

Pension Fund Committee

Meeting to be held on 27 March 2015

Electoral Division affected: None

Responsible Investment

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

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Executive Summary

The Fund aspires to be a good asset owner and is continuing to develop its approach to responsible investment. In doing so, activity is centred upon four distinct areas, being; global voting as a shareholder in invested companies, engagement with these companies (either alone or in partnership), effective litigation when things go wrong, and active investing (including active engagement with investment managers).

The Fund achieves some of this through engaging Pensions and Investment Research Consultants Ltd (PIRC) as its Governance Adviser and also through the Local Authority Pension Fund Forum (LAPFF). This report provides the latest quarterly update for the Committee on the work undertaken on the Fund's behalf by PIRC in accordance with current voting guidelines and the engagement activity undertaken by LAPFF.

The attached report from PIRC (Appendix 'A') covers the period 1 October 2014 to 31 December 2014. The Fund has voted on 351 occasions and has opposed or abstained in 35% of votes. PIRC recommends not supporting resolutions where it does not believe best governance practice is being applied. PIRC's focus has been on promoting independent representation on company boards, separating the roles of CEO and Chairman and ensuring remuneration proposals are aligned with shareholders' interests.

The attached engagement report from LAPFF (Appendix 'B') also covers the quarter to 31 December 2014.

Details of actual and potential actions in relation to companies in which the Fund currently owns shares or has previously owned shares are set out in the report.

Finally, progress in implementing the actions agreed from the work of the member working group, which completed its consideration towards the end of 2014, is noted.

Recommendation

The Committee is asked to note the report.

Background and Advice

The previous meeting of the Pension Fund Committee received a report detailing the outcome of the member working group into (socially) responsible investment. As part of this work, the adoption of the term 'responsible investment', to reflect the Fund's investment approach, was accepted in line with the definition provided by the National Association of Pension Funds (NAPF):

Responsible Investment is an investment approach in which investors recognise the importance of the long-term health and stability of the market as a whole; seeking to incorporate material extra-financial factors alongside other financial performance and strategic assessments within investment decisions; and utilise ownership rights and responsibilities attached to assets to protect and enhance shareholder value over the long term – primarily through voting and engagement.

The Fund has a longstanding policy of supporting good corporate governance in the companies in which it invests, and challenging companies who do not meet the standards set by their peers or reasonable expectations as measured by best practice.

The Fund's approach is part of its overall investment management arrangements and its intention to be a good asset owner for which its approach is developing. Accordingly, the Fund's approach to responsible investment divides into four areas of activity, and this (and future) monitoring reports will reflect this structure.

a) Voting Globally

PIRC, who act as the Fund's proxy and casts the Fund's votes at shareholder meetings, are instructed to vote in accordance with their guidelines unless the Fund instructs an exception. PIRC analyses investee companies and produces publically available voting recommendations to encourage companies to adhere to high standards of governance and social responsibility.

The analysis includes a review of the adequacy of environmental and employment policies and the disclosure of quantifiable environmental reporting. PIRC is also an active supporter of the Stewardship Code, a code of practice published by the Financial Reporting Council with the aim of enhancing the quality of engagement between institutional investors and companies.

PIRC also lobbies actively on behalf of its investing clients as well as providing them with detailed support. It works closely with NAPF (the National Association of Pension Funds) and LAPFF (the forum of Local Authority Pension Funds). The Lancashire County Pension Fund is a member of both these organisations.

PIRC's quarterly report to 31 December 2014 is presented at Appendix 'A'. This report not only provides details of the votes cast on behalf of the Fund but also provides a commentary on events during the period relevant to environmental social and governance issues. It should be noted that if the Fund so wished, it retains the ability to cast a vote which does not accord with PIRC's recommendations.

The Fund's voting record using PIRC as its proxy for the three months ended 31 December 2014 is summarised below:

	For	Abstain	Oppose	Non-Voting	Not Supported	Withhold	Withdrawn	US Frequency Vote on Pay	Total
UK & BRITISH OVERSEAS	66	7	9	0	0	0	0	0	82
EUROPE & GLOBAL EU	10	2	10	0	0	0	0	0	22
USA & CANADA	76	5	43	0	0	9	0	0	133
ASIA	17	2	7	0	0	0	0	0	26
AUSTRALIA & NEW ZEALAND	44	4	33	7	0	0	0	0	88
TOTAL	213	20	102	7	0	9	0	0	351

The Fund was party to 351 resolutions during this period, of which 213 (61% resulted in positive votes for shareholder resolutions and 35% were opposed or an abstention given. Voting abstention is regularly used by institutional investors as a way of signalling a negative view on a proposal without active opposition. In addition, within certain foreign jurisdictions, shareholders either vote for a resolution or not at all, opposition to these votes is described as vote withheld. These totalled 9 within the period, just under 3%.

