# LOCAL PENSIONS PARTNERSHIP INVESTMENTS LIMITED

|  |  |
| --- | --- |
| **Title of Paper** | **Quarterly Report on Responsible Investment (2019 Q4)** |
| **Lead Officer:** | Frances Deakin Head of Responsible Investment  Local Pensions Partnership Investments Ltd  [frances.deakin@localpensionspartnership.org.uk](mailto:frances.deakin@localpensionspartnership.org.uk) |

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.

1. Introduction

The Fund's approach to RI is articulated within an Investment Strategy Statement (ISS) 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. LCPF’s ISS is supplemented by a Responsible Investment Policy which explains that the Fund's preferred 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 Local Pensions Partnership Investments Ltd (LPPI) as LCPF's provider of investment management services. The report which follows provides the Committee with an update on RI activity during the period 1 October to 31 December 2019 plus insights on current and emerging issues.

1. Voting Globally

Through its investment in the LPPI 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 LPPI. This reflects that clients owning units in the GEF are beneficial owners in common but do not directly own shares in underlying companies.

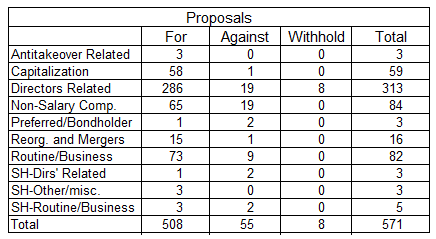
LPPI exercises shareholder voting rights for the GEF centrally rather than delegating voting to individual asset managers and takes account of voting recommendations from an external provider of proxy voting and governance research (ISS) in accordance a Sustainability Voting Policy designed to ensure the consideration of ESG factors within analysis. LPPI reviews voting recommendations and takes the final decision on all voting.

In the fourth quarter of 2019 shareholder voting headlines for the GEF were as follows:

LPPI Global Equities Fund (GEF)

|  |  |
| --- | --- |
| Total company meetings taking place | 69 |
| Total resolutions  (Management and shareholder proposals) | 571 |
| Total company proposals in the period | 560 |
| Total shareholder proposals in the period | 11 |

The following table summarises resolutions by type and indicates where opposition voting was concentrated in Q4.





LPPI voted against or withheld support for management proposals in 63 instances (across 23 company meetings).

These included opposing or withholding support for 27 management proposals connected with the election / re-election of directors. Opposition voting most commonly addressed concerns about the composition and independence of company boards and the independence of individual board members but also reflected concern at instances of poor risk oversight and inadequate internal controls.

Director Related

LPPI voted against the re-election of the Chief Finance Officer and incumbent Audit Committee members at Sasol Ltd (South Africa: Diversified Chemicals). This followed material failures in internal controls relating to the construction of a new petrochemicals complex. In the period after a final investment decision in 2014, project costs were revised upwards from USD 8.9bn to 12.9bn and an internal review concluded the project’s management team demonstrated a lack of competence and poor transparency. (Results: Between 12.7% and 29.3% against the re-election of the various incumbents).

At Harvey Norman Holdings Ltd (Australia: General Merchandise Stores), LPPI voted against the re-election of two incumbent non-independent directors where the board is not majority independent. One of the incumbents (judged to be non-independent on the basis of excessive tenure) is the Chair of the Remuneration Committee. (Result: 28.4% against the Chair of RemCom and 15.1% against the other incumbent).

At Commonwealth Bank of Australia (Diversified Banks), in place of the Chair (who was not up for re-election) LPPI opposed the re-election of two other incumbent board members in response to severe failings in the prevention of money laundering through its Australian banking services. Reportedly this resulted in the largest ever civil penalty in Australian corporate history. (Result: 4.5% and 1.9% against).

Non-Salary Compensation

Management proposals on compensation arrangements prompted 19 opposition votes. These were in response to a lack of transparency around performance conditions, poor alignment of performance conditions with shareholder interests, and variable pay terms considered to be excessive.

At Wesfarmers Ltd (Australia: General Merchandise Stores) LPPI voted against the remuneration report. This reflected concerns relating to a remuneration structure which produces a high quantum of CEO remuneration (2.25 times peer median), has poor disclosure of performance targets, and uses the same performance measure across two different aspects of remuneration. (Result: 21.4% against).

At Goodman Group (Australia: Industrial Real Estate Investment Trust), LPPI voted against the remuneration report. This reflected a long-term incentive plan considered to be insufficiently testing and excessive relative to the market median in similarly sized industry peers. Remuneration has been a consistent point of contention at Goodman where votes against the remuneration report have ranged between 24% and 45% from 2016-2019. Due to the continuation of problematic remuneration practices, LPPI opposed the re-election of the Chair of the Remuneration Committee. (Results: Remuneration Report – 16.2% against. Remuneration Committee Chair – 26.1% against).

Shareholder Proposals

LPPI supported 7 shareholder proposals across 11 company meetings in Q4.

