

Committee(s)	Dated:
Financial Investment Board - For decision	5 th September 2017
Subject: Responsible Investment – Next Steps	Public
Report of: Chamberlain, Dr Peter Kane	For Decision
Report author: Dr Peter Kane, Chamberlain’s department	

Summary

Following a presentation and discussion at FIB in June 2016 Members confirmed their interest in developing a step by step approach to Responsible Investment. Subsequently,

- IfM, our infrastructure investment manager, presented to FIB in October 2016 on the synergy between their high performance track record and their commitment to Responsible Investment (RI).
- Mercer outlined their assessment of the level of maturity in the approach of our Investment Managers to RI. And we also invited them to spell out how they integrated Environmental, Social and Governance (ESG) considerations into their investment policies. This confirmed that over 70% of our funds are managed by signatories to the Principles of Responsible Investment (PRI).
- We have been exploring with Mercer, PRI and investment managers possible approaches to RI.
- At the July Policy & Resources Committee Members considered the outcome of a Responsible Business Survey of the Corporation and agreed an initial action plan, which referenced the work already underway on Responsible Investment.

This report sets out further actions we can now take to build on progress over the last year, which is aligned with the refreshed draft investment strategy. It includes a suggested roadmap to signing up to the Principles of Responsible Investment over the next year.

Members are asked to agree to:

- A Survey of FIB Members on their investment beliefs in relation to RI/ESG considerations.
- Following the analysis of the survey results, a workshop/ FIB discussion on a Responsible Investment draft policy statement (see Appendix 1 as an example) that would feed into the wider Investment Strategy
- Subsequently, prepare an implementation plan that would enable us to commit to the UK Stewardship Code and to the Principles of Responsible Investment within an agreed timeframe

Main Report

Background

1. Responsible Investment is an approach to investment that explicitly acknowledges the relevance to the investor, in carrying out their fiduciary duties, of environmental, social and governance (ESG) factors, and the long-term health and stability of the market as a whole. It recognises that generating long-term sustainable returns is dependent on stable, well-functioning and well governed social, environmental and economic systems. It is driven by a growing recognition in the financial community that effective research, analysis and evaluation of ESG issues is a fundamental part of assessing the value and performance of an investment over the medium and longer term, and that this analysis should inform asset allocation, stock selection, portfolio construction, shareholder engagement and voting.

One way in which asset owners, investment consultants and investment managers have underlined their commitment to RI is to sign up to the United Nations Principles of Responsible Investment (PRI). The six principles state:

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

There are more than 1,700 signatories from over 50 countries, of which around two thirds are investment managers, representing over US\$60 trillion of assets.

Progress to date

2. Members responded positively to the Responsible Investment presentation by Mercer at their September 2016 FIB. They agreed that we should adopt a step by step approach to strengthening our commitment to RI and to ensuring ESG considerations inform our approach to our investment strategy.

A number of steps have therefore been taken over the last 12 months:

- IfM presented to FIB in October 2016 on how they saw RI as central to their investment philosophy and that it underpinned their strong investment performance.

- We have discussed with Mercer the basis for the ESG ratings for each of our principal Investment Managers, which we see reflected in their regular performance reports. This suggests that most have signed up to the Principles of Responsible Investment (PRI) and will argue that they have taken on board ESG considerations. But they are still at a relatively early stage (Level 3 on a scale of 1 – best practice – to 5) in fully integrating RI into their ways of working.
- We also wrote to Investment Managers (IMs) to alert them to the increasing interest in RI and to give them an opportunity to set out how they currently approach ESG considerations and what they plan to do in the future. The responses confirmed that 71% of funds are managed by signatories to the PRI but that they were not able to evidence clearly in a number of cases how this has impacted on their investment strategies, backing up the Mercer analysis.
- Further discussions with Mercer have helped to shape the suggested next steps set out below. And discussions with individual IMs – most recently with Pyrford – confirm that RI/ESG considerations are increasingly seen as a mainstream/core business, in part in response to a growing expectation across public and charitable sectors that they should form an integral part of the investment offer. ESG was also a key element of the Private Rented Sector presentations to FIB recently.
- The Responsible Business Survey, which was reported on to P&R in July, highlighted the Corporation wide benefits of strengthening our commitment to being a Responsible Business and it identified Responsible Investment as an area where work was underway and early progress could be made.

