



Agenda Item 6

Consideration of Divestment from Fossil Fuels – Pensions Committee

Falkirk Council

Title: Consideration of Divestment from Fossil Fuels – Pensions Committee
Meeting: Executive
Date: 30 November 2021
Submitted by: Director of Corporate and Housing Services

1. Purpose of Report

- 1.1 The purpose of this report is to advise the Executive of the outcome of the Pensions Committee's consideration of divestment from fossil fuels following a request by the Executive.

2. Recommendation

- 2.1 **It is recommended that the Executive notes the report to the Pensions Committee on Consideration of Divestment from Fossil Fuels (attached) and notes the outcome of the considerations by the Committee.**

3. Background

- 3.1 At a special meeting on 14 September 2021 the Executive agreed:-

- (1) that the climate emergency requires action on a just transition from the use of fossil fuels and the move towards Net Zero but that any such action should be based on properly informed decisions;
- (2) that the Pensions Committee is not asked to make a decision prior to COP26 committing it to fossil fuel divestment with the intention of divesting completely as quickly as possible;
- (3) instead the Pensions Committee is asked to give wider consideration to the question of divestment including the extent to which divestment can take place without detriment to the interests of the all stakeholders in the fund and whether continuing to hold investments provides a platform to influence companies in the fossil fuel sector to move to a just transition, and
- (4) asks that any report setting out the consideration of these issues is reported back to the Executive following discussion at the Pensions Committee recognising that this may be a substantial piece of work that comes after COP26.

3.2 A report on the considerations of divestment from fossil fuels was considered by the Pensions Committee and is appended to this report. The Committee agreed:-

- (1) to refer the report to the Falkirk Council's Executive consistent with the terms of its decision of the special meeting of the Executive on 14 September 2021;
- (2) to confirm the Fund's position on divestment as set out in paragraph 4.7 of the report; and
- (3) to instruct officers to identify a process and methodology whereby direct investments in fossil fuel companies, could be tracked in terms of effective actions by these companies consistent with the UN Paris Agreement (set out in paragraph 4.22 of the report).

4. Consultation

4.1 No consultation was carried out on this report.

5. Implications

Financial

5.1 Any financial implications are set out in the appended report.

Resources

5.2 Any resource implications are set out in the appended report.

Legal

5.3 Any legal implications are set out in the appended report.

Risk

5.4 Any risk implications are set out in the appended report.

Equalities

5.5 Any equalities implications are set out in the appended report.

Sustainability/Environmental Impact

5.6 No sustainability assessment has been completed as part of compiling the report.

6. Conclusions

- 6.1 The Executive is asked to note the outcome of the Pension Committee's considerations in regard to divestment from fossil fuels.

Director of Corporate & Housing Services

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Date: 16 November 2021

Appendix 1 - 'Consideration of Divestment from Fossil Fuels' – Joint meeting of the Pensions Committee and Pensions Board 22 October 2021

List of Background Papers:

No background papers were relied on in the preparation of this report in terms of the Local Government (Scotland) Act 1973.

Falkirk Council

Subject: Consideration of Divestment from Fossil Fuels
Meeting: Joint Meeting of Pensions Committee & Pensions Board
Date: 22 October 2021
Submitted by: Director of Corporate and Housing Services

1. Purpose of Report

- 1.1 Whilst this report has been triggered by representations from the two largest employers in the Fund, an update on the topic is in any case timely, given its interest to Fund stakeholders & the added topicality with the imminent COP 26 in Glasgow.

2. Recommendations

These recommendations flow from consideration of the two Councils' submissions related to the material set out in this report:-

- (i) The Pensions Committee & Board are invited to note the representations from the two Council employers & the content of this report**
- (ii) The Pensions Committee is invited to confirm the Fund's position on divestment as set out at para 4.7**
- (iii) The Pensions Committee & Board instruct officers to identify a process & methodology whereby direct investments in fossil fuel companies, can be tracked in terms of effective actions by these companies consistent with the Paris Agreement (see para 4.22)**
- (iv) The Pensions Committee agree that the Falkirk Council amendment is responded to in terms of para 3.3.**

3. Background

- 3.1 The appended letter dated 26 July has been received from Stirling Council. The letter notes that Council's concerns over the climate emergency & whilst recognising the Fund's fiduciary responsibilities, advocates a course of divestment, "as soon as is practically possible".

