ITEM

London Borough of Enfield

REPORT TO;	**Pension Policy & Investment Committee**
SUBJECT:	**Responsible Investment Framework**
LEAD OFFICER	**Paul Reddaway**

1. **RECOMMENDATIONS**

1.1 To note the contents of this report and to consult with the wider membership of the Fund

EXECUTIVE SUMMARY

This report sets out an approach to develop a framework for Responsible Investment by the London Borough of Enfield Pension Fund. It is recognised that further consultation will be required with other stakeholders.

DETAIL

The starting premise of this review is that the fund will maintain its engagement policy, however it is recognised that this view may change as the consultation process continues. This provides a platform for the Fund to build a robust commitment towards Responsible Investment (RI) strategy based on a framework of investment beliefs.

The strategy will detail the approach the Fund aims to follow in integrating environmental, social and governance (ESG) issues in its investments. It is considered supplementary to the Fund's Investment Strategy Statement and thus in alignment with its fiduciary duty. This framework needs to be developed in the context of relevant regulations and statutory guidance.

The Pensions Policy & Investment Committee (the Committee) is at all times responsible for the Fund's investments, including oversight of the RI strategy. Responsibility for oversight of the Fund's RI framework sits with the Local Pension Board. **Appendix 1** shows the relationship between responsible investments and ESG.

The Committee will review this policy at a minimum annually, or at such time as the Fund sees fit to revise its RI policies and procedures.

London CIV

From October 2018 it will have a significant proportion of the Fund's RI activities. It will be executed on the Fund's behalf London Collective Investment vehicle (LCIV). The LCIV is a company established by the Fund and 31 other London Boroughs to operate collective investment vehicles through which the Fund may invest to save costs over the long term. The LCIV is expected to have a leading approach to RI. Where this document refers to “fund management arrangements”, this is defined to include arrangements with the LCIV.

Definitions of Responsible Investment and Stewardship
The term ‘responsible investment’ refers to the integration of financially material environmental, social and corporate governance (“ESG”) factors into investment processes. It has relevance both before and after the investment decision and is a core part of fiduciary duty. It is not simply a box-ticking exercise nor is it merely a matter of managing reputational risk. It is distinct from ‘ethical investment’, which is an approach in which the moral persuasions of an organisation take primacy over its investment considerations.

We define the concept of stewardship in the same way as the Financial Reporting Council (FRC), the organisation that oversees the UK Stewardship Code:

“Stewardship aims to promote the long-term success of companies in such a way that the ultimate providers of capital also prosper. For investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings.”

2) Beliefs and Guiding Principles

RI Integration
The Fund believes that effective management of financially material RI risks should support the Fund’s requirement to protect returns over the long term. The Fund considers RI to be relevant to the performance of the entire Fund across asset classes.

There are some investment opportunities arising from environmental and social challenges which can be captured so long as they are aligned with the Fund’s investment objectives and strategies.

The Fund recognises the importance of taking ‘proper advice’ (as defined in the regulations) and coming to investment decisions after adequate scrutiny of a robust evidence base.

Engagement Versus Exclusion
Investee companies with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events. There is risk but also opportunity in holding companies that have weak governance of financially material RI issues. Thus, the Fund prefers to adopt a policy of risk monitoring and engagement in order to positively influence company behaviour and enhance shareholder value, influence that would be lost through a divestment approach. The Fund extends this principle of ‘engagement for positive change’ to the due diligence,

appointment and monitoring of fund managers who are at an early stage of developing its RI approach.

The Fund believes that it will improve its effectiveness by acting collectively with other like-minded investors because it increases the likelihood that it will be heard by the company, fund manager or other relevant stakeholder compared to acting alone. The Fund recognises the need to operate at a market-wide level to promote improvements that will help it to deliver sustainable long-term growth.

Remuneration, Fees and Incentives

Executive remuneration and investment management costs matter, particularly in low-return environments. Fee arrangements with fund managers and the remuneration policies of investee companies should be aligned with the Fund's long-term interests. The Fund recognises that it is part of its fiduciary duty to ensure that there is an appropriate alignment.

Climate Change[1]

Financial markets could be materially impacted by climate change and by the response of climate policy-makers. Responsible investors should proactively manage this risk factor through stewardship activities, using partnerships of like-minded investors where feasible. It should also promote the aims of the Paris Agreement.

