

Pension Fund Committee

Meeting to be held on 5 June 2015

Electoral Division affected: None

Responsible Investment

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

Contact for further information:

Andrew Fox, (01772) 535916, Lancashire County Pension Fund

andrew.fox@lancashire.gov.uk

Executive Summary

This report provides the Pension Fund Committee with updated information on Responsible Investment, an agenda which spans activities associated with fulfilling the Fund's commitment to being a good asset owner.

The report presents the Committee with:

- latest information from Pensions and Investment Research Consultants Ltd (PIRC) in its capacity as the Fund's Governance Adviser (Appendix A);
- a quarterly update from the Local Authority Pension Fund Forum (LAPFF) on engagement activities undertaken on behalf of Forum members (Appendix B);
- details of actual and potential actions (legal cases) connected with companies in which the Fund is currently or was previously a shareholder;
- progress against the actions agreed by the Member Working Group on Responsible Investment.

Recommendation

The Committee is asked:

1. To note the report.
2. To give consideration to Committee members participating in the forthcoming LAPFF mentoring scheme.

Background and Advice

Lancashire County Pension Fund aspires to be a good asset owner and is in the process of developing its approach to Responsible Investment in line with the following definition from 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's current approach to Responsible Investment is set out within its Statement of Investment Principles and features four key strands of activity:

1. Voting Globally
2. Engagement Through Partnerships
3. Shareholder Litigation
4. Active Investing

Working across these strands, the Fund is aiming to ensure an investment approach which considers relevant Environmental, Social and Governance (ESG) factors as part of its identification of new and sustainable investment opportunities. The Fund is also seeking to be an active asset owner, an aspiration which recognises that engagement activity is linked to risk mitigation and value creation. Working collaboratively, in partnership and via the targeted use of agents, the Fund's engagement activities are intended to encourage best practice and performance gains.

This report provides Committee members with up to date information on the work undertaken against each activity strand and gives details of specific matters of note.

1. Voting Globally

To ensure effective and consistent use of its voting rights as a shareholder in companies worldwide, the Fund employs Pensions and Investment Research Consultants Ltd (PIRC) as its agent. PIRC vote on behalf of the Fund at shareholder meetings.

Unless the Fund instructs an exception, all voting is in accordance with standing guidelines which capture PIRCs independent judgement on what constitutes good corporate governance practice (UK Shareholder Voting Guidelines 2015).

PIRC recommend clients do not support resolutions which fall short of best governance practice and give particular focus and attention to promoting independent representation on company boards, separating the roles of CEO and Chairman and ensuring remuneration proposals are aligned with shareholders' interests.

PIRC continually analyse investee companies across a range of considerations including:

- composition and effectiveness of the board
- quality of stewardship including protection of shareholder interests
- sufficiency of risk management and financial controls
- accurate and compliant reporting and accounting practices
- adequacy of environmental, sustainability and employment policies
- disclosure of quantifiable environmental reporting

and issue voting recommendations intended to encourage companies to adhere to high standards of corporate governance and social responsibility. If the Fund so wishes, it can instruct PIRC to cast a vote which does not follow the PIRC recommendation.

Quarterly reports are received from PIRC which provide a retrospective summary of votes cast on behalf of the Fund. The most recent quarterly report is attached at Appendix A and covers the period from 1 January to 31 March 2015. An extract showing the geographical coverage of voting activity in the period is provided below:

Number of Votes by Region

	For	Abstain	Oppose	Non-Voting	Withhold	Total
UK & BRITISH OVERSEAS	32	3	3	0	0	38
EUROPE & GLOBAL EU	103	24	38	20	0	185
USA & CANADA	124	12	34	0	19	189
ASIA	16	0	0	0	0	16
JAPAN	6	0	2	0	0	8
SOUTH AMERICA	3	1	1	0	0	5
TOTAL	284	40	78	20	19	441
	64%	9%	18%	5%	4%	100%

The Fund was party to 441 resolutions during the period, of which 284 votes (64%) supported shareholder resolutions and 118 (27%) opposed or abstained. Institutional investors commonly use abstention to signal a negative view on a proposal without actively opposing it. Within certain foreign jurisdictions, shareholders either vote in favour of a resolution or do not vote at all (described as a vote being withheld). There were 19 instances (4%) where votes were withheld in the period.

