

The background of the slide features a large, light blue crest of the University of Alberta. The crest is a shield with a crown on top. The shield is divided into four quadrants: top-left shows a cross, top-right shows a stag's head, bottom-left shows a sailing ship, and bottom-right shows a beaver. A banner at the bottom of the shield contains the motto 'ANNE FOR A'.

AGENDA ITEM

8

**INVESTMENT STRATEGY –
ESG UPDATE**

FALKIRK COUNCIL

Subject: INVESTMENT STRATEGY – ESG UPDATE
Meeting: JOINT MEETING OF PENSIONS COMMITTEE AND PENSION BOARD
Date: 11 MARCH 2016
Author: DIRECTOR OF CORPORATE AND HOUSING SERVICES

1. INTRODUCTION

- 1.1 This report updates the Pensions Committee and Board on environmental, social and governance (ESG) considerations arising from the review of investment strategy.
- 1.2 These matters have been the subject of discussion by the investment sub group.
- 1.3 Further legal and governmental announcements are pending and it is expected that the Committee and Board will wish to await the outcome of these developments before reaching a settled view.

2. CURRENT POLICY

- 2.1 The Fund's approach to ESG matters is set out in Section 9 of its Statement of Investment Principles (SIP). This acknowledges the Fund's obligations as a responsible investor and highlights its commitment to ensuring companies meet acceptable standards of practice with a particular focus on human rights, environmental issues and employment standards.
- 2.2 Engagement and influence takes place through the Fund:
 - having regular discussions with its Asset Managers on their own specific ESG monitoring;
 - exercising voting rights through proxy voting agents; and
 - being a member of the Local Authority Pension Funds Forum.
- 2.3 Fund policy, in general, is not to interfere in the investment decisions of Managers and to allow them to base their decisions on the risk / return characteristics of each investment opportunity.
- 2.4 Corporate governance matters of significance are reported quarterly to the Pensions Committee and Board. Managers are also monitored to ensure that they have ESG considerations embedded into their investment processes and into their evaluation of risk and return.

3. WIDER CONSIDERATIONS

3.1 The sub group considered the following aspects of the Fund's ESG obligations:

Regulatory

3.2 Funds must maintain a statement of the investment principles ("SIP") which specifies how social, environmental or ethical matters are taken into account in investment decision making.

3.3 Funds must take proper advice to ensure that their investment policy delivers a wide variety of suitable investments.

Fiduciary Duty

3.4 Pensions Committees owe a fiduciary duty to Fund stakeholders (i.e. beneficiaries, employers and tax payers) to act in their best interests putting their own personal interests and views aside.

3.5 Historically, the prevailing view has been that the interests of stakeholders are best served by Trustees pursuing the maximum financial returns for an acceptable level of risk - this being the investment principle most likely to find favour amongst widest range of stakeholders.

3.6 As bad corporate practice can impact on shareholder value and be a Fund risk, it may be a breach of fiduciary duty if Trustees do not take account of ESG issues in some way.

Legal Consensus

3.7 A number of legal opinions have been provided regarding the extent to which Trustees (and Pensions Committees) can base investment decisions on factors other than financial ones

3.8 The consensus of opinion is broadly as follows:

- Funds' primary focus should be on generating financial returns
- Investment decisions should be aimed at achieving a wide variety of suitable investments
- Excluding certain investments is acceptable so long as:
 - financial returns are not harmed
 - the Fund is continuing to invest in a wide variety of investments
 - proper advice as to the financial consequences of exclusion has been taken
 - the non-financial aims giving rise to the divestment or exclusion are shared by the majority of stakeholders

Divestment

3.9 The Fund periodically receives representations from lobbyists to refrain from investing in certain assets on ethical grounds (e.g. fossil fuel, tobacco and arms).

3.10 The main arguments against divestment are:

- Fund's primary focus should be to maximise returns
- Risk of legal challenge from members, employers and taxpayer groups
- Investment risk is best controlled by having the broadest diversification
- Excluding one sector increases the pressure to exclude others, resulting in a shrinking investable universe

- Divestment removes the chance to influence corporate practice in that sector
- Other less socially responsible investors may simply replace the divestment, quite possibly at an attractive share price

3.11 Set against 3.10, an investment policy that gives Managers a “free hand” carries the risk of reputational damage from being invested in contentious shares. Some investments may also be at odds with public policy initiatives (e.g. health).

4. CURRENT DEVELOPMENTS

4.1 Several important pronouncements are expected in the coming months on the extent to which Funds can take non-financial factors into account when formulating investment policy. These are:

- a legal opinion commissioned by the Scottish Scheme Advisory Board
- the UK Government response to a consultation on Occupational Pension Schemes Investment Regulations
- pending amendments to scheme rules in England and Wales

4.2 In view of the fact that further information on ESG responsibilities will be available later this year, it is proposed to revisit this topic at that time, and hold a training session dedicated to the subject. This need not delay implementation of other strands of the investment strategy since, if it transpired that Funds were to be given greater scope to divest or refrain from investing in certain sectors (and the Committee wished to pursue that course), it would be possible to amend investment mandates at that time.

5. CONCLUSION

5.1 Successive legal opinions suggest that a Fund’s primary goal should be to deliver the financial returns necessary to meet the ongoing cost of pensions and lump sum benefits.

5.2 There may be scope for LGPS Funds to refrain from investing in certain sectors or from investing in certain companies. However, this is subject to constraints such as ensuring that financial returns are not damaged; that the Fund continues to have a broad range of suitable investments; and that the rationale behind the non-investment is a view commonly held by the majority of Fund stakeholders.

5.3 A training event to take account of the latest developments in this area will be held later in the year.

6. RECOMMENDATIONS

6.1 **The Pensions Committee and Pension Board are invited to note the content of this report and comment as appropriate.**

- 6.2 The Pensions Committee is asked to agree that a dedicated training event be held in due course addressing the Fund's approach to Environmental, Social and Ethical matters in relation to investment decision making.

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