

Essex Pension Fund Investment Steering Committee	ISC 03
Date: 24 March 2021	

Outcome of the Responsible Investment (RI) Workshop

Joint Report by the Interim Director for Essex Pension Fund and the Investment Manager in consultation with Hymans Robertson and the Independent Investment Adviser

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1. Purpose of the Report

- 1.1 To provide an overview of the Fund's current RI Policy, Beliefs and Priorities.
- 1.2 To provide the Committee with an update on the outcome of the RI Workshop held on 12 March 2021.

2. Recommendation

2.1 The Committee **agree that:**

- the RI Policy and RI beliefs used to formulate the Policy as outlined in the Investment Strategy Statement (ISS) remain appropriate;
- the RI priorities remain relevant, and should be viewed holistically, and not in isolation for the Committee to focus entirely on one would be to miss other important aspects of RI that could lead to improved financial outcomes for the Fund and wider society;
- equities mandates, being the largest asset allocation of the Fund should be reviewed as a priority;
- the level of influence the Committee has differs depending on whether the equity mandate is managed on an active or passive basis;
- the Fund develop a clear, documented engagement process with the active equity managers;

- in relation to their passive mandates, the Committee acknowledges it is able to determine the index the passive investment manager tracks and as such would like it to be more aligned where possible with all its RI priorities, noting that at present the current indices that the passive manager tracks excludes investing in controversial weapons, one of its ten priorities and that any deviation from tracking a market capitalisation index would incur a higher management fee than currently paid;
- Officers and Advisers investigate the types of indices available in the market, working with the Fund's current passive provider and the ACCESS Pool in the first instance to establish suitable solution(s); and
- the content of the report be noted.

3. Background

- 3.1 Over the last two years the Committee has dedicated considerable time and focus of attention to formulating its RI Policy, establishing its RI Beliefs and Priorities.
- 3.2 Following some preparatory work in the summer of 2019, the ISC convened a workshop in October 2019 specifically on ESG to enable a more in-depth discussion.
- 3.3 At its November 2019 meeting, an update was provided on the outcome of the RI Workshop, which lead the Committee to articulate and agree a set of RI Beliefs including working collaboratively with other pension funds. Initial consideration was also given in regard to RI Priorities.
- 3.4 Following the meeting, the ISC agreed that further consideration should be made in relation to the RI Priorities. As a consequence, the ISC and a sample of the Fund's stakeholders were surveyed to ascertain their views.
- 3.5 Ten RI Priorities were identified importantly no one priority viewed more important than another. Instead it was acknowledged that they should not be viewed in isolation but holistically and be integral, in the Fund's Investment Managers' investment process which is used to determine stock selection as well as form the basis of any future engagement with the Fund's Investment Managers and the companies they invest in on the Fund's behalf.
- 3.6 The RI Policy, Beliefs and Priorities attached at Appendix A, forming parts of the Investment Strategy Statement was subject to a full stakeholder consultation during the summer of 2020 and was approved by the ISC at their October 2020 meeting.

4. Implementing the RI Policy

- 4.1 At its January 2021 meeting, the Committee dedicated a session to revisiting its RI Policy, Beliefs and Priorities. Initial discussions were had in regard to how best the RI Policy could be implemented, monitored and reviewed in practice.
- 4.2 The Committee noted that this would be the start of a process and that further deliberation would be required. A dedicated RI Workshop for ISC Members was subsequently held on 12 March 2021.

5. RI Workshop

5.1 Six ISC Members attended the RI Workshop and took part in an interactive discussion.

5.2 Building on the initial discussions held on the 20 January 2021 meeting. The workshop was broken down into the following:

- a reminder of the RI Policy, the Beliefs used to formulate the Policy and the ten RI Priorities initially identified;
- an overview of the Fund's mandates and the decision to target the review of the equity part of the portfolio as priority;
- the difference between active and passive managed equity mandates and the influence that the Committee has in regard to engagement and determining the companies the investment managers invest in on the Fund's behalf;
- a reminder of how both an active manager and passive manager manages the portfolio and the benchmark which is set and how this is used in practice.

