

# Pensions Committee

2.00 p.m., Wednesday, 16 December 2015

## Environmental Social and Governance Activity Report update (including class actions)

Item number	5.9
Report number	
Executive/routine	
Wards	All

### Executive summary

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

This report also provides an annual update on the Funds' class action activity. A class action is a type of lawsuit in which a group (a class) sues another party. Typically, these actions happen in the US. The type of class action relevant to the Funds is one in which a group of shareholders collectively sues a company in order to recover a loss in share value, or to exert influence on the company. Since 2006 the fund has received US\$3.3 million in class action compensation.

### Links

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Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

## Environmental Social and Governance Activity Report update (including class actions)

### Recommendations

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- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 That Committee notes the contents of this report.
- 1.3 That Committee endorses Councillor Cameron Rose's nomination to stand for re-election to the Local Authority Pension Fund Forum (LAPFF) Executive and also for the position of Vice Chair at the January 2016 AGM.

### Background

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- 2.1 The Funds pursue a policy of constructive engagement on issues, which is consistent with fiduciary duties. As an aside, the Scheme Advisory Board for LGPS Scotland has requested that a firm of solicitors prepare an overview of the existing advice south of the border on the exercise of "fiduciary duty" by administering authorities of LGPS funds with a view to pulling this together and also identifying any matters of Scots law which may be different. We will continue to update the Committee on any developments in this regards that might deviate from previous analysis by the Fund.
- 2.2 As previously reported to Committee, the ability of investors to seek redress via class actions in the US has been narrowed since 2010.

### Main report

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#### Voting and Engagement

- 3.1 The voting and engagement arrangements for the Funds' equity holdings are shown in the tables below.

Mandate	Voting and Engagement Arrangement
UBS (Emerging Markets - Lothian Pension Fund)	UBS
Baillie Gifford (Global - Lothian Buses Pension Fund)	Baillie Gifford

State Street Pooled Funds (for Scottish Homes Pension Fund)	State Street
All other listed equities	Hermes Equity Ownership Services (EOS)

- 3.2 The busiest voting season is the quarter ending 30 June (Q2). In Q2 2015 Hermes EOS voted on the Funds' behalf at 389 meetings on 5,772 resolutions. Hermes opposed 402 resolutions and supported management on 5,370.
- 3.3 Hermes EOS' recent engagement activity is detailed in Hermes' (Q2) quarterly report, which is available on the Funds' website. The report includes a section on the strategy of engagement with fossil fuel companies, which has met with some success. A number of fossil fuel companies are committing to more transparency on how their business would be affected if stronger public policies to tackle climate change were introduced.
- 3.4 There are bribery and corruption and labour rights concerns around the World Cup in Qatar in 2022. Hermes EOS is engaging with construction companies and Cup sponsors on these issues in order to promote anti bribery and corruption practices, protect fundamental human rights, ensure adequate labour standards and so avoid reputational damage to companies and their shareholders.
- 3.5 Uptake of good corporate governance practices by US companies has lagged behind European counterparts. Constructive engagement with boards in the US has had results and improvements are beginning to be seen. Hermes EOS reports greater scope for collaboration and cooperation between boards and long term investors.

#### **Local Authority Pension Fund Forum (LAPFF)**

- 3.6 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 65 of the 110 UK local government pension schemes).
- 3.7 LAPFF has again continued its work on accounting standards for the banking industry and has made significant progress. LAPFF has obtained and published further legal opinion that supports their position. Other recent efforts have included activity to improve corporate governance, to highlight and address carbon risk and to encourage the appointment of women to company boards. Further information, such as Quarterly Engagement Reports and Newsletters, is available on the LAPFF website.

3.8 Councillor Cameron Rose is currently Vice Chair of the Executive Committee of the LAPFF. The role entails participating in quarterly meetings of the LAPFF executive and also the quarterly Business meetings. Councillor Rose also participates in LAPFF’s engagement meetings with companies. Committee is asked to endorse Councillor Rose’s nomination to stand for re-election to the Executive and also for the position of Vice Chair at the AGM in January 2016. 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.

**Principles for Responsible Investment (PRI)**

3.9 Lothian Pension Fund signed the PRI in 2008. The PRI is a 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.

3.10 Signatories complete a self assessment each year to measure progress against the PRI principles and also to allow comparison with peers.

3.11 The 2014 assessment process was still at the pilot stage, but signatories are allowed to publish their feedback reports. The Fund’s report and scores are available on its website. The results are summarised below.

MODULE	Score	Comments
Overarching approach	A	Funds' overall ESG arrangements are good.
<b>External Fund Managers</b>		
Listed Equity Manager selection appointment & monitoring	A	ESG approach regarding external Fund Managers is good.
<b>Internal fund Managers</b>		
Listed equity incorporation	C	It is hoped that ESG integration in investment decision making will improve with systematic use of quantitative ESG data. (see below)
Listed equity active ownership	A	Voting and engagement for internal equity funds is good.
Fixed Income Government	E	These investments (<10% of the Fund ) were in US and UK Government debt.

