



Derbyshire
Pension
Fund

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Responsible Investment Framework

Draft – September 2020

1. Introduction

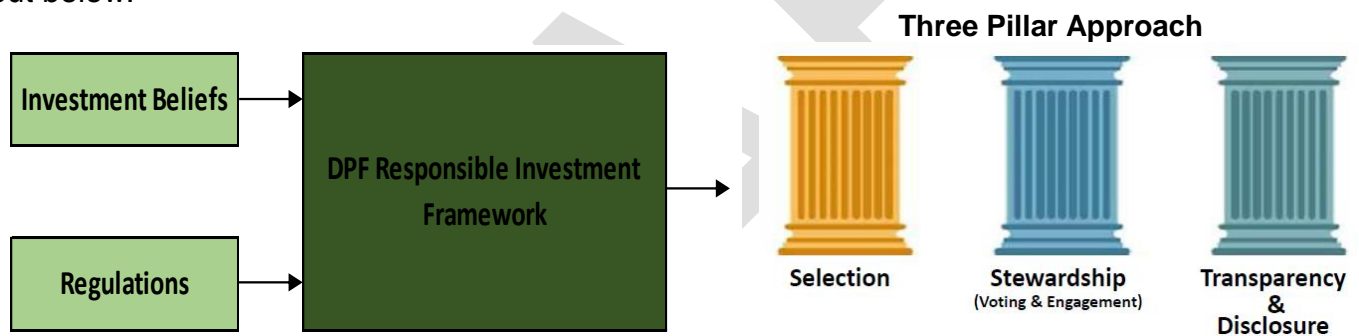
This Responsible Investment Framework (RI Framework) sets out Derbyshire Pension Fund’s (the Fund) approach to responsible investment (RI) which includes the integration of environmental, social and governance (ESG) considerations into the investment process and Fund stewardship and governance activities.

The Pensions and Investments Committee (the Committee) is responsible for reviewing and approving the Fund’s policies and strategies, including the RI Framework. The RI Framework works in tandem with the Fund’s Climate Strategy, Investment Strategy Statement and Funding Strategy Statement aligning with the Fund’s investment beliefs and fiduciary duty.

The Committee will review the Responsible Investment Framework at least every three years, or at such time as the Committee determines it is appropriate to review the Fund’s approach to RI.

Responsibility for the implementation of the Framework resides with the Head of Pension Fund and the Investments Manager.

The Fund takes a three-pillar approach to the implementation of Responsible Investment as set out below:



2. Responsible Investment

Responsible investment is an approach to investment that aims to incorporate ESG factors into investment decisions, to better manage risk and generate sustainable, long term returns.¹ It has relevance both during the selection of an investment and after an investment decision has been made, through on-going stewardship activity which covers considered voting and engagement with investee companies.

Responsible investment is a core part of the Fund’s fiduciary duty. It is distinct from ‘ethical investment’, which is an approach to selecting investments on the basis of ethical beliefs (beliefs about what is morally right and wrong).

Effective management of financially material ESG risks should support the requirement to protect investment returns over the long term. The Fund’s investment team seeks to understand relevant ESG factors alongside conventional financial considerations within the investment process, and the

¹ PRI Principles for Responsible Investment
Responsible Investment Framework
Draft - September 2020

Fund’s external investment managers are expected to do the same. Non-financial factors may be considered to the extent that they are not detrimental to the investment return.

ESG factors include:

Environmental	Social	Governance
Climate Change (including physical risk and transition risk)	Working Conditions (including slavery & child labour)	Executive Pay
Resource Depletion	Health & Safety	Bribery & Corruption
Waste & Pollution	Employee Relations	Board Diversity
Deforestation	Community Relations	Tax Strategy
		Political Lobbying
		Disclosure & Transparency

The Fund’s Strategic Asset Allocation Benchmark includes an allocation to Global Sustainable Equities. Sustainable investment managers are regarded as managers who invest in companies with a long-term approach to sustainability where the effective management of environmental, social and governance risks and opportunities is an integral part of the strategy to create a sustainable business. Companies with strong ESG business practices have the potential to create additional value for shareholders.

Within the Global Sustainable Equities allocation, the Fund will consider impact investment managers who invest in companies which aim to contribute to a more sustainable world, by seeking to effect positive social and environmental change, while generating investment returns.

The Committee recognizes its responsibility to act in the best interest of the Fund’s employers and scheme members, whilst seeking to protect local taxpayers and employers from unsustainable pension costs.

3. Investment Beliefs

The Fund’s investment beliefs as set out in the Fund’s Investment Strategy Statement are as follows:

- A long-term approach to investment will deliver better returns
- The long-term nature of LGPS liabilities allows for a long term investment horizon
- Asset allocation is the most important factor in driving long term investment returns
- Liabilities influence the asset structure; funds exist to meet their obligations
- Risk premiums exist for certain investments; taking advantage of these can help to improve investment returns
- Markets can be inefficient, and mispriced for long periods of time; therefore, there is a place for active and passive investment management
- Diversification across investments with low correlation improves the risk/return profile
- Secure and growing income streams underpin the ability to meet future liabilities
- Responsible investment can enhance long term investment performance
- Investment management costs should be minimized where possible but net investment returns after costs are the most important factor

4. Regulations & Statutory Guidance

The Responsible Investment Framework works in tandem with the Fund's Investment Strategy Statement. The Framework and Investment Strategy Statement have been developed in accordance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, statutory guidance, and best practice.

