

LB Barnet Pension Fund

Responsible Investment – Considering
the LGPS requirements and Your approach to RI

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Agenda



Background



LGPS Regulations and Guidance



Considering your current RI approach



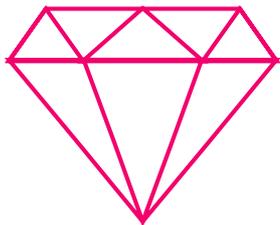
Developing your RI approach



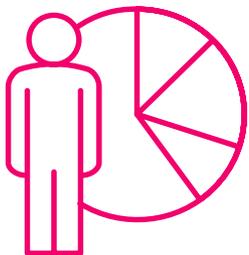
Background - RI

What is Responsible Investment?

Responsible investment refers to investment practices that integrate the consideration of environmental, social and governance (ESG) factors into **investment management processes** and **ownership practices**, recognising that these factors can have a **material impact** on financial performance.



Sustainable investment: Investors should recognise the potential financial impact of ESG factors in investment decision making.



Effective stewardship: Investors should act as responsible and active owners, through considered voting of shares, and engagement with company management when required.

Why consider Responsible Investment? The four R's...



ESG factors can be a source of financial risk within different asset classes



| Environmental factors | Social factors | Governance factors |
|-----------------------|-----------------------|-------------------------|
| Climate Change | Customer satisfaction | Board Structure |
| Resource scarcity | Community relations | Accounting & Audit |
| Water stress | Working conditions | Executive remuneration |
| Biodiversity | Diversity | Bribery & corruption |
| Pollution | Health & Safety | Shareholder rights |
| Energy efficiency | Employee wellbeing | Transparency |
| Waste management | Data protection | Political contributions |

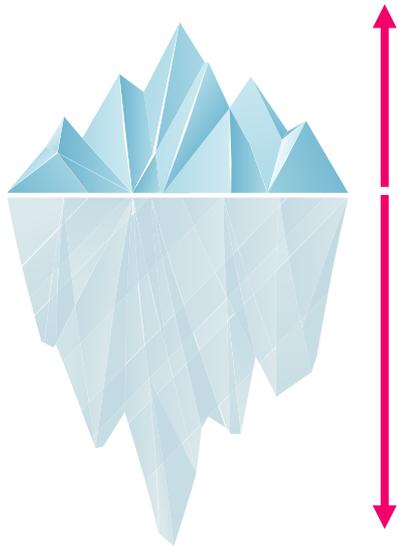
Sources of risk...  ...can have a financial impact

- Increased input costs
- Higher environmental taxes
- Environmental liabilities
- Brand value
- Company reputation
- Productivity
- Well managed company more successful
- Cost/risk controls
- Stable share price

Operational risks: managed through effective stewardship

Systemic risks: strategic approach

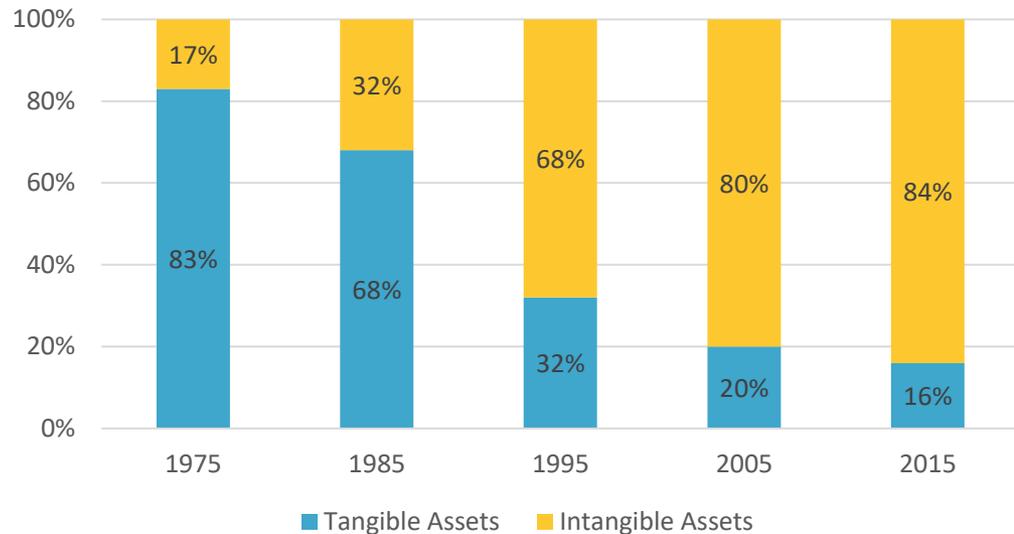
The intangible component of value is increasing



