

Responsible Investment Policy

Addressee

This paper, prepared for the Investment Steering Committee ("ISC") of the Essex Pension Fund ("the Fund")¹, discusses the ISC's development of investment beliefs regarding Responsible Investment ('RI') and the translation of those beliefs into a policy for inclusion in the Fund's Investment Strategy Statement ('ISS').

Background

The ISC is required to maintain an Investment Strategy Statement ('ISS') setting out its principles for governing the Fund's assets.

The four main areas for setting its principles are:

- 1 The Fund's investment strategy and the process for determining suitability;
- 2 Risk measurement and management;
- 3 Asset pooling; and
- 4 Approach to Environmental, Social and Governance ('ESG') considerations.

The first three of these are a relatively straightforward documentation of an existing process. However, ESG is far more qualitative and depends on an individual's viewpoint. The area of ESG has also experienced far more scrutiny recently.

Reflecting the above, the ISC have been undertaking an in-depth and robust consideration of its ESG beliefs and policies as set out in this paper.

Beliefs workshop

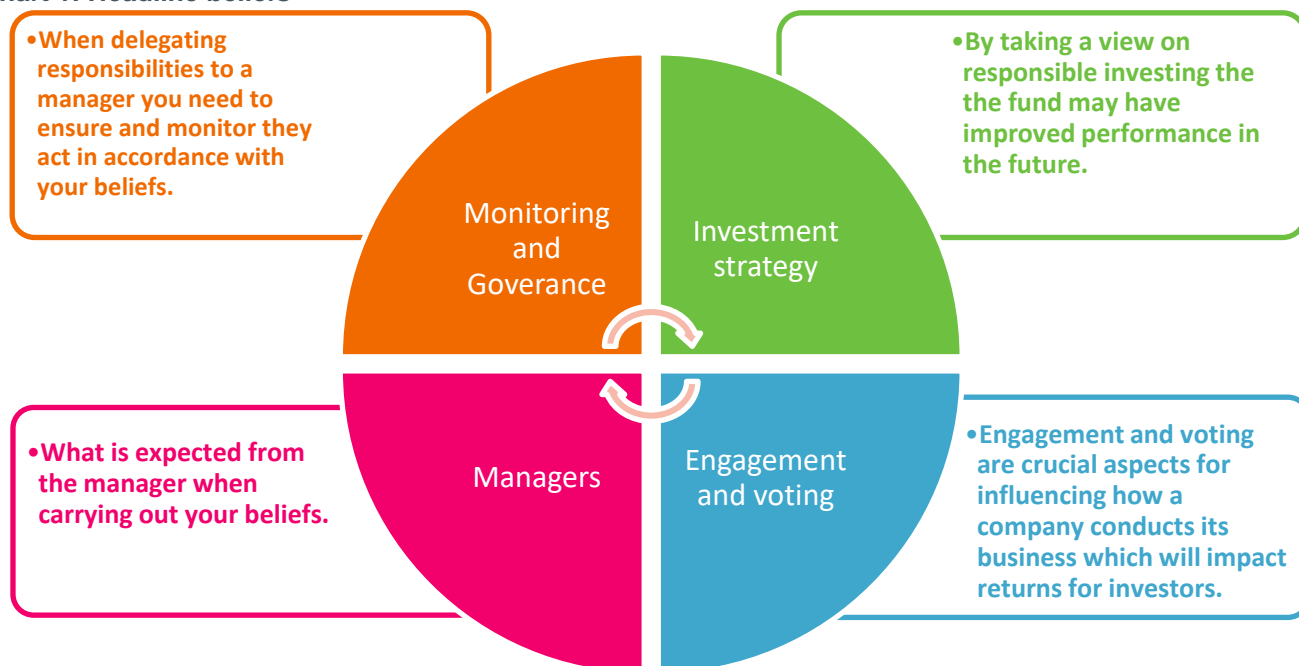
The first stage of this review was for the ISC to undertake an RI workshop on 25 October 2019 (encompassing all areas of ESG considerations) to receive training, consider and articulate their beliefs in relation to RI.

