Pensions CIV Sectoral Joint Committee

Item no: 8

London CIV Stewardship Update

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Summary: At its meeting of 13 December 2016 the committee considered a report from London Councils covering constitutional matters associated with this Sectoral Joint Committee. This report provides a further update to Members and proposals for taking forward a wider governance review of all the arrangements pertaining to London CIV and the participating London local authorities, before making any changes that would have a direct impact on this committee.

Recommendations: The committee is recommended to:

i. Consider and note the contents of this report

ii. Approve the LCIV draft Stewardship Code Statement of Compliance

London CIV Stewardship Update

Background

1. The London CIV as a regulated fund manager looking after the assets of the London Local Authority Pension Funds takes its stewardship responsibilities seriously recognising that good stewardship plays a key role in the management of assets delivering long term financial benefits.

2. The Joint Committee has established a Member working group to work closely with the CIV to develop stewardship activities including the drafting of a Stewardship Code Statement of Compliance, which is now coming before this Committee for consideration prior to the Board Meeting of the London CIV and submission to the Financial Reporting Council (FRC).

3. The Member Stewardship Working Group met on 16 January 2017 (minutes attached at Annex A for information) to consider the draft Stewardship Statement. The Stewardship Code aims to enhance the quality of engagement between asset managers and companies to help improve long-term risk-adjusted returns to shareholders. It was first published in July 2010 and the Code was revised in September 2012. The Code sets out a number of areas of good practice to which the FRC believes institutional investors should aspire. It also describes steps asset owners can take to protect and enhance the value that accrues to the ultimate beneficiary. The FRC sees the UK Stewardship Code as complementary to the UK Corporate Governance Code for listed companies and, like that Code, it should be applied on a 'comply or explain' basis.

4. Since December 2010 all UK-authorised Asset Managers are required under the FCA's Conduct of Business Rules to produce a statement of commitment to the Stewardship Code or explain why it is not appropriate to their business model.

5. In 2016 the FRC assessed signatories to the Stewardship Code based on the quality of their Code statements. This work was undertaken to improve the quality of reporting against the Code, encourage greater transparency in the market and maintain the credibility of the Code. Tiering distinguishes between signatories who report well and demonstrate their commitment to stewardship, and those where reporting improvements are necessary. The tiering exercise has improved the quality of reporting against the Code, promoted best practice and resulted in greater transparency in the UK market.

6. Asset manager signatories have been categorised in three tiers, with asset owners and service providers being categorised in two tiers. The FRC has stated that the additional tier for asset managers reflects the greater relevance of the Code’s provisions to asset managers, their role as agents and the wide range of reporting quality.

7. Officers of the CIV and the officer stewardship working group met with the FRC to discuss the position of the London CIV in the reporting structure and to seek guidance on how assessments are undertaken. Following these discussions, the London CIV has now drafted a Statement of Compliance with the Code, which has been agreed with the Stewardship Working Group, a copy of this is attached at Annex B for consideration by the Joint Committee.

8. Whilst the London CIV is a regulated fund manager, at this time all of the investments are managed externally. This puts the London CIV in a similar position to a number of other collective funds which have been classified as asset owner rather than asset managers. It would seem appropriate at this stage of the London CIV development to aim for a Tier One classification as an asset owner rather than as an asset manager. Also attached at Annex C is the FRC Stewardship Code for information.

9. Officers have also reviewed the status of the managers on the London CIV platform following the tiering classification by the FRC. All with the exception of Pyrford have met the criteria for a tier one, who has achieved a level two status.

10. Members should also be aware that individual funds under the new guidance for the Investment Strategy Statement (ISS) which is required to be issued by 1st April 2017, also have to include an explanation on their policy on stewardship with reference to the Stewardship Code. London Funds may therefore find the draft statement useful when either compiling their own statement or setting out their approach to Stewardship in their ISS.

11. With Funds in the process of drafting their ISS, Members will be aware that the 2016 Regulations also require funds to set out their approach to voting and engagement more broadly. Whilst recognising that it is absolutely for Funds to determine their own policies, the officer working group has been liaising with the London CIV to see if some generic wording could be developed to assist Funds in compiling these aspects of the ISS. With 33 London Local Authorities, it is recognised that there is likely to be a wide dispersion of approaches to these statements and this could result in additional complexity when assets transfer to the CIV if there is not some flexibility built into statements or they would ultimately conflict with what the CIV is able to provide by way of voting and stewardship. The draft wording agreed with the officer working group is attached at Annex D for information and also covers the pooling statements. This has also been reviewed by the Investment Advisory Committee and they have endorsed the approach and options being put forward.