- 3.2 It is noteworthy that the letter expects that, in addition to carbon-producing fossil fuels, divestment should extend to, “any other investments that are contributing to the climate change emergency”. This is a significant stretching of a potential divestment agenda & in this regard attention is drawn to para 4.18.6 of the report.
- 3.3 Falkirk Council considered the appended motion & amendment at its Executive on 14 September. The amendment was approved & it is proposed that this report together with today’s decisions by Pension Committee & Board are presented to the Falkirk Council Executive consistent with the terms of the Amendment.
- 3.4 The meeting will also have the opportunity to hear a short presentation from David Hickey, a Portfolio Manager with the Lothian Fund, who is a specialist in this subject area.

4. Considerations

Overview

- 4.1 The first point to make is this is a complex subject with multiple dimensions, it is important, it is sensitive & it is also very topical. Clearly, all wish to move to a more sustainable world of lower carbon and lower emissions. The issue is how best to use the capital and influence to help achieve that within the wider parameters of Pension Fund investment responsibilities.
- 4.2 Proponents of divestment argue that selling out of fossil fuel is a moral imperative. By contrast, although the Fund agrees completely with the need for rapid economic decarbonisation, it takes the view blanket divestment is too simplistic an approach for what is a complicated subject and that morally & effectively, it is better to remain invested in companies and use shareholder power to achieve **actual** change.
- 4.3 The Fund’s approach to responsible investment seeks to strike a balance between satisfying legal obligations but also promoting high standards of corporate behaviour. In relation to climate change, this involves:
- engaging with companies to reduce emissions;
 - working with like-minded investors to help shape national policies;
 - using collective financial strength to force change in company behaviour;
 - protecting jobs and communities by supporting a just transition;
 - investing in low carbon opportunities;
 - and, as a last resort, divesting

Context

- 4.4 Falkirk Council is one of eleven Scottish local authorities with a legal responsibility to administer a pension fund under the Local Government Pension Scheme (LGPS).
- 4.5 Scheme rules are made by the UK and Scottish Governments. Rules include a requirement for Funds to hold a wide variety of investments and for Funds to take “proper advice” from investment specialists.

- 4.6 In addition to Falkirk, around 30 other employers, including Stirling and Clackmannanshire Councils participate in the Fund. Consequently, although Falkirk is the largest employer and legal administrator, the Fund must be viewed as belonging to all its employers and members.
- 4.7 The Council has delegated pension fund business to a Pensions Committee. The Committee sets the investment strategy and the principles to be followed when making investments. This includes the following principle:
- “Committee believes it should exercise its ownership rights in a responsible way, constructively engaging with companies to reduce risk, rather than divesting..... [However} where material risks remain following engagement activity, we ultimately retain the ability to divest by selling out from any position.”**
- (Extract from Fund’s Statement of Responsible Investment Principles).
- 4.8 The Fund pays out around £80m in benefits each year. Where investment returns are insufficient to cover the Fund’s needs, it is employer contributions that will eventually need increased to meet the shortfall. This is against a backdrop of all these employers facing significant financial pressure.
- 4.9 To generate the necessary investment returns and to minimise investment risk, the Fund invests in a wide range of assets across various geographies and industry sectors. Depending on the choices made by the Fund’s investment managers, this can result in the Fund being invested in fossil fuel companies. The Fund also invests in certain low-cost vehicles which track indices (e.g. FTSE All Share). This inevitably results in exposure to fossil fuel companies in line with the index.
- 4.10 Currently, the Fund’s direct fossil fuel holdings (i.e. primarily Shell, BP and Centrica) are relatively small and amount to c£50m (or 1.5%) of total fund assets of £3bn.

Legal Considerations

- 4.11 Blanket divestment from a single sector or geography in response to climate change carries the risk of a legal challenge. This is because the purpose for which pension funds exist is to provide retirement benefits and not to further some other aim (no matter how well intentioned the aim). There is an important distinction between properly recognising climate change as a risk factor in investment decision-making, relative to acting with an outright purpose to mitigate climate change, the latter is not of itself a duty.
- 4.12 This view is based on case law and legal opinion, the most recent of which was provided in 2016 by specialist lawyers Pinsent Mason. This was instructed by the national Scheme Advisory Board to inform the national dialogue and facilitate a consistent approach in this area. The opinion can be accessed [link](#) on the SAB website.

