RESPONSIBLE INVESTMENTS UPDATE

Committee	Pensions Committee
Officer Reporting	James Lake, Finance Babatunde Adekoya, Finance
Papers with this report	Stewardship Code Report

HEADLINES

Environmental, Social, and Governance (ESG) refers to the three central factors in measuring the sustainability and societal impact of an investment in a company or business. These criteria help to better determine the future financial performance of companies (return and risk).

The purpose of this report is to provide information on how managers entrusted with investing the Pension Fund assets are implementing their ESG policies and demonstrate their commitment to ensuring it is a cogent part of their investment process.

In addition, the report details the progress on the UK Stewardship Code project, next steps in terms of TCFD reporting and other relevant updates.

RECOMMENDATIONS

That the Pensions Committee:

1. **Approve the UK Stewardship Code Report for submission;**
2. **Note the TCFD and next steps;**
3. **Note the fund managers' ESG activities and compliance efforts;**
4. **Note the update on the Boycotts, Divestment and Sanctions Bill; and,**
5. **Note the update Israel and the Occupied Palestinian Territories.**

SUPPORTING INFORMATION

Progress Update

The Stewardship Code project has progressed in accordance with the project timeline and the draft report is attached for review and approval.

The report covers the Code's required principles for asset owners and covers:

1. Purpose, strategy & culture
2. Governance, resources & incentives
3. Conflicts of interest

4. Promoting well-functioning markets
5. Review & assurance
6. Client & beneficiary needs
7. Stewardship, investment & ESG integration
8. Monitoring managers &service providers
9. Engagement
10. Collaboration
11. Escalation
12. Exercising rights and responsibilities

Following Committee approval, formal submission will be made to the Financial Reporting Council (FRC) ahead of the 30th April 2022 deadline.

Reports submitted to the FRC are read in full and assessed against the principles and reporting expectations of the Code in a way that is proportionate to the organisation's size and type. This assessment is then reviewed and discussed among FRC staff to ensure it is fair and appropriate. A sample of reports reflecting a range of applicants are reviewed by the FRC's panel of independent advisors to ensure consistency.

Both successful and unsuccessful applicants are provided a summary of where their reporting met expectations and where improvement is required when re-applying to the Code.

Unsuccessful applicants may address the feedback and re-apply in a future reporting window. This would be October 2022 for Hillingdon.

Once the applicant has been accepted as a Code signatory and the report is approved by the FRC, the report will be a public document. The signatory must also make it available on their website within one month of being notified by the FRC.

ESG initiatives and collaboration - TCFD

At September 2021 meeting, Members agreed to collaborate with the Task Force on Climate-Related Financial Disclosures (TCFD). The Fund has completed the sign-up process which shows their support.

Consultation is due mid-2022 on how the LGPS should adopt and report on TCFD, however scoping work will be carried out in the meantime to prepare for implementation following any regulatory guidance.

The Fund will wait to receive the outcome of the consultation and issuance of guidance before taking any formal next steps.

Boycotts, Divestment and Sanctions Bill

In April 2020 the Supreme Court handed down its judgment in the case of R (on the application of Palestine Solidarity Campaign Ltd and another) (Appellants) v Secretary of State for Housing, Communities and Local Government (Respondent) which was originally heard on 20th November 2019. The court found in favour of the appellants and would appear to take the position that the Government has the power to direct authorities on the approach they take to investment decisions, but not the investments they make.

At the time SAB welcomed the clarity brought by the judgment of the Supreme Court and advised that: in seeking to restrict the outcome as well as the considerations taken account of by an LGPS administering authority when developing its responsible investment policy, the government has been judged to have overstepped its powers. It is the Board's view that Responsible Investment policy decisions belong at the local level reflecting: the need to pay pensions both now and in the future; local democratic accountability and the views of scheme members; and that outcomes of policy developments should not be subject to restrictions based on unrelated matters.

In May 2021 the government's legislative programme was laid out and includes a Boycotts, Divestment and Sanctions Bill, the purpose of which will be to stop public bodies from taking a different approach to UK Government sanctions and foreign relations, and will cover purchasing, procurement, and investment decisions.