3) In Practice

Through fund management arrangements, the Fund aims to put its responsible investment beliefs into practice through actions taken both before the investment decision (which we refer to as the selection of investments) and after the investment decision (the stewardship of investments). The Fund aims to be transparent to its stakeholders through regular and high-quality disclosure. These ambitions yield the Fund's three RI pillars: Selection, Stewardship and Transparency and Disclosure.

Selection

The Fund aims to be aware of and monitor financially material RI issues in the context of investment and manager selection. Depending on the asset class and nature of the proposed mandate or vehicle, the Fund will monitor:

- RI issues in relation to directly managed investments;

- The extent to which fund managers incorporate RI issues into their investment processes, with the expectation that managers' processes will improve over time. This is managed at the due diligence and appointment states as further explained below:

[1] By highlighting climate change, rather than other RI risk factors, we are not asserting that climate risk has, for all assets, greater economic significance than other factors. Our motivation for referring specifically to climate change risk derives from our recognition that it is a risk factor of particular importance to a number of stakeholders, and we have communicated our investment beliefs about climate change for reasons of transparency.

Fund Manager Due Diligence
The Fund collects the following information from each manager before they are appointed where applicable to the asset class:

- Copy of their RI or stewardship policies (or equivalent) which articulates how RI factors, whether stemming from research, stewardship activities or other sources, are integrated into their investment process. Fund Managers are also given case studies or examples of where RI issues have influenced an investment decision.

- Information on the process for integrating any third-party RI data into their company financial models, investment strategies and portfolio construction.

- Fee transparency and evidence of disclosure.

- RI reporting format.

- Whether they are a signatory of the UN-backed Principles for Responsible Investment (PRI) and UK (or other) Stewardship Code. Fund Managers are given a copy of their PRI public report and annual assessment scores if applicable.

Fund Manager Appointments
The Fund assesses the RI capability of a fund manager as a factor within each of the people, process and performance categories. In its decision to appoint a fund manager, the Fund takes a balanced consideration of all relevant factors including RI. However, the Fund will pay a particular attention to adherence to relevant soft regulatory codes depending on the market in which it invests.

In practice, this means the Fund is willing to hire a fund manager at an early stage of developing its RI approach as long as there is a demonstrable RI commitment and a willingness to improve in their approach over time. In alignment with our guiding principles on ‘engagement versus exclusion’, the Fund believes that there is added value in working with them to improve their approach.

London CIV
The LCIV is now managing the majority our equity holdings. The LCIV is in the process of developing its own RI policy. This will be based on an agreement with all the boroughs that make-up the LCIV.

Stewardship
The Fund aims to make full use of its stewardship rights, including voting and engagement activities. From April 2018 this will be executed on the Fund’s behalf by LGPS Central for certain investments.

Fund Manager Monitoring
Each fund manager is expected to report at agreed intervals to the Fund on how their RI activities are contributing to improved long-term risk-adjusted returns.

Examples of information that can be provided in aid of this objective include but are not limited to the following:

- The evolution of how the manager integrates the consideration of RI issues into its investment and stewardship activities.

- How investment and stewardship functions are combined to protect and/or enhance value.

- Any outcomes arising from the manager's engagement with companies and their effectiveness.

Industry Engagement
In collaboration with other like-minded investors, the Fund may engage with public policy makers, regulators, trade bodies, indexes and other players in the financial markets to further support the Fund's fiduciary responsibilities. The Fund considers these initiatives on a case-by-case basis.

Shareholder Litigation
The Fund is eligible to participate in certain individual and class action securities litigation. Securities litigation may be used as an escalation technique within an engagement process. There are a number of litigation options available when a company has violated securities laws that result in losses to the Fund.

Voting
The Fund uses its voting rights to support the long term economic interests of its stakeholders and to ensure boards of directors are accountable to shareholders. The Fund expects UK companies to adhere to the UK Corporate Governance Code on a comply or explain basis.