Two of the four resolutions LPPI did not support were proposals to amend company constitutions to enable shareholders to place resolutions on the agenda (Australia & New Zealand Banking Group, National Australia Bank Limited). LPPI voted against the proposed changes which were broadly expressed and (if put into practice) would not be subject to any legal or regulatory supervision of the appropriateness of shareholder proposals arising.

LPPI supported two shareholder resolutions seeking greater transparency on the gender pay gap (at the AGM of Microsoft and of Oracle Corporation). At Oracle the resolution followed a complaint filed by the US Department of Labor alleging discrimination in compensation practices. (Results: Microsoft: 29.6% for, Oracle: 34.8% for).

LPPI supported a resolution at Cintas Corporation (USA: Diversified Support Services) seeking greater transparency about the company’s political contributions. The proposal called for annual reporting on corporate electoral expenditure to improve information and bring Cintas into closer alignment with leading companies which disclose detailed policies governing political expenditures from corporate funds. (Result: 32.3% For).

1. Engagement through Partnerships

**Appointment of an Engagement Services Provider**

LPPI is a responsible investor on behalf of client pension funds and takes the responsibilities of active asset ownership seriously. We recognise that monitoring and engagement protect long term value and our ongoing efforts include both direct engagements with companies and participation in targeted collaborations alongside other progressive investors.

Engagement is a time consuming and resource intensive activity. The global nature and considerable scale of the listed portfolio LPPI is managing has prompted consideration of how to resource this commitment on an ongoing basis. After considering options our solution is to work with an experienced external provider of engagement services whose expertise and capabilities will complement our in-house approach, extend its coverage and improve our transparency.

In January we completed a tender process using the National LGPS framework for Stewardship Services and appointed Robeco as our provider. A joint press release announcing the partnership gives further information on our collaboration to deliver an engagement strategy for the LPPI Global Equities Fund and LPPI Fixed Income Fund. <https://www.localpensionspartnership.org.uk/News-and-views/details/LPP-partners-with-Robeco-to-support-engagement-activity-for-Global-Equities-Portfolio>

Service take-on is currently underway for the new contract. We will share further information on the overall strategy and provide a first set of reporting on engagement activities underway as part of LPPI’s RI report on Q1 2020.

**LAPFF**

LAPFF has long been LCPF's preferred engagement partner. The Fund is a long-standing member of the Forum and the Head of Fund and Chair of the Pension Fund Committee currently sit on the LAPFF Executive.

The Forum reports on the engagement activities undertaken on behalf of member funds by publishing Quarterly Engagement Reports (QER). To enable Committee members to review the Forum’s engagement activity in Q4 2019 a link to the 2019 QERs is provided below.

<http://www.lapfforum.org/publications/qrtly-engagement-reports/>

At the most recent Quarterly Business Meeting (29 January 2020) LAPFF shared a draft Workplan which identifies where work will focus in the year ahead. LGPS Funds who are Forum members are due to receive the Draft Workplan by email and have an opportunity to review and give feedback as well as to raise additional priorities they would like to be considered. The Committee may wish to take this opportunity to review whether the Fund’s RI priorities are reflected in the Forum’s forward plan.

**PLSA**

As reported to the last meeting, the Head of RI is a member of the Pensions and Lifetime Savings Association’s Defined Benefit Scheme Stewardship Advisory Group (SAG) and has participated in a detailed review of the Association’s Corporate Governance Policy and Voting Guidelines as part of an investor working group.

As a result of the review the PLSA will publish a new, reoriented document - PLSA Stewardship Guide and Voting Guidelines 2020 – in February 2020.

**Principles of Responsible Investment (PRI)**

LPPI is in the process of assembling detailed annual reporting for submission to the PRI.

The PRI’s online reporting platform is open from the middle of January until 31 March each year for signatories to compile and submit the extensive content required. LPPI’s reporting period is from 1st Jan to 31st December each year. In due course the information LPPI submits will feature in a Transparency Report publicly available from the PRI website. Separately LPPI will receive a private Assessment Report which evaluates our progress (compared with our first reporting submitted in March 2019) and our position relative to a comparable peer group.

LPPI has supported an investor initiative co-ordinated by the PRI which opposes plans by the US Securities and Exchange Commission (SEC) to

* change current rules around shareholder proposals at company meetings (by increasing the ownership requirements and percentage vote a proposal must receive to be resubmitted, making it more difficult to submit and sustain shareholder proposals).
* Remove the independence of proxy voting advisers by requiring their voting recommendations to be reviewed by and commented on by companies before investors receive them.

The PRI’s investor letter to the SEC (**Appendix B** ) was signed by LPPI and provides further details on the issues and consequences the SEC is encouraged to avoid.

The letter urges the Commission to preserve the right of shareholders to make their voices heard and to support the mechanisms which enable discussion of emerging ESG issues and allow them the time to evolve and gain shareholder support. The letter also asks the SEC to uphold the independence of proxy voting advice as something many investors (including LPPI) utilise to reach informed and objective decisions about shareholder voting.