Financial information

ESG information

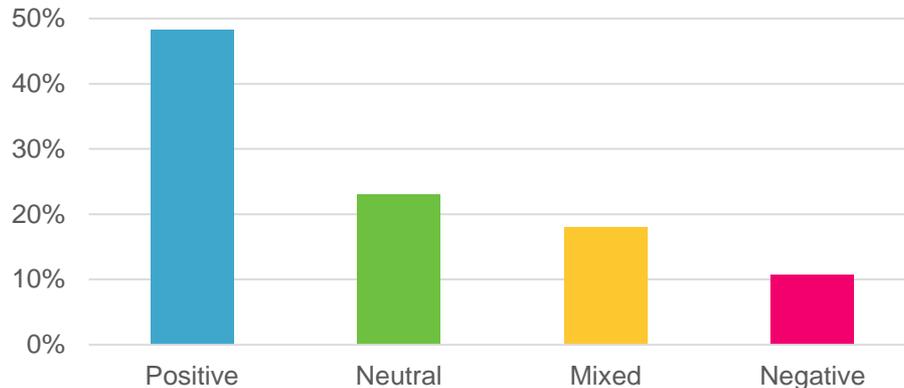
Components of S&P500 Market Value



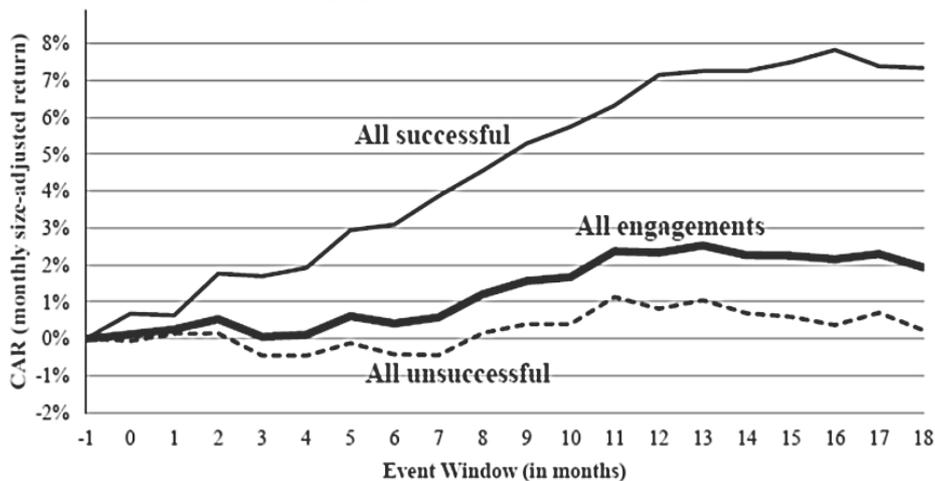
How well do you understand the value of your intangible assets?

Studies demonstrate that responsible investment activity adds value

Relationship between ESG criteria and corporate financial performance in published studies

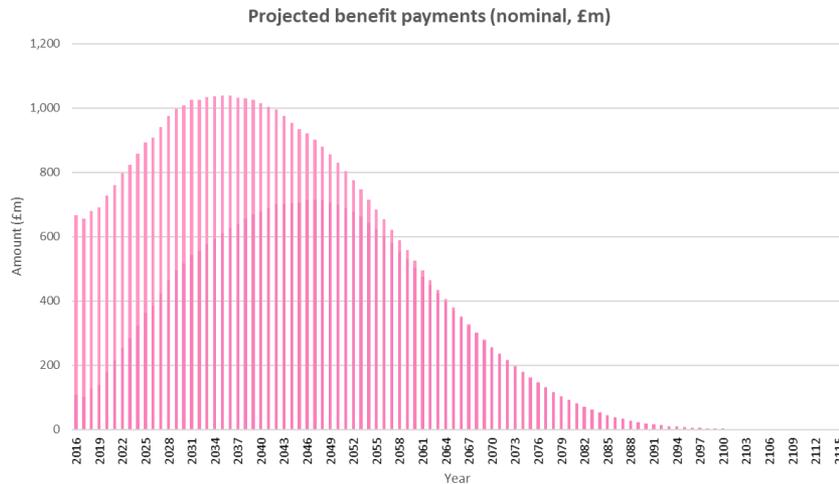


Comparison of performance between successful and unsuccessful engagements



- “Will it impact our returns” is a commonly posed question
- Consideration of ESG factors is fundamentally a risk management exercise, rather than for return generation
- Differences in approach mean that there is no simple answer, but research demonstrates that RI practices do not harm return
- This applies to both integration and stewardship activity

Climate change has been singled out as a particular consideration for asset owners...with good reason



- The impact of climate change is unknown given its dependence on the actions of humans, but policy response is inevitable
- Pension fund liabilities are long-term spanning many decades meaning that climate risks fall within the time horizon of decision making
- Climate change represents an uncertainty for funding and investment decisions and can be considered within your approach to risk management

LGPS Regulations and Guidance



Guidance requires that Responsible Investment is considered in your decision making

The law is generally clear that schemes should **consider any factors that are financially material** to the performance of their investments, including social, environmental and corporate governance factors, and over the long term, dependent on the time horizon over which their liabilities arise.

