Engagement & divestment: is it time for pension schemes to vote with their feet?

By Rachel Lewis

During this Paris Alignment session, the speakers investigated the theory of engagement with investee companies, explored the nuances that constitute effective stewardship and discussed how to distinguish different approaches

After a decade of engagement, the *Church of England Pension Board* recently decided to disinvest from Shell and some other oil and gas companies as a result of their inaction to decarbonise in line with the Paris Agreement.

This decision served as the springboard for a discussion at our September 2023 Paris Alignment Forum (PAF) event. Participants were:

- **Cllr Robert Chapman**, Councillor at *Hackney Council's Pension Committee* and Vice-chair of *LAPFF (Local Authority Pension Fund Forum).*
- **Laura Hillis**, Director of Climate and Environment at the *Church of England Pensions Board.*
- **Kerry King**, Director Capital Markets and Fundraising at *Accounting for Sustainability (A4S)* and Paris Alignment Forum partner.
- **Karen Shackleton**, Founder and Director at *Pensions for Purpose.*

The session looked at engagement plans and the use of escalation strategies to affect real change. It investigated the factors which determine the 'line' between engagement (actively engaging with companies on environmental, social, governance (ESG) risks and opportunities in an investment) and divestment (diverting funds away from an investment). Discussion also included the layers of stewardship and how service providers can be encouraged to optimise a stewardship approach.

Q&A

Karen Shackleton to Cllr Robert Chapman

In a Q&A discussion with Karen, Robert set out the difference between his roles at the *Local Authority Pension Fund Forum (LAPFF)* and as Chair of the *Pension Committee at Hackney Council.*

LAPFF represents members with over £300bn in assets and, rather than investing through asset managers, they deal directly with companies who make significant contributions to the running of the UK economy. Having been established for 37 years, he considers the organisation to be an early operator in responsible investment.

On the other hand, *Hackney Pension Fund* invest via asset managers and, more recently, through local government pension scheme (LGPS) pools. This has had the advantage of being able to act collectively within a bigger organisation, albeit with less control over ESG engagement. At the LGPS pool level, it can be difficult to make decisions, such as divestment, as they may not align with the views of all stakeholders/beneficiaries.

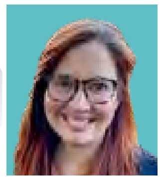
In your role as chair of *Hackney Pension Committee* (2014-2022), what has the pension fund's approach to engagement been? When may divestment be considered?

Robert explained, in general, *Hackney Pension Fund* try to avoid the term 'divestment'. Instead, they prioritise completing due diligence and research on their fund managers' approach to sustainability and openly communicate their vision and values as an asset owner prior to investment. For example, while one principle of their investment strategy is not to make decisions on moral or political grounds, they do communicate with pressure groups. They invite them to attend meetings and consider ongoing petitions to further contextualise their investment decisions. He claims that while hearing observations from pressure groups is useful, Hackney's strategic core mission is to secure future pensions. Through this balancing act, and by effective asset allocation to low carbon funds rather than divestment, they believe they have reduced their exposure to 97% of fossil fuel driven companies over six years.

Do you have an example of a company progressing their climate transition plans as a direct result of engagement?

Robert referred to ArcelorMittal – the world's second largest steel company. He highlighted there are still plenty of structural issues affecting their sustainability commitment, such as blast furnaces and navigating generational management change. However, since asking them to engage with the Energy Transition Commission at the 2018 AGM, Arcelor's CEO has become an active participant with the Commission and the subsequent engagement has built momentum in green manufacturing for the company.

Kerry King
to Laura Hillis



Can you tell us about the Church of England Pension Board's stewardship approach?

Laura noted stewardship is important for their smaller-scale pension fund (c £3.2bn assets under management). The *Church of England Pensions Board* use stewardship as a lever to address systemic risks and assert a level of influence over the economy. Taking a long-term view, and by (examining) areas where they can exert power rather than addressing entire sectors, they can account for both financial and global risks. They consider both the potential portfolio return profile and the longer-term world context their beneficiaries will retire into. For example, Laura referenced the importance of fossil fuel phase-out pathways. By engaging with companies which demand fossil fuels (such as coal, oil and gas), they use their influence, stewardship and public policy engagement to move away from reliance on fossil fuels.