5. Engagement & Collaboration

The Fund adopts a strategy of engagement with companies to influence behaviour and enhance value, rather than adopting a divestment approach, believing that this is more compatible with the administering authority's fiduciary duties and supports responsible investment.

Engagement allows the Fund to use its influence as an active owner, with other like-minded investors, to improve ESG practices in investee companies, influence that would be lost through a divestment approach. It is recognised that change takes time, as a long-term investor the Fund takes a long-term approach to its stewardship activities.

6. Remuneration and Cost Management

Executive remuneration and investment management costs are important, particularly in low-return environments. Fee arrangements with fund managers and the remuneration policies of investee companies should be aligned with the Fund's long-term interests.

7. Climate Change

The Committee recognises that financial markets will be impacted by climate change and by the response of climate change policy makers. Risks and opportunities related to climate change are likely to be experienced across the whole of the Fund's portfolio. The current understanding of the potential risks posed by climate change, together with the development of climate-related measurements and disclosures, are still at an early stage, and there is considerable variability in the quality and comparability of carbon emission estimates. It is recognised that it will take time for companies to adapt to the changing regulatory and market positions.

Reflecting the potential material effect of climate change, and the response to climate change, on the assets and liabilities of the Fund, a separate Climate Strategy has been developed, a copy of which can be found on the Fund's website at: derbyshirepensionfund.org.uk/investments

(Note: Following this consultation, the Climate Strategy will be available via this page on the website)

8. LGPS Central Limited

The Fund is part of the LGPS Central Pool (the Pool) with the LGPS funds of Cheshire, Leicestershire, Nottinghamshire, Shropshire, Staffordshire, West Midlands and Worcestershire (the eight Partner Funds). The Pool has been established in accordance with Government requirements for the pooling of LGPS investment assets. LGPS Central Limited has been established to manage investments on behalf of the Pool and received authorization from the Financial Conduct Authority

in January 2018. The Company launched its first sub-funds within an Authorised Contractual Scheme collective investment vehicle in April 2018 and has launched several additional sub-funds since that date.

LGPS Central Limited has developed a Responsible Investment & Engagement Framework (LGPSC Framework) incorporating the investment beliefs and responsible investment beliefs of the eight Pension Funds within the LGPS Central Pool which will be applied to both internally and externally managed investment mandates. The LGPSC Framework contains the following beliefs:

- Long-termism: A long-term approach to investment will deliver better returns and the long-term nature of LGPS liabilities allows for a long-term investment horizon.
- Responsible Investment: Responsible Investment is supportive of risk adjusted returns over the long-term, across all asset classes. Responsible investment should be integrated into the investment process of the Company and its investment managers.
- Diversification, risk management and stewardship: Diversification across investments with low correlation improves the risk return profile. A strategy of engagement, rather than exclusion, is more compatible with fiduciary duty and more supportive of responsible investment, because the opportunity to influence companies through stewardship is waived in a divestment approach. Even well-diversified portfolios face systematic risk. Systematic risk can be mitigated over the long-term through widespread stewardship and industry participation.
- Corporate governance and cognitive diversity: Investee companies and asset managers with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events. There is clear evidence showing that decision-making and performance are improved when company boards and investment teams are composed of cognitively diverse individuals.
- Fees and remuneration: The management fees of investment managers and the remuneration policies of investee companies are of significance for the Company's clients, particularly in a low-return environment. Fees and remuneration should be aligned with the long-term interests of our clients, and value for money is more important than the simple minimisation of costs.
- Risk and opportunity: Risk premia exist for certain investments; taking advantage of these can help to improve returns. There is risk, but also opportunity in holding companies that have weak governance of financially material ESG issues. Opportunities can be captured so long as they are aligned to the Company's objectives and strategy, and so long as there is a sufficient evidence base upon which to make an investment decision.
- Climate change: Financial markets could be materially impacted by climate change and by the response of climate policy makers. Responsible investors should proactively manage this risk factor through stewardship activities, using partnerships of like-minded investors where feasible.

In collaboration with the eight Partner Funds, LGPS Central Limited has identified four themes that will be given particular attention in its ongoing stewardship efforts. The four themes, which will be reviewed after three years, are: Climate change; Single-use plastics; Fair tax payment and tax transparency; and Technology and disruptive industries. The Partner Funds and LGPS Central Limited believe that identifying material core themes helps direct engagement and sends a clear signal to companies of the areas that the Partner Funds and LGPS Central Limited are likely to be concerned with during engagement meetings.