In February 2022, after failing to defend previous LGPS investment guidance in the Supreme Court the government undertook to bring it before Parliament through legislation. The Boycotts, Divestment and Sanctions (BDS) Bill was announced in the Queen's speech for this Parliament. Although no timetable for the Bill is available it was expected to be the primary measure to bring about the restrictions in the original guidance plus other measures to restrict expenditure and procurement decisions made by public bodies.

Current position - It is currently understood that it is for LGPS funds to make prudent divestment decisions based on an assessment of the financial consequence of a number of matters, including those relating to Environmental, Social and Governance (ESG) factors. Where such decisions are based on non-financial factors LGPS funds should follow the Law Commission's direction that any financial impact should not be significant and that the decision would likely be supported by scheme members.

PSPJO Bill - In advance of the BDS Bill Robert Jenrick MP raised, at second reading in the Commons, the possibility of amending the Public Service Pensions Service and Judicial Officers (PSPJO) Bill to include a power for the Secretary of State to make guidance in this area. Support from government was not forthcoming in terms of its own amendment, however he subsequently tabled an amendment (listed as NC1) which was debated on 22nd February at report stage.

Following the debate, the government changed its stance to support the amendment, which was passed. On the same day (22nd February) the Bill passed its third reading and will now return to the Lords for consideration of amendments prior to royal assent.

The Amendment NC1 - Guidance to public service pension scheme managers on investment decisions and the Public Service Pensions Act 2013 is amended accordingly.

This new clause would enable the Secretary of State to issue guidance to those authorities that administer public sector pension schemes, including the local government pension scheme, that they may not make investment decisions that conflict with the UK's foreign and defence policy

Effect of the amendment - The amendment would alter the Public Service Pensions Act (PSPA) 2013 including the giving of guidance or directions by the responsible authority to the scheme manager including guidance or directions on investment decisions which it is not proper for the scheme manager to make in light of UK foreign and defence policy.

Next steps - The above changes to the PSPA 2013 will not occur until the PSPJO Bill gains royal assent which is expected sometime in March. Prior to it gaining assent the Bill will return to the Lords for consideration of amendments at which time the amendment may be subject to further debate.

Guidance under this provision, should it be forthcoming, would be expected to be drafted under Investment Regulation 7. (*7.(1) An authority must, after taking proper advice, formulate an investment strategy which must be in accordance with guidance issued from time to time by the Secretary of State)*

Such guidance would also be expected to be subject to a period of consultation which would provide an opportunity for interested parties to comment on its potential impact. Furthermore, as this will be guidance and not primary legislation further legal action cannot be ruled out. Although the courts could this time be assured it was the intention of Parliament to provide a power to the Secretary of State in this area, a challenge could still be made on the grounds that the guidance was seen to go beyond that intention.

Israel and the Occupied Palestinian Territories

In November 2021, a UN special rapporteur on the situation of human rights in the Palestinian territory, wrote to LGPS funds asking them to review and divest from companies linked to Israel 'settlement economy'.

This issue has previously been considered by Pensions Committee with all relevant fund managers asked to comment on their related investments. Based on the evidence and guidance provided it was concluded that the Fund would continue to act in the best fiduciary interests of its members.

It has now been reported that a legal group of UK Lawyers for Israel has argued that the letter from the UN special rapporteur contained inaccuracies around existence of the "settlement economy", and that advising on investment decisions was outside his remit.

Chief executive of UKLFI advised the letter contains serious misrepresentations and any investment decision influenced by this intervention, supposedly in his capacity as a rapporteur of the UNHRC, will be challengeable on the basis of error of law, taking into account irrelevant considerations, failure to act with due skill, care and diligence, and breach of fiduciary duties.

SAB advised they are taking advice and considering the letter ahead of the next meeting of the Scheme Advisory Board.