Although schemes should make the pursuit of a financial return their predominant concern, they **may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment** to the scheme and where they have good reason to think that scheme members would support their decision.

The long-term investment interests of administering authorities are **enhanced by the highest standards of corporate governance and corporate responsibility** amongst the companies in which they invest. Poor governance can negatively impact shareholder value.

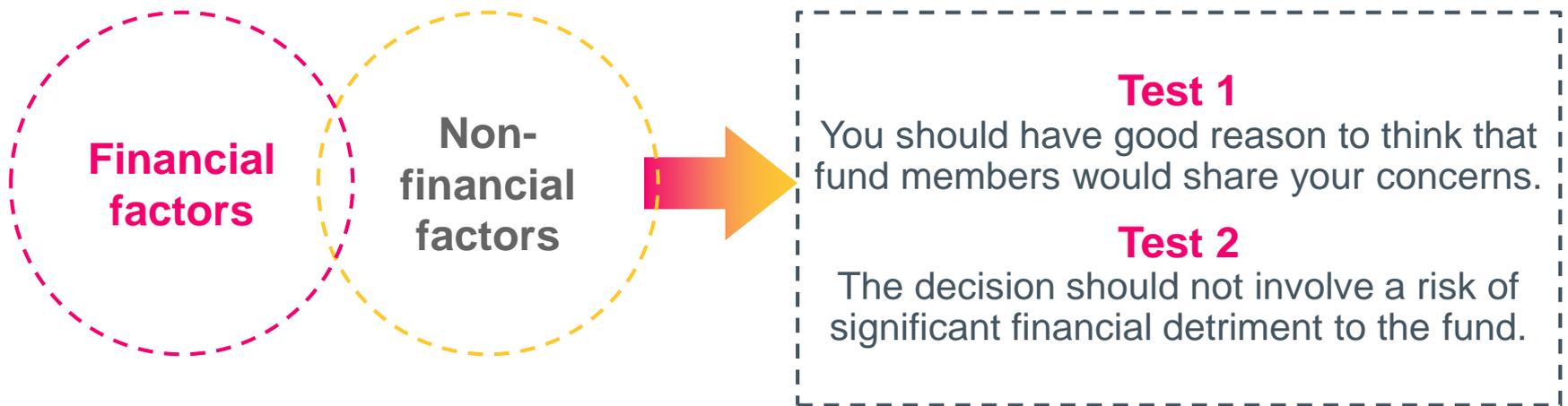
Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper.

DCLG: Guidance on Preparing and Maintaining an Investment Strategy Statement – June 2017

Financial and non financial factors

“ The most important distinction is between the factors relevant to increasing returns or reducing risk (financial factors) and those which are not (non-financial factors)”

Law Commission, 2014



Law Commission found barriers to social investment were structural and behavioural rather than legal or regulatory

2016 Investment Regulations - 7(e) and (f)

Regulation 7 requires an administering authority to formulate an investment strategy statement in accordance with guidance issued by the Secretary of State.

The ISS required by Regulation 7 must include:

- e) The authority's policy on how social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and**
- f) The authority's policy on the exercise of rights (including voting rights) attaching to investments.**

2016 Regulations - 7(e) Guidance

In formulating and maintaining their policy on social, environmental and corporate governance factors, an administering authority:

- Must take proper **advice**
- Should explain the extent to which the views of their local pension board and other interested parties who they consider may have an interest will be taken into account when making an **investment decision based on non-financial factors**
- Must explain the extent to which non-financial factors will be taken into account in the **selection, retention and realisation of investments**
- Should explain their **approach to social investments**

2016 Regulations - 7(f) Guidance

In formulating their policy on the exercise of rights, administering authorities:-

- Must **give reasons in their ISS** for not adopting a policy of exercising rights, including voting rights, attaching to investments
- Should, where appropriate, **explain their policy on stewardship** with reference to the Stewardship Code
- Should strongly **encourage their fund managers, if any, to vote** their company shares in line with their policy under Regulation 7(2)(f)
- May wish to **appoint an independent proxy voting agent** to exercise their proxy voting and monitor the voting activity of the managers, if any, and for reports on voting activity to be submitted annually to the administering authority
- Should **publish a report of voting activity** as part of their pension fund annual report under Regulation 57 of the 2013 Regulations

2016 Investment Regulations

Administering authorities are encouraged to consider the best way to engage with companies to promote their long-term success, either directly, in partnership with other investors or through their investment managers, and explain their policy on stewardship with reference to the **Stewardship Code**. Administering authorities should become Signatories to the Code and state how they implement the seven principles and guidance of the Code, which apply on a “comply or explain” basis.

