AGENDA ITEM 7

FALKIRK COUNCIL

Subject: **TREASURY MANAGEMENT STRATEGY 2010/11 – CONSIDERATION OF ETHICAL INVESTING**
Meeting: **FALKIRK COUNCIL**
Date: **23 June 2010**
Author: **DIRECTOR OF FINANCE**

1. INTRODUCTION

1.1 This report considers the scope for ethical investment in the Council's treasury investment strategy.

2. BACKGROUND

2.1 The Policy & Resources Committee held on 9 March considered the Council's Treasury Management Strategy for 2010/11 and the Committee agreed to refer the Report to Council for approval. The Committee also requested a Report on "the concept of an "ethical investment" element to the investment strategy by such as not investing in banks that breach the Chancellor of the Exchequer's guidance on the payment of bonuses."

2.2 Council at its meeting on 28 April considered that report and requested a further report "on the concept of an ethical investment element to the investment strategy".

3. WHAT IS ETHICAL INVESTMENT?

3.1 "Ethical Investment", or "Responsible Investment" as it is now more commonly referred, relates to investment in company shares, and may be defined as an investment strategy which incorporates the investor's environmental, social and governance (ESG) concerns as well as their financial objectives.

3.2 This is a significant dimension to the Investment Committee's management of the Pension Fund. ESG is reflected in the pension fund's Statement of Investment Principles. Rather than disinvesting, a proactive approach is taken whereby engagement takes places with problematic companies.

3.3 The Pension Fund has, as a shareholder, a number of avenues open to it to engage with companies. It can vote its shares at company meetings, engage through its Fund Managers or support work of the Local Authorities Pension Fund Forum (LAPFF) which acts on behalf of around 50 Local Government funds in the UK. The Fund's ESG considerations are supported by PIRC, a specialist adviser on these matters.

3.4 On a practical level, the Pension Fund is a shareholder in both the Royal Bank of Scotland Group and Lloyds Banking Group. In both cases the Fund had concerns at the "trigger" levels for release of executive performance related pay and as such opposed the Remuneration Reports at their recent AGM's. Of particular note, was the high level of votes cast against the RBS Remuneration Report which has resulted in the company reviewing its "trigger" level. Also, through the LAPFF, research is ongoing on levels of Executive Remuneration across the FTSE 350 companies from which further engagement with companies will take place.

4. THE SCOPE FOR ETHICAL INVESTMENT IN THE TREASURY STRATEGY

4.1 The first, and primary point, to make is that the considerations hitherto have related to the investor as a shareholder. In the case of treasury investment this, however is being done as a customer and not a shareholder. In consequence, there are fundamental differences in terms of both investor responsibilities and leverage.

4.2 The previous report identified practical difficulties in two probable key areas of interest to the Council. The first of these was bank lending, where it was noted that the dynamics of varying degrees of state ownership and revised risk assessment by banks allied to the continually shifting stances of banks made the selection of a "good" bank challenging to determine.

4.3 The other key areas was excessive bank bonuses. Here again there are difficulties in that bonuses are a feature across the whole banking sector and the position is dynamic as indicated by the introduction of a remuneration code by the Financial Services Authority and the comments at para 3.4.

4.4 It is important to note that the Treasury Strategy's primary concern is to protect the value of any investments the Council makes. This has been emphasised during the recent turmoil in financial markets. In pursuit of this primary objective the Council only lends to the very highest credit rated counterparties and with caps on the lending in terms of value and period. A consequence of this is that the number of counterparties on the approved lending list is reduced and, moreover, the Council's lending caps do not necessarily match the borrowing requirements of the banks themselves.

4.5 Members should also note that Treasury investment activity is ad hoc in so far as it is a function of cashflow which can be difficult to predict. Lending (and borrowing) in consequence are very dynamic and these decisions are being taken at an operational level on a daily basis. It should also be noted that as the Council has paid down its level of debt, the level of lending going forward is projected to be much lower.

5. CONCLUSIONS

5.1 Ethical investment is essentially related to shareholder activity and in these terms the Pension Fund is active, and not least relative to banks as noted at para 3.4. Treasury lending is a different matter as section 4 endeavoured to demonstrate, and thus the capacity to introduce an ethical framework to counterparty lending is problematic. Therefore, the best approach is to link the Council's Treasury Management Strategy to the Pension Fund's ESG monitoring which includes receiving advice from its specialist adviser, PIRC.

6. RECOMMENDATION

6.1 Council is invited to note that effective ethical investment is conducted by the Pension Fund and consequently to link the Council's Treasury Management Strategy in respect of ethical investment accordingly.

Director of Finance

Date: 8 June 2010

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LIST OF BACKGROUND PAPERS

NIL