6. RI Workshop Outcome of the discussions

6.1 Following discussions, Members were satisfied that the RI Policy, Beliefs and Priorities remain relevant and appropriate. Of the ten priorities identified whilst it was acknowledged that there is greater media coverage around climate change Members continued to believe that it should take a holistic view as this should lead to improved financial outcomes for the Fund and wider society in the longer term.

6.2 That the equity part of the portfolio, being the largest single asset class allocation of the Fund (currently c50%) be reviewed as priority and in particular, the equity allocation managed by the passive manager.

6.3 It was acknowledged the role of the benchmark allocated to Fund's Investment Managers differed depending on whether the mandate was being actively or passively managed. It was explained that the Fund's active managers whilst measured against a stated benchmark for merely performance monitoring purposes had full discretion as to how the portfolio that they manage on the Fund's behalf is constructed from the universe of companies that are either included or not within a given benchmark. The

influence of the Committee would be limited to determining the broad objectives of the mandate, engagement with the manager would therefore be key. Whilst on the other hand, the benchmark given to the passive manager is a mechanism of determining the construction of and the companies that make up the portfolio. As such, the Committee could influence the companies that the passive manager invested in by determining the benchmark that they then track. For example: the FTSE All Share.

- 6.4 Members acknowledged that the regional market capitalisation equity indices* currently tracked by the passive manager, whilst took account of one of the Fund's ten priorities, that of excluding controversial weapons was not specifically aligned with the Fund's current RI Policy and that further exploration was desirable to establish market indices that would better align to the Fund's Policy and be in keeping with the direction the Fund wished work towards. It was acknowledged that deviating from the current market capitalisation benchmarks would incur further management fee costs and this would need to be taken into account.
- 6.5 There was appetite from Members that Officers and Advisers work with the Fund's current passive provider and the ACCESS Pool in the first instance to establish suitable solution(s).
- 6.6 An illustration outlining the conclusion of the discussions held at the RI workshop in regard to the assets managed passively has been provided at Appendix B of this report.

7. Background Papers

- 7.1 Appendix B – Illustrative conclusion of the discussions held at the RI Workshop.
- 7.2 Investment Strategy Statement as published on www.essexpensionfund.co.uk
- 7.3 Minutes of the ISC meeting on 20 January 2021.

Responsible Investment Policy



Environmental



Social



Governance

Essex Pension Fund

Responsible Investment Policy

Environmental, Social & Governance Considerations

Fiduciary duty

The fundamental responsibility of the Fund is to ensure that it has adequate monies available to pay pensions as they fall due. This objective must be achieved in a cost-effective way for members, employers and the taxpayer. Moreover, in reaching decisions, the Fund must comply with its fiduciary responsibilities.



Responsible Investment (RI) Policy

The ISC recognises that environmental, social and governance (ESG) factors (including those related to climate risk) can influence long term investment performance and the ability to achieve long term sustainable returns. To this end the Committee identified four key headline responsible investment beliefs, with a number of sub beliefs sitting underneath these headings. The Committee in formulating the Responsible Investment Policy below have incorporated the Fund's investment beliefs articulated on page 5.

Investment Strategy

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

Engagement and Voting

4. 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

5. The ISC will seek to implement mandates in line with its RI Policy.
6. ESG factors should (amongst others) be an integral component in the consideration of investment in a stock by active managers.
7. 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.
8. The ISC will seek to utilise mandates in line with its RI Policy and expects these to be made available via the ACCESS Pool.

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Responsible Investment Policy

Monitoring/governance

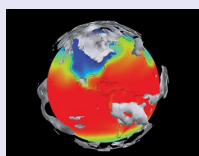
9. The ISC will monitor and challenge their providers on their ESG implementation and any intended changes over time.
10. The ISC will take a long-term view on RI, including the direction of travel as well as the current implementation.

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 Committee agreed at its November 2019 meeting to join Local Authority Pension Fund Forum ('LAPFF') as part of a drive to work collaboratively with others on RI issues.