A more detailed summary of voting by category for the largest markets (UK and US) is set out below:

United Kingdom	For	Abstain	Oppose	Total
Annual Reports	3	0	3	6
Auditors	3	1	0	4
Corporate Actions	1	0	0	1
Corporate Donations	0	2	0	2
Directors	15	0	0	15
Dividend	2	0	0	2
Miscellaneous	2	0	0	2
Share Issue/Re-purchase	6	0	0	6
Total	32	3	3	38
	84%	8%	8%	100%

USA & Canada	For	Abstain	Oppose	Withheld	Total
All Employee Schemes	3	0	1	0	4
Annual Reports	4	0	0	0	4
Articles of Association	10	0	1	0	11
Auditors	9	4	0	0	13
Corporate Actions	2	0	0	0	2
Directors	81	6	19	19	125
Dividend	1	0	0	0	1
Executive Pay Schemes	0	0	1	0	1
Miscellaneous	0	0	2	0	2
Non- Exec Director Fees	1	0	0	0	1
Say on Pay	1	0	10	0	11
	For	Abstain	Oppose	Withheld	Total
Share Capital Restructuring	2	0	0	0	2
Shareholder Resolution	10	2	0	0	12
Total	124	12	34	19	189
	66%	6%	18%	10%	100%

Section 3 of the quarterly report provides a commentary on the rationale for each case of opposition or abstention.

2. Engagement through Partnerships

Through engagement, the Fund is ultimately seeking to influence investee companies to adopt good corporate governance practices and socially responsible policies which make them less vulnerable to risks and more profitable in the longer term. The breadth of investments held and finite officer resources mean engagement activities to date have focussed on working through partnerships which bring additional capacity and are likely to achieve impact. Specifically, the Fund is a member of the Local Authority Pension Fund Forum (LAPFF) which exists to promote the investment interests of local authority pension funds.

Working collaboratively via LAPFF offers a valuable opportunity to gain experience and insight from other funds and puts Lancashire's support behind campaigns targeted at the companies invested in collectively by local authority pension schemes in the UK. Joint actions wield far greater influence and create a much stronger impetus for change than working alone and also help to fulfil the Fund's commitment (as a recent signatory of the United Nations Principles of Responsible Investment) to working together to further the 6 principles of Responsible Investment. As part of developing its approach to RI it is intended that the Fund will increase its involvement with LAPFF and explore the opportunities associated with membership of the forum.

From 2015, LAPFF is seeking to offer its members the benefit of a mentoring scheme intended to provide additional support to investment officers and managers within the local authority pensions sector. The scheme will be widened to include councillors (as trustee equivalents) if there is a sufficient demand for this. Further details of the scheme are attached at Appendix C and a copy of the application form at Appendix D. The Committee is asked to consider whether the opportunity for one or more members to participate in the LAPFF mentoring scheme is something they would like to pursue either now or in the future.

Details of engagement activities undertaken by LAPFF are set out in the latest engagement report at Appendix B which reflects the period from 1 January 2015 to 31 March 2015. Of greatest note was a recommendation (by the Boards of BP and Shell) that shareholders should support 'strategic resilience' resolutions filed by LAPFF members as partners within the 'Aiming for A' coalition. It is unprecedented in the UK for a company to recommend support for a shareholder resolution and reflects the positive impact of engagement activity by the coalition on a campaign aimed at improving carbon disclosure and gaining a commitment to greater environmental sustainability through research, development and forward investment. While the Fund would have been supportive of these resolutions as it did not have holdings in either company it was unable to vote on these resolutions.

3. Shareholder Litigation

The Fund is committed to remaining informed about the extent to which asset values may have been diminished through financial misconduct and will take action to safeguard the financial interests of members by seeking to recover losses through shareholder litigation. Class action settlements in the USA typically enforce both financial reparations and corporate governance reforms which are designed to minimize the risk of future misconduct. Litigation offers a route of last resort by which the Fund can continue to actively engage with investee companies.

The Fund retains two US law firms - Barrack, Rodos and Bacine (BR&B) and Robbins Geller Rudman and Dowd (RGRD). Both firms provide a securities litigation monitoring service which ensures prospective actions are known about and the Fund's interest (level of loss) can be estimated in order to inform a decision on the most appropriate form of action before the deadline for registering an interest expires. These services are provided to the Fund at no cost.

United States

Under US law, any shareholder subject to loss is automatically entered into and will benefit from a class action without having to file an individual claim. BR&B and RGRD monitor and identify class actions where the Fund was potentially subject to loss and ensure a proof of claim is filed for each case. Occasionally the Fund may be asked to participate in a class action, and/or to apply to become the lead or co-lead plaintiff, something which attaches greater and more onerous responsibilities. A decision on the appropriateness of agreeing to do so would be considered carefully on a case by case basis.

