

Corporate Policy and Strategy Committee

10.00am, Tuesday, 3 December 2013

Lothian Pension Fund Engagement Activities

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Lothian Pension Fund Engagement Activities

Summary

Background

At its meeting on 24 October 2013, Council called for a report to Corporate Policy and Strategy Committee providing more detail of the engagement activities relating to social and environmental responsible investment of the pension funds and criteria used to judge the social and environmental impacts of the funds' investments, with a view to including a KPI on how the fund performs in these areas.

The City of Edinburgh Council is the administering authority for three Local Government Pension Funds: the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund ('the Funds'). The City of Edinburgh Council is one of over 100 employers who participate in the Lothian Pension Fund.

The Council has delegated power to exercise all functions relating to the pension funds, within the terms of the legislation, to the Pensions Committee. In administering the Funds, the Pensions Committee must exercise fiduciary duty, which is generally interpreted to mean the best financial interests of the members, employers and tax payers.

More detail on the pension funds can be found at www.lpf.org.uk.

Engagement Activities

The Funds' Statement of Investment Principles, including its approach to engagement activities relating to environmental, social and governance (ESG) investment issues, is reviewed and agreed by the Pensions Committee every year. As fiduciary duty is paramount, the Funds' primary approach is to judge whether ESG issues pose risks to the value of the Funds' investments, rather than to judge the social and environmental impact. However it is anticipated that good ESG practice leads to improved social and environmental impacts.

Therefore, the Funds pursue a policy of constructive engagement on ESG, consistent with fiduciary duty. The Funds' take ESG issues seriously and work proactively to improve standards in the investment industry. However, influencing company behaviour and standards can be a lengthy process. As a relatively small asset owner, to make a difference, collaboration with other investors is important.

Engagement activities cover three strands of work: voting and engagement with the Funds’ individual investments, membership of the Local Authority Pension Fund Forum and being a signatory to the United Nations Principles for Responsible Investment. All engagement activity is reported to the Pensions Committee annually and a summary of each of these strands is provided below.

Voting and Engagement

The voting and engagement arrangements on the Funds’ equity holdings are shown in the tables below.

Mandate	Voting and Engagement Arrangement
Baillie Gifford (for Lothian Pension Fund’s Pacific equities & Lothian Buses’ global equities)	Baillie Gifford
UBS (Emerging markets)	UBS
State Street Pooled Funds (for Scottish Homes Pension Fund)	State Street
All other listed equities	Hermes Equity Ownership Services (EOS)

Hermes EOS is owned by the BT Pension Scheme. It undertakes voting and engagement activities for the BT Pension Scheme and other asset owners.

Details of voting and engagement activity undertaken are reported on the pension funds’ website. This includes both the total number of companies where the Funds have voted, details of votes against company management and engagement activity with companies.

Hermes EOS’ recent activity includes engagement with companies on the environment, human rights, ethics, corporate governance, strategy and risk. They have also progressed engagements with a number of companies in relation to significant employee relations issues and allegedly inappropriate labour practices. On supply chain issues, Hermes has engaged with a number of companies in relation to the tragedies in Bangladesh. They also continued to pursue engagements with banks on the issues of risk management, culture and remuneration.

Local Authority Pension Fund Forum (LAPFF)

Lothian Pension Fund was a founding member of the LAPFF when it was established in 1990. It promotes the long-term investment interests of local authority pension funds and aims to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest, commensurate with statutory regulations.

Councillor Cameron Rose is currently Vice Chair of the Executive Committee of the LAPFF. Its membership has increased over recent years (currently 56 of the 110 local government pension schemes). It is increasingly able, because of its size and reputation, to access company boards.

It has also met with a number of companies to scrutinise how they are responding to the increased scrutiny on safety in overseas factories following the RANA Plaza factory collapse in Bangladesh. Other recent activity has targeted corporate governance, climate change and executive pay. Since the financial crisis, LAPFF has also undertaken significant amount of work on accounting standards for the banking industry.

United Nations Principles for Responsible Investment (UN PRI)

The United Nations-supported Principles for Responsible Investment (PRI) Initiative is an international network of investors working together to put responsible investment into practice. The six principles are:

- Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
- Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
- Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
- Principle 6: We will each report on our activities and progress towards implementing the Principles.

Lothian Pension Fund signed the PRI in 2008. There are now over 1,200 signatories from across the globe.

Assessing Impact of Engagement Activity

The Funds' ESG activity is focussed on engagement with companies in order to improve performance. Officers monitor the implementation of the Funds' strategy on a regular basis. However, the strategy is essentially qualitative and is wide ranging. The impact is very difficult to quantify, especially in the short term.

Hermes EOS measures its own success by setting and monitoring progress against 'milestones' for each company engagement. In addition, the University of St Andrews is currently undertaking a study to assess the impact of Hermes' Environmental, social and governance interventions on company performance in the long term. Results are expected in 2014.

The PRI undertakes an assessment of compliance of each signatory with the principles. In 2011, Lothian Pension Fund ranked in the top or second quartile against its peers in five out of the six UNPRI principles. Lothian Pension Fund's activity was also quoted in its 'Case Study and Guidance' report. Details can be found on the pension fund website. Since 2011, changes have been made to the UNPRI assessment process as a result of its complexity. The 2012 assessment does not include a comparison with the fund's peers and PRI are continuing to develop the assessment tool.

Given the difficulties in assessing the impact of such qualitative work, and also because improving the social and environmental impact of the Funds is only one aspect of investing pension fund monies, a KPI for the environmental, social and governance aspects of the pension fund is considered to be inappropriate.

However, the pension funds will continue to participate in the PRI assessment and publish its results. Officers will continue to keep abreast of industry developments in order to assess the impact of the Funds' strategies and make recommendations to the Pensions Committee to ensure it remains appropriate.

Recommendations

Committee is recommended to:

1. note the fiduciary role of the Council and the Pensions Committee in administering the pension funds;
2. note that the strategy for incorporating environmental, social and governance issues into the pension funds is agreed and monitored by the Pensions Committee; and
3. note that the inclusion of a Key Performance Indicator for such activity is inappropriate given its qualitative nature.

Measures of success

Success of engagement with companies is very difficult to measure.

However, the strategy is essentially qualitative and is wide ranging. The impact is very difficult to quantify, especially in the short term.

Lothian Pension Fund is a signatory to UN PRI and as such, completes the annual self assessment.

Financial impact

There are no direct financial implications of this report. Arguably, engagement activities on environmental, social and governance issues ensure companies manage these risks more proactively which should have a positive impact on financial performance.

Equalities impact

There are no adverse equalities impacts arising from this report.

Sustainability impact

Engagement activity is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

The Lothian Pension Funds' Consultative Panel, including employer and member representatives, plays an integral part in the pension fund governance. They participate in the meetings of the Pensions Committee. The Funds' policy on ESG issues is included in Statement of Investment Principles, which was agreed by the Pensions Committee. Stakeholders are kept informed of engagement activity via the pension funds' website.

Background reading / external references

None.

Links

Lothian Pension Fund:

- General information: <http://www.lpf.org.uk/>
- Responsible Investment http://www.lpf.org.uk/info/68/responsible_investment
- <http://www.lpf.org.uk/lpf1/info/76/unpri>

Hermes Equity Ownership Services <http://www.hermes.co.uk/eos/en-gb/home.aspx>

United Nations Principles for Responsible Investment <http://www.unpri.org/>

Local Authority Pension Fund Forum <http://www.lapfforum.org/>

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Links

Coalition pledges

Council outcomes CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.

Single Outcome Agreement

Appendices None