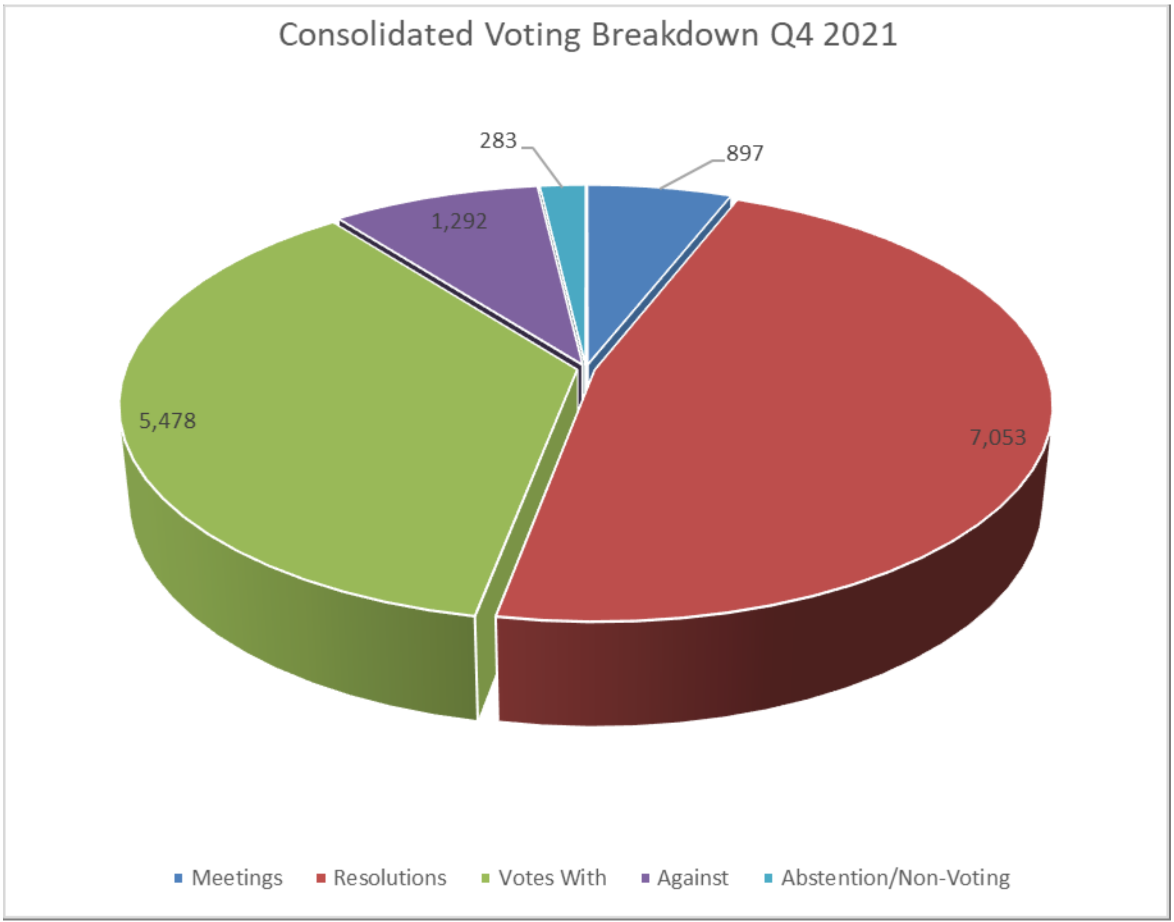
Voting and Engagement

Fund managers carry out proxy voting on the Pension Fund's behalf. Below is a breakdown of voting statistics by LGIM, and London CIV (Ruffer and Baillie Gifford).

