

The background of the slide is the coat of arms of the City of Vancouver. It features a shield divided into four quadrants. The top-left quadrant shows a sailing ship on the water. The top-right quadrant shows a stag's head with antlers. The bottom-left quadrant shows a beaver. The bottom-right quadrant shows a grizzly bear. Above the shield is a crown with four maple leaves. Below the shield is a banner with the motto "A NE FOR A".

Agenda Item 5

Engagement Services

Falkirk Council

Subject: Engagement Services

Meeting: Joint Meeting of Pensions Committee and Pension Board

Date: 13 January 2020

Submitted by: Director of Corporate and Housing Services

1. Purpose of Report

- 1.1 This report asks the Pensions Committee to approve the issuing of a tender for specialist engagement services.
- 1.2 The report also summarises the Fund's existing engagement work and outlines recent developments surrounding the UK Stewardship Code.

2. Recommendations

2.1 The Pensions Committee and Pension Board are invited to note the contents of the report, including:

- (i) the intention to procure a specialist firm of engagement advisers; and**
- (ii) the current engagement activities of the Fund.**

2.2 The Pensions Committee is invited:

- (i) to ask the Chief Finance Officer to undertake a tender for an engagement specialist;**
- (ii) to specify the priority issues it would wish an engagement provider to address; and**
- (iii) to ask the Chief Finance Officer to report on progress at a future joint meeting of Committee and Board.**

3. Background

- 3.1 The Fund recognises that environmental, social and governance (ESG) factors can pose a risk to the Fund and its long term financial returns. It is therefore important that due regard is paid to ESG factors to ensure that the Fund's interests are properly protected and that financial and reputational risks are minimised.
- 3.2 The role of engagement in managing ESG factors is recognised in the Fund's Statement of Investment Principles which states that:

- the Fund should exercise its ownership rights in a responsible way, constructively engaging with companies to reduce risk.

3.3 The Fund currently seeks to engage:

- through its Fund managers, many of whom publish a quarterly report on responsible investment and give details of their engagement programme;
- through partnering like-minded investors in organisations such as the Local Authority Pension Funds Forum (LAPFF), the Institutional Investors Group on Climate Change (IIGCC) and Climate Action 100+; and
- by voting shares through its proxy agents, the Pensions and Research Consultants Ltd (PIRC).

3.4 A summary of recent engagement activity is included in the Engagement and Voting Report tabled later in today's meeting.

3.5 The Committee and Board have previously received reports and attended workshops on ESG matters and have indicated that they would be supportive of the Fund being more pro-active in engaging with investee companies to encourage better standards of corporate behaviour.

3.6 The voluntary UK Stewardship Code sets out the best practice that Fund Managers and Asset Owners should follow in order to improve the quality of engagement with companies and protect long terms returns.

3.7 With effect from 1st January, 2020, the 2012 Stewardship Code is being replaced by a revised 2020 version. Amongst a number of requirements, the new Code requires that there should be:

- a focus on actual stewardship achievements and outcomes; and
- an annual stewardship report.

3.8 The new Code "raises the bar" in terms of the standards that signatories are required to meet and is consistent with the greater attention being given to ESG matters by investors, markets and society in general. The UK Business Secretary has stated that the new Code is "an important piece of work..... It recognises the essential role of effective stewardship in supporting stronger corporate governance, diversity and social environmental priorities. I urge asset managers and owners to lead by example and sign up".

4. Engagement

4.1 The Committee has previously expressed a wish that the Fund extends its engagement activities beyond what is currently being undertaken. A more pro-active approach would therefore seem appropriate, especially given the high profile of various ESG issues (e.g. climate change), not to mention the recent changes to the UK Stewardship Code.

4.2 Despite having assets of £2.6 billion, it is unlikely that the Falkirk Fund would have sufficient scale to enable it to engage directly or demand audiences with its investee companies. Nor does it have the necessary specialist skills in house. The alternative is for the Fund to hire external engagement advisers which is what both the Lothian and Fife partner funds have done. External advisers could be expected to have the following attributes, namely:

- global reach;
- specialist ESG knowledge; and
- market presence to enable engagement with companies at a senior level.