1. **Shareholder Litigation**

LPPI employs 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 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 shares have been sold and monitoring new cases and referring back to historic records to establish rights of ownership is an ongoing task.

IPS provide LPPI with monitoring information on a quarterly basis detailing the number of cases investigated. The monitoring report for Q4 2019 confirms that two new potential cases have been identified where the Fund may have an entitlement to join a class action and eligibility is being assessed. There are a further 13 confirmations of no claim and no recognised loss.

1. **Active Investing**

The LCPF Responsible Investment Policy describes active investing as the search for sustainable investments which meet LCPF’s requirements for strong returns combined with best practice in ESG and corporate governance. The Fund has not set allocations for investments within specific sectors or identified impact themes but in general favours investments with positive social outcomes and has expressed an interest in understanding where current investments are delivering social benefits in addition to generating investment returns. Examples of socially positive investments are available from across the asset classes the fund invests in.

Infrastructure

In the period since the committee last met the Fund’s exposure to renewable energy generation has been increased through an infrastructure investment (via GLIL) in Cubico Sustainable Investments.

A press release produced by GLIL provides further details on the investment in Cubico’s UK portfolio of operational wind and solar assets. GLIL has acquired a minority (49%) equity stake in the portfolio, which has been operational for more than three years and comprises over 250 MW of wind and solar projects at 18 sites across the UK.

<https://www.glil.co.uk/assets/Press-release-Cubico-sells-minority-stake-in-UK-wind-and-solar-portfolio-to-GLIL-Infrastructure-002.pdf>

LGPS Cross Pool Responsible Investment Group

The Head of RI has recently become the Chair of the LGPS Cross Pool Responsible Investment Group. The group is an active network for RI practitioners within the LPGS which brings together representatives from across the 8 constituent LGPS pools to share information, collaborate, and collectively support the development of RI by the LGPS. The group currently produces and delivers the RI content for the Local Government Association’s (LGA) LGPS Governance Fundamentals Training.

The group has formed productive relationships with a number of key organisations including the PRI, Financial Reporting Council and LGA and is an efficient forum for collectively discussing new initiatives, sharing insights, noting good practice and providing general commentary when asked to provide an initial LGPS sounding board.

Approached by the LGA, the Head of RI led on the group’s review and initial impressions of the LGPS Scheme Advisory Board (SAB) draft guidance on Responsible Investment which was out for consultation from November 2019 to Jan 2020. In follow-up, the Head of RI was invited to be a panellist at a joint SAB/LGA Workshop on Responsible Investment (January 2020) which discussed current regulations and the need for clearer guidance to help Funds understand their responsibilities and recognise the flexibilities they have to pursue RI under current Investment Regulations

LPPI has made a separate response to the consultation on the SAB RI Guidance which was critical of the failure to explicitly reference the role of Pool companies in implementing RI policies for funds and providing support, guidance and a focus for consensus around common standards where assets are under pooled management and stewardship.

1. **Other**

UK Stewardship Code (2020)

In October 2019 the Financial Reporting Council published the updated UK Stewardship Code (2020) which came into force from January 2020.

<https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf>

The Code comprises a set of ‘apply and explain’ Principles for asset managers and asset owners (moving discernibly forward from the prior Code’s comply or explain format). The 2020 Code sets a very high benchmark for potential signatories, requiring them to comply with 12 Principles and disclose on their actions and outcomes against these each year.

It is no longer sufficient to report the fact that appropriate policies and approaches are in place; the new Code requires up to date evidence of activity. This reflects the FRC’s intention that the Code will be a basis for differentiating true stewardship best practice. Asset owners and asset managers who wish to be in the first cohort of prospective signatories assessed by the FRC must submit their applications and detailed reporting between January and March 2021.

As a signatory to the prior Stewardship Code (2012) the Fund will continue to be listed as a signatory until the beginning of 2021 at which point it will either need to submit reporting and be assessed against the new Code or will cease to be listed as a Code signatory.

LPPI is currently considering the requirements for compliance with the Stewardship Code (2020) alongside other regulatory requirements coming into force relating to RI and ESG disclosure. We will provide more information on our schedule for LPPI compliance in due course. In the meantime, the Committee is encouraged to consider whether the Fund aspires to be a signatory to the 2020 Code going forward.

It is not a requirement for LGPS Funds to be Code signatories. The requirement (conferred under DCLG Guidance on Preparing and Maintaining an Investment Strategy Statement) is for Administering Authorities to “explain their policy on stewardship with reference to the Stewardship Code”. This can be achieved without being a signatory through placing reliance on the policies and procedures in operation by LPPI.

Given the extent of delegation associated with the LPP pooling model (stewardship tasks being undertaken by LPPI) and the high benchmark set by the new Code it would be prudent to reflect in advance on the practicalities of compliance and allowing adequate time for preparation to report against the Code should the Fund wish to take this route.

As an assistance the Head of RI has begun a discussion with the FRC around the situation of LGPS funds whose assets and stewardship are pooled and how this position can best be accommodated under the new Code.