil fuels and should pursue active investment in order to change behaviours rather than disinvestment which was viewed as a last resort.

The Working Group agreed that in accordance with the Responsible Investment Policy LPP's immediate focus should be on identifying companies within the existing portfolio that are involved in fossil fuel extraction, quantifying this exposure accurately, and reporting this to the Committee to allow monitoring of the position. Once the quantum and nature of current exposure had been confirmed, the focus would then move to considering the implications of reducing the Fund's current and future exposure to fossil fuels (based on reviewing information about the logistical, financial, regulatory and performance aspects of potentially seeking to do so).

**Action Point 3 - Instruct LPP to continue to develop the Dashboard model (as approved by the Pension Fund Committee on the 23<sup>rd</sup> March 2018) as a means of enabling the Committee to monitor progress and targets on Responsible Investment within individual assets classes.**

The Working Group welcomed the up to date information circulated at the meeting in relation to Listed Equities (see Part II report later on the agenda) and agreed that it should inform the development of a Dashboard by LPP which would include the other asset classes referred to in the response to Action Point 1 above and feature the Fund's holdings in different sectors including renewable energy and broader social infrastructure.

**Action Point 4 - Instruct LPP to continue to work with LAPFF to develop relationships with energy companies to enable LCPF to invest in sustainable energy infrastructure products while reducing the exposure to fossil fuels.**

As LAPFF is an engagement focussed organisation rather than an investment

focussed on the Working Group did not consider it to be the appropriate partner to develop relationships with energy companies.

It was noted that any investment instructions to LPP would need to be reflected in the Fund's Investment Strategy and considered by the Investment Panel which did not favour strategic asset allocation changes or disinvestments based on ESG characteristics. The Working Group agreed that, if appropriate, further conversations between the Fund and LPP take place with regard to opportunities (and routes) for increasing investment in renewable energy and reducing investments in fossil fuel extraction.

**Action Point 5 - That the Head of Fund review the Asset Management Agreement to ensure that LPP implement the agreed LCPF Responsible Investment Policy and are required to report any breaches of the policy directly to the Pension Fund Committee.**

It was reported that a breach of the priority areas within the current Responsible Investment Policy was not possible as the Policy did not contain any specific targets or measures which LPP were required to meet. The Working Group agreed that no amendment be made to the Asset Management Agreement as the Fund does not have any specific allocations on responsible investment and the focus of the Action Point be amended in order to emphasise ensuring that the Committee review the usefulness of the enhanced reporting to be developed by LPP to ensure that it secures appropriate insights and provides adequate assurance to the Committee that the Fund's RI policy is being implemented.

Taking account of the responses of the Working Group a revised Action Plan for the future development/implementation of the Responsible Investment Policy has been drafted, a copy of which is set out at **Appendix 'B'** to this report for the consideration of the Committee.

### **3. Responses to four issues referred to the Working Group by the Pension Fund Committee.**

At the meeting on the 8<sup>th</sup> June, 2018, the Pension Fund Committee referred the following issues to the Working Group for consideration.

**Reducing pay differentials** – During a discussion on the draft Responsible Investment Policy it was suggested that the reference to reducing pay differentials in Section 4a) should be included within the 'Improving Employment Practices' priority area of the Policy. Having considered the suggestion the Working Group agreed that reference to reducing pay differentials should remain separate from the 'Improving Employment Practices' priority area.

**Public sector pension fund investments in Scottish private finance schemes linked to offshore tax havens** – Under 'Any Other Business' concern was raised regarding a recent report in the media regarding public sector pension fund investments in Scottish private finance schemes being linked to offshore tax havens.

The Working Group received a detailed response from LPP regarding the above and noted that whilst LCPF did have interests in investments domiciled in offshore locations those structures were not designed to (and did not in practice) save the Fund any tax.

The following items were referred to the Working Group for consideration by the Pension Fund Committee on the 14<sup>th</sup> September 2018.

**Active promotion of LCPF green energy investments** – The Committee asked the Working Group to consider how the Fund could best promote good news about renewable energy investments.

At the meeting on the 11<sup>th</sup> October 2018 the Working Group was presented with details of a number of renewable energy schemes and noted that the LCPF website which was being developed would include a section on responsible investment which would enable positive news items on renewable energy to be regularly promoted.

**Transition Pathway Initiative** – Use of the Transition Pathway Initiative (TPI) was discussed at the last meeting when the Committee agreed to ask the Working Group to consider the future use of TPI by LPPI

The Working Group recognised that the TPI process was still relatively new and would need time to develop and provide useful benchmarks by which to judge progress. It was suggested that further research was needed to establish whether TPI was a sufficiently accurate metric by which to judge progress, either on its own or in conjunction with other measures such as the Carbon Disclosure Project.

The Committee is asked to note the responses of the Working Group regarding the four issues referred to it by the Pension Fund Committee.

#### **4. Proposal by the LPFA to establish a joint Working Group on Responsible Investment.**

The Deputy Chairman of the LPFA Board and Managing Director of the LPFA attended the Working Group on the 11<sup>th</sup> October 2018 and informed the meeting that having improved the funding level of the scheme the LPFA was now considering how best to promote responsible investment in the future and had identified investing in social housing and establishing a local investment fund as potential areas to be explored. It was suggested that now was the time for both shareholders to discuss their individual approaches to responsible investment and identify differences and areas of commonality where resources could be combined in order to maximise impact.

The LPFA representatives proposed that the LCPF and LPFA (as the two shareholders in LPP) should establish a joint Working Group to discuss the future approach to responsible investment and identify specific priority areas so that future investments could be coordinated in order to maximise benefits.

The proposed joint Working Group would consist of 6 members (3 representatives from each shareholder) with Terms of Reference to be agreed with the Chair of the Committee and would meet every two months, alternating between London and Preston.

The Working Group agreed that the proposed establishment of a joint Working Group with the LPFA to discuss the future working relationship between the two shareholders with regard to responsible investment be referred to the Pension Fund Committee on the 30<sup>th</sup> November 2018 for consideration.

## **Consultations**

The Head of Fund, the Governance and Risk Officer and the Responsible Investment Manager from the Local Pensions Partnership.

## **Implications:**

This item has the following implications, as indicated:

### **Risk management**

The Lancashire County Pension Fund's (LCPF) current approach to Responsible Investment is set out in the Policy which was agreed by the Committee on the 23<sup>rd</sup> march 2018. It is good practice to review LCPF's stewardship and responsible investment approach based on the current guidance and regulations and the delegation of investment functions to LPPI.

### **Financial implications**

The LGPS Management and Investment of Funds Regulations 2016 (as interpreted by DCLG Guidance on Preparing and Maintaining an Investment Strategy Statement) has confirmed that schemes should make the pursuit of financial return their predominant concern and must not involve significant risk of financial detriment to the scheme from taking non-financial factors into account within investment decision-making.

An evaluation of the financial return likely to be foregone in connection with any divestment required under the Responsible Investment Policy or to achieve priorities identified in that Policy will precede and inform ongoing decision-making on stock selection and retention.

Financial data included in the proposed LPP dashboard will be reviewed against custodian records on a quarterly basis. The practicalities of what information the dashboard should or shouldn't have within it to be part 1 and what divestment monitoring is practical/achievable will be subject to the Committee's approval

## **Local Government (Access to Information) Act 1985 List of Background Papers**

Paper  
N/A

Date

Contact/Tel

Reason for inclusion of report in Part II,  
N/A