DCLG guidance, September 2016

UK Stewardship Code

The **2012 Code** comprises a set of 7 ‘apply and explain’ Principles for asset managers and asset owners.

The FRC launched its update on the 2012 UK Stewardship Code in October 2019, which will take effect from 1 January 2020.

The **2019 Code** comprises a set of 12 ‘apply and explain’ Principles for asset managers and asset owners, and six Principles for service providers, including investment consultants.

Existing signatories will need to submit a Stewardship Report by 31 March 2021 in order to continue as a signatory to the Code.

The majority of investment managers are signatories to the UK Stewardship Code and therefore this addition to the Code will help align manager behaviour with revised ISS wording.

Considering your current RI approach



Current LBB ISS wording on RI (1)

The LB Barnet Investment Strategy Statement (ISS) (March 2017):

1. defines 'ESG risk' as *the risk that ESG related factors reduce the Fund's ability to generate the long-term returns*
2. states *the Committee consider the Fund's approach to RI in **two key areas:***
 - *Sustainable investment / ESG factors; and*
 - *Stewardship and governance.*

Current LBB ISS wording on RI (2)

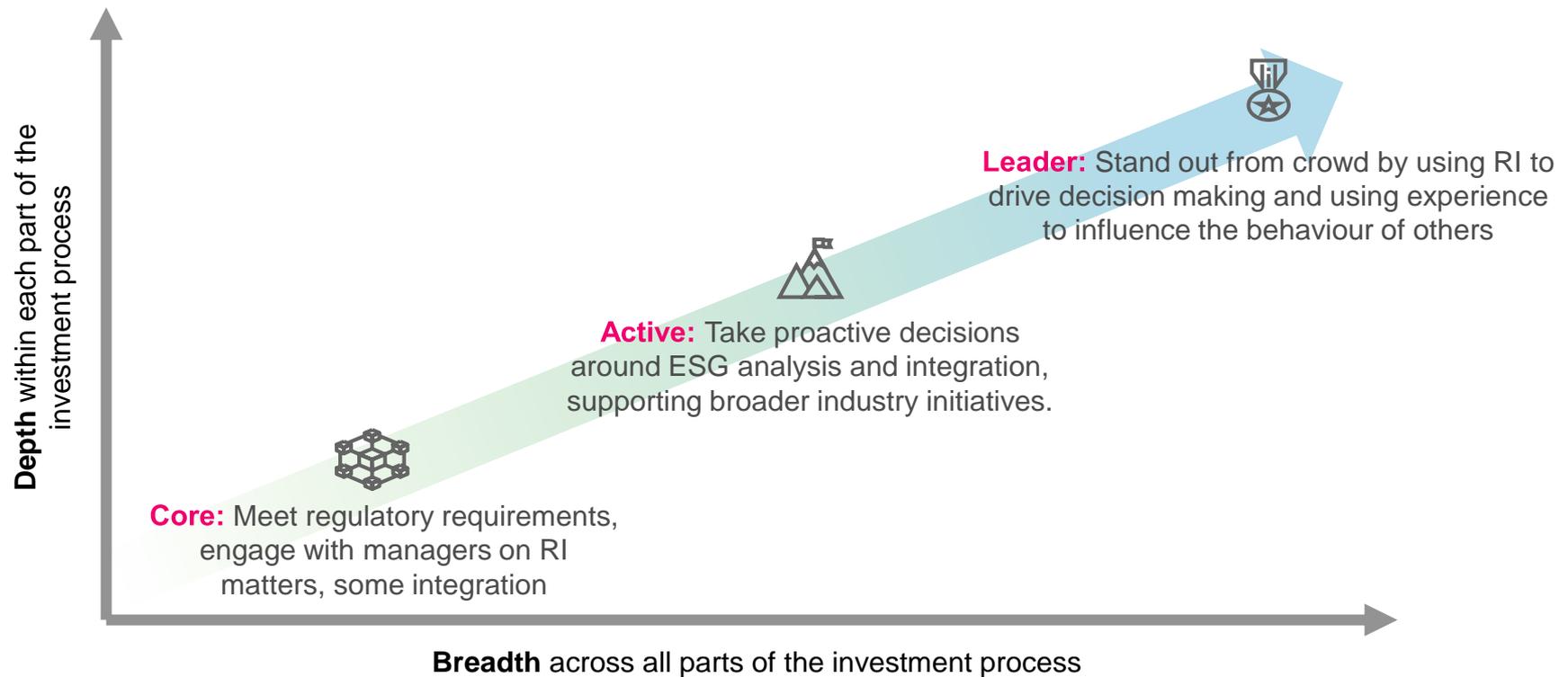
The ISS also notes that:

- *ESG factors can influence LT performance and ability to achieve LT returns*
- *The Panel take training on a regular basis, including on ESG matters, and seeks advice from managers with the requisite knowledge and skill*
- *The Fund requires its investment managers to integrate all material financial factors including ESG and ethical considerations, into decision making*
- *The Fund expects managers to:*
 - *promote good practice and use their influence to promote good practice in the investee companies and markets.*
 - *monitor managers on their policies and practices on all material financial issues including ESG.*
- *Voting rights are delegated to investment managers. The Fund monitors this activity on an ongoing basis with the aim of maximising its impact and effectiveness.*
- *The Fund fully endorses the Stewardship Code. The Fund will review this position in 2017-18 with a view to formally adopt the Code.*

Developing your RI approach



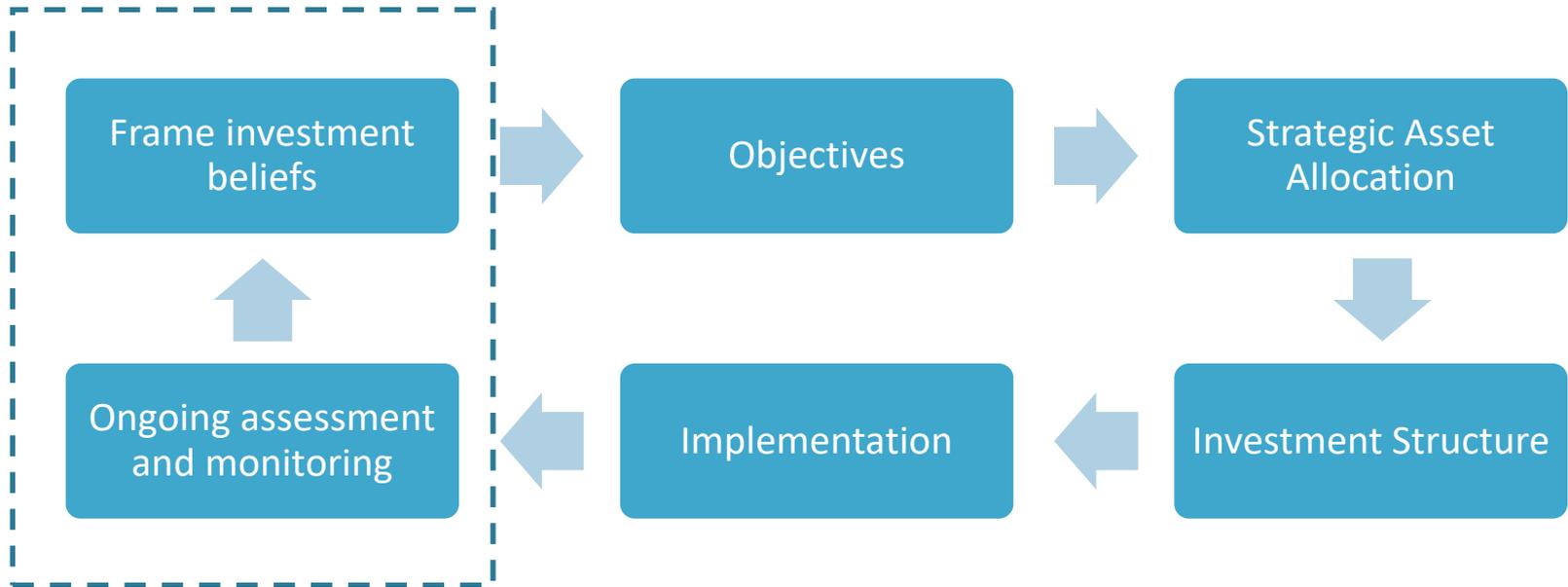
What sort of responsible investor are you going to be?



Various factors influence the sort of responsible investor you will be including

- Views and investment beliefs
- Investment time horizon
- Means of implementation
- Governance budget
- Asset size and the associated complexity of the investment arrangements
- Potential scrutiny of the investment arrangements

Responsible Investment is relevant and should be addressed at each stage of the investment process



Start by:

- Determining your investment beliefs, including RI beliefs
- Understanding the extent and quality of RI practices in your current arrangements

Three aspects of responsible investment are relevant in decision making

Impact

Where you want to invest your money, i.e. what mandate, asset class. Do you just want a financial return or do you want a financial return with broader impact

Integration

How your money is invested, i.e. the processes your manager uses to assess the risks and opportunities presented by individual ESG factors