12. Members have also requested that a report be brought to this Committee on the National Frameworks Stewardship Framework. At this time, the final touches are still being put to this Framework in terms of legal agreements and therefore it is not currently operational. However in brief the Stewardship Framework will enable both Funds and Pools to access providers offering a range of services in connection with stewardship. There are 5 lots under the Framework as set out below:

    i. Lot 1 Voting Services – support for the design, implementation and reporting of your voting activity

    ii. Lot 2 Engagement Services – support for the design, implementation and reporting of your engagement activity

    iii. Lot 3 Voting and Engagement Services – support for the design, implementation and reporting of your voting and engagement activity

    iv. Lot 4 Stewardship Research and Data Services - provision of data/research at sectoral, regional, asset class and/or investment level of environmental, social, governance and other stewardship matters in relation to your current or prospective investments

v. Lot 5 Stewardship-related Project Services - Discrete pieces of specialist, stewardship-related project work

13. Once the Framework is operational, the London CIV will provide a further update on the providers and types of service available.

Recommendations

14. The committee is recommended to:

    i. Consider and note the contents of this report

    ii. Approve the LCIV draft Stewardship Code Statement of Compliance

Legal Implications

15. There are no legal implications at this time.

Financial implications

16. There are no financial implications for London Councils

Equalities Implications

17. There are no equalities implications for London Councils

Attachments

Annex A – Member Stewardship Working Group Minutes 16 January 2017

Annex B – London CIV Draft Stewardship Code Compliance Statement

Annex C – FRC Stewardship Code

Annex D – Suggested wording for Investment Strategy Statements

PENSIONS SECTORAL JOINT COMMITTEE – LONDON CIV

Stewardship Working Group

16th January 2017 – Minutes

Attendees:

Borough	**Representative**
Ealing	Cllr Yvonne Johnson (YJ), Chair
Hackney	Cllr Rob Chapman (RC)
Islington	Cllr Richard Greening (RG)
Richmond	Cllr Thomas O'Malley (TOM)
Wandsworth	Cllr Maurice Heaster (MH), Vice Chair

London CIV	
Chief Executive	Hugh Grover (HG)
AD, Client Management	Jill Davys (JD)

Agenda Item Number	Agenda Item	Actions
1.	**Apologies:** Cllr Toby Simon (Enfield)	
2.	**Minutes and Matters Arising** Minutes Agreed Matters Arising: • LCIV Monitoring and managing voting alerts and informing managers as they arise. Quarterly reporting to PSJC on voting included in the Investment Updates. Noted that around 2/3rds of London Funds participate in LAPFF, RG commented Islington also use PIRC for voting, recognition that if LCIV used, this would lead to additional costs. • Stewardship Code, Seminar and future dates picked in the main agenda • RC and YJ asked if it was possible for the CIV to look into a London wide offering for carbon tracking to negotiate better rates for the tracking of carbon investments. JD replied that the CIV was currently working on a template IMA which would require the managers it invests with to provide disclose on their carbon footprint and to provide reporting. JD would also approach providers to ask about wider carbon reporting for funds.	JD to approach carbon tracking providers to look at options for a wider London framework for monitoring carbon exposure

3.	**Stewardship Code – Draft Compliance Statement** The Committee reviewed the draft Code of Compliance with the Stewardship Code. JD and a colleague from LB Hackney had met with the FRC to discuss the options for LCIV and the Stewardship Code. Whilst LCIV is a fund manager, the asset owner category for compliance would seem more appropriate at this stage in its development. For Asset managers, there are 3 levels of compliance (level 1 being the highest), but the standards to achieve level 1 would require additional resources for the CIV to be able to demonstrate compliance. Asset Owners are classified in 2 levels (with most funds in London with a statement having achieved the second level). LCIV would be looking to achieve the highest level as an asset owner (there are other precedents of similarly structured funds in the asset owner category). The Statement had been reviewed by the officer stewardship working group and was now coming before this Committee for consideration in advance of presenting to the PSJC. TOM suggested that further enhancements be made to the voting section that LCIV would include a voting and engagement report in its annual report and accounts and also on the website. Also need to include some comments that for the purpose of the Code, LCIV was acting as asset owners rather than an asset manager – agreed that JD would incorporate suggestions in the final version. A question was raised over the cost of ensuring compliance with the code – would this require additional resources for the CIV? It was agreed that a Level 1 Compliance Statement would not require additional resources at this stage and would be managed by the Client Manager. JD to amend Statement and forward to FRC for review.	JD to include additional wording on voting in the Statement in advance of sending to FRC for comment
4.	**Global Equity Procurement:** Members reviewed the confidential report on the sustainable equities Lot from the global equities procurement exercise, along with the survey which had been carried out amongst the London Funds. JD commented that the proposed manager for sustainable equities did not have an exclusion approach, rather the manager looked for companies which had a sustainable approach to its business, which therefore tended to mean low exposures to sectors such as those exposed to carbon risks. Recognition that a number of Funds across London were experiencing significant pressure from the Divest movement and that at some point LCIV might need a more focused 'no carbon' offering. Overall the group felt that engagement with companies was a better approach than outright divestment at this stage.	

