



Responsible Investment Framework 2015

June 2015

Responsible Investment Framework 2015

1) Introduction

This framework defines the commitment of West Midlands Pension Fund ('the Fund') to responsible investment (RI). Its purpose is to detail the approach that Fund aims to follow in integrating environmental, social and governance (ESG) issues in its investments. It is considered supplementary to the Fund's Statement of Investment Principles and thus in alignment with its fiduciary duty.

1.1 Beliefs and Guiding Principles

The Fund's RI beliefs and guiding principles underpin its RI approach and are described below.

ESG Integration

The Fund believes that effective management of financially material ESG risks should support the Fund's requirement to protect returns over the long term. With regard to climate change risks, the Fund recognises that the scale of the potential impacts is such that a proactive and precautionary approach is needed in order to address them.

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 strategy.

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.

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 ESG 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 external 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 with acting alone.

Fees and Incentives

Managing fees and costs matter in low-return environments. Fee arrangements with external fund managers – as well as 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 appropriate alignment.

An Evolving and Flexible Approach

The Fund recognises that it, along with the entire investment chain, is on a journey with respect to RI. This framework will remain flexible and will evolve over time to reflect evolving market developments.

1.2 Oversight and Application

The Pensions 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 Strategic Director of Pensions and Assistant Director (Investments). Responsibility for the implementation of this framework sits with the RI Officer. This policy applies to all members of the Pensions Committee and the Fund officers.

The Pensions Committee will review this policy at a minimum annually (in June of each year), or at such time as the Fund sees fit to revise its RI policies and procedures.

1.3 Content

The RI framework is divided into two distinct sections:

- What the Fund expects of itself, companies and fund managers with respect to RI (Section 2).
- How the RI beliefs and guiding principles are implemented in practice (Section 3).

Definitions are also provided in Section 4.

2) RI Expectations

2.1 Fund

2.1.1 General

The Fund aims to:

- 1) Be aware of and monitor financially material ESG 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:
 - ESG issues in relation to internally managed investments (equities, direct property);
 - the extent to which the external managers incorporate ESG issues into their investment processes; and
 - hold external managers to account for improvement in their ESG performance over a reasonable timeframe.
- 2) Make full use of its ownership rights, including voting and engagement activities. Either directly, collaboratively or through specialist service providers:
 - hold constructive dialogue with listed companies;
 - encourage the disclosure by companies of ESG issues; and

- participate in the development of public policy on ESG issues.
- 3) Disclose and maintain a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of the Fund's beneficiaries first.
 - 4) Participate as a signatory to the Principles of Responsible Investing (PRI) a principles-based framework designed to encourage the incorporation and analysis of ESG into investment decision-making.
 - 5) Keep our beneficiaries aware of our RI activities through:
 - making its RI policy documents public, eg. voting policies, RI policy;
 - providing a summary of the Fund's RI activities in the annual report;
 - publishing aggregate voting and company engagement statistics on a quarterly basis
 - tracking its progress on implementing its RI strategy using the PRI framework.
 - 5) Strive to be a good corporate citizen, in alignment with what we expect of companies in which we invest.

2.12 Climate Change

The Fund aims to:

- encourage improvement in the level of disclosure by companies of material climate change impacts through collaborative initiatives, for example via our partnership with the LAPFF, the Carbon Disclosure Project (CDP), and the Institutional Investors Group on Climate Change (IIGCC);
- 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 regard 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 Change¹;
- increase awareness of climate change as it applies to investment decision making through participation in relevant industry forums and collaborative initiatives; and

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

2.2 Companies

The Fund expects UK companies to adhere to the UK Corporate Governance Code² on a comply or explain basis. Further, the Fund has bespoke UK corporate governance guidelines which are available on its website³, which aim to deal with issues that are either not covered by the Code, require greater emphasis or are specifically left open for shareholders to resolve with company boards.

The Fund expects companies outside the UK to adhere to international voting principles⁴, recognising local application and development.

Environmental and Social Risks

The Fund expects companies to manage and disclose its environmental and social risks to the extent required for an understanding of the development, position and performance of the company. In alignment with the Association of British Insurers' position⁵, there are aspects of environmental and social reporting on which the Fund places particular value given their relevance across all sectors, its holistic approach to risk management, and the view that owners should not micro-manage companies. This is narrative reporting which:

- sets ESG risks in the context of the whole range of risks and opportunities facing the company;
- contains a forward looking perspective; and
- describes the actions of the board in mitigating these risks.

In terms of the specific environmental and social issues to focus upon, the Fund prefers to take a case-by-case, sector-based approach.

2.3 Fund Managers

2.3.1 Due Diligence

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

- Copy of their ESG, active ownership policies or equivalent which articulates how ESG factors (stemming from research, active ownership activities or other sources) are integrated into their investment process
- Case studies or examples of where ESG issues have influenced an investment decision

¹ <http://www.iigcc.org/publications/publication/2014-global-investor-statement-on-climate-change>

² <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf>

³ <http://www.wmpfonline.com/article/5693/Voting-Globally>

⁴ Draws from international best practice corporate governance standards such as OECD and ICGN: <http://www.wmpfonline.com/article/5693/Voting-Globally>

⁵ https://www.ivis.co.uk/media/5893/ABI_RID_guidelines.pdf

- Information on the process for integrating any third party ESG data (for example, MSCI) into their company financial models, investment strategies and portfolio construction
- RI reporting format
- Whether they are a signatory of the UN-backed Principles for Responsible Investment (PRI) and Stewardship Code, copy of their PRI public report and annual assessment scores if applicable.

