

REPORT OF THE GROUP DIRECTOR, FINANCE AND CORPORATE RESOURCES

Responsible Investment – Training and Options Overview	Classification PUBLIC	Enclosures:
	Ward(s) affected ALL	
Pensions Committee 12th December 2018		

1. INTRODUCTION

- 1.1 This report provides the Pensions Committee with a broad overview of the Fund’s approach to Responsible Investment (RI) across two dimensions; sustainable investment and effective stewardship. The report considers applicable legislation and guidance and best practice across each dimension and sets out areas where the Fund could look to change and improve its approach. The report will be considered alongside a discursive training session delivered by Hymans Robertson’s RI team

2. RECOMMENDATIONS

2.1 The Pensions Committee is recommended to:

- **Note the report**
- **Consider priorities for improvement to the Fund’s approach to Responsible Investment**

3. RELATED DECISIONS

- Pensions Committee (27th June 2017) – Stewardship Framework – Engagement Overlay Options
- Pensions Committee (24th January 2017) – Voting and Engagement Overlay Services
- Pensions Committee (24th January 2017) – Investment Strategy Statement

4. COMMENTS OF THE GROUP DIRECTOR, FINANCE AND CORPORATE RESOURCES

- 4.1 Effective stewardship and sustainable investing are key components of the Fund’s investment approach. Ensuring good corporate governance and the adoption of sustainable business models at the companies in which the Fund invests should over the longer term ensure that they are able to deliver superior returns to the Fund. Poor corporate governance and unsustainable business practices can impact on share prices and increases the risk that the Fund may experience a loss of value in its investments in the future.

- 4.2 There are no immediate financial implications arising from this report. .

5. COMMENTS OF THE DIRECTOR OF LEGAL AND GOVERNANCE

- 5.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 Regulation 7 requires the Administering Authorities to publish and maintain an Investment Strategy Statement which includes, amongst other items, details of:
- The authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments.
 - The authority's policy on the exercise of the rights (including voting rights) attaching to investments.
- 5.2 In addition, Government guidance on the preparation and maintenance of the Investment Strategy Statement states that Administering Authorities should explain their policy on stewardship with reference to the Stewardship Code, the seven principles of which apply on a 'comply or explain' basis.
- 5.3 This report helps to demonstrate that the Fund regularly reviews and updates its policies with regards to ESG consideration and the exercise of voting rights, ensuring it remains compliant with the relevant LGPS Regulations and statutory guidance.

6. DEFINING RESPONSIBLE INVESTMENT

- 6.1 No consistent definition of Responsible Investment exists and the term has a variety of meanings. The UN Principles for Responsible Investment (PRI) uses a definition of responsible investment that emphasises the health of the market as a whole: *"Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and governance factors, and of the long-term health and stability of the market as a whole. It recognises that the generation of long-term sustainable returns is dependent on stable, well-functioning and well governed social, environmental and economic systems."*
- 6.2 The subject of Responsible Investment has been considered by the Pensions Committee on a number of occasions. The Committee has aimed to reduce the extent to which the Fund is exposed to financial risk associated with Environmental, Social and Governance (ESG) factors but also to effectively express its views on ESG issues through the exercise of the Fund's voting rights and enhance the Fund's approach to engagement with its investee companies more generally. However, the rapid changes currently taking place across the sector have raised a number of questions about how RI approaches can best be delivered through the new pooled structures.
- 6.3 The report below considers the Fund's current approach across two dimensions of RI, sustainable investing and effective stewardship, and introduces for discussion practical ways in which these approaches could be improved.

7 SUSTAINABLE INVESTING

- 7.1 The term 'sustainable investing' refers to the idea that investors should recognise the potential financial impact of (ESG) factors in investment decision making. Under the LGPS (Investment and Management of Funds) Regulations 2016, the Fund is required to meet a minimum standard with regards to its position on sustainable investment and must disclose, in its Investment Strategy Statement, how social,

environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments.