	MH commented that the survey was useful in identifying where Funds were looking to invest in the global equity area with particular reference to the equity income space. LCIV are looking to open 3-4 sub-funds over the summer and this would include both equity income and sustainable equities. Further sub-funds would follow later in the year, but these were still to be decided. The Working Group was also keen to understand how the CIV can assist London Funds in implementing their investment strategies, particularly as these were currently under review following the valuation. The CIV is already conducting surveys and working closely with the investment consultants along with the Funds themselves to better understand the needs of the Funds.	
5.	**Stewardship Seminar:** The Committee were broadly happy with the content of the Seminar, but asked that it finish by 4.30 even if this meant removing a refreshment break. This would enable Members to travel back from the event in time to attend evening meetings.	
5.	**Dates of Future Meetings:** The Group were content to have a further meeting in the summer, dates to be proposed by LCIV	JD to provide possible dates for further meetings
6.	**A.O.B** None raised	

LONDON CIV

STEWARDSHIP CODE

STATEMENT OF COMPLIANCE

LONDON CIV

UK STEWARDSHIP CODE STATEMENT

The London Collective Investment Vehicle (CIV) was formed as a voluntary collaborative venture by the London Local Authorities in 2014 to invest the assets of London Local Government Pension Scheme (LGPS). The London CIV and its London Local Authority investors recognise the importance of being long term stewards of capital and in so doing supports the UK Stewardship Code, which it recognises as best practice.

The London LGPS CIV Limited ("London CIV") is fully authorised by the FCA as an Alternative Investment Fund Manager (AIFM) with permission to operate a UK based Authorised Contractual Scheme fund (ACS Fund). The London CIV in the management of its investments has appointed a number of external investment managers. We therefore see our role as setting the tone for the effective delivery of stewardship managers on our behalf and on behalf of our investing Funds. We are clear that we retain responsibility for this being done properly and fully in the interests of our own shareholders.

This Statement sets out how the London CIV implements the seven principles of the Code. For the purpose of the Code, London CIV is acting in the capacity of an asset owner rather than an asset manager, representing the interests of the London Local Authority LGPS Funds.

Principle 1
Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

The London CIV on behalf of its London Local Authority Shareholders recognises its position as an investor on their behalf with ultimate responsibility to members and beneficiaries and recognises that effective stewardship can help protect and enhance the long-term value of its investments to the ultimate benefit of all stakeholders in the LGPS.

As we do not invest directly in companies, we hold our fund managers accountable for the delivery of stewardship on our behalf in terms of day-to-day implementation of its stewardship activity. We require the appointed fund management teams to be responsible for holding to account the management and boards of companies in which they invest. The London CIV believes that this approach is compatible with its stewardship responsibilities as it is the most effective and efficient manner in which it can promote and carry out stewardship activities in respect of its investments, and ensure the widest reach of these activities given the CIV's investment arrangements.

A key related area where stewardship is integrated into the wider process is in the selection and monitoring of external investment managers. When considering the appointment of external investment managers the consideration of Environmental

Social and Governance (ESG) integration and stewardship activity of each investment manager is part of the selection process.
The London CIV expects its equity investment managers to adhere to the principles within the UK Stewardship Code. This position is communicated to the Fund's investment managers and forms the basis of the approach to monitoring the investment managers as outlined in this document. Whilst the Stewardship Code is primarily directed at UK equity investments, the CIV encourages its investment managers to apply the principles of the Code to overseas equity holdings where possible.

The primary mechanisms for the application of effective stewardship for the CIV are exercise of voting rights and engagement with investee companies. The CIV expects its external equity investment managers that invest directly in companies, to pursue both these mechanisms. We receive quarterly reporting from managers which includes their stewardship and voting activities where appropriate. We seek consistently to ensure that these stewardship activities are carried out actively and effectively in the furtherance of good long-term investment returns.

We expect all of the CIV's equity managers to be signatories to the Code and have publicly disclosed their policy via their Statements on how they will discharge their stewardship responsibilities. We expect managers that invest in companies directly to discharge their responsibilities by:

- having extensive dialogue with the company's management throughout the year on a range of topics such as governance, financial performance and strategy; and
- voting, either directly or via the services of voting agencies.

Principle 2
Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.

Day-to-day implementation of the Fund's stewardship activity has been delegated to external investment managers. The CIV expects its investment managers to document their approach to stewardship, which should include how they manage any conflicts of interest that arise to ensure that the interests of the CIV's Investors are prioritised. The CIV will review annually the conflicts of interest policy of its managers and how any conflicts have been managed during the year.

The London CIV has policies in place to manage conflicts of interest that may arise for the Board and its officers when making decisions on its behalf. The Conflicts of Interest policy is reviewed by the CIV board on a regular basis. A Conflicts of Interest Register is maintained.