Stewardship

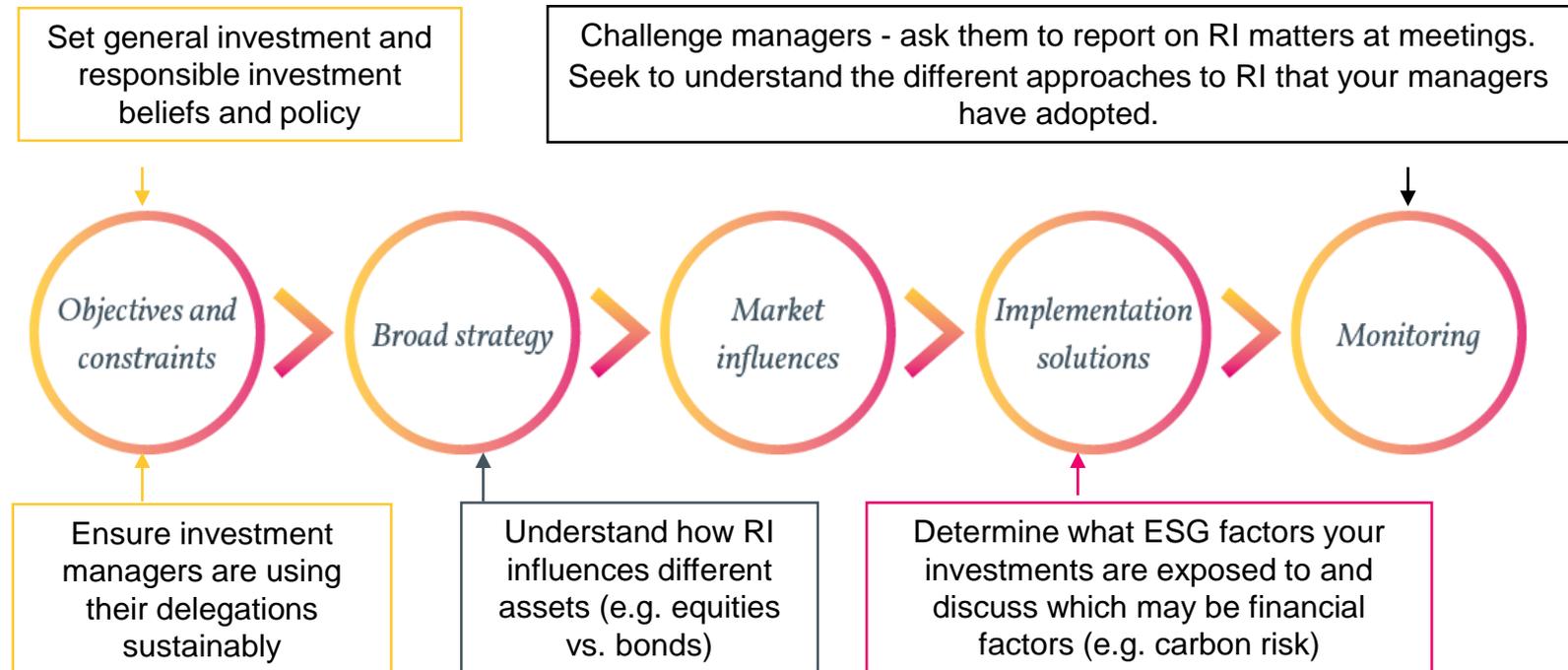
How your money is looked after once invested, i.e. the exercise of the rights and responsibilities that come as an asset owner and associated reporting

RI Integration: What it isn't, and what it is

- × Prohibiting investment in sectors, countries, and companies
- × Ignoring traditional financial factors
- × Assessing every ESG issue for every asset
- × Every investment decision
- × Major changes to investment process
- × Sacrificing portfolio returns
- ✓ Analysing **financial and ESG** information
- ✓ Identifying **materiality**
- ✓ **Assessing impact** on economy, country, sector, and company performance
- ✓ **Making investment decisions** that include considerations of all material factors, including ESG factors.

Actions we are seeing from other LGPS

- Developing **Responsible Investment Policy** and monitoring manager adherence to codes and policies.



RI decisions should be broader than manager monitoring alone

Steps for you to consider in future...



- Develop investment beliefs (including RI beliefs)



- Develop and agree a process with managers on monitoring and reporting RI related issues



- Update ISS to take account of any new regulations and consider how you will monitor adherence to your own policies



- Consider Impact and Local Investing
- Consider carbon footprinting & low carbon or pro-ESG equity

Responsible Investment is a part of good investment decision making



Appendix

Hymans' view on RI

We want to support behavioural change amongst our clients, encouraging them to think as responsible asset owners, whose actions make a difference in shaping the future developments of their investments in a sustainable way and at the same time influence public policy and positive change.