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.	08/12/2010	03/08/2011	27.71
Verisign, Inc.	25/06/2012	25/10/2012	246.21
Intuitive Surgical, Inc.	19/10/2011	18/04/2013	251.54
Barrick Gold Corp.	07/05/2009	23/05/2013	364.67
Prospect Capital Corporation	14/09/2009	06/05/2014	450.97
CenturyLink, Inc.	08/08/2012	14/02/2013	521.63
ITT Educational Services, Inc.	24/04/2008	25/02/2013	760.06
Weight Watchers International, Inc.	14/02/2012	30/10/2013	2,265.97
Petroleo Brasileiro S.A. Petrobras	07/01/2010	26/11/2014	6,158.91

United Kingdom

Unlike class actions in the US, securities claims in the UK require investors to file actions individually in order to benefit from a successful group action (they must be named as a claimant on an issued Claim Form). Actions are much less prevalent in the UK than equivalent class actions in the US.

Royal Bank of Scotland

As part of a large group of institutional investors, the Fund is a claimant in a group action relating to alleged misrepresentation by Royal Bank of Scotland Group Plc (RBS) under which it is argued that investors suffered losses in connection with a Rights Issue in 2008.

Monthly updates on the pre-trial progress of the RBS case are received from the law firm representing the group. Since the previous meeting of the Committee, a 6th Case Management Conference (CMC) has taken place at the High Court in London (Tuesday 17 March 2015). The outcome was reportedly very positive for claimants with progress having been made on each of the applications submitted namely, on the nature and speed of RBS's disclosure, on a timeframe for RBS to provide further information on their case, and on an agreement regarding disclosures by the Director Defendants.

A further (7th) CMC is scheduled for 28-30 July 2015 and the trial date is set for 7 December 2016 with an anticipated trial window of 25 weeks.

Voting, engagement and litigation are all activities undertaken **after** a decision to invest has been made. They form part of a fiduciary commitment to maximising financial returns through actively seeking to reduce risk exposure through the adoption of socially responsible policies, forward investments in sustainability and high standards of corporate governance by investee companies. The fourth strand in the Fund's approach to RI focusses on activity undertaken **before** an investment takes place. It relates to how ESG characteristics feature in the identification of potential opportunities and in the process of selecting between shortlisted investments.

4. Active Investing

The term active investing implies a conscious effort to select a particular type of investment on the basis that it possesses certain desirable characteristics. The Fund has a track record of investing in opportunities with strong ESG characteristics and currently has holdings in both alternative energy and clean energy as follows:

- £12 million invested in a UK solar co-operative;
- £14 million invested in a separate Solar Energy Fund;
- Almost £100m invested in the recovery of methane from landfill gas sites and coal mines (for generation of electricity);
- £55m invested in biomass electricity generating plants;
- £30 million committed to a clean energy fund focussed on wind energy assets.

In addition, the Fund is promoting the installation of photo-voltaic panels across all suitable roofs within its £435m commercial property portfolio. 17 installations have been agreed with tenants, represents a +£3m investment in solar panels. £180m has been committed to a social housing partnership of which £42 million has already been invested.

The Fund's approach to actively seeking investments with ESG characteristics (and to taking other actions in line with being a responsible asset owner) is an area of its RI strategy which requires further development. Specifically, it is important for the Fund to develop a clearer statement about its aspirations with regard to RI and the approach it will take to achieve them. The Members Working Group on Responsible Investment made a series of recommendations for specific actions which included (action 5a) the development of an RI Policy for the Fund. The recruitment of a Financial Policy Officer has brought the additional capacity required to undertake the work involved which, it is recognised, will need to consider the extent to which Fund is seeking to apply ESG criteria to the full range of its investment choices, or to focus efforts on specific aspects of its portfolio such as its public equity holdings and infrastructure.

As an initial step, a mapping exercise is underway to capture the range of personnel and processes currently involved in identifying, analysing and selecting between potential investment options in order to understand the ways in which ESG characteristics are already being included within selection and decision-making. Based on findings, it will be considered whether (and how) ESG considerations could be integrated

- to a greater extent;
- in a more consistent and systematic way going forward.

Any adverse consequences, practical difficulties or increased costs associated with implementing a different approach will also be identified for consideration.

Whilst this initial work is underway, the Committee will be made aware of new investments as they are committed, and where appropriate, it will be highlighted how investment return requirements are being complemented by ESG considerations.

Other developments

Members Working Group on RI: Action Plan

An updated version of the action plan reflecting the work of the Member Working Group on RI is set out below. The action plan provides further details on progress made against each action and identifies whether they have been concluded, are underway currently, are in planning or are on hold pending related developments.