3.12 Previous assessments of the Fund's activities have generally been very good. Feedback on the Fund’s submissions has highlighted scope for improvement in ESG integration in investment decision making. As a result, the Fund reviewed options in this area for the internally managed equity portfolios leading to the procurement of an ESG research service. The systematic use of quantitative ESG data has been integrated into the decision making process for internal portfolios since March 2015. The improvement will be reflected in the next PRI

assessment score, which will cover the year to 31 December 2015. (It is not reflected in the table.)

- 3.13 The E rating in the table for Fixed Income Government is not a concern as the Fund's holding is in UK and US government debt which is not usually perceived as having any significant ESG risk. If in future the Fund invested in a wider range of instruments an ESG approach would be considered more appropriate.
- 3.14 In the past, the self assessment process was time consuming and complex and the value of the resulting report questionable. However, the Fund has worked with PRI to improve the process with some success - the process is quicker and the new assessment is also more relevant and useful.

**Fiduciary Duty**

- 3.15 Committee discussed recent opinions on fiduciary duty at their meeting in June 2015 (one opinion for the Local Government Pension Scheme (LGPS) Shadow Scheme Advisory Board in England and Wales and the other from the Law Commission).
- 3.16 These developments do not strictly speaking apply to the Scottish Local Government Pension Scheme. Therefore the LGPS Scheme Advisory Board in Scotland has included consideration of fiduciary duty in its workplan. This is expected to be progressed in the first half of 2016.
- 3.17 The Fund will continue to monitor developments in the interpretation of fiduciary duty and potential changes to investment regulations.

**Class Actions**

- 3.18 In shareholder class actions one or more investors agree to act as lead plaintiff(s). A law firm acts on behalf of the class, with the lead plaintiffs being treated as the representatives of the class. In the US cases are typically taken on a "no win no fee" basis.
- 3.19 If a class action case is won, the compensation fund, net of legal fees approved by the court, is distributed to eligible shareholders who make a claim within the relevant time limit. The Funds claim for compensation on all relevant class action settlements. Compensation received by the Funds from class actions is shown in the table below:

<b>Financial Year</b>	<b>US\$ (000's)</b>
<b>Prior to 31/03/12</b>	<b>2,140</b>
<b>2012/13</b>	<b>483</b>
<b>2013/14</b>	<b>285</b>
<b>2014/15</b>	<b>284</b>
<b>2015/16 [1]</b>	<b>102</b>
<b>TOTAL [1]</b>	<b>3,294</b>

**[1] To 05 November 2015**

## Lead Plaintiff and Opt-in Cases

- 3.20 In addition the Funds may act as a lead plaintiff on class actions. However a court ruling in the case of Morrison vs National Australia Bank (NAB) in 2010 narrowed the ability of investors to seek redress under the laws of the US, particularly where shares are purchased on non-US stock exchanges.
- 3.21 The Funds are not currently acting as Lead plaintiff, but have done in several cases in the past with little success and minimal compensation received. In some instances the case was difficult to prove and in others the settlement was a small proportion of overall shareholders' loss.
- 3.22 As a further result of the reduced ability to claim compensation in the US, investors are increasingly looking to claim through other jurisdictions where the legal process may require investors to "opt-in" to the case prior to the trial if they wish to participate.
- 3.23 Officers have reviewed a small number of such cases. Considerations have included the estimated financial loss, potential for recovery, the resource needed to monitor the case and the risk of further detriment to the Funds. The Funds have not entered into any of these cases.

## Measures of success

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- 4.1 Success of engagement with companies is very difficult to measure. The Funds' approach is essentially qualitative and is wide ranging. The impact is very difficult to quantify, especially in the short term. The Funds are signatories to PRI and complete the annual self assessment process which compares ESG activity with peers.

## Financial impact

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- 5.1 There is no financial impact as a result of this report. The costs of the Funds' ESG activity are included in the pension funds' budget. US class actions are conducted on a "no win no fee" basis. The Funds' are not involved in any non-US actions.

## Risk, policy, compliance and governance impact

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- 6.1 The ESG activity of the Funds, complies with the Statement of Investment Principles. The Funds' policy is to take ESG issues seriously and where appropriate to act upon them in a manner which is consistent with the paramount fiduciary duty to provide the highest standards of stewardship on behalf of the members, employers and tax payers. The Funds' policy of being responsible, informed and involved investors is expected to reduce risk.

## Equalities impact

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- 7.1 As much of the engagement activity is on equalities issues it is expected to have a positive impact and also to contribute to the sustainability of the Funds' investments.

## Sustainability impact

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- 8.1 As much of the engagement activity is on sustainability issues, it is expected to contribute to the sustainability of the Funds' investments.

## Consultation and engagement

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- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

## Background reading/external references

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None

### **Alastair D Maclean**

Chief Operating Officer

Deputy Chief Executive

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## Links

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Lothian Pension Fund: [http://www.lpf.org.uk/info/68/responsible\\_investment](http://www.lpf.org.uk/info/68/responsible_investment)

<http://www.lpf.org.uk/lpf1/info/76/unpri>

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

**Single Outcome Agreement**

**Appendices** None