As part of the workshop, the ISC members were asked to complete a questionnaire to elicit their views around ESG and RI issues alongside a decision tree to help guide the views articulated into a coherent set of beliefs. The decision tree is included in the appendix 2 along with the progress achieved.

The following chart highlights the main areas for articulating ESG and RI beliefs.

¹ It should not be released or otherwise disclosed to any third party without our prior written consent except as required by law or regulatory obligation. We cannot be held liable for any loss incurred by a third party relying on this report.

Chart 1: Headline beliefs



Beliefs articulated

The output of the meeting (ratified with some minor amendments at the November ISC meeting) were the following set of beliefs.

Investment strategy (IS)

- 1 Having a responsible investment policy could lead to better financial outcomes.
- 2 Having a responsible investment policy could lead to better outcomes for society.
- 3 Long term, businesses with more sustainable practices should outperform.
- 4 Allowing for the impact of ESG issues has many dimensions to it.
- 5 The Fund should avoid/limit exposure to securities where environmental or social aspects will be financially detrimental to the portfolio.
- 6 Environmental and social investing only needs to not be detrimental to returns.
- 7 Poor management of ESG risks has led to financially material losses in the past and is expected to do so in the future.
- 8 ESG is a factor, but not the only factor in choosing investments.

Engagement and voting (EV)

- 1 Engagement in a company is more effective than disinvesting from the company.
- 2 Engagement and voting are influential and can be effective in changing behaviour and improving the Fund's performance as well as having a positive impact on the environment/society.
- 3 Collaboration with other investors gives the Fund a stronger voice.

Managers (M)

1 *Passive managers*

- 1.1 The only influence an investor has on a passive manager is the choice of benchmark and level of engagement.
- 1.2 The choice of benchmark is important as it defines the investment portfolio.
- 1.3 The Fund should be an active owner seeking to influence behaviour in investee companies.
- 1.4 The Fund should consider alternative indices that reflect ESG factors.
- 1.5 The direction of travel of the investee companies is even more important than their current scoring on ESG factors.

2 *Active managers*

- 2.1 The social cost of companies will eventually need to be self-financed.
- 2.2 Managers should try as far as possible to price in the potential future impact of ESG risk in asset selection.
- 2.3 Active managers can take into account forward-looking metrics better than passive managers.
- 2.4 The Fund's investment managers should embed the consideration of ESG factors into their investment process and decision making, taking into account the direction of travel and not only current scoring.

Monitoring and Governance (MG)

- 1 The ISC should not rely on the pool for leadership on ESG issues.
- 2 The ISC should expect the pool to be able to implement investments in line with its RI policy.
- 3 The Fund needs to engage and challenge managers on integrating ESG issues in their investment process in line with the RI policy.
- 4 An RI policy focussed on improving financial outcomes will be to the benefit of Fund stakeholders.
- 5 It is best to engage stakeholders on the overall approach to managing the Fund rather than on RI policy only.
- 6 ESG factors should be incorporated into manager reporting in due course.

Proposed RI Policy

The next stage is to translate the beliefs into a set of policies for governing investments and inclusion in the ISS.

The Officers and Advisers have reviewed the beliefs articulated by the ISC and have drafted the following proposed policies for review and agreement by the ISC (a mapping of the agreed beliefs to the policies below is included in appendix 1):

Strategy

- The RI policy should be integral to the investment strategy and not considered in isolation.
- The Fund should minimise exposure to securities where environmental or social aspects could be financially detrimental to the portfolio.
- Investments expected to deliver positive environmental or social benefit are encouraged as long as they are not expected to dilute overall returns.

Engagement

- The ISC will only exclude stocks in limited or specific instances, but will actively encourage engagement and work collaboratively with other investors to increase the impact of engagement.