Priority for RI consideration and engagement

The Committee recognises that there are a range of interested parties all of whom will have differing interests in the Fund and as such have identified the following areas which it expects the Fund's investment managers to treat as priorities when engaging with companies invested in on the Fund's behalf:



Climate change



Resource scarcity



Pollution



Weapons



Remuneration



Labour Practices



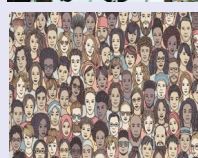
Employee relations



Company governance



Manager board structure



Gender diversity

Essex Pension Fund

Responsible Investment Policy

Exercise of voting rights

Assets outside the ACCESS Pool

The Fund has instructed its investment managers to vote in accordance with their in-house policies and practices within the framework of the ISC's agreed policies which has been shared with the investment managers as set out above.

Assets inside the ACCESS Pool

The ACCESS pool has formulated a voting guidance which it expects each of the underlying investment managers managing sub funds on its behalf to comply with or when this is not the case to provide an explanation.

The Fund fully supports the UK Stewardship Code and requires those of its investment managers who hold shares on its behalf to comply with it or to provide the ISC with an explanation of why it is not appropriate to do so, in the exercise of the mandate that they have been given, and how they will instead achieve and demonstrate the same level of responsible share ownership.

The majority of the Fund's investment managers are signatories to the UK Stewardship Code and have all gained a Tier 1 status (demonstrating a good quality and transparent description of their approach to stewardship and explanations of an alternative approach where necessary).

Engagement

The Fund expects its investment managers to take account of social, environmental and ethical considerations in the selection, retention and realisation of investments as an integral part of the normal investment research and analysis process. The Fund also expects its investment managers to engaged with companies held on all matters in regard to Good Stewardship. The Fund believes taking account of such consideration's forms part of the investment managers' normal fiduciary duty.

Ongoing Monitoring

The Committee actively monitors the Fund's investment managers' approaches. As part of this regular manager monitoring, the ISC will challenge their managers on how they consider and manage all financial risks faced by their investments, including those that arise from ESG considerations. The Committee also strives to improve and develop their knowledge and understanding on how ESG factors will impact the Fund's investments in the future.

Stock Lending

The policy on stock lending (below) reflects the nature of the mandates awarded to investment managers by the ISC, which include both pooled and segregated mandates:

Assets within the ACCESS Pool

The Fund participates in ACCESS's stock lending programme for investments under ACCESS Pool governance.

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Responsible Investment Policy

Segregated Investments

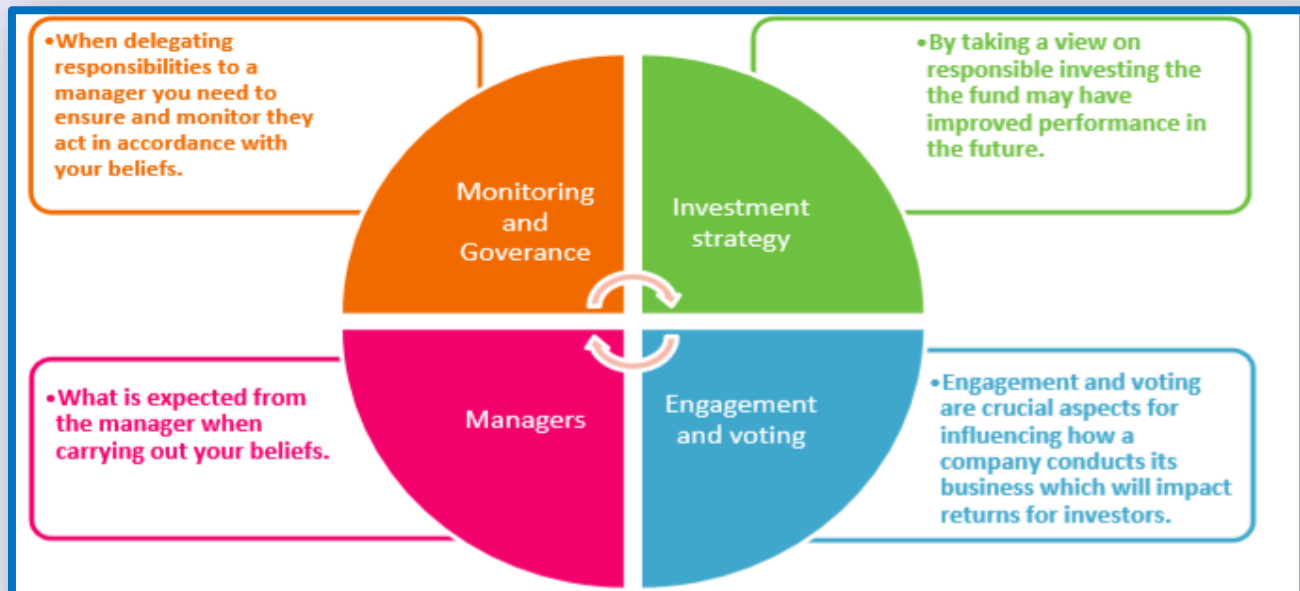
The Fund does not participate in stock lending schemes nor allow its stock to be lent.