- 7.2 The extent of investors' fiduciary duty with regards to ESG factors has been the subject of considerable debate in recent years. The Law Commission published a report, 'Fiduciary Duties of Investment Intermediaries', which offered guidance to investors on the circumstances under which they might have a fiduciary duty to consider ESG factors. A recent update to the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2018, although not directly applicable to the LGPS, provided a further steer on the Government's view of the duties of trustees. It is therefore clear that investors are expected to take account of ESG factors where these are financially material and that such a stance should be assumed to be part of any compliant approach to this subject.
- 7.3 The Hackney Pension Fund takes an active approach to sustainable investing. The core legislative requirements are met via a clear statement on its approach to ESG factors within the Investment Strategy Statement, stating that the Fund will explicitly consider ESG factors in its decision making where these are financially material. The Fund, however, also takes a more active stance by using dedicated ESG reporting on a triennial basis to track its exposure to fossil fuel reserves and carbon emissions, and in 2016 set a target to reduce its exposure by 50% over 6 years.
- 7.4 The Fund could potentially look to improve this approach by acquiring a better understanding of some of its non-carbon related ESG exposures, and lending its support to broader industry initiatives, potentially through the Local Authority Pension Fund Forum (LAPFF).

8 EFFECTIVE STEWARDSHIP

- 8.1 Effective stewardship means investors acting as responsible and active owners, through considered voting of shares, and engagement with company management when required. The Hackney Pensions Committee has long taken an interest in being an active steward of its assets; however, as a relatively small investor the Fund has faced challenges in resourcing an active engagement programme and ensuring its views are properly reflected when voting shares. The Fund can therefore be viewed as being at a relatively early stage of its journey with regards to effective stewardship.
- 8.2 In common with many pension funds, The Fund currently delegates the exercise of its voting rights to its external equity managers, who are asked to comply as far as possible with the Fund's voting policies, most notably the request that its managers vote in line with alerts from the Local Authority Pension Fund Forum. However, the inefficiency of the investment chain and the introduction of asset pooling poses difficulties for the Fund in ensuring that its views are properly reflected.
- 8.3 The Fund now holds all of its equity assets (currently approx. 60% of total assets) through pooled funds. Whilst the exact structure of these vehicles varies, their pooled nature makes following individual investor preference extremely challenging as voting rights are exercised at pooled fund rather than individual investor level. Given this difficulty, the Pensions Committee has previously determined that pursuing a fund-level voting overlay approach is likely to be ineffective at this time.
- 8.4 Manager engagement is therefore essential if the Fund is to ensure its shares are voted in line with LAPFF alerts. The Fund is likely to have most traction where assets are actively managed and the Fund invests as part of a relatively small pool of

investors. Engagement with the London CIV is therefore a priority – the CIV currently requests that its third party vote in line with LAPFF alerts on a ‘comply or explain’ basis. Fund officers will monitor the effectiveness of this approach and step up engagement with the London CIV (together with other interested Boroughs) if necessary. It should be noted that the London CIV does not currently plan to use a pool level overlay approach to vote its shares.

- 8.5 The Fund also currently delegates broader engagement with investee companies around ESG issues to its external managers and to the Local Authority Pension Fund Forum (LAPFF), which comprises 79 local authority pension funds with combined assets of £230 billion. The Forum exists to promote the investment interests of local authority pension funds, and in particular to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest.
- 8.6 This arrangement remains appropriate in a pooled environment, and the Committee has stepped up its involvement in the LAPFF. However, it may be appropriate to consider further improvements to enhance this area of the Fund’s RI approach. Given the Fund’s size and available resources, use of an engagement overlay service is unlikely to prove economically viable at present. However, the Fund does conduct some company-specific engagement with its managers and a more formal approach to planning and reporting this could be considered to take a more active approach in this area

Ian Williams
Group Director, Finance & Corporate Resources

Report Originating Officers: Rachel Cowburn ☎020-8356 2630

Financial Considerations: Michael Honeysett ☎020-8356 3332

Legal Considerations: Sean Eratt ☎020-8356 6012

Background Papers

None