NorthernLGPS
The Collective Asset Pool for Greater Manchester
Merseyside and West Yorkshire Pension Funds

Responsible Investment **Policy**

January 2019

Introduction

The combined assets of the Northern LGPS now stand at over £40bn. These assets are invested to fund the retirements of hundreds of thousands of beneficiaries who live both within the North and beyond. The Northern LGPS will always act in accordance the interests of those beneficiaries and we want our Responsible Investment activities to make a positive contribution to our region.

The Northern LGPS will provide democratic oversight, accountability and transparency whilst also ensuring that costs are kept low. Our structure also ensures that all investment strategy decisions are driven from bottom-up by the funds, rather than top-down by the pool. The Northern LGPS's Responsible Investment activity is controlled by the funds themselves, is focused purely on our own assets, and will always have a regional dimension.

Environmental, social and governance (ESG) issues are important to the Northern LGPS for a number of reasons. ESG factors can be financially material and, as such, should be part of the assessment and monitoring of investments in all asset classes. Achieving sustainable, long-term financial returns underpins the ability to pay pensions. A focus on ESG issues helps reduce risks to the Pool and its beneficiaries. These risks might be financial, such as the underperformance or failure of an investee company, or reputational, resulting from poor corporate behaviour.

In addition, our beneficiaries live in a society that is affected by the behaviour of investee companies. Therefore we expect high standards from those businesses. Consistent with the Northern LGPS's fiduciary duty to our beneficiaries we will ensure that the businesses in which we invest are both financially and environmentally sustainable, have high standards of governance and are responsible employers. As far as possible the Northern LGPS will seek to invest in a way that is financially and socially beneficial for the North.

1. About the Northern LGPS Responsible Investment policy

This policy set outs the Northern LGPS's approach Responsible Investment activities. It provides an overview of themes that will form part of those activities in addition to information on how this policy is implemented and our commitments to reporting and accountability.

Our approach to responsible investment has been informed by a number of important initiatives. The Northern LGPS fully supports the aims and objectives of the Stewardship Code and member funds are signatories of the Code. Two pool members are also signatories of the Principles for Responsible Investment.

We have also considered guidance from the Law Commission, Department of Work and Pensions and Ministry of Housing, Communities and Local Government in developing this policy.

We consider our approach to Responsible Investment to be rooted in financial materiality and risk management. It will also be informed by our understanding of our beneficiaries' views, and by reference to international standards such as the UN Sustainable Development Goals. Therefore we have expectations of investee businesses that encompass more than financial considerations alone.

The Northern LGPS will seek to apply the RI policy to all asset classes over time. Our initial focus will be on listed equity, but we also see infrastructure as an asset class where progress can be made quickly given the Pool's leading role in this area. The policy applies to both internally and externally managed assets.

The Northern LGPS has appointed PIRC as its Responsible Investment adviser, to assist in the development and implementation of the RI policy.

2. Major ESG themes

Over time the Northern LGPS will publish policy positions on specific ESG issues in order to provide greater clarity about our expectations to both investee businesses and other stakeholders. Below we set out ESG themes that will be important areas of focus for our Responsible Investment activities, and our core positions in each area.

Climate change

The Northern LGPS considers climate change risk as financially material to long-term performance of investments and shareholder value. Pool members aim to integrate climate change considerations in the overall investment strategy, with the aim of minimising adverse financial impacts and maximising opportunities for long-term economic returns in all asset classes.

The Northern LGPS's long-term goal is for 100% of assets to be compatible with the net zero-emissions ambition by c.2050 in line with the Paris agreement. This decarbonisation goal will be regularly evaluated in line with our objective of maintaining long-term financial performance.

In implementing our approach, the Northern LGPS:

- takes financially material climate change considerations into account as an integral part of its investment strategy and asset allocation;
- reviews a variety of research and analytical materials to encourage the use of scenario analysis to provide estimations of relative performances of asset classes and sectors under different scenarios which will be used where possible in asset allocation decisions;
- monitors and provides feedback to external investment managers in relation to incorporation of climate risk in the investment process;
- engages with companies on the resilience of their business strategies for a low-carbon economy;
- liaises with company boards in improving the governance, management and disclosure on climate risk;

- takes company approaches to climate risk and responsiveness to engagement into account in proxy voting;
- supports the filing of relevant climate related shareholder resolutions;
- interacts with policy makers and regulators on investment implications of climate change;
- collaborates with other investors and participates in investor initiatives to leverage outcomes of company and policy engagement;
- and will report on policy objectives and activities regularly.
- Two pool members have also included the Task Force on Climate-Related Financial Disclosures reporting in their annual reports.
- The Northern LGPS will also give consideration to supporting the objectives of a Just Transition to a low-carbon economy, and will actively engage with the social aspects of responding to climate change. We consider this fits well with our objective of seeking to ensure a regional dimension to our RI activities.