Climate Change Stewardship
The Fund, either directly, through partnerships or fund management arrangements, aims to:

- Encourage improvement in the level of disclosure by companies of material climate change risks through collaborative initiatives, for example via our affiliations with Local Authority Pension Fund Forum (LAPFF), and the Institutional Investors Group on Climate Change (IIGCC); (membership costs £8k pa) http://www.iigcc.org/)

- Support and where applicable co-file –reasonable shareholder proposals to disclose/justify a company's approach to climate change risk;

- Review its fund managers to understand their approach to incorporating climate change considerations and encourage improvements in identifying and assessing the potential impact of climate change;

- Contribute to public policy with regards to climate change as it relates to investment considerations through participation with organisations such as the IIGCC. In support of this aim, the Fund is a signatory to the Global Investor Statement on Climate Change;

- Increase awareness of climate change as it applies to investment decision making through participation in relevant industry forums and collaborative initiatives;

- Keep up to date on the latest research and thinking on the financial materiality and interconnectedness of climate change within and across asset classes;

- Use and encourage adoption of the Transition Pathway Initiative's (TPI) toolkit for climate change management and performance; (http://www.lse.ac.uk/GranthamInstitute/tpi/)

- Disclose using the framework recommended by the Taskforce on Climate-related Financial Disclosures (TCFD), which is recognised as best practice. (https://www.fsb-tcfd.org/)

Memberships and Affiliations

Local Authority Pension Fund Forum. The Fund is a founding member of the Local Authority Pension Fund Forum (LAPFF). LAPFF is the UK's leading collaborative shareholder engagement group encompassing more than 70 local authority pension funds from across the country with combined assets of around £200 billion. The Fund is an active participant in LAPFF's engagement programs. Membership of LAPFF provides the Fund with:

- Independent research and advice on the RI risks of companies to inform further stakeholder engagement;

- Advice on the governance practices of companies;

- A forum to engage with companies to improve governance practices.

Appendix 1

Responsible Investment

Ethical investing: using ethical principles as the primary filter for choosing where to invest

ESG: investing which takes into account financial risks posed by environmental, social and governance factors

Green investing: investing in companies focussed on conserving natural resources or working on clean air and water initiatives, alternative energy sources and other environmental projects

Sustainable investment: a broad term, often considered synonymous with ESG, meaning investing in assets which are judged to be able to deliver long-term competitive returns and positive social impact.

Social impact investment: investments made with the intention of generating a positive social impact alongside a financial return

ESG factors can affect risk and returns

ESG factors comprise the following attributes and can affect potential risks and returns in some of the following ways (Figure 2):[6]

Figure 2: examples of ESG factors and risks

Environmental factors:

- Resource depletion, including water waste and pollution;
- Air pollution; and
- Deforestation.

Risks include:

- Poor environmental practices leading to depletion of resources, and/or hindering production and development; and
- Reputational risk.

Social Factors:

- Working conditions, including slavery and child labour;
- Health and safety;
- Employee relations;
- Diversity;
- Social unrest; and
- Income inequality.

Risks include:

- Reputational risk;
- Poor productivity; and
- Potential for legal difficulties (fines, sanctions, being forced to close or change).

Governance factors:

- Executive pay;
- Bribery and corruption;
- Board diversity, structure and culture.

Risks include:

- Some stakeholders being prioritised over others and/or disaffected;
- Poor strategic and operational decision-making; and
- Legal and regulatory risks.

Source: Pension Policy Institute ESG: past, present &future

4) Appendix: Glossary of Terms

Responsible Investment
The integration of environmental, social and corporate governance (ESG) considerations into investment management processes and stewardship practices in the belief that these factors can have an impact on financial performance. The Fund also supports the PRI's definition of responsible investment which can be found here:
http://www.unpri.org/introducing-responsible-investment

ESG
Environmental, social and corporate governance factors which could impact company performance and therefore investment returns. Examples include (but are not limited to) climate change, workforce issues, remuneration, independence of the board and auditors, board composition and diversity.

Governance
The process and principles by which a company or organisation undertakes its business. For the Fund, governance includes how it undertakes both its operational and investment responsibilities on behalf of its members.

Stewardship
Refers to the responsibility of the Fund to participate, where appropriate, in the governance decision-making of companies in which it invests by way of voting and by engagement with company management, either directly or via its fund managers. It also recognises the relevance of engaging with regulatory bodies and other market players to support policies that promote long-term sustainable growth.

Fund
London Borough of Enfield Pension Fund

Pensions Committee
Body established by London Borough of Enfield (the administering authority) in charge of the management of the administration of benefits and strategic management of the Fund's assets. The Committee is made up of 6 Councillors.

Pensions Board
The role of the Pensions Board is to assist in the good governance of the scheme through the monitoring of Fund performance and adherence to statutory duties. The Board consists of four employer and four member representatives The Pensions Board is not a decision-making body, nor does it hold a scrutiny function; its role is to assist in the compliance with scheme rules. The Fund's policies, including the ISS and the RI Framework, are reviewed annually by the Pensions Board.