Bob Holloway

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Date: 2019

This matter is being dealt with by: George Graham

Dear Bob,

Responsible Investment in the Local Government Pension Scheme – Part 1 Guidance

South Yorkshire Pensions Authority welcomes the opportunity to comment on the draft guidance produced by the Scheme Advisory Board. The Authority is responsible for one of the largest funds within the LGPS and places an extremely high priority on responsible investment which is one of its corporate objectives. We also seek to exhibit best practice in our governance (for example publishing our Gender Pay Gap when we are not required to) in order to encourage investee companies to behave in the right way.

In general the document seems a reasonable survey of the landscape but that is where it stops. While we understand that part 2 will contain best practice studies etc. there appears to be a gap between these and the analysis of the landscape. The best way in which this can be defined is some form of statement of expectations by the SAB around what practical steps administering authorities should be taking in this area, providing some amplification of the baldly stated statutory requirements. For example does the Board expect administering authorities to sign up to the FRC Stewardship Code at the highest level? Does the Board recognise the value of collaboration as a “force multiplier” in this field and if so does it wish to encourage administering authorities to participate in collaborations through this guidance.

These sorts of statements would not prescribe a policy stance, which as the document states, is a matter remaining in the province of the individual administering authority. However, in the same way as the Good Governance project is doing statements of this sort would set minimum standards against which all might be judged.

There is also, in our view, a gap in terms of pooling. While it is clear in the document that the primary responsibility in this area remains with the administering authority there are a range of practical issues about this where investments are pooled as the pooling entity, acts as a form of “managing agent” for the partner funds in the pool, and in many cases has received through staff transfers from individual funds the resource required to undertake much of the work on responsible investment. This tends towards the development of collective policies and voting guidelines adopted by all partner funds in order to facilitate the practical operation of the pool. This does not prevent individual funds taking their own positions or adopting a policy position which seeks to move others in a particular direction.

It would perhaps be helpful for the guidance to recognise these sorts of practical implications of pooling where the ceding of sovereignty in one area through pooling means that the practical exercise of sovereignty in other areas needs to change.

There are a number of more detailed points, as follows:

Introduction and Purpose
The spectrum of capital diagram is a useful tool. However, there is a danger that it is simplistically interpreted to imply a left to right direction of travel. The reality must be more nuanced and different parts of a fund's portfolio will fit in to different parts of the spectrum and be held for different purposes, and it is also possible that some investments can be seen as falling into more than one category. For example SYPA's developing portfolio of real estate development loans focussed in South Yorkshire can be seen as a means of achieving exposure to real estate debt which exploits a niche in the market where others are not lending thus allowing good commercial returns. The fact that this has a beneficial impact in terms of local housing and employment is simply incidental. Equally the impact could be viewed as the prime driver.

Section 1A – What is RI?
This section should include reference to stewardship and active ownership which in addition to a focus on ESG factors are key aspects of an RI approach.

Section 1B – What are ESG Factors?
This would benefit from being a simple introduction rather than a long list which has some notable omissions and might well be wrongly seen as exhaustive, and is also repeated later in the document. There should be reference to materiality and the management of risk.

Section 1C – What about Climate risk?
The inclusion of this section is important but it needs to be expanded to include reference to the systemic risk which has the potential to impact long term investment returns across all asset classes. Considering this risk is a key part of Pension Committee's fiduciary responsibilities. Reference should also be included to the growing impetus for mandatory reporting in line with the TCFD requirements.

Section 1E – Non Financial Factors
The inclusion of a percentage, even if only in an example is inadvisable, as it will tend to become written in stone. As ever context here is key. Deciding to divest from a sector which is 3% of a portfolio may not involve any worse impact than divesting from one that is 15%, it all depends on the alternative investment opportunities.

Section1F – Asset Stewardship
It would be appropriate to bring the references to the FRC Stewardship Code up to date with the new and much more ambitious version of the Code which is what individual administering authorities will be needing to address when the guidance is published. This version of the Code seems to move those adopting it very much in the direction of the PRI which while undoubtedly the right thing to do will likely have some significant resource implications. It would also be appropriate to include reference to the Shareholder Rights Directive II.

Section 2E – What an Administering Authority May Do
This is one of the areas where the impact of pooling is not recognised (in this case in relation to appointing voting agents). There needs to be a recognition that arrangements will differ depending on the agreement within the pool. The key point is that Administering Authorities need to exercise robust oversight of and report to stakeholders on their voting activity, or voting activity carried out on their behalf.

Section 3C – Elected Members Code of Conduct
It is not entirely clear how this is relevant to this context given the clear exposition above which takes precedence over the Code.

Undoubtedly the issuing of guidance in this area that could result in improved standards of stewardship across LGPS and works with the grain of the work being undertaken by the pools and the Cross Pool group is a significant opportunity which should not be missed. However, if this is to be effective we feel that there needs to be a bit more meat on the bones in terms of what is expected.

I hope this is helpful and look forward to seeing the final version of the guidance together with Part 2 which I have no doubt will have useful learning for all funds within LGPS.

Yours sincerely

George Graham
Fund Director