The application of RI is a part of Committee' fiduciary duty to protect and enhance the long term value of investments.

Climate change is a systemic risk factor which is likely to impact economic growth, asset returns and longevity.

Core-Active-Leader framework (1)

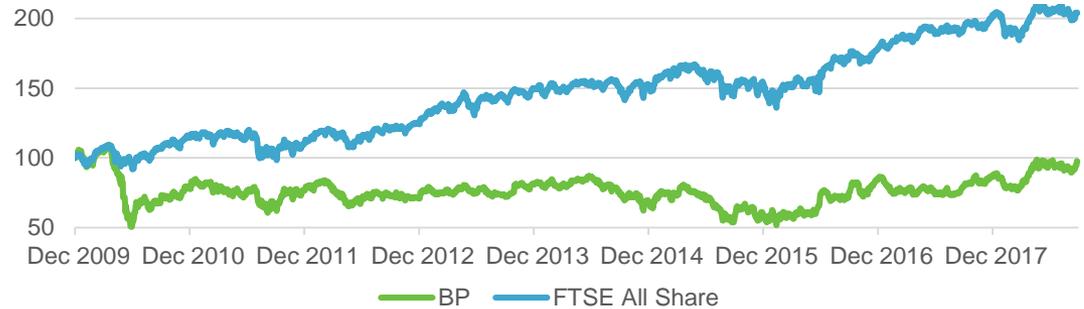
| | RI Criteria | Core Position | Active Position | Leader Position |
|--------------------|-------------|--|---|---|
| Objectives | Training | Committee have a basic understanding of RI and its impact on investments. Training received periodically on RI matters from advisers and/or managers | Committee have a clear understanding of RI and good awareness of market developments. Training is regularly provided , including by industry specialists | Committee have an excellent understanding of RI and will actively seek further more detailed knowledge on RI matters Market developments are regularly considered and inform decision making. |
| | Beliefs | RI-related risks are clearly represented in Committee investment beliefs | Committee have identified and well documented RI beliefs . Committee will consider how beliefs are used in the determination and implementation of investment strategy. | Committee have clearly identified RI beliefs which are developed to a more granular level . Committee will publicly disclose their investment beliefs |
| | Policy | Committee have clear, scheme-specific policies on stewardship and sustainable investment to meet regulatory requirements RI related risks (e.g. climate risk) included where appropriate in the risk register | Committee recognise the sponsor's attitude to RI and will ensure, where appropriate, consistency with scheme-specific policies Committee have clear RI policy priorities Committee publicly disclose support for industry-wide RI initiatives (e.g. PRI, UK Stewardship Code, TCFD) | Committee have clear RI policies in place and develop issue specific policies . Committee will seek means of actively implementing their policies . Committee comment publicly using their activity as a benchmark for others |
| Strategy/Structure | Strategy | Where there is an appropriate investment horizon, Committee will consider the potential impact of ESG factors on risk and return | Committee seek to explicitly model ESG risks in the determination of investment strategy. Committee will seek direct input from advisers and/or managers on the financial impact of particular ESG issues | Financially material ESG themes are identified and used to drive strategy decisions |
| | Structure | Committee recognise the influence of benchmarks on the selection of assets by investment managers Committee consider alternative approaches in some asset classes | Committee actively consider alternative benchmarks and products in the determination of strategy Committee consider investments that are consistent with RI beliefs Strategic ESG targets e.g. lower carbon exposure are set for the portfolio | Investment in opportunities from identification of ESG risks e.g. renewable energy infrastructure and impact investments |

Core-Active-Leader framework (2)

| | RI Criteria | Core Position | Active Position | Leader Position |
|-----------------------|-----------------------------------|---|--|--|
| Implementation | Manager selection and appointment | <p>RI criteria explicitly included as a consideration in manager selection process</p> <p>Committee understand the extent to which managers take account of ESG issues in their investment processes</p> | <p>ESG issues/minimum RI criteria are a key consideration in the selection of managers</p> <p>Managers demonstrating weaker practices will not be considered for appointment.</p> | <p>ESG issues are an integral consideration in the selection of managers</p> <p>Committee explicitly aim to appoint managers with strong or improving practices</p> <p>Committee agree specific RI related KPIs with the manager.</p> |
| | Collaboration | <p>Collaboration is achieved via investment managers only</p> | <p>Committee participate in collaborations initiated by other investors.</p> | <p>Committee will engage with industry partners to advance the RI agenda</p> <p>Committee lead or participate in specific collaborative engagements with other investors</p> |
| Monitoring/Governance | Reporting | <p>Committee will request RI issues be included in reporting by advisers and managers</p> <p>Committee receive quarterly reporting on stewardship (voting and engagement) activities</p> <p>Committee include high level RI information in their own reporting to members.</p> | <p>Committee require greater levels of ESG information from managers, e.g. reporting on carbon exposure, as standard</p> <p>Committee receive quarterly reporting on stewardship activity and use this to actively challenge managers</p> <p>Committee provide detailed RI information in their own reporting to members.</p> | <p>Monitor RI 'hot topics' and take any required action to protect long term value</p> <p>Committee drive improvements in reporting</p> |
| | Monitoring | <p>Managers RI credentials and changes in house policies are reviewed annually</p> <p>Managers' adherence to RI policies is considered and questioned in meetings</p> <p>Committee question managers on particular RI issues</p> | <p>Committee develop and monitor the scheme against explicit RI related KPIs</p> | <p>Committee identify and monitor the scheme against specific 'red flags' on ESG issues</p> <p>Committee use monitoring as a means for reframing objectives and will actively seek areas for change</p> |
| | Adherence | <p>Adherence to beliefs/policy is checked as part of review of ISS</p> | <p>RI implications documented when changes made to strategy / structure</p> | <p>Current approach benchmarked e.g. relative to peer group</p> <p>Committee will actively engage with managers to drive improvement</p> |