	Fund Managers Voting Breakdown Q4, 2021				
LCIV	**Meetings**	**Resolutions**	**Votes With**	**Against**	**Abstention/Non-Voting**
Dec-21					
LCIV - Ruffer	7	60	60	0	0
LCIV - Baillie Gifford	14	196	64	11	121
	21	**256**	**124**	**11**	**121**
%			**48.44**	**4.30**	**47.27**
LGIM	**Meetings**	**Resolutions**	**Votes With**	**Against**	**Abstention**
Dec-21	876	6,797	5,354	1,281	162
	876	**6,797**	**5,354**	**1,281**	**162**
%			**78.77**	**18.85**	**2.38**

The volume of meetings attended, and resolutions voted on by all the fund managers shown above encapsulate their commitment to ESG issues and demonstrates alignment of their stewardship activities with their own investment beliefs, policies, and guidelines. Through this approach, they seek to be active owners on behalf of their clients, by encouraging good governance and a high standard of corporate practices.

The voting breakdown above indicates LGIM have voted against proposed management resolutions on 19% of voting opportunities and supported resolutions on about 79%of occasions. Both LCIV portfolios combined, backed various management resolutions on 49% of voting opportunities and about 4% against the resolutions proposed by company managements. Abstentions totalled 47% and 2% for LCIV and LGIM respectively.



The chart above provides a consolidated overview of voting pattern by all fund managers shown in the table above.

Engagement
ESG factors play an increasingly important role in determining the performance of certain assets. Pension Fund asset managers, as part of their ESG commitments undertake various engagement activities in their holistic approach in making investment decisions. These activities aim to affect changes within invested companies where it is deemed necessary or to complement existing practices.

LGIM

Holding boards to account
To be successful, companies need to have people at the helm who are well equipped to create resilient long-term growth. By voting and engaging directly with companies, LGIM encourage management to control risks while seeking to benefit from emerging opportunities. They aim to safeguard and enhance clients' assets by engaging with companies and holding management to account for their decisions. Voting is an important tool in this process, and one which is used extensively.

Creating sustainable value
LGIM believe it is in the interest of all stakeholders for companies to build sustainable business models that are also beneficial to society. They work to ensure companies are well-positioned for sustainable growth, and to prevent market behaviour that destroys long-term value. Their investment process includes an assessment of how well companies incorporate relevant ESG factors into their everyday thinking. The manager engages directly and collaboratively with companies to highlight key challenges and opportunities, and support strategies that can deliver long-term success.

Promoting market resilience
As a long-term investor for clients, it is essential that markets are able to generate sustainable value. In doing so, LGIM believe companies should become more resilient to change and therefore seek to benefit the whole market. They use their influence and scale to ensure that issues impacting the value of clients' investments are recognised and appropriately managed. This includes working with key policymakers, such as governments and regulators, and collaborating with asset owners to bring about positive change.

Environment

Climate Impact Pledge – launch of the 5th engagement cycle
In October, LGIM launched the fifth engagement cycle of the Climate Impact Pledge, their flagship climate engagement programme. From apparel and airlines to technology companies and utilities, they analyse and directly engage with around 60 companies in 15 climate-critical sectors on their strategic approach to climate change, and to what extent they are aligning their businesses with the constraints and opportunities of a net-zero transition.

The programme targets companies that are large and influential in their respective sectors, but which are not yet meeting 'best practice' expectations. These are companies which could have a significant positive trickle-down effect across their industries and value chains by setting and pursuing ambitious net-zero targets.

Case Study

BHP - Climate Transition Plan
BHP, one of the world's largest mining companies, had put its climate transition plan to a shareholder vote for the first time in its history – a trend expected to gather pace across the extractives sector in the coming years. When assessing such plans, among other factors, LGIM look closely at how aligned the emissions reduction targets are to 'Paris' goals and whether the milestones set are credible and pragmatic. While it was noted BHP has made a substantial progress in its environmental footprint, the manager opposed its climate transition plan as it was deemed to be insufficient and fall short of the level of ambition required to support a net zero pathway.

Social

Ethnicity campaign

In September 2020, LGIM launched their ethnicity engagement campaign and voting strategy, where it committed to engaging with the largest US and UK companies with no ethnic diversity on the board, with a commitment to taking action on a lack of improvement by placing a negative vote at their 2022 AGM. LGIM wrote to 79 companies across the S&P500 and FTSE 100 indices to alert them of their expectations, and to the potential voting action they would take. In October 2021, the manager re-visited the board's ethnic representation of the companies in these indices, with the intention of writing to those who were still in breach of its expectations of one person of diverse ethnicity on the board.