Details of the voting details by category for the largest markets (UK and US) are set out below:

	UK						
	For	Abstain	Oppose	Non-Voting	Not Supported	Withheld	Withdrawn
All Employee Schemes	1	0	0	0	0	0	0
Annual Reports	6	2	5	0	0	0	0
Articles of Association	0	0	0	0	0	0	0
Auditors	5	3	0	0	0	0	0
Corporate Actions	1	0	0	0	0	0	0
Corporate Donations	2	1	0	0	0	0	0
Debt & Loans	0	0	0	0	0	0	0
Directors	32	1	3	0	0	0	0
Dividend	4	0	0	0	0	0	0
Executive Pay Schemes	0	0	1	0	0	0	0
Miscellaneous	4	0	0	0	0	0	0
NED Fees	0	0	0	0	0	0	0
Non-Voting	0	0	0	0	0	0	0
Say on Pay	0	0	0	0	0	0	0
Share Capital Restructuring	0	0	0	0	0	0	0
Share Issue/Re-purchase	11	0	0	0	0	0	0
Shareholder Resolution	0	0	0	0	0	0	0

US/Global US & Canada

	For	Abstain	Oppose	Non-Voting	Not Supported	Withheld	Withdrawn
All Employee Schemes	0	0	0	0	0	0	0
Annual Reports	0	0	0	0	0	0	0
Articles of Association	2	0	0	0	0	0	0
Auditors	9	1	0	0	0	0	0
Corporate Actions	0	0	0	0	0	0	0
Corporate Donations	0	0	0	0	0	0	0
Debt & Loans	0	0	0	0	0	0	0
Directors	59	1	27	0	0	9	0
Dividend	0	0	0	0	0	0	0
Executive Pay Schemes	0	0	4	0	0	0	0
Miscellaneous	0	0	1	0	0	0	0
NED Fees	0	0	0	0	0	0	0
Non-Voting	0	0	0	0	0	0	0
Say on Pay	0	0	10	0	0	0	0
Share Capital Restructuring	0	0	0	0	0	0	0
Share Issue/Re-purchase	0	1	1	0	0	0	0
Shareholder Resolution	6	2	0	0	0	0	0

b) Engagement through Partnerships

Lancashire County Pension Fund is also a member of the Local Authority Pension Fund Forum (LAPFF), which exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest.

Members of the Committee may be interested to note the attached engagement report from LAPFF (Appendix 'B') which covers the period 1 October 2014 to 31 December 2014.

It sets out details of their activities in influencing governance, employment standards, reputational risk, climate change, finance and accounting, and Board composition, and provides a slightly different and wider perspective than the PIRC report.

c) Shareholder Litigation

The third approach, adopted by the Fund in order to encourage corporate management to behave responsibly and honestly, is through shareholder litigation. The Fund, in partnership with two US law firms and other shareholders, submits class actions globally where possible and where appropriate.

United States

The Fund has appointed Barrack, Rodos and Bacine (BR&B) and, more recently in addition, Robbins Geller Rudman and Dowd (RGRD) to provide securities litigation (class action) monitoring with the aim of ensuring that the Lancashire County

Pension Fund receives all monies due to the Fund by filing its proof of claim from these cases. These services are at no cost to the Fund.

BR& B and RGRD will identify class actions where the Fund has a potential loss arising from an alleged fraud or a securities law violation. This is achieved through their respective monitoring systems which follows each potential securities case from the beginning to the end by ensuring its filing of the proof of claim so that the Fund may receive its payment.

Occasionally the Fund may be asked to participate in a class action, and/ or to apply to become the lead or co-lead plaintiff, but under US law any shareholder subject to such a loss will be automatically entered into and benefit from a class action without having to file an individual claim.

Details of current potential cases are set out below.

Company name	Effective class period begin	Effective class period end	Potential loss incurred (\$'000)
Medtronic, Inc	08/12/10	03/08/11	27.71
CenturyLink, Inc.	08/08/12	14/02/13	521.63
Barrick Gold Corp.	07/05/09	23/05/13	411.36
Intuitive Surgical, Inc.	19/10/11	18/04/13	251.54
ITT Educational Services, Inc.	24/04/08	25/02/13	760.06
Weightwatchers International	14/02/12	30/10/13	2,265.97
Petroleo Brasileiro SA Petrobras	07/01/10	26/11/14	6,158.91

United Kingdom

Unlike class actions within the US jurisdiction, where all relevant recipients benefit from a class action when filed, securities claims in the UK require investors to file their actions individually (i.e. be named as a Claimant on an issued Claim Form) in order to benefit from a successful action. Such actions are therefore much less prevalent.