- 4.13 The legal opinion and guidance issued by the SAB to LGPS Funds reaffirmed the view that to meet their fiduciary obligations, trustees (i.e. Committee members) should make the generation of financial returns their primary focus.
- 4.14 The opinion also indicated that where a decision to sell assets/divest was being made on non-financial grounds (e.g. because of climate risks), that should be done on a case-by-case basis rather than “across the board”.
- 4.15 To further reduce the risk of legal challenge, any divestment should ensure that:
- Financial returns would not be harmed
 - Professional advice is taken to consider wider financial consequences

Is Divestment Effective?

- 4.16 It is important to stress that selective divestment is already part of the Fund’s overall strategy and will be applied if, following engagement, it is clear that a company has no credible strategy to deal with climate risk. Specific examples of the type of activity that should be a focus of review are:-
- cessation of lobbying against climate mitigation measures
 - removal of link between executive compensation and fossil fuel exploration
 - a reduction in investment in projects not consistent with a below 2°C scenario
 - substantial short-term commitments to renewables
 - additional disclosures
- 4.17 The Fund’s approach, which forms the basis of its Statement of Responsible Investment Principles, has been agreed by the Pensions Committee and endorsed by the Pensions Board. (refer para 4.7)
- 4.18 In addition to the legal and fiduciary concerns, the following paras contain other arguments against blanket divestment:
- 4.18.1 By divesting, you cease to have any influence/vote over a company. There are now many examples where shareholder pressure has been the catalyst to get companies to adopt more carbon efficient business models. This is a continuing trend as can be seen from further resolutions being submitted this year at the AGMs of BP, Shell, Rio Tinto, Berkshire Hathaway, Barclays and others.
- 4.18.2 Selling your shares does not make the problem go away. It is a misconception that by selling out, you starve companies of capital. This is not the case. All that happens is the shares are sold to someone else eg private equity or a sovereign wealth fund, who may well have less of an environmental conscience.
- 4.18.3 Fossil fuel companies of today may be the important renewables companies of tomorrow. French oil giant Total are positioned to become one of the largest European renewable energy providers by 2030. Spanish energy company Repsol has already unveiled its strategic plan to be a major player in low carbon generation by 2030. Dong Energy (Danish Oil and Natural Gas) has transformed itself into Orsted – a leading renewable energy company. Moreover, fossil fuel companies have immense resources as well as engineering and project

management skills, and are capable of contributing significantly to the growth of renewable energy and carbon solutions. Premature divestment could therefore be counter-productive.

- 4.18.4 A blanket ban on fossil fuel may be difficult to reconcile with the significant role that oil and gas plays in the local economy through the Grangemouth complex and nationally throughout Scotland. Ensuring that jobs and communities are protected through a managed transition to net zero is an important aspect of the climate change debate and the Fund's strategy.
- 4.18.5 In terms of pure investment theory, a policy of exclusion means a rise in investment risk due to the Fund's assets being less well diversified.
- 4.18.6 Fossil fuel is only one part of the climate equation. Lots of other industry sectors contribute to emissions eg agriculture, transportation, industrial production. Equally, the environmental and social risks associated with mining raw materials for the renewables industry (e.g. cobalt, nickel, lithium) brings its own challenges. The problem is wider than fossil fuel.
- 4.18.7 The vast bulk of financing for fossil fuel projects comes from bank lending and bond issuance, not equities. Rather than divestment, the more effective strategy (as the Fund did with Barclays) is to engage with financial institutions on their lending policies.
- 4.18.8 It has to be borne in mind that an exclusions policy on fossil fuels would set a precedent for other sectors to be similarly screened out. Whereas climate is currently (and rightly) attracting the headlines, there are periods when other legitimate but controversial areas such as defence companies, tobacco, gambling and alcohol come under the spotlight and face similar pressure for divestment. Where does one draw the line and still have a viable universe of differentiated stocks from which to select?

What is the Falkirk Fund Doing Already?