Shareholders of the CIV attending the Pensions Sectoral Joint Committee are required to declare any conflicts of interest at the start of any meeting.

Principle 3
Institutional investors should monitor their investee companies.

We recognise that active and ongoing monitoring of companies is the foundation of good stewardship, reminding companies in which we invest that they have obligations to their shareholders to deliver returns over the appropriate long-term investment timeframe and, consistent with this, to manage any related environmental and social risks responsibly.

The CIV requires its external investment managers to monitor investee companies. Issues to be monitored are likely to vary, however typically these might include a company's corporate strategy, financial performance, risk (including those from environmental and social factors), capital structure, leadership team and corporate governance. The CIV encourages its investment managers to satisfy themselves that investee companies adhere to the spirit of the UK Corporate Governance Code.

The CIV reviews investment managers in this area as part of their regular meetings. For equity investment managers this includes consideration of:

- who has overall responsibility for ESG risk analysis and integration;
- resources and experience of the team;
- at what stages of the process ESG risks are considered;
- exposures to environmental, social or governance risk within the portfolio; and
- the investment manager's willingness to become an insider and, if so, whether the manager has a policy setting out the mechanisms through which this is done.

Principle 4
Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

The CIV recognises that constructive engagement with company management can help protect and enhance shareholder value. Typically, the CIV expects its investment managers to intervene with investee companies when they view that there are material risks or issues that are not currently being adequately addressed.

The CIV reviews investment managers in this area as part of their regular meeting. For equity investment managers that invest directly in Companies, this includes consideration of:

- whether voting activity has led to any changes in company practice;
- whether the investment manager's policy specifies when and how they will escalate engagement activities;
- overall engagement statistics (volume and areas of focus);
- example of most intensive engagement activity discussed as part of the manager's annual review meeting; and
- the estimated performance impact of engagement on the strategy in question.

Given the range of fund managers and Fund investments, the CIV carries out its monitoring at the manager level to identify:

- trends to ensure progress is being made in stewardship activities;
- specific managers where progress or the rate of progress is not adequate; and
- appropriate specific actions necessary.

Principle 5
Institutional investors should be willing to act collectively with other investors where appropriate.

As day-to-day management of the Fund's assets has been delegated to external investment managers, the CIV expects its investment managers to get involved in collective engagement where this is an efficient means to protect and enhance long-term shareholder value.

In addition the London CIV will work collectively with other investors including other LGPS Asset pools and the Local Authority Pension Fund Forum (LAPFF) to enhance the impact of their engagement activities.

Principle 6
Institutional investors should have a clear policy on voting and disclosure of voting activity.

The CIV has delegated its voting rights to the Fund's investment managers and requires them to vote, except where it is impractical to do so. The CIV also monitors the voting alerts of the LAPFF and where these are issued, requires the investment managers to take account of these alerts as far as practical to do so. Where the investment manager does not vote in line with the LAPFF voting alerts, the CIV will require detailed justification for non compliance.

The CIV reviews and monitors the voting policies and activities of its investment managers, this includes consideration of:

- the manager's voting policy and, what areas are covered;
- the level of voting activity
- whether the investment manager typically informs companies of their rationale when voting against or abstaining (and whether this is typically in advance of the vote or not);
- if securities lending takes place within a pooled fund for the strategy, whether the stock is recalled for all key votes for all stocks held in the portfolio; and
- whether a third party proxy voting service provider is used and, if so, how.

Principle 7
Institutional investors should report periodically on their stewardship and voting activities.

The London CIV encourages transparency from its investment managers and expects its managers to report publicly on their voting in an appropriate manner. In addition the London CIV receives reviews and monitors quarterly the voting and stewardship engagement activities of its investment managers.

The CIV reports quarterly to its investors and will include information on voting and engagement activities from investment managers where appropriate including updates as required on updated stewardship and voting policies of managers. The CIV also requires its managers to provide it with annual assurances on internal controls and compliance through recognised framework such as the AAF01/06 or equivalent.

The CIV will incorporate a voting and engagement report in its annual report and accounts and will also place a copy of the report separately on the website.

This statement will be reviewed regularly and updated as necessary.

Code

Corporate Governance

Financial Reporting Council

September 2012

The UK Stewardship Code

Contents

Stewardship and the Code

1. Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole.

2. In publicly listed companies responsibility for stewardship is shared. The primary responsibility rests with the board of the company, which oversees the actions of its management. Investors in the company also play an important role in holding the board to account for the fulfilment of its responsibilities.

3. The UK Corporate Governance Code identifies the principles that underlie an effective board. The UK Stewardship Code sets out the principles of effective stewardship by investors. In so doing, the Code assists institutional investors better to exercise their stewardship responsibilities, which in turn gives force to the "comply or explain" system.