Royal Bank of Scotland

The Committee will recall a current claim relating to the alleged actions of Royal Bank of Scotland Group Plc (RBS) where, it is argued, investors suffered losses in respect of a subsequent Rights Issue in 2008.

Since the previous meeting of the Committee, a Case Management Conference (CMC) took place on 15-17 December 2014 in front of Mr Justice Hildyard. In addition to arguments around information disclosure between the respective parties, the timetable to trial was also discussed. The claimants assertion that a trial was possible in Autumn 2016 (rather than the Autumn 2017 as suggested by RBS) was upheld by the Court and a trial date of 7 December 2016 was scheduled, and expected to last 25 weeks. Further case management conferences are scheduled for March 2015 and July 2015.

d) Active Investing

The fourth and most challenging activity for the Fund in this particular field is actively seeking investments with ESG characteristics, provided these meet the Fund's requirements of strong returns combined with best practice in ESG and/ or corporate governance. Such investments include alternative energy, clean energy, shared ownership housing.

The Committee will recall that the Fund has previously made the following investments in renewable and clean energy, and social housing:

- £12 million investment in a UK solar co-operative;
- £14 million in a separate Solar Energy Fund;
- Almost £100m in recovery of methane from landfill gas sites and coal mines for generation of electricity;
- £55m in biomass electricity generating plants;
- The Fund has also made a £30 million commitment to a clean energy fund focussed on wind energy assets and is actively considering further opportunities in anaerobic digestion, solar and wind projects;
- In addition the Fund is promoting the installation of photo-voltaic panels across all suitable roofs of its £435m commercial property portfolio with 17 installations currently agreed with tenants representing an investment in solar panels of over £3 million;
- Most recently, £180m has been committed to a social housing partnership, of which over £42 million has been currently invested.

In addition, the Fund was the winner of the British Renewable Energy Awards Pioneer Award 2013 for its approach to investment in these areas.

The Committee will be made aware of new investments as they are committed, and where appropriate, highlight where investment return requirements are complemented by any ESG aspects.

Other developments

Staffing

The Committee will be pleased to note that, as part of the County Council's ongoing transformation process, an appointment has recently been made to the new position of Financial Policy Officer within the Policy and Compliance Team of the Fund. This appointment, effective from 1 April 2015, will give the team the much needed capacity to progress many of the intended developments in governance, and in particular the Fund's aspirations in responsible investment, including taking forward the agreed actions from the recent member working group in this area. In addition, it is anticipated this appointment will enable the Fund to further develop its relationships and approach to voting and engagement.

United Nations Principles of Responsible Investment (UNPRI)

An application was submitted by the County Council as administering authority of the Lancashire County Pension Fund to become an Asset Owner signatory to UNPRI, which was provisionally approved on 13 February 2015. On 10 March 2015, the

Fund was formally welcomed as a signatory, and this acceptance is now recognised on the UNPRI website.

Guidance

In January 2015, BT Pension Scheme, in conjunction with several public and private sector pension funds, produced a guide to Responsible Investment (RI) in listed equity investment, which seeks to help Funds develop their approach to reporting and stewardship in this area. This is attached at Appendix 'C' and will be considered as part of the development of the Lancashire County Pension Fund's own RI policy.

RI working group action plan

As mentioned above, an action plan was created following the work undertaken by the member working group. Developments undertaken against those intended actions are set out below:

RI Working Group – action plan

Area	Action	Progress since previous Pension Fund Committee meeting
Fiduciary duty		
<p>Outcome 1 Having considered all the information presented to its meetings, the Working Group agreed that it would wish to recommend the Pension Fund Committee to consider a more active stance in relation to RI issues than had previously been the case where that did not pose the risk of financial detriment to the Fund. Members acknowledged that the primary aim of an investment strategy was to secure the best possible return and that the administering authority and trustees should not impose their own ethical views on issues such as tobacco, energy, food etc., on scheme beneficiaries.</p>		
Action 1	<p>Recommendation to Pension Fund Committee to consider a move towards RI where it was practicable to do so, and without posing a detrimental financial risk to the Fund.</p>	<p><i>Implicitly accepted by the Pension Fund Committee on 27 November 2014 in accepting the recommendations of the member working group. Recognition of this stance will be reflected in the Fund's first Responsible Investment policy document, currently being drafted.</i></p>
<p>Outcome 2 Concerns were expressed about the Fund's ability to canvass and assess the views of scheme employers and members on specific social, ethical and environmental considerations and investments. Before taking any specific steps that could potentially lead to the investment in or disinvestment from particular sectors, Members acknowledged that it was important to canvass and understand the views of scheme stakeholders, and agreed that different ways of achieving this needed to be explored.</p>		
Action 2	<p>A policy setting out the circumstances in which stakeholder consultation would be sought and the possible methods for achieving this should be developed.</p>	<p><i>No actions to report since the previous meeting of the Pension Fund Committee.</i></p>
<p>Outcome 3 The Working Group felt that it now had a much greater understanding of RI, SRI and ESG issues and in particular the legal framework around fiduciary duties and the issue of disinvestment. Members again acknowledged that the primary aim of the Fund's investment strategy was to secure the best possible return and it was agreed that disinvestment was not an option which should be pursued by the Fund at this moment.</p>		
Action 3	<p>No action required.</p>	

Area	Action	Progress since previous Pension Fund Committee meeting
Existing investment activity		
<p>Outcome 4 The Working Group encouraged the taking of specific steps or actions to reduce carbon production within the Fund's portfolio - for example, within the property portfolio. In addition, the Group supported the continued identification of good investment opportunities and the making of investments that provide appropriate returns and which may possess certain 'green' or clean energy characteristics.</p>		
Action 4	Reduce carbon footprint of LCPF property portfolio wherever possible	<i>No additional actions to report since the previous meeting of the Pension Fund Committee.</i>
Governance and policy		
<p>Outcome 5 The Working Group recommend the establishment by the Fund of a Responsible Investment Policy based on the Policy Tool produced by UNPRI, and subsequently work towards the adoption of the UN Principles.</p>		
Action 5a	Create a Responsible Investment Policy for the Fund	<i>A literature review of good practice in this area has been undertaken, included reference to UN PRI suggested examples. A structure of a draft Responsible Investment Policy for LCPF has been created and it is intended to table a first draft at the Pension Fund Committee in Summer 2015.</i>
Action 5b	Consider signing up to the UN PRI initiative	<i>LCPF submitted an application to UNPRI in February 2015 to become an Asset Owner signatory, which was formally accepted on 10 March 2015, and recognised on the UNPRI website.</i>
<p>Outcome 6 A proposal for revised SRI wording within the SIP should be produced.</p>		
Action 6	Rewrite Statement of Investment Principles section on RI/ ESG	<i>Revised wording in relation to responsible investment will be incorporated into the next revision of the Fund's Statement of Investment Principles when it falls due.</i>
Analysis and monitoring		
<p>Outcome 7 Investigate the options for procuring/ signing up to an SRI/ ESG monitoring tool/ service.</p>		
Action 7	Procure/ sign up to RI/ ESG monitoring tool/ service eg RobecoSAM	<i>Discussions have begun with potential providers, but requires the Fund to determine through its Responsible Investment Policy what its aims and aspirations are in this area before deciding upon the best way to fulfil these requirements.</i>
<p>Outcome 8 Formalise SRI/ ESG discussions with external investment managers as part of ongoing engagement.</p>		
Action 8	Create structured framework for ongoing discussions with external investment managers.	<i>To form part of the draft Responsible Investment Policy, with reference to recent guidance produced by BT Pension Scheme.</i>

Consultations

N/A

Implications

It is a key component of good governance that the Fund is an engaged and responsible investor complying with the Stewardship Code.

Well-run, responsible companies are more likely to be successful and less likely to suffer from unexpected scandals.

Risk management

The promotion of good responsible corporate governance in the companies the Fund is invested in reduces the risk of unexpected losses arising as a result of poor over-sight and lack of independence.

Involvement in a non-US type of “class action” may result in losses incurred being recovered for the Fund, but should the claim be lost then the Fund may incur related costs which may not be known with certainty at the time of filing.

Should the claimants in the litigation against RBS fail, then it is possible that LCPF faces having to make a contribution towards RBS costs notwithstanding the insurance in place. The amount of any shortfall following an insurance settlement and the LCPF contribution thereto is impossible to quantify at this stage.

Furthermore, if successful the LCPF will be required to pay the amounts owing to SL under the Conditional Fee Agreement (insofar as not recovered from RBS) and pay a proportion of any sum recovered to the funder from the proceeds of the litigation.

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

Paper	Date	Contact/Directorate/Tel
Report of the SRI Working Group to Pension Fund Committee – November 2014	27 November 2014	Andrew Fox/ County Treasurer's Directorate/ 01772 535916
National Association of Pension Funds (NAPF) Responsible Investment Guide	2013	Andrew Fox/ County Treasurer's Directorate/ 01772 535916

Reason for inclusion in Part II, if appropriate

N/A