- 4.19 In keeping with expectations that asset owners should try to deliver returns which are sustainable in the long term, the Fund:
- has made a £150m commitment (6% of Fund) to an environmentally themed mandate managed by experienced Swiss based asset managers Pictet. This a global mandate which mainly invests in companies whose businesses are in clean energy and water, pollution control, agriculture, forestry and other areas of the environmental value chain.
 - has made various investments in the renewables/low carbon space, including:
 - Wind Farms in Ochils, W.Loithian, Borders, Northern England and Wales
 - Solar Parks in Middle England
 - Hydroelectric Schemes / Renewable Energy Projects in North America
 - Waste to Energy re-cycling facilities in London, Wales and North East
 - Thames Tideway Tunnel – upgrade of London sewerage facility
 - High speed trains – UK, Italy and Netherlands
 - Carbon credits programme in Australasia

- is an active member of several influential multi-fund pressure groups which collectively have responsibility for over £35 trillion worth of assets:
 - Local Authority Pension Funds Forum
 - Institutional Investors Group on Climate Change
 - Climate Action 100+
- has sponsored high profile climate resolutions at AGMs (Barclays, BP) helping change company policy
- invests through reputable asset managers, including the Lothian in-house team, who screen holdings for environmental considerations
- has procured an engagement specialist to liaise directly with investee companies on a range of issues but particularly climate risk
- will refrain from subscribing to new equity and fixed income investments from companies whose business plans are not aligned with the aims of the Paris agreement

4.20 Although the Fund is committed to seeking out investments that are set to benefit from the transition to a low carbon economy, this is an area of the market that is in high demand and commanding ever higher prices. The Fund's managers are mindful that carbon friendly assets still need to represent good value for the Fund.

4.21 The level of reporting of climate risk by pension funds is being made mandatory over the course of the next two years. This should encourage the collating of more accurate emissions data and help Funds monitor their own journeys towards having net zero portfolios.

4.22 It is proposed that officers research & then devise a process & methodology which will allow the progress & effectiveness of fossil fuel companies actions to be monitored consistently with the Paris Agreement. This will relate to companies where the Fund has a direct investment rather than via an index. The potential sanction of divestment will consequently be better informed & targeted.

5. Consultation

5.1 No direct consultation is reflected in this report.

6. Implications

Financial

6.1 Climate change brings financial risks which will require to be managed by a combination of strategies e.g. close monitoring of the transition journey of companies invested in. Given the cash generative nature of some of these companies, there is a potential financial impact on the Fund resulting from divestment, particularly premature divestment.

Resources

- 6.2 There may be some resource implications flowing from Recommendation (iii).

Legal

- 6.3 There is a strong legal dimension to the matter & this is clearly set out in the report.

Risk

- 6.4 There is risk, both financial & legal, in pursuing a course of blanket divestment. There is also risk in not taking appropriate action. The Fund endeavours to strike an effective balance.

Equalities

- 6.5 There are no direct implications in this report

Sustainability/Environmental Impact

- 6.6 This is the essence of the report

7. Conclusions

- 7.1 Being invested in fossil fuel companies is a stance that is likely to attract comment & criticism due to the complexities and subtleties of the subject matter not being particularly well understood or appreciated. Despite this and balancing all its obligations, it is argued that the correct approach is one of company engagement with a divestment option as a last resort. This is deemed more effective and legally sound than sector wide divestment.
- 7.2 The Committee & Board are asked to note the report's content and in particular the unique legal and fiduciary responsibilities placed on those responsible for the governance of the Pension Fund. Also, to note the limiting legal scope that the Fund has to institute a policy of fossil fuel divestment and to recognise the positive steps being taken by the Fund in the face of climate risk.

pp. Director of Corporate & Housing Services

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Date: 14 October 2021

Appendices

- 1) Letter from Stirling Council
- 2) Motion from Falkirk Council



26 July 2021

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Dear Debbie,

Falkirk Council Pension Fund Fossil Fuels Divestment Strategy

Stirling Council Members recently supported a request to Officers to make a written request to Falkirk Council Pension Fund on the Fund's strategy for divestment of fossil fuel investments. I realise that the pension fund will have received many requests on this subject from a number of parties, as the concern over the climate change emergency gathers pace. Stirling Council has already very clearly stated its recognition of the climate emergency, and addressing it is one of the Council's absolute priorities, and as one of the larger employer members of the Fund, we would expect that Falkirk Council Pension Fund has a strategy in place to divest from investments that are associated with carbon-producing fossil fuels, or indeed any other investments that are contributing to the climