# Responsible Investment Collaboration - Further Opportunities

## Introduction

This paper has been prepared for the Officers and Pensions Committee ("Committee") of the East Sussex Pension Fund ("the Fund"). The paper summarises the recent changes to the UK Stewardship Code and sets out the future expectations and requirements on the Fund of being a signatory to the Code, and discusses the potential for signing up to the UN Principles of Responsible Investment ("PRI").

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## Executive summary

The key points discussed in this paper are as follows:

- The requirements of being a signatory to the UK Stewardship Code have become tougher;
- The revised Code came into effect on 1 January 2020 and the Committee would need submit a report that meets the Financial Reporting Council's ("FRC") reporting expectations by 31 March 2021 for the Fund to remain listed as a signatory to the Code;
- There is no obligation for the Fund to be a signatory to the Code. However, we believe that signing up to the Code is strongly aligned with the views and beliefs of the Committee in relation to responsible investment;
- The UN Principles of Responsible Investment ("PRI") can be thought of as a 'club' of asset owners and investment managers, with the collective aim of promoting responsible investment;
- The requirements of the UN PRI do not appear to be overly onerous in terms of general principles. However, the issue is one of understanding why a member wants to join and what they can bring to the collaboration project, rather than meeting a strict set of qualifying criteria. We suggest the Committee consider what they want to contribute to the group before deciding to proceed; and
- In order to assist in this process, we recommend the Committee invite a representative from the PRI to present at a Committee meeting so that the Committee can hear directly from the PRI of the main benefits and demands of signing up.

## UK Stewardship Code Changes

In October 2019, the Financial Reporting Council launched its updated UK Stewardship Code. This follows the publication of a draft Code and a consultation on the proposed changes earlier in 2019. The new Code aims to improve stewardship practices and sets a substantially higher standard, reflecting the changing expectations of investors since the Code was last revised in 2012.

The revised Code seeks to raise standards for asset owners and managers, extending to establishing clear stewardship objectives, integration of stewardship in investment strategies, and adhering to clearer and more elaborate reporting requirements.

The 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.

### Key changes in the new Code

- There is an extended focus that includes asset owners, such as pension funds, and service providers, including investment consultants, as well as asset managers. This is aimed at helping align the approach of the whole investment community in the interest of end-investors and beneficiaries.
- Annual reporting on stewardship activity and outcomes. Signatories' reports should set out in detail:-
  - what has been done in the previous year;
  - what the outcome was;
  - the signatory's engagement with the assets they invest in;
  - the signatory's voting records; and
  - how they have protected and enhanced the value of their investments.

  This greater transparency will allow stakeholders to see how their interests are being served.
- Signatories will be expected to take ESG factors, including climate change, into account and to ensure their investment decisions are aligned with the needs of their clients. Signatories are expected to disclose the issues they have prioritised for assessing investments, prior to holding, monitoring through holding and exiting. This should include the ESG issues of importance to them. This change is in parallel with the recent changes to the Investment Regulations for Occupational Pension Schemes.
- Signatories are expected to explain how stewardship has been exercised across asset classes beyond listed equity such as fixed income, private equity and infrastructure, and in investments outside the UK.
- Signatories are required to explain their organisation's purpose, investment beliefs, strategy and culture and how these enable them to practice stewardship. They are also expected to show how they are demonstrating this commitment through appropriate governance, resourcing and staff incentives.
- There is also an expectation within the new Code for signatories to work in a collaborative fashion with regulators and industry bodies to identify and respond to the risk of market and systemic failure. Signatories are expected to show how they have worked with other stakeholders to promote continued improvement of the functioning of financial markets and outline the role they played in any relevant industry initiatives in which they have participated.
- Signatories are expected to explain how they escalate stewardship activities where necessary.

### Next steps for the Fund

Responsible investment is an area of continually growing importance and an area of particular focus for the Fund. Both minimum standards and best practice are being driven higher and the changes to the Code certainly achieve this.

The Fund has previously been a signatory to the UK Stewardship Code. Although the requirements to remain a signatory of the revised Code will be tougher, and there is no obligation for the Fund to remain a signatory, we believe that signing up to the Code is strongly aligned with the views and beliefs of the Committee.

The Fund is currently a Tier 1 signatory to the Code. The new Code took effect from 1 January 2020. Organisations will remain signatories to the UK Stewardship Code until the first list of signatories to the 2020 Code is published. Existing signatories to the Code will need to submit a Stewardship Report that meets the FRC's reporting expectations by 31 March 2021, in order to continue to be listed as signatories to the UK Stewardship Code.