LGPS Central Limited also supports the Fund through the annual preparation of a Climate Risk Report which supports the Fund in the preparation of the Fund's Climate Related Disclosure Report

prepared in alignment with the recommendations of the Taskforce on Climate-related Financial Disclosures.

9. Implementation

The Fund aims to put its Responsible Investment Strategy into practice through actions both before (selection) and after the investment decision (stewardship).

As a largely externally managed pension fund, the identification and assessment of RI factors is also the responsibility of individual investment managers appointed by the Fund.

The Fund aims to be transparent to its stakeholders through regular, high quality disclosure.

9.1 Selection

ESG factors are integrated into the Fund's investment decision making process where those factors are financially material within the context of the investment mandate. As part of the investment manager due diligence process, the Fund obtains a copy of the potential investment manager's RI or stewardship policies which sets out how RI factors are integrated into the investment manager's investment process.

9.2 Investment Manager Monitoring

Existing investment managers are monitored on a regular basis to review the integration of ESG risks into the portfolio management, and to understand their engagement activities.

9.3 Company Engagement and Engagement through Partnership

The Fund's strategy is to engage with its investee companies either on its own or through partnerships on a range of financially material ESG investment factors to protect and increase shareholder value. These partnerships include:

- The Local Authority Pension Fund Forum (LAPFF): a voluntary association of the majority of Local Authority pension funds based in the UK with combined assets of over £300bn. Membership of LAPFF provides the Fund with independent research and advice on RI risks of companies to inform further stakeholder engagement; advice on the governance practices of companies; and a forum to engage with companies to improve governance practices
- LGPS Central Limited: The Fund's pooled investment operator
- Hermes EOS: Hermes EOS is engaged by LGPS Central Limited to expand the scope of its engagement programme, especially to reach non-UK companies

The Fund will develop an Annual Responsible Investment Stewardship Plan and hold constructive dialogue with investee companies on RI issues (either on its own or through partnerships), and where practicable, participate in the development of public policy on RI issues.

9.4 Voting

The Fund places great importance on the exercise of voting rights. The Fund's voting policy covers the Fund's directly held investments in the United Kingdom and North America. The Committee has appointed Institutional Shareholder Services (ISS), a specialist third party voting service provider to make recommendations on casting votes in respect of the Fund's directly held UK listed

investments. Voting is carried out in line with recommendations from ISS, whose voting principles cover four key tenets on: accountability; stewardship; independence; and transparency. The Fund also periodically receives voting alerts from the LAPFF on certain resolutions. If the voting alert from the LAPFF conflicts with the voting service recommendation, due consideration is given to all the arguments before the vote is cast.

The Fund has appointed Wellington Management (Wellington) in a discretionary capacity to manage its directly held North American investments, including voting in line with local practice. Wellington have policies and procedures to ensure that they collect and analyse all relevant information for each meeting, applying their proxy voting guidelines accurately and executing votes in a timely manner.

A significant proportion of the Fund's assets are managed through pooled products, where the voting activity is carried out by external investment managers. These principally relate to funds managed by Legal & General Investment Management (LGIM).

Voting activity is carried out in accordance with LGIM's voting policy and is based on a set of corporate governance principles. Previous engagement with an investee company also determines the manner in which voting decisions are made and cast. Voting activity is combined with direct engagement with the investee company to ensure that the investee company fully understands any issues and concerns that LGIM may have and to encourage improvement. LGIM utilises the voting information services of ISS and Institutional Voting Information Services (IVIS) to conduct thorough analysis and research on investee companies.

The Fund expects an increasing proportion of its assets to be managed by LGPS Central Limited going forward, as assets are transitioned into its pooled products. LGPS Central Limited's Responsible Investment & Engagement Framework will be applied to both internally and externally managed investment mandates.

Copies of LGIM's and LGPS Central Limited's Stewardship Reports are presented to the Committee on a quarterly basis.

9.5 UK Stewardship Code

The Fund is a Tier 1 signatory to the Financial Reporting Council's (FRC) UK Stewardship Code 2012. A copy of the Fund's statement of compliance with the code can be found on the Fund's website at:

derbyshirepensionfund.org.uk/responsibleinvestments

The UK Stewardship Code has recently been updated (2020 Code); the updated code came into effect on 1 January 2020. The 2020 Code consists of 12 Principles for Asset Managers and Asset Owners, with a focus on the activities and outcomes of stewardship, not just policy statements.

Organisations that want to become signatories to the 2020 Code will be required to produce an annual Stewardship Report explaining how they have applied the 2020 Code in the previous twelve months. To be included in the first list of signatories, organisations must submit a final report to the FRC by 31 March 2021. The Fund intends to fully comply with the 2020 Code.

10. Transparency and Disclosure

The Fund aims to keep its stakeholders aware of RI activities through:

- Making its Responsible Investment Framework, together with the supporting Climate Strategy, public documents
- Reporting to Committee on the stewardship activities (including voting decisions) of the Fund's principle investment managers on a quarterly basis
- Providing a summary of the Fund's RI activities in the annual report
- Reporting annually using the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD)
- Reporting on progress against the RI Stewardship engagement goals every two years