Pooled Investments

In regard to the Fund's pooled investments, where the Fund is buying units in a pooled vehicle, stock lending is outside the control of the Fund and undertaken at the discretion of the pooled fund manager.

RI Investment Beliefs

The Committee have articulated a set of RI investment beliefs based on the four key headline beliefs below:



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.

Essex Pension Fund

Responsible Investment Policy

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.

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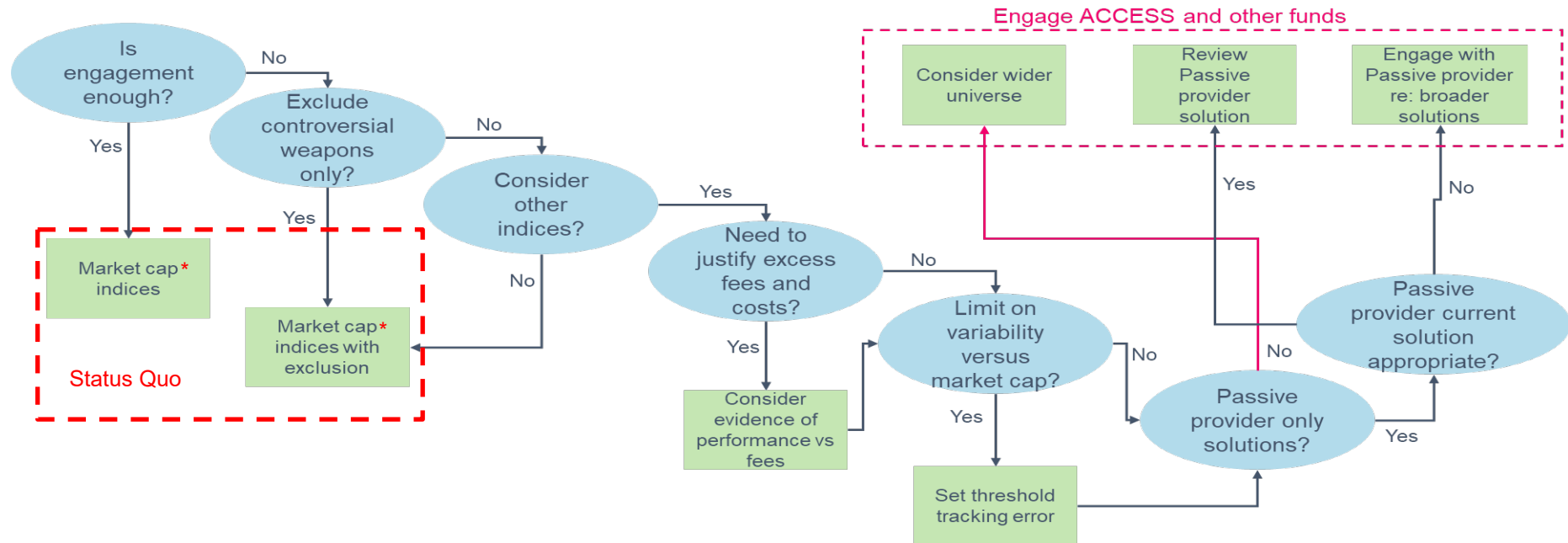
Responsible Investment Policy

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.

Illustrative diagram

Appendix B

The illustration below outlines the conclusion of the discussions held at the RI workshop in regard to the assets managed passively:



*market capitalisation (market cap) indices are a component of the number of shares issued x the price per share. The larger the market capitalisation of a company the greater the weighting attributable to the index.