4.3 A UK wide procurement framework for engagement services is maintained by Norfolk County Council and would represent an efficient way for the Fund to appoint an engagement provider. The six companies named on framework are as follows:

- BMO Global Asset Management
- Ethical Investment Research Services Ltd (EIRIS)
- GES Investment Services AB
- Hermes Equity Owner
- Pensions & Investments Research Consultants Ltd (PIRC)
- Robeco Institutional Asset Management B.V

4.4 The services specified in the framework are wide ranging and are set out below:

- Undertaking engagement on behalf of clients
- Identifying and prioritising fund engagement activities
- Identifying key engagement risks
- Identifying collaboration opportunities for clients
- Supporting the client's external fund manager monitoring efforts
- Supporting the integration of engagement best practice into decision-making
- Provision of ongoing training for clients in relation to engagement
- Provision of regular monitoring reports
- Analysing the effectiveness of engagement activity
- Supporting clients with stewardship-related compliance e.g. Stewardship Code

4.5 Services are likely to be scalable so that Fund's involvement with the provider can be tailored to its available resources. It is anticipated that the fees for the engagement service would be between £60k to £90k p.a.

5. Engagement Issues

5.1 Given the wide range of ESG topics that exist, it will be impossible for all of these to be addressed even with a dedicated engagement provider. To help identify the most appropriate provider for the Fund, the Committee is invited to highlight those topics, other than climate change (which is assumed to be the most pressing priority), which are of particular interest to the Fund. These will be compared with the workstreams and priorities of the various providers.

5.2 A list of 15 ESG related topics is set out in Appendix 1 for Committee members to indicate preferences. It will be evident from the list that many of these fall into the

Climate Change /Environment bucket (i.e. Sustainable Fashion, Plastic Use, Water Stress, Energy Efficiency, Palm Oil and Deforestation). Beyond that, the list contains a number of other important issues such as Executive Pay, Diversity, Labour Standards and Modern Slavery, and Artificial Intelligence

6. Next Steps

- 6.1 Subject to Committee approval, it is proposed to conduct a tender for an engagement provider in the early part of 2020. The provider would be selected on the basis of Cost, Quality and Service Fit.
- 6.2 The cost of providing the service will be included in the 2020/21 Pension Fund budget being brought to the joint meeting of the Committee and Board on 19th March.

7. Implications

Financial

- 7.1 The specialist nature of engagement services means that fees will be material. These could however be met from the significant savings being made from other structural changes in the portfolio. Fees will not be known until tenders have been submitted.

Resources

- 7.2 The relationship with the engagement provider will require to be managed and will have a minor local resourcing impact. There will be opportunities in future for the collaborative partners to align contracts in this area and potentially share resources.

Legal

- 7.3 No legal issues are raised by this report.

Risk

- 7.4 More granular monitoring of / engagement with investee companies should reduce financial and reputational risks for the Fund.

Equalities

- 7.5 No equalities issues are raised by this report.

Sustainability/Environmental Impact

- 7.6 A dedicated engagement provider will be able to pursue sustainability and environmental issues on behalf of the Fund

8. Conclusion

- 8.1 The report proposes hiring engagement specialists to improve the level of oversight of the Fund's investments. This is consistent with the aspirations of the Committee to maintain and enhance the Fund's reputation as a responsible investor.

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Appendices:

Appendix 1 – List of Engagement Issues

List of Background Papers:

UK Stewardship Code 2020

Engagement question

What are the 6 most important issues that you would like to prioritise in the Fund's engagement with the companies in which it invests?

- 1 Executive remuneration (Does remuneration of senior persons reflect their value added and is it reasonable relative to median salary levels)
- 2 Diversity (Diversity of gender, ethnicity and skills at Board level and in other senior management roles; addressing gender pay gaps)
- 3 Labour standards and modern slavery (Prevention of forced labour, adequate health and safety regulation, management of labour standards in the supply chain)
- 4 Sustainable fashion (Targeting changes in the fashion industry to reduce resource use)
- 5 Employee remuneration (Payment of living wage etc)
- 6 Animal welfare (Challenging food and animal standards, addressing risks from anti-microbial resistance)
- 7 Climate change (Action to support the transition to a low carbon economy, promoting disclosures on climate risks; challenging management on strategy actions)
- 8 Plastic use (Where relevant, are companies making efforts to reduce the use or production of single use plastics)
- 9 Water stress (Are companies cognisant of the risks posed by the supply of water and are they taking efforts to manage water usage?)
- 10 Energy efficiency (Minimising energy use; energy management)
- 11 Cyber security (Are companies aware of and addressing cyber risks and data security)
- 12 Artificial intelligence (Are sufficient safeguards being introduced into AI technology and are societal and ethical considerations being factored in)
- 13 Taxation (are companies paying fair levels of tax)
- 14 Palm oil and deforestation (reducing damage to global ecosystems)
- 15 Financial inclusion (addressing issues that result in individuals being excluded from the financial system and the social burden that results)