We believe that best practice in stewardship begins with strong governance structures and clearly defined objectives which are linked to the purpose of the organisation and reinforced through the culture and values of that organisation. We are also in favour of the increased transparency which we expect will benefit funds more widely in developing reporting and monitoring practices going forward.

We propose that a draft Report is prepared by the second half of 2020 in order to allow time for the Committee to consider the Report in detail and make amendments as necessary.

### UN Principles for Responsible Investment ("PRI")

The UN PRI were developed by an international group of institutional investors to reflect the increasing relevance of environmental, social and corporate governance issues to investment practices. The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice.

The 6 principles are as follows:

- Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
- Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
- Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
- Principle 6: We will each report on our activities and progress towards implementing the Principles.

The UN PRI website suggests possible actions that demonstrate adherence to the principles. This provides an indication of the types of actions that the Committee would need to take in order to be satisfied that they comply with the UN PRI and demonstrate that the Fund operates within the spirit of the UN PRI. These potential actions are shown in Appendix 1.

In contrast to the Stewardship Code above, the PRI can essentially be thought of as a club of asset owners and investment managers, with the collective aim of promoting responsible investment. To that end, involvement is more about what members are interested in contributing to those aims rather than satisfying a strict set of criteria to qualify for acceptance. For that reason, we suggest that a helpful first step might be to invite a representative from the PRI to present at a future Committee meeting or training event. This will enable the Committee to hear directly from the PRI what the main benefits for the Fund would be from getting involved, and for the Committee to consider how they want to participate before deciding to sign up.

Should the Committee choose to sign the Fund up to the PRI, the only mandatory requirement is to publicly report on the Fund's responsible investment activity through the PRI's reporting framework. There is also an annual fee for joining the PRI, which is £3,009 for funds between $1-4.99bn and £6,528 for funds between $5-9.99bn. The Fund's current asset size is very close to the $5bn mark, depending on the prevailing exchange rate.

We look forward to discussing this paper with you at the March Committee meeting.

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For and on behalf of Hymans Robertson LLP

**Risk Warning**
Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, 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 overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

# Appendix 1: United Nations Principles of Responsible Investment

**Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.**
Example of demonstration:

- Address ESG issues in investment policy statements.
- Support development of ESG-related tools, metrics, and analyses.
- Assess the capabilities of internal investment managers to incorporate ESG issues.
- Assess the capabilities of external investment managers to incorporate ESG issues.
- Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis.
- Encourage academic and other research on this theme.
- Advocate ESG training for investment professionals.

**Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.**
Example of demonstration:

- Develop and disclose an active ownership policy consistent with the Principles.
- Exercise voting rights or monitor compliance with voting policy (if outsourced).
- Develop an engagement capability (either directly or through outsourcing).
- Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights).
- File shareholder resolutions consistent with long-term ESG considerations.
- Engage with companies on ESG issues.
- Participate in collaborative engagement initiatives.
- Ask investment managers to undertake and report on ESG-related engagement.

**Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.**
Example of demonstration:

- Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative).
- Ask for ESG issues to be integrated within annual financial reports.
- Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact).
- Support shareholder initiatives and resolutions promoting ESG disclosure.

**Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.**
Example of demonstration:

- Include Principles-related requirements in requests for proposals (RFPs).
- Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate).
- Communicate ESG expectations to investment service providers.
- Revisit relationships with service providers that fail to meet ESG expectations.
- Support the development of tools for benchmarking ESG integration.
- Support regulatory or policy developments that enable implementation of the Principles.

**Principle 5: We will work together to enhance our effectiveness in implementing the Principles.**
Example of demonstration:

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning.
- Collectively address relevant emerging issues.
- Develop or support appropriate collaborative initiatives.

**Principle 6: We will each report on our activities and progress towards implementing the Principles.**
Example of demonstration:

- Disclose how ESG issues are integrated within investment practices.
- Disclose active ownership activities (voting, engagement, and/or policy dialogue).
- Disclose what is required from service providers in relation to the Principles.
- Communicate with beneficiaries about ESG issues and the Principles.
- Report on progress and/or achievements relating to the Principles using a comply-or-explain approach.
- Seek to determine the impact of the Principles.
- Make use of reporting to raise awareness among a broader group of stakeholders