This review resulted in LGIM writing to 37 companies in total, meaning that the target list has almost halved compared to the previous year, demonstrating decent progress. On initial study of the data, it was discovered that in 2021, they wrote to 10 US and 12 UK companies which have been persistent laggards – falling short of their expectations in both 2020 and 2021 – which means that they have not improved the ethnic diversity of their boards over the last 18 months. In Q1 2022 LGIM will be taking a more granular look at the data to understand in more detail any trends and improvements. LGIM voting commitment is steadfast, and from January 2022 they shall be voting against the board chair of UK companies and the Chair of the Nomination Committee of US companies with no ethnic diversity on the board.

Social responsibility for social media

In early 2019, the Social Media Collaborative Engagement of 104 global investors was established, representing approximately £7 trillion AUM, in response to the live streaming of the Christchurch terror attack on 15 March 2019 on Meta1, Alphabet and Twitter. It was believed that these companies betrayed their users' trust, breached their duty of care, and severely damaged their social licence to operate.

The purpose of the collaboration was to engage these three social media companies with a single focus: to strengthen controls to prevent the livestreaming and dissemination of objectionable content.

What action did the collaboration take?

The first action was to speak out publicly on the Collaboration's intention to engage the identified social media companies – Meta, Alphabet, Twitter – on this issue. This decision was taken to indicate clear dissatisfaction with the companies who showed a lack of accountability. Engagement letters were sent to the chairs of the boards of each of the three companies and engagement meetings were held to discuss their responses.

The identified companies assured the collaboration that they were making changes to strengthen controls to avoid a similar situation in future. However, none of the companies agreed for a board member to meet the collaboration, and it was felt that there wasn't enough commitment from the companies on the issue.

Therefore, the collaboration published an open letter distributed via global press, calling for:

- clear lines of governance and accountability to ensure social media platforms cannot be used to promote objectionable content; and
- sufficient resources dedicated to combatting the live streaming and spread of objectionable material across the platforms.

Additionally, during 2020 and 2021, LGIM voted in favour of various shareholder proposals at all three companies that focused on human rights issues, such as expertise at board level and further disclosures.

What are the results?

- In late 2020, Meta informed the collaboration that it had strengthened its Audit & Risk Oversight Committee charter to explicitly include a focus on the sharing of content that violate its policies.
- Meta also made a commitment to prevent such abuse, not just to mitigate it; and
- all the company platforms have moved to strengthen controls to prevent the live streaming and distribution of objectionable content.

Governance

Filing of shareholder proposals
LGIM have once again filed a shareholder resolution requesting that an S&P pharmaceutical company appoint an independent chair, thereby splitting its currently combined chair and CEO role. They engaged with the company since filing the shareholder proposal and will continue to monitor the situation to consider whether to maintain the proposal or withdraw it.

Cardinal Health
In May 2021, LGIM America co-filed a shareholder resolution, together with other investor colleagues within The Investors for Opioid Accountability (IOPA), asking the company to publish annually an in-depth report disclosing its direct and indirect lobbying activities and expenditures, as well as its policies and procedures governing such activities (a ‘Political Contributions and Activities Report’).

Following engagements with the company, the board agreed to expand its Political Contributions and Activities Report to include all disclosures relating to state lobbying expenses exceeding US$25,000; payments to trade associations and other organisations (including to those that draft and support model legislation); and the approach the company will take when a trade association of which it is a member takes a position which differs from the company’s corporate position.

Following the engagement, LGIM, together with the other co-filing investors, withdrew the shareholder proposal. This is a concrete example of using a shareholder proposal as an engagement tool and demonstrates the positive impact of engagement.

FINANCIAL IMPLICATIONS

ESG initiatives circa £95,000 for 22/23.

LEGAL IMPLICATIONS

Legal implications are included in the report.