4. For investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings.

5. Institutional investors' activities include decision-making on matters such as allocating assets, awarding investment mandates, designing investment strategies, and buying or selling specific securities. The division of duties within and between institutions may span a spectrum, such that some may be considered asset owners and others asset managers.

6. Broadly speaking, asset owners include pension funds, insurance companies, investment trusts and other collective investment vehicles. As the providers of capital, they set the tone for stewardship and may influence behavioural changes that lead to better stewardship by asset managers and companies. Asset managers, with day-to-day responsibility for managing investments, are well positioned to influence companies' long-term performance through stewardship.

7. Compliance with the Code does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding, where this is considered in the best interest of clients or beneficiaries.

Application of the Code

1. The UK Stewardship Code traces its origins to 'The Responsibilities of Institutional Shareholders and Agents: Statement of Principles,' first published in 2002 by the Institutional Shareholders Committee (ISC), and which the ISC converted to a code in 2009. Following the 2009 Walker Review of governance in financial institutions, the FRC was invited to take responsibility for the Code. In 2010, the FRC published the first version of the UK Stewardship Code, which closely mirrored the ISC code. This edition of the Code does not change the spirit of the 2010 Code.

2. The Code is directed in the first instance to institutional investors, by which is meant asset owners and asset managers with equity holdings in UK listed companies. Institutional investors may choose to outsource to external service providers some of the activities associated with stewardship. However, they cannot delegate their responsibility for stewardship. They remain responsible for ensuring those activities are carried out in a manner consistent with their own approach to stewardship. Accordingly, the Code also applies, by extension, to service providers, such as proxy advisors and investment consultants.

3. The FRC expects signatories of the Code to publish on their website, or if they do not have a website in another accessible form, a statement that:

    - describes how the signatory has applied each of the seven principles of the Code and discloses the specific information requested in the guidance to the principles; or
    - if one or more of the principles have not been applied or the specific information requested in the guidance has not been disclosed, explains why the signatory has not complied with those elements of the Code.

4. Disclosures under the Code should improve the functioning of the market for investment mandates. Asset owners should be better equipped to evaluate asset managers, and asset managers should be better informed, enabling them to tailor their services to meet asset owners' requirements.

5. In particular the disclosures should, with respect to conflicts of interest, address the priority given to client interests in decision-making; with respect to collective engagement, describe the circumstances under which the signatory would join forces with other institutional investors to ensure that boards acknowledge and respond to their concerns on critical issues and at critical times; and, with respect to proxy voting agencies, how the signatory uses their advice.

6. The statement of how the Code has been applied should be aligned with the signatory's role in the investment chain.

7. Asset owners' commitment to the Code may include engaging directly with companies or indirectly through the mandates given to asset managers. They should clearly communicate their policies on stewardship to their managers. Since asset owners are the primary audience of asset managers' public statements as well as client reports on stewardship, asset owners should seek

to hold their managers to account for their stewardship activities. In so doing, they better fulfil their duty to their beneficiaries to exercise stewardship over their assets.

8. An asset manager should disclose how it delivers stewardship responsibilities on behalf of its clients. Following the publication in 2011 of the Stewardship Supplement to Technical Release AAF 01/06, asset managers are encouraged to have the policies described in their stewardship statements independently verified. Where appropriate, asset owners should also consider having their policy statements independently verified.

9. Overseas investors who follow other national or international codes that have similar objectives should not feel the application of the Code duplicates or confuses their responsibilities. Disclosures made in respect of those standards can also be used to demonstrate the extent to which they have complied with the Code. In a similar spirit, UK institutions that apply the Code should use their best efforts to apply its principles to overseas equity holdings.

10. Institutional investors with several types of funds or products need to make only one statement, but are encouraged to explain which of their funds or products are covered by the approach described in their statements. Where institutions apply a stewardship approach to other asset classes, they are encouraged to disclose this.

11. The FRC encourages service providers to disclose how they carry out the wishes of their clients with respect to each principle of the Code that is relevant to their activities.

12. Signatories are encouraged to review their policy statements annually, and update them where necessary to reflect changes in actual practice.

13. This statement should be easy to find on the signatory's website, or if they do not have a website in another accessible form, and should indicate when the statement was last reviewed. It should include contact details of an individual who can be contacted for further information and by those interested in collective engagement. The FRC hosts on its website the statements of signatories without their own website.

14. The FRC retains on its website a list of asset owners, asset managers and service providers that have published a statement on their compliance or otherwise with the Code, and requests that signatories notify the FRC when they have done so, and when the statement is updated.

15. The FRC regularly monitors the take-up and application of the Code. It expects the content of the Code to evolve over time to reflect developments in good stewardship practice, the structure and operation of the market, and the broader regulatory framework. Unless circumstances change, the FRC does not envisage proposing further changes to the Code until 2014 at the earliest.