Employment standards and human capital management

The assets of the Northern LGPS represent the combined savings of generations of public sector workers, without whom the pension funds would not exist. Therefore we have a responsibility to act in the best interests of those workers, and we actively promote decent work.

We consider effective management of people is a source of both value creation and competitive advantage. We support initiatives to improve corporate reporting and investor understanding in relation to employment practices and human capital management.

We expect all businesses in which the Pool invests to treat their workforce with respect and to employ and reward them fairly. Companies should offer secure, direct employment where possible, and should not interfere with the right of their workforce to seek representation through a trade union. We will consider whether the actions of investee businesses are in accordance with ILO Core Conventions both in relation to their directly employed workforce and in their supply chain. We will consider whether investee businesses act in accordance with ILO Core Conventions both in relation to their directly employed workforce and in their supply chain.

The Northern LGPS looks favourably on opportunities to invest in ways that aid the creation of good jobs, and have other social benefits, particularly within the North. We will also consider the potential impact of our investments on public service provision and public sector employment practices.

Corporate governance and financial reporting

The Northern LGPS considers good corporate governance practices continue to provide protection to shareholders and to our beneficiaries. A full list of positions that the pool takes is provided in the shareholder voting guidelines that we have adopted.

Division of responsibilities and board independence are fundamental principles of good governance. We seek separation of chair and chief executive positions and independent representation on boards in all markets. We fully support board diversity in its widest sense. Diversity is desirable not only in its own right, but also because there is evidence that diverse boards make better decisions. In addition to supporting the 30% Club and recommendations of the Parker Review [1], we actively encourage employee representation at board level. We also consider that diversity and equal pay is important throughout organisations, not simply at board level.

In relation to remuneration it is our view that executives must be appropriately rewarded for their contribution to the success of the businesses that they steward. Where performance-related reward is used this should be focused on long-term performance and take account of ESG factors. The reputational risk of overly generous pay including the comparison to average employee pay should be taken into consideration in remuneration packages. As a Pool, we also consider that excessive executive reward contributes to wealth and income inequality.

Beneficiaries' interests are well served by ensuring the highest standards in financial reporting and related issues. We take a robust position on audit quality and auditor independence as we view this as the first line of defence for shareholder interests. We encourage auditors not to undertake non-audit work for the same company, and support mandatory rotation of the audit firm. We also advocate reform of accounting standards.

[1] https://www.gov.uk/government/publications/ethnic-diversity-of-uk-boards-the-parker-review

Tax

We consider certain corporate tax arrangements, whilst potentially beneficial to shareholders in the short term, can be a source of regulatory, financial and reputational risk to companies and their investors. Aggressive corporate tax avoidance may have a negative effect on public finances and by extension on public service provision. Therefore we seek to monitor the behaviour of investee companies in respect of tax planning and challenge where necessary.

3. Application of the policy

Investment decisions

Pool members employ a mixture of in-house and external asset managers. Where management is undertaken in-house, ESG factors will be considered as part of the assessment process both before and after investment decisions are made. This integration applies to both equity and other asset classes.

Pool members do not typically divest from businesses unless ESG factors are likely to have a financially material negative impact. Instead we seek to use our influence as investors to address issues of concern. We recognise that our ability to act as effective stewards, and our responsibility to do so, is greater where our holdings are greater or more concentrated. Therefore we monitor sizeable investments closely and engage where necessary.

In addition, pool members are involved in impact investing. Whilst this is not synonymous with 'Responsible Investment' this is an area where the policy may have significant practical application.

Where external managers are appointed, we envisage analysis of their competence in relation to Responsible Investment to form part of the appointment process. Expectations in relation to incorporation of ESG factors are part of the manager agreement, and managers are monitored in relation to performance on these factors. Appointed managers are also expected to report back to the Northern LGPS on their activities.