2.3.2 Appointment

The Fund assesses the ESG 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 ESG. However, the Fund will pay particular attention to adherence to relevant soft regulatory codes⁶ 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 so 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.

2.3.3 Monitoring and Reporting

Each external fund manager is expected to report⁷ 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 ESG issues into its investment and active ownership activities.
- How investment and active ownership functions are combined to protect and/or enhance shareholder value
- How the manager exercised the Fund's voting rights.
- Any outcomes arising from the manager's engagement with companies and their effectiveness.

Further details on the Fund's future expectations of listed equity fund managers on RI reporting can be found on the Fund's website here:

<http://www.wmpfonline.com/article/5708/Engagement-through-partnerships>

3) RI Implementation

The Fund's active ownership approach can be divided into three distinct areas: **voting globally**, **engagement through partnerships** and **shareholder litigation**. This section briefly outlines the Fund's processes for each.

3.1 Voting Globally

Where practical⁸, the Fund aims to vote in every single market in which it invests. In the interests of sending a consistent signal to investee companies, the Fund has decided to use a third party provider for analysis of governance issues and executing its proxy voting rights across all markets in which it invests. At the present time, the Fund believes that the advantage of a consistent signal outweighs the inherent disadvantages to disconnecting the voting function from the investment and engagement decisions of external fund managers. However given market developments in this area, the Fund will re-evaluate this position on a yearly basis.

Reference to the Fund's voting policies is provided in Section 2.2 under 'Company Expectations'.

Securities Lending Programme

The Fund has an active securities lending programme. To ensure that the Fund is able to vote all its shares at important meetings has worked with service providers to establish procedures to restrict lending for certain stocks and recall shares in advance of shareholder votes. The Fund monitors the meetings and proportion of the securities on loan, and will restrict and/or recall lent stock in select circumstances.

3.2 Engagement Through Partnerships

The Fund uses various engagement platforms to maximise its influence as an active owner in collaboration with other like-minded investors. The Fund's primary engagement partnerships are highlighted below.

Local Authority Pension Fund Forum

The Fund is a founding member of the Local Authority Pension Fund Forum (LAPFF) and the Fund's Strategic Director of Pensions is the Honorary Treasurer. LAPFF is the UK's leading collaborative shareholder engagement group encompassing 64 local authority pension funds from across the country with combined assets of over £160 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 ESG 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; and

⁶ For example, UK and Japanese Stewardship Codes

⁷ Refers to either formal written reporting and to informal verbal communications, which can be regular and/or ad-hoc in frequency.

⁸ Issues such as power of attorney or share blocking in certain markets may prevent the Fund's ability to do so

- proxy voting advice on proxy voting for annual general meetings.

UN-backed Principles for Responsible Investment

The Fund signed the PRI in 2011 and the Fund's Assistant Director (Investments) is a member of the PRI Board⁹. The PRI is a set of six aspirational principles¹⁰ designed to encourage and assist investors integrate ESG into their investment processes.

The Fund is an active participant in the PRI's engagement program. The Fund considers the following criteria amongst others in determining its participation in PRI-related initiatives:

- Initiative is in alignment with the Fund's RI policy.
- The ESG issue or company of concern is considered to be particularly material to the Fund.
- Certain impediments (eg. geographic) make investor collaboration the preferred option.

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 achieve the aim of promoting sustainable growth. The Fund considers these initiatives on a case-by-case basis.

3.3 Shareholder Litigation

The Fund frequently hold securities that are the subject of individual and class action securities litigation. There are a number of litigation options available when a company has violated securities laws that result in losses to the Fund.

For US-based claims, the options would be to:

- remain in the class action and file proof of claim through our claims administrator Goal Group;
- participate as a lead plaintiff in a class action; or
- opt out and file a private action.

For non-US based claims, the options would be to join an existing group action or file a group action as a lead plaintiff.

The Fund takes a case-by-case approach in determining whether or not to join a class action but considers factors such as:

- advantages and disadvantages of the Fund becoming actively involved;
- relative size of the Fund's potential losses compared to other organisations;
- likelihood of success; and

- whether the Fund is fully indemnified against costs, expenses, counterclaims and any other losses.

4) Definitions

Responsible Investment

The integration of environmental, social and corporate governance (ESG) considerations into investment management processes and active ownership practices in the belief that these factors can have an impact on financial performance.¹¹ 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 governance factors which may impact on company performance and therefore investment returns. Examples include resource management and pollution prevention, climate change impacts, labour management, product integrity, executive compensation, board independence and audit function.

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.

Active Ownership

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 recognizes the relevance of engaging with regulatory bodies and other market players to support policies that promote long-term sustainable growth.

Fund

West Midlands Pension Fund

Pensions Committee

Body established by City of Wolverhampton Council (the administering authority) in charge of the management of the administration of benefits and strategic management of the Fund's assets, which has representation from the seven West Midlands metropolitan district councils and local trade unions.

⁹ <http://www.unpri.org/about-pri/pri-governance/pri-association-board-members/>

¹⁰ The six principles can be found here: <http://www.unpri.org/about-pri/the-six-principles/>

¹¹ Mercer, ABC of ESG, 2014

Investments Division

PO Box 5327
Wolverhampton
WV1 9LS
United Kingdom