Financial Reporting Council
September 2012

Comply or Explain

1. As with the UK Corporate Governance Code, the UK Stewardship Code should be applied on a "comply or explain" basis.

2. The Code is not a rigid set of rules. It consists of principles and guidance. The principles are the core of the Code and the way in which they are applied should be the central question for the institutional investor as it determines how to operate according to the Code. The guidance recommends how the principle might be applied.

3. Those signatories that choose not to comply with one of the principles, or not to follow the guidance, should deliver meaningful explanations that enable the reader to understand their approach to stewardship. In providing an explanation, the signatory should aim to illustrate how its actual practices contribute to good stewardship and promote the delivery of the institution's or its clients' investment objectives. They should provide a clear rationale for their approach.

4. The Financial Services Authority requires any firm authorised to manage funds, which is not a venture capital firm, and which manages investments for professional clients that are not natural persons, to disclose "the nature of its commitment" to the Code or "where it does not commit to the Code, its alternative investment strategy" (under Conduct of Business Rule 2.2.3[1]).

5. The FRC recognises that not all parts of the Code are relevant to all signatories. For example, smaller institutions may judge that some of its principles and guidance are disproportionate in their case. In these circumstances, they should take advantage of the ''comply or explain'' approach and set out why this is the case.

6. In their responses to explanations, clients and beneficiaries should pay due regard to the signatory's individual circumstances and bear in mind in particular the size and complexity of the signatory, the nature of the risks and challenges it faces, and the investment objectives of the signatory or its clients.

7. Whilst clients and beneficiaries have every right to challenge a signatory's explanations if they are unconvincing, they should not evaluate explanations in a mechanistic way. Departures from the Code should not be automatically treated as breaches. A signatory's clients and beneficiaries should be careful to respond to the statements from the signatory in a manner that supports the "comply or explain" process and bears in mind the purpose of good stewardship. They should put their views to the signatory and both parties should be prepared to discuss the position.

[1] http://fsahandbook.info/FSA/html/handbook/COBS/2/2

The Principles of the Code

So as to protect and enhance the value that accrues to the ultimate beneficiary, institutional investors should:

1. publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.
3. monitor their investee companies.
4. establish clear guidelines on when and how they will escalate their stewardship activities.
5. be willing to act collectively with other investors where appropriate.
6. have a clear policy on voting and disclosure of voting activity.
7. report periodically on their stewardship and voting activities.

The UK Stewardship Code

Principle 1

Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

Guidance

Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meetings.

The policy should disclose how the institutional investor applies stewardship with the aim of enhancing and protecting the value for the ultimate beneficiary or client.

The statement should reflect the institutional investor's activities within the investment chain, as well as the responsibilities that arise from those activities. In particular, the stewardship responsibilities of those whose primary activities are related to asset ownership may be different from those whose primary activities are related to asset management or other investment-related services.

Where activities are outsourced, the statement should explain how this is compatible with the proper exercise of the institutional investor's stewardship responsibilities and what steps the investor has taken to ensure that they are carried out in a manner consistent with the approach to stewardship set out in the statement.

The disclosure should describe arrangements for integrating stewardship within the wider investment process.

Principle 2

Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.

Guidance

An institutional investor's duty is to act in the interests of its clients and/or beneficiaries.

Conflicts of interest will inevitably arise from time to time, which may include when voting on matters affecting a parent company or client.

Institutional investors should put in place, maintain and publicly disclose a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of their client or beneficiary first. The policy should also address how matters are handled when the interests of clients or beneficiaries diverge from each other.

Principle 3

Institutional investors should monitor their investee companies.

Guidance

Effective monitoring is an essential component of stewardship. It should take place regularly and be checked periodically for effectiveness.

When monitoring companies, institutional investors should seek to:

- keep abreast of the company's performance;
- keep abreast of developments, both internal and external to the company, that drive the company's value and risks;
- satisfy themselves that the company's leadership is effective;
- satisfy themselves that the company's board and committees adhere to the spirit of the UK Corporate Governance Code, including through meetings with the chairman and other board members;
- consider the quality of the company's reporting; and
- attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.

Institutional investors should consider carefully explanations given for departure from the UK Corporate Governance Code and make reasoned judgements in each case. They should give a timely explanation to the company, in writing where appropriate, and be prepared to enter a dialogue if they do not accept the company's position.

Institutional investors should endeavour to identify at an early stage issues that may result in a significant loss in investment value. If they have concerns, they should seek to ensure that the appropriate members of the investee company's board or management are made aware.

Institutional investors may or may not wish to be made insiders. An institutional investor who may be willing to become an insider should indicate in its stewardship statement the willingness to do so, and the mechanism by which this could be done.

Institutional investors will expect investee companies and their advisers to ensure that information that could affect their ability to deal in the shares of the company concerned is not conveyed to them without their prior agreement.