A discussion with the Principles of Responsible Investment (PRI) organisation, which provides support to signatories and is based in London, suggests that:

- Signing up to the PRI can help to provide a strong message of intent to Investment Managers, other stakeholders and the public.
- The reporting requirements, particularly for asset owners, are not overly onerous, particularly after the initial investment in establishing the reporting framework. Investment managers provide the bulk of the required data. There are a significant number of resource constrained asset owner (university endowments, family offices) signatories who find the reporting workload manageable. We would bring in some additional support in the first instance, given the pressures on the team.
- Signatory reporting data feeds into two publicly available outputs – the Transparency and Progress Reports. New signatories have one full reporting cycle during which it is voluntary to report. The Assessment Report is a private confidential report given to the signatory offering feedback on their reporting. This is designed to assist the signatory in

progressing their RI implementation journey, which begins with signing up and an initial period spent defining objectives, followed by reporting and feedback on future opportunities. In other words, it is not a name and shame model and it is recognised that change does not happen overnight – this mitigates any perceived reputational risk.

- Current UK signatories include Lloyds Banking Group, the BT and Marks & Spencer Pension Schemes, the Pension Protection Fund and Kent and Lancashire County Council Pension Funds. Fees payable to PRI would amount to around £3k each year.

Next Steps

3. There are a number of steps that can now be taken to build on the groundwork over this last year. Following discussion with Mercer, we would suggest the following actions:
 - A Survey of FIB Members of their investment beliefs – Mercer have provided us with a previously used draft, which could be adapted if necessary, and circulated after the September FIB.
 - A workshop/extended FIB discussion on the outcome of the survey and a draft RI policy statement, which could in turn feed into the refreshed Investment Strategy. Appendix 1 is the RI statement made by the Pension Protection Fund and forms an integral part of their wider strategy.
 - Following the conclusion of the workshop/FIB discussion, prepare an implementation plan that would enable us to commit to the UK Stewardship Code and to the Principles of Responsible Investment within an agreed timeframe.

Conclusion

4. Strengthening our commitment to RI/ESG will support the long term performance of our assets. The proposed actions provide a step by step approach which would ensure we have a clear strategy which recognises that it will take time to implement fully.

Appendices

- Appendix 1 – Example of RI policy statement

Dr Peter Kane

Chamberlain

T: 0207 332 1300; E: peter.kane@cityoflondon.gov.uk

Pension Protection Fund Statement of Investment Principles:

Chapter 9 Responsible Investment and corporate governance

9.1 The Board's primary concern, in setting its investment strategy, is to act in the best financial interests of the Fund and its beneficiaries, seeking the best return that is consistent with a prudent and appropriate level of risk.

9.2 The Board believes that in order to fulfil this commitment and to protect and enhance the value of the Fund's investments over the long-term, it must act as a responsible and vigilant asset owner and market participant.

9.3 The Board further believes that environmental, social and governance (ESG) factors can have an impact on the long-term performance of its investments, and that the management of ESG risks and exploitation of ESG opportunities can add value to its portfolio.

9.4 The Board is a signatory of the UN Principles of Responsible Investment (UN PRI), a set of best practice principles on Responsible Investment (RI). The Board intends to use these Principles as a benchmark with which to guide its own approach to RI, and in doing so will seek to apply RI principles across all the assets in which it invests.

9.5 The Board defines environmental, social and governance (ESG) factors as the interaction of its investments with:

- The physical environment (environmental);
- Communities, workforces, wider society and economies (social);
- The governance structures of the organisations and markets we invest in, as well as of our agents (governance, including corporate governance).

9.6 The Board will integrate the consideration of ESG issues across all asset classes and markets in which it invests. In particular the Board, or its agents on its behalf, will exercise its ownership rights, including voting rights, in order to safeguard sustainable returns in the long-term.

9.7 The Board expects its fund managers, where appropriate, to have integrated ESG factors as part of their investment analysis and decision-making process. Appropriate weight will be given to ESG factors in the appointment of fund managers. The Board will hold fund managers to account in this regard as part of its regular monitoring process.

9.8 In line with its commitment to transparency, the Board will report to its stakeholders on its responsible investment activities.