How did your engagement parameters ensure the desired outcome?

Firstly, Laura explained the *Church of England Pensions Board* have a dedicated responsible investment team which is larger than many comparable pension funds. Engagement is resource-intensive given the need for stewardship professionals to know and thoroughly understand the company. As this is not viable for all pension funds, she stressed maximum engagement can still be achieved by internal clarity of purpose and strategy and external collaboration.

Next, they consider the end-to-end implications of stewardship and the systemic issues they work on. They decide which companies are the most influential and account for the 'value chains' those companies are associated with (such as products they buy or the public policy contexts they sit within). Similarly, voting on equities and expressing their values and mission in all conversations is a reliable technique for ensuring consistent, desired results.

Laura also noted securities litigation could be important; legal strategies have a place when shareholders begin to be affected negatively.

The final tool is an escalation hierarchy that may result in divestment. This is employed as a last resort where companies do not align with the fund's expectations.

Which factors led to the disinvestment from *Shell* and other oil and gas companies?

Laura explained the financial and reputational risk of having these companies in a portfolio. As such, the *Church of England Pensions Board* set out a five-year programme of engagement with the oil and gas companies owned by the Pensions Board within equities and debt. The engagement focused on emissions reduction targets, transition plans and lobbying. Using independent analysis from the *Transition Pathway Initiative*, they were able to assess the companies against climate pathways.

Another tactic was to attempt escalations within their public collaborations – for example with *Shell* and via the *Climate Action 100+* initiative.

Ultimately, at the end of the five years, they reached the point of divestment. Laura stressed withdrawing investment from all oil and gas companies was not divestment of an entire sector, but divestment of companies with plans misaligned to limiting global warming to 1.5°C. This means the *Pensions Board* is open to investing in companies that realign their plans with 1.5°C limits.

Do you have any suggestions for members without the resources for a dedicated stewardship team?

Laura suggested:

1. Collaborative engagement with other investors to bring in expertise across fields and use time most effectively.
2. Clearly outline how you work with asset managers to achieve your stewardship goals.
3. Where possible, bring voting in-house. Despite being resource-intensive, it ensures consistency in the stewardship approach.
4. Carefully choose the issues most financially material to your beneficiaries, rather than attempting to achieve many goals at a lower level of commitment.

Audience Q&A

Member question

On a long enough timescale, can ethical and financial issues be separated?

Robert and Laura agreed framing divestment against engagement is unhelpful as they are not mutually exclusive. Instead, Laura posited 'divestment after engagement' as a more beneficial conversation.
In fact, and arguably the takeaway of the event, employing both approaches can be highly effective. Divestment can also create time and space for greater engagement elsewhere. Likewise, with divestment an option on the table, a company may be more likely to respond to engagement.

Similarly, talking to the stranded assets argument, Robert highlighted the financial risks of investing in less ESG-focused causes. Both speakers refer to the helpful, priceable risks that can be attributed to environmental and social causes, such as the risk of litigation and reputational risk. While a company could transition away from oil and gas investment towards climate change mitigation, Laura argued there is currently not enough progress from companies in the sector. This makes it easier to justify engagement in the scenarios where divestment is not possible.

However, Laura argued the first aim should be to create strategic, targeted engagement approaches with companies you can meaningfully influence.

Insights

After breakout room discussions, delegates returned to share some main insights:

- More collaborative engagement with policymakers, regulators and asset managers is needed to bring change.
- Investing in other companies, rather than divesting, adds pressure on less sustainably driven players.
- Escalation policies do not have to end in divestment.
- It is important to involve board-level decision-makers and the more detailed-oriented players, who have influence over the specific actions a company takes.

Currently, the time frame for engagement is not keeping pace with the urgency to reach climate goals.

Conclusion

Stewardship is a nuanced approach with many routes to achieve the desired outcomes. Whether it is voting, one-to-one-engagement or divestment, it is evident for investors to contribute effectively to a better future, stewardship cannot be approached as one-size-fits-all.

Click to read the synopsis and watch the recording of the event.

Rachel Lewis is Event Coordinator at Pensions for Purpose.

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