Principle 4

Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

Guidance

Institutional investors should set out the circumstances in which they will actively intervene and regularly assess the outcomes of doing so. Intervention should be considered regardless of whether an active or passive investment policy is followed. In addition, being underweight is not, of itself, a reason for not intervening. Instances when institutional investors may want to intervene include, but are not limited to, when they have concerns about the company's strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matters.

Initial discussions should take place on a confidential basis. However, if companies do not respond constructively when institutional investors intervene, then institutional investors should consider whether to escalate their action, for example, by:

- holding additional meetings with management specifically to discuss concerns;
- expressing concerns through the company's advisers;
- meeting with the chairman or other board members;
- intervening jointly with other institutions on particular issues;
- making a public statement in advance of General Meetings;
- submitting resolutions and speaking at General Meetings; and
- requisitioning a General Meeting, in some cases proposing to change board membership.

Principle 5

Institutional investors should be willing to act collectively with other investors where appropriate.

Guidance

At times collaboration with other investors may be the most effective manner in which to engage.

Collective engagement may be most appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten to destroy significant value.

Institutional investors should disclose their policy on collective engagement, which should indicate their readiness to work with other investors through formal and informal groups when this is necessary to achieve their objectives and ensure companies are aware of concerns. The disclosure should also indicate the kinds of circumstances in which the institutional investor would consider participating in collective engagement.

Principle 6

Institutional investors should have a clear policy on voting and disclosure of voting activity.

Guidance

Institutional investors should seek to vote all shares held. They should not automatically support the board.

If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution. In both instances, it is good practice to inform the company in advance of their intention and the reasons why.

Institutional investors should disclose publicly voting records.

Institutional investors should disclose the use made, if any, of proxy voting or other voting advisory services. They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services.

Institutional investors should disclose their approach to stock lending and recalling lent stock.

Principle 7

Institutional investors should report periodically on their stewardship and voting activities.

Guidance

Institutional investors should maintain a clear record of their stewardship activities.

Asset managers should regularly account to their clients or beneficiaries as to how they have discharged their responsibilities. Such reports will be likely to comprise qualitative as well as quantitative information. The particular information reported and the format used, should be a matter for agreement between agents and their principals.

Asset owners should report at least annually to those to whom they are accountable on their stewardship policy and its execution.

Transparency is an important feature of effective stewardship. Institutional investors should not, however, be expected to make disclosures that might be counterproductive. Confidentiality in specific situations may well be crucial to achieving a positive outcome.

Asset managers that sign up to this Code should obtain an independent opinion on their engagement and voting processes having regard to an international standard or a UK framework such as AAF 01/06[2]. The existence of such assurance reporting should be publicly disclosed. If requested, clients should be provided access to such assurance reports.

[2] Assurance reports on internal controls of service organisations made available to third parties: http://www.icaew.com/en/technical/audit-and-assurance/assurance/technical-release-aaf-01-06

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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LONDON LOCAL AUTHORITY PENSION FUNDS - INVESTMENT STRATEGY STATEMENTS

Suggested Draft Wording for Pooling, ESG and Voting

Regulation 7(2)(d) - The approach to pooling investments, including the use of collective investment vehicles and shared services

The Fund has formally agreed to join the London Collective Investment Vehicle (CIV) as part of the Government's pooling agenda. The London CIV has been operational for some time and is in the process of opening a range of sub-funds covering liquid asset classes, with less liquid asset classes to follow.

(Please insert as appropriate – liquid assets)

(a) The Fund has already transitioned assets into the London CIV with a value of £xm or x% of the assets and will look to transition further liquid assets as and when there are suitable investment strategies available on the platform that meet the needs of the Fund.

(b) The Fund will transition liquid assets into the London CIV when there are suitable investment strategies that meet the asset allocation and investment strategy available on the London CIV platform. The Fund anticipates being able to transition some of the liquid assets across in advance of April 2018.

(c) The Fund is monitoring developments and the opening of investment strategy fund openings on the London CIV platform with a view to transitioning liquid assets across to the London CIV as soon as there are suitable sub-funds to meet the Fund's investment strategy requirements.

(Please insert as appropriate – passive life funds and other life funds)

The Fund holds x% £m of its assets in life funds and intends to retain these outside of the London CIV in accordance with government guidance on the retention of life funds outside pools for the time being. The Fund agrees for the London CIV to monitor the passive funds as part of the broader pool

(Please insert as appropriate –illiquid assets)

The Fund holds £m or x% of the Fund held in illiquid assets and these will remain outside of the London CIV pool. The cost of exiting these strategies early would have a negative financial impact on the Fund. These will be held as legacy assets until such time as they mature and proceeds re-invest through the pool assuming it has appropriate strategies available or until the Fund changes asset allocation and makes a decision to disinvest.