Managers/implementation

- The ISC will seek to implement mandates in line with its RI policy.
- ESG factors should (amongst others) be an integral component in the consideration of investment in a stock by active managers.
- For passive allocations, in choosing the reference benchmark careful consideration will be given to the ESG aspects of that benchmark. Although it is recognised that the passive manager has no choice of stocks within the benchmark index, the passive manager will be expected to actively engage with companies held to the benefit of the Fund and its members.
- The ISC will seek to utilise mandates in line with its RI policy and expects these to be made available via the ACCESS Pool.

Monitoring/governance

- The ISC will monitor and challenge their providers on their ESG implementation and any intended changes over time.
- The ISC will take a long-term view on RI, including the direction of travel as well as the current implementation.

Collaborative working

In line with their belief and policy to work collaboratively with other pension funds to increase the strength of its voice in RI matters, the ISC received a presentation regarding the Local Authority Pension Fund Forum ('LAPFF') at their November meeting.

Following that presentation, the ISC agreed to join the LAPFF as part of a drive to work collaboratively with others on RI issues.

Priority for RI consideration and engagement

Both the ISC and a range of interested parties with interests in the Fund have been asked to identify priority areas for RI consideration and engagement.

The following areas have been identified and will be considered priorities:

- | | |
|----------------------|--------------------------|
| • Climate change | • Weapons |
| • Resource scarcity | • Company governance |
| • Pollution | • Manage board structure |
| • Labour Practices | • Remuneration |
| • Employee relations | • Gender diversity |

Next steps

The ISC are asked to note the process undertaken and to agree or propose amendments to the proposed RI policy set out above.

Following agreement of the policy, the ISC are asked to agree:

- The RI policy is incorporated into the updated ISS;
- The updated ISS is issued to investment managers for comment following the February ISC meeting (or following the March ISC if substantial change is required);
- At the next ISC following comment from the managers, the ISC undertakes a review of managers' ESG and voting policies and how these are aligned with the RI policy and implications for Fund's investments and strategy;
- Following this review the ISS is issued for consultation.

In relation to the RI engagement priorities, the ISC are asked to note these and agree to share with the LAPFF and fund managers for consideration.

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For and on behalf of Hymans Robertson LLP

Appendix 1 - Mapping beliefs to the policy

The RI policy below is mapped to RI beliefs in Appendix 1, the acronyms for the beliefs sections are defined in the main paper.

Strategy

- The RI policy should be integral to investment strategy and not considered in isolation. (Belief MG5)
- The Fund should minimise exposure to securities where environmental or social aspects could be financially detrimental to the portfolio. (Beliefs IS1, IS3, IS5, IS7, M2.1, MG4)
- Investments expected to deliver positive environmental or social benefit are encouraged as long as they are not expected to dilute overall returns. (Beliefs IS2, IS6)

Engagement

- The ISC will only exclude stocks in limited or specific instances, but will actively encourage engagement and work collaboratively with other investors to increase the impact of engagement. (Beliefs EV1 – EV3, MG3)

Managers/implementation

- The ISC will seek to implement mandates in line with its RI policy. (Beliefs MG1, MG2)
- ESG factors should (amongst others) be an integral component in the consideration of investment in a stock by active managers. (Beliefs IS4, IS8, M2.2 - M2.4)
- For passive allocations, in choosing the reference benchmark careful consideration will be given to the ESG aspects of that benchmark. Although it is recognised that the passive manager has no choice of stocks within the benchmark index, the passive manager will be expected to actively engage with companies held to the benefit of the Fund and its members. (Beliefs M1.1 - 1.4)
- The ISC will seek to utilise mandates in line with its RI policy and expects these to be made available via the ACCESS Pool. (Beliefs MG2)

Monitoring/governance

- The ISC will monitor and challenge their providers on their ESG implementation and any intended changes over time. (Beliefs M1.5, M2.4, MG3, MG6)
- The ISC will take a long-term view on RI, including the direction of travel as well as the current implementation. (Beliefs M1.5, M2.4, MG3, MG6)

Appendix 2 – Decision Tree

PRIMARY OBJECTIVE:

TO DELIVER A SMOOTHER, MORE SUSTAINABLE, INVESTMENT RETURN OVER THE LONG TERM CONSISTENT WITH FUNDING PLANS