Failing to recognise material ESG issues risks a permanent loss of capital

BP Deepwater horizon 2010



PG&E 2018



Source: Bloomberg

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Reputation and peer pressure is also focusing attention on RI considerations



Company reputation can be a source of risk



Best practice standards are being raised for asset owners and asset managers



Asset owners are being scrutinised and challenged



Stewardship Code

The **2012 Code** comprises a set of 7 'apply and explain' Principles for asset managers and asset owners, which states that institutional investors should:

1. publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.
3. monitor their investee companies.
4. establish clear guidelines on when and how they will escalate their stewardship activities.
5. be willing to act collectively with other investors where appropriate.
6. have a clear policy on voting and disclosure of voting activity.
7. report periodically on their stewardship and voting activities.

LCIV policy (selected extracts)

| Area | Policy |
|--------------------------------------|--|
| Principles/ Beliefs | <ul style="list-style-type: none">• Belief that suppliers should be held to account on exercise of ownership rights (1.1.2)• Responsible investing reduces risk over the long term (1.1.3)• Responsible investment is relevant to investment performance across asset classes (1.1.3)• Preference for engagement over exclusion (1.1.4) |
| Integration | <ul style="list-style-type: none">• Expectation that managers will consider material ESG factors• Ensure managers operate RI policies and are accountable for these• Hold managers to account for improving integration (3.1.1) |
| Stewardship | <ul style="list-style-type: none">• Expectation that managers will vote (consistency?) (4.1)• Vote in line with LAPFF guidance (comply or explain) (4.2.1)• Expectation of compliance with corporate governance codes (3.2.1) |
| Manager selection & monitoring | <ul style="list-style-type: none">• Ability to demonstrate integration and evidence practices (3.3.1)• Consideration of manager reporting on ESG (3.3.1)• Manager compliance with policies will influence use of manager by LCIV• Pool will monitor extent to which external managers incorporate ESG issues into processes (3.1.1) |

London CIV looking to hire permanent head of ESG
and additional resource into investment team

Effective stewardship

Voting

Are managers using the voting rights attached to shares? What are their policies and are you comfortable with them?

 Financial Reporting Council

September 2012

The UK Stewardship Code

Engagement

Are managers communicating with companies to effect improvements in practice? Are managers collaborating with other like minded investors



Monitoring

Are managers setting objectives and monitoring progress against these objectives? Are asset owners monitoring what their managers are doing and asking questions

Stewardship best practice begins with strong governance structures and clearly defined objectives and beliefs

We can assess the overall importance, and quality of RI in your strategy

Importance of attributes by asset class

| | Impact | Integration | Stewardship |
|-------------------------|--------|-------------|-------------|
| Listed equity (Active) | ✓ | ✓ | ✓ |
| Listed equity (Passive) | ? | ✗ | ✓✓ |
| Multi-Asset (DGF) | ✗ | ? | ✓ |
| Investment Grade Credit | ✗ | ? | ? |
| Real Estate | ✓ | ✓✓ | ✓ |

Impact is a function of the mandate objectives. For example, sustainable equities have a greater “impact”

Integration and stewardship are a function of the manager employed and the quality of their processes

A portfolio health check can provide information on your current approach to responsible investment and identify areas for future focus



Thank you

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General risk warning

Please note the value of investments, and income from them, may fall as well as rise. You should not make any assumptions about the future performance of your investments based on information contained in this document. This includes equities, government or corporate bonds, currency, derivatives, property and other alternative investments, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an investment. As a result, an investor may not get back the full amount originally invested. Past performance is not necessarily a guide to future performance.

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