Regulation 7(2)(e) - How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments

The Fund is committed to being a long term steward of the assets in which it invests and expects this approach to protect and enhance the value of the Fund in the long term. In making investment decisions, the Fund seeks and receives proper advice from internal and external advisers with the requisite knowledge and skills. *In addition the Pensions Committee undertakes training on a regular basis and this will include on training and information sessions on matters of social, environmental and corporate governance.*

The Fund requires its investment managers to integrate all material financial factors, including corporate governance, environmental, social, and ethical considerations, into the decision-making process for all fund investments. It expects its managers to follow good practice and use their influence as major institutional investors and long-term stewards of capital to promote good practice in the investee companies and markets to which the Fund is exposed.

The Fund expects its external investment managers (and specifically the London Collective Investment Vehicle through which the Fund will increasingly invest) to undertake appropriate monitoring of current investments with regard to their policies and practices on all issues which could present a material financial risk to the long-term performance of the fund such as corporate governance and environmental factors. The Fund expects its fund managers to integrate material ESG factors within its investment analysis and decision making.

Effective monitoring and identification of these issues can enable engagement with boards and management of investee companies to seek resolution of potential problems at an early stage. Where collaboration is likely to be the most effective mechanism for encouraging issues to be addressed, the Fund expects its investment managers to participate in joint action with other institutional investors as permitted by relevant legal and regulatory codes.

The Fund monitors this activity on an ongoing basis with the aim of maximising its impact and effectiveness.

The Fund will invest on the basis of financial risk and return having considered a full range of factors contributing to the financial risk including social, environment and governance factors to the extent these directly or indirectly impact on financial risk and return.

The Fund in preparing and reviewing its Investment Strategy Statement will consult with interested stakeholders including, but not limited to Fund employers, investment managers, Local Pension Board, advisers to the Fund and other parties that it deems appropriate to consult with.

Regulation 7(2)(f) - The exercise of rights (including voting rights) attaching to investments

The Fund recognises the importance of its role as stewards of capital and the need to ensure the highest standards of governance and promoting corporate responsibility in the underlying companies in which its investments reside. The Fund recognises that ultimately this protects the financial interests of the Fund and its ultimate beneficiaries. The Fund has a commitment to actively exercising the ownership rights attached to its investments reflecting the Fund's conviction that responsible asset owners should maintain oversight of the companies in which it ultimately invests recognising that the companies' activities impact upon not only their customers and clients, but more widely upon their employees and other stakeholders and also wider society.

(Please insert as appropriate)

(a) The Fund has appointed a dedicated voting provider and has delegated voting its holdings in investee companies in accordance with the Fund's voting policy, which is set out (below / in a separate document).

(b) The Fund has delegated responsibility for voting rights to the Fund's external investment managers and expects them to vote in accordance with the Fund's voting policy as set out (below / in a separate document).

(c) The Fund's investments through the London CIV are covered by the voting policy of the CIV which has been agreed by the Pensions Sectoral Joint Committee. Voting is delegated to the external managers and monitored on a quarterly basis. The CIV will arrange for managers to vote in accordance with voting alerts issued by the Local Authority Pension Fund Forum as far as practically possible to do so and will hold managers to account where they have not voted in accordance with the LAPFF directions.

The Fund will incorporate a report of voting activity as part of its Pension Fund Annual report which is published on the *Council / Pension* Fund website: …….

(Please insert as appropriate)

(a) The Fund has issued a Statement of Compliance with the Stewardship Code which can be found on the Council / Pension Fund website.

(b) The Fund has reviewed the London CIV Statement of Compliance with the Stewardship Code and has agreed to adopt this Statement.

(c) The Fund has not issued a separate Statement of Compliance with the Stewardship Code, but fully endorses the principles embedded in the 7 Principles of the Stewardship Code.

(d) The Fund expects its external investment managers to be signatories of the Stewardship Code and reach Tier One level of compliance or to be seeking to achieve a Tier One status within a reasonable timeframe. Where this is not feasible the Fund expects a detailed explanation as to why it will not be able to achieve this level.

In addition, the Fund expects its investment managers to work collaboratively with others if this will lead to greater influence and deliver improved outcomes for shareholders and more broadly.

The Fund through its participation in the London CIV will work closely with other LGPS Funds in London to enhance the level of engagement both with external managers and the underlying companies in which invests.:

(Please insert as appropriate)

In addition the Fund:

(a) is a member of the Local Authority Pension Fund Forum (LAPFF) and in this way joins with other LGPS Funds to magnify its voice and maximise the influence of investors as asset owners

(b) is a member of the Pension and Lifetime Savings Association (PLSA) and in this way joins with other investors to magnify its voice and maximise the influence of investors as asset owners

(c) gives support to shareholder resolutions where these reflect concerns which are shared and represent the Fund interest

(d) joins wider lobbying activities where appropriate opportunities arise.