

WMPF – EXPOSURE TO COMPANIES IN THE AEROSPACE AND DEFENCE SECTOR

INTRODUCTION

The West Midlands Pension Fund (“the Fund”) takes a proactive approach to responsible investment and notes the concerns raised in relation to exposure to companies operating in the Aerospace and Defence sector, linked to the ongoing conflict in Israel. We acknowledge these concerns in what is a complex and evolving situation.

This statement outlines the Fund’s approach in the context of being a global investor with its primary objective of meeting current and future member benefits and how the Fund’s responsible investment criteria is integrated across the Fund’s investment strategy.

The Fund’s approach is determined by its need to meet member benefits in line with its fiduciary duty. In recognising that the Fund operates to serve its members across the region, neither the Fund or its Governing Bodies operate on a political basis. Political views are, therefore, not considered when determining investment strategy and asset allocation decisions. The Fund does integrate financially material Environmental, Social and Governance (ESG) factors across its investment strategy. Such factors are used to appropriately manage risk and evaluate investment opportunities. The Fund’s investments are not led by ethical or moral principles.

BACKGROUND – THE FUND’S ARRANGEMENTS

The Fund is a universal asset owner that invests assets in the region of £20 billion across global investment markets. The Fund invests through a range of investment vehicles and strategies to generate return to support meeting the long-term cost of pensions payable to Fund members. Such investment strategies include low-cost passively managed portfolios that aim to replicate broader market exposure. These investments are deemed an efficient way to gain exposure to a range of companies across a variety of sectors, in line with the Fund’s fiduciary duty. This will include investment in companies that can be classified as operating within the Aerospace and Defence sector, in a proportion that is reflective of their weight in the broader market.

The Fund acknowledges the difficulties in categorising companies into certain sectors and sub-sectors which can lead to inconsistencies and difficulties in making comparisons. Companies are often multi-faceted and can be global conglomerates with complex business structures consisting of several business lines and revenue streams. Any decision to divest or exclude certain sectors or companies is therefore nuanced and requires careful consideration. The Fund makes such decisions based on the expected impact this will have on investment outcomes and the ability to meet its fiduciary duty.

THE FUND’S INVESTMENT APPROACH

In line with our stewardship beliefs, the Fund expects its investee companies to comply with relevant laws applicable in the jurisdictions in which they operate and to comply with the United Nations Guiding Principles on Business and Human Rights. The Fund currently does not apply any exclusions to its investments or have policies for specific countries, sectors or issues, but instead adopts a holistic approach to investing responsibly across its investment portfolio. Applying blanket exclusions at the portfolio level may result in more concentrated exposures and potential unintended consequences including restricting the opportunity set and limiting the Fund’s ability to generate attractive risk-adjusted returns.

The Fund integrates ESG factors across its investment strategy. As stated in the Fund’s Annual Stewardship Report and set out in its Responsible Investment Framework, social equality and human rights continue to be a priority engagement area for the Fund. The Fund actively continues to engage, monitor, and assess this, amongst other issues as part of its engagement priorities outlined in the Fund’s Responsible Investment Framework and aims to undertake the correct due diligence to serve the best interest of our beneficiaries and uphold our fiduciary duty.

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Day-to-day management, including the purchase and sale of individual positions, of the investment portfolio is carried out by third-party investment managers. Therefore, it is critical that the Fund employs investment managers that adopt strong responsible investment principles in the management of their portfolios and whose values and behaviours are aligned to that of the Fund. The Fund works with its third-party investment managers on developing their approach to responsible investing with analysis of a manager’s approach undertaken prior to appointment and monitored on an ongoing basis to ensure they remain fit for purpose and continue to enhance their approach as the market and environment evolves.

ACTION THE FUND HAS TAKEN

Since 2020 the Fund has invested in specialist “sustainable equity” mandates. As at 31 March 2024 the Fund had £1.2bn invested in these strategies. These mandates have a greater emphasis on the integration of responsible investment factors and typically have minimal exposure to companies operating in the Aerospace and Defence sector.

The Fund does not strictly divest from companies without financial rationale or without implications that will affect our ability to pay pension benefits. The Fund takes the view that being invested in portfolio companies provides opportunity to influence change and enhance the value of assets that would otherwise be lost through a divestment only approach. Engagement is undertaken with a long-term approach to address systemic issues that require a greater scale of change. The Fund collaborates with like-minded investors as one collective investor voice to invoke urgency and pressure on companies to change through partnerships with EOS at Federated Hermes, Local Authority Pension Fund Forum (LAPFF) and LGPS Central.

The Fund acknowledges the role it can play as an institutional global investor to influence company behaviour and positively influence outcomes, however, the Fund is also aware of the limitations over the level of influence it may have in certain circumstances. To date, as part of a broader human rights engagement approach, the Fund’s engagement partners have engaged with several companies on matters relating to humanitarian and human rights impacts in global conflict zones. Engagement focus has been on understanding companies’ approach to managing human rights-related risks and ensuring adherence to international humanitarian and human rights standards, which employs companies to review their own processes and policies. Engagement outcomes are presented quarterly to the Pensions Committee.

The Fund understands its position and responsibility in this matter and continues to monitor, assess, and evaluate these ongoing risks in line with the Responsible Investment Framework and quarterly disclosures to the Pension Committee.

West Midlands Pension Fund

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