Voting and engagement

Voting and engagement is a cornerstone of our RI activities. We take the legal right to vote seriously and exercise it in a way consistent with our publicly disclosed objectives and policy positions. How we vote is one way of providing investee companies with an indication of our views as shareholders, as well as to the wider market.

Therefore, in line with our commitment to transparency and democratic accountability, we ensure that our voting aligns with our engagement. For example, if we have informed a company we do not support a certain director, or consider the remuneration policy is inappropriate, we will not vote in favour.

The Northern LGPS retains the maximum possible authority to direct voting, rather than delegating authority to asset managers. We have dedicated voting guidelines that inform how our votes are cast. This combination of retained authority and a clear framework ensures both a consistent approach is taken across equity holdings and provides clarity to the businesses in which we invest about our expectations.

We also recall stock that has been lent in order to be able to vote.

All three members of the Northern LGPS are long-standing and active participants within the Local Authority Pension Fund Forum (LAPFF). Most engagement activity is undertaken through the Forum and representatives of the pool's members frequently take part in company engagements.

The Northern LGPS and its members also undertake their own engagement, either on specific companies or sectors, and we envisage that this will increase particularly in relation to major and unique investments, such as in infrastructure assets.

Shareholder resolutions

The Northern LGPS considers shareholder resolutions a useful tool to proactively raise issues of concern either where boards of investee businesses are resistant to dialogue or change, or to amplify the shareholder voice where engagement with boards has been positive. All three members of the Pool have co-filed resolutions at different companies in recent years on issues ranging from climate change to employment practices.

Members of the Northern LGPS will consider filing or co-filing resolutions in cases where engagement has not resulted in the achievement of change or as part of systemic engagement on issues such as climate change.

Collaboration and partnerships

The Northern LGPS often has a significant ownership of particular businesses or other assets and therefore can be an influential voice. There are also many instances where it is advantageous to work in collaboration with other investors and investor initiatives. In addition to participating in existing investor groups, the Northern LGPS seeks to initiate collaboration where it believes it can play a useful role.

As well as all members of the Pool being LAPFF members the three fund members participate in, or are members or signatories of, the following initiatives:

- The Stewardship Code
- The Principles for Responsible Investment
- The Institutional Investor Group on Climate Change
- The Carbon Disclosure Project
- The Transition Pathway Initiative
- the 2018 Global Investor Statement to Governments on Climate Change
- Climate Action 100+
- Pensions For Purpose

Other collaborations will be reviewed in due course, following consideration of the Pool's interests in participation.

Securities litigation

Given the focus on cost reduction, the Pool will be an active participant in securities litigation. Where there has been corporate wrongdoing that has resulted in a financial loss to the Pool as shareholders, we seek to recoup these losses where practical.

Public policy advocacy

We recognise that regulatory intervention is sometimes necessary to address issues such as corporate disclosure requirements and shareholder rights. Where appropriate the Northern LGPS will participate in public policy consultations and engagement. This may be through LAPFF and other collaborative investor initiatives or by the Pool on its own.

Costs and charges

We recognise the growing interest in costs and charges incurred as part of local authorities' investment activities. The Northern LGPS supports the Transparency Code and expects all external managers to become signatories. We consider reducing unnecessary costs is part of our fiduciary duty, and is one of the core objectives of the Northern LGPS. We will closely monitor all investment costs to ensure that greatest possible benefits from our investment activities are returned to pool members.

4. Reporting and accountability

The importance of accountability to beneficiaries is a central element of our approach. Therefore, the Northern LGPS will make its voting record, and those of asset managers that have delegated voting authority, publicly available. In the case of the Northern LGPS's own voting decisions, we will pre-disclose votes on all companies. The Pool will also produce a regular stewardship report on its broader activity.

In addition we intend to hold an annual public stewardship event to provide an update on activities and for there to be open discussion of current or emerging ESG themes. This will form part of the Northern LGPS's process for taking beneficiaries' views into account.

Pool members meet quarterly to discuss the implementation of the RI policy, and will undertake an annual review of activities. The RI policy will be reviewed and updated as required.

For further information on the Northern LGPS Responsible Investment policy please contact: info@northernlgps.org

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