RI Action Plan

Area	Action	Update on actions taken since previous Pension Fund Committee meeting and in planning currently	Status
Fiduciary Duty			
Outcome 1			
<p>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 developed.</i></p>	Concluded
Outcome 2			
<p>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>			

Area	Action	Update on actions taken since previous Pension Fund Committee meeting and in planning currently	Status
Action 2	A policy setting out the circumstances in which stakeholder consultation would be sought and the possible methods for achieving this should be developed.	<p><i>The recruitment of a Financial Policy Officer has brought the additional capacity needed to facilitate the further development of an RI policy for the Fund.</i></p> <p><i>The RI policy will set out the aspirations of the fund in relation to any use of any positive or negative filters in either the identification of future investment options or the consideration of divestment. Any filter which is not clearly and directly aligned with the Fund's primary fiduciary objective of maximising financial returns from investment will be subject to stakeholder consultation.</i></p> <p><i>An approach to stakeholder consultation and possible methods for undertaking it will be addressed as part of the work under action 5a below.</i></p>	Under planning as part of action 5a
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.			
Action 3	No action required.		Concluded

Area	Action	Update on actions taken since previous Pension Fund Committee meeting and in planning currently	Status
Existing Investment Activity			
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.			
Action 4	Reduce carbon footprint of LCPF property portfolio wherever possible	<i>Consideration will be given to how the carbon footprint of the current property portfolio can be captured in order to facilitate the identification of opportunities for reduction going forward. Will foreseeably be related to and affected by action 7 below.</i>	Under planning
Governance and Policy			
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.			
Action 5a	Create a Responsible Investment Policy for the Fund	<i>The recruitment of a Financial Policy Officer has brought the additional capacity needed to facilitate the further development of an RI policy for the Fund. Achieving a policy which is of practical benefit to the Fund and its stakeholders going forward and which contributes to the fulfilment of commitments made as a signatory of UNPRI will involve a number of steps - a more detailed position statement on the Fund's aspirations in relation to RI - the identification of practical approaches by which these aspirations will be fulfilled - the design of any new agreements/documents and reporting/monitoring approaches needed (minimal bureaucracy being a key aim)</i>	Under planning

Area	Action	Update on actions taken since previous Pension Fund Committee meeting and in planning currently	Status
		<p><i>- the agreement by key personnel (e.g. internal investment managers, external fund managers, expert advisors, and agents) of any practical/operational changes or new approaches/ requirements placed on them in order to comply with/deliver the approach set out within the RI Policy</i></p>	
Action 5b	Consider signing up to the UN PRI initiative	<p><i>LCPF became an Asset Owner signatory on 10 March 2015, and is recognised on the UNPRI website.</i></p>	Concluded
Outcome 6			
A proposal for revised SRI wording within the SIP should be produced.			
Action 6	Rewrite Statement of Investment Principles section on RI/ ESG	<p><i>Revised wording in relation to responsible investment was incorporated into the revision of the Statement of Investment Principles approved by the Pension Fund Committee on 27 March 2015. Any further changes as the Responsible Investment approach develops will be incorporated accordingly.</i></p>	Concluded

Analysis and Monitoring

Outcome 7

Investigate the options for procuring/ signing up to an SRI/ ESG monitoring tool/ service.

Action 7	Procure/ sign up to RI/ ESG monitoring tool/ service e.g. RobecoSAM	<i>Discussions have begun with potential providers, but further progress 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>	Pending - subject to development / clarification of RI aspirations as part of 5a above
----------	---	--	--

Outcome 8

Formalise SRI/ ESG discussions with external investment managers as part of ongoing engagement.

Action 8	Create structured framework for ongoing discussions with external investment managers.	<i>Action 8 (Engagement) will be addressed as part of Action 5a above. The development of an RI Policy will include consideration of what is practical and desirable in terms of a more structured approach and will identify any changes/additional requirements this places upon key personnel (including external investment managers) or existing processes in preparation for discussion and agreement. The RI Policy (when drafted) will reflect the approach and advice on engaging with external fund managers set out within the NAPF publication "Incorporating ESG considerations into investment decisions" (This document was a PF Committee agenda item in March 2015).</i>	Under planning
----------	--	--	----------------

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 which impact on shareholder value.

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 the recovery of losses incurred by the Fund but, should the claim be lost, 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 which is 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 the case is successful the LCPF will be required to pay the amounts owing for Legal Services under the Conditional Fee Agreement (insofar as not recovered from RBS) and to 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