

Pensions Committee

2pm, Wednesday, 18 December 2013

Environmental Social and Governance Activity Update

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Executive summary

Environmental Social and Governance Activity Update

Summary

Background

This report provides the annual update on Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund's, (the Funds), activity on environmental, social and governance (ESG) issues. The Funds pursue a policy of constructive engagement on issues, which is consistent with fiduciary duties.

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)

The busiest voting season is the quarter ending 30 June (Q2). In Q2 2013 Hermes EOS voted on the Funds' behalf at 502 meetings (6,812 resolutions). At 235 of those meetings, Hermes EOS opposed one or more resolutions. They voted with management by exception at six meetings and abstained at one meeting. They supported management on all resolutions at the remaining 260 meetings.

Hermes EOS' recent activity includes engagement with companies on the environment, human rights, ethics, corporate governance, strategy and risk. It has 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 EOS has engaged with a number of companies in relation to the tragedies in Bangladesh. It has 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. 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 review how they are responding to the increased scrutiny on safety in overseas factories following the RANA Plaza factory collapse in Bangladesh. Other recent activity includes 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.

Councillor Cameron Rose is currently Vice Chair of the Executive Committee of the LAPFF. Committee is asked to endorse Councillor Rose's nomination to stand for re-election to the Executive and for the position of Vice Chair at the AGM in January 2014. If successful, Council's endorsement of the appointment will be sought. Councillor Rose will provide a verbal update to Committee on his role on the Executive.

United Nations Principles for Responsible Investment (UN PRI)

Lothian Pension Fund signed the UN PRI in 2008. The UN PRI is a leading global network for investors to publicly demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices. Through membership of UN PRI we have been able to join various working groups on specific responsible investment issues. We also participate in an informal group of UK UN PRI signatories which has been very useful.

Signatories complete a self assessment each year to measure progress against the UN PRI principles and also to allow comparison with peers. We have found that the self assessment process is time consuming and complex. For officers, the value of the resulting report is questionable, with a time lag in receiving the report. For example, the next report, based on the 2012/13 financial year will not be received until late 2014.

The UN PRI reviews the assessment and reporting process from time to time. Last year, after consultation with signatories, changes were again made to the reporting framework. Signatories were asked to complete a pilot assessment on a voluntary (non-public) basis. This assessment was based on the 2011 calendar year. Lothian Pension Fund participated in the pilot and submitted feedback to UN PRI on the new framework. UN PRI has taken signatories' views on board.

The report on the Funds' pilot assessment shows a small selection of our responses and they are not scored or independently audited. As a result of the difficulties encountered with the pilot process our responses are, in some cases, not a 100% accurate reflection of the Funds' activity. For example, the description of how our voting is done and how it is disclosed is not accurate. However in the interest of transparency we have decided to make the report available on the Funds' website.

The assessment process will hopefully be improved. However there is such diversity in type and size of signatories, it will only be known if the new process is better when the assessment of the 2012/13 year is completed. This assessment is currently in progress.

Unison request on TUC guidelines

City of Edinburgh Council UNISON has asked if the policy guidelines adopted by the TUC for union pension funds, could be included in discussion at Pensions Committee. The guidelines are outlined in http://www.tuc.org.uk/economy/tuc-22042-f0.cfm?utm_source=dlvr.it&utm_medium=twitter#

With the assistance of Hermes EOS we have compared the TUC's guidelines with Hermes EOS Responsible Ownership Principles, which have been adopted as the Funds' guidelines. We have noted that similar to the EOS approach, the TUC's guidelines are based on the UK Corporate Governance Code. However, there are two areas where EOS and TUC take a different approach:

- The comprehensive approach versus organisational priorities; and
- Remuneration.

Hermes EOS, on behalf of the Funds, applies a comprehensive approach when analysing companies, to identify those which are failing to perform in terms of immediate financial returns, risk management, or those who are potentially destroying long term value. The Funds' approach is to encourage change in line with the interests of all long-term shareholders, with a focus on wider issues as well as corporate governance concerns. The TUC's voting guidelines have an emphasis on the TUC priorities, including worker representatives on boards.

The TUC guidelines focus substantially on the details of remuneration, and in particular the differences in pay and pensions received by company executives compared to average employees. This focus is based on the TUC belief that large pay differentials have far-reaching economic and social consequences. The Funds' approach is that executive remuneration and incentive structures should drive performance and support behaviours that are aligned with the interests of all shareowners and company performance over the long-term.

The differences highlighted above illustrate different approaches to corporate governance. As fiduciary duty is paramount, the Funds' primary approach is to judge whether ESG issues pose risks to the value of the Funds' investments. However, corporate governance is a very subjective area and it is inevitable that the Fund will exercise its voting rights in different ways to the TUC.

Corporate Policy and Strategy Committee

At its meeting on 24 October 2013, the City of Edinburgh 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 key performance indicator on how the fund performs in these areas'.

A report was submitted to Corporate Policy and Strategy Committee on 3 December 2013. The report provided detail of the Funds' ESG activity, explained how the funds are governed and the role of the Pensions Committee. The Committee agreed with the recommendation that the inclusion of a key performance indicator for ESG activity is inappropriate given its qualitative nature.

Recommendations

Committee is recommended to:

- Note the contents of this report;
- Endorse Councillor Cameron Rose's nomination to stand for re-election to the LAPFF Executive and for the position of Vice Chair.

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.

The Funds are signatories to UN PRI and complete the annual self assessment process.

Financial impact

The costs of the Funds' ESG activity are included in the pension funds' budget.

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 to 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 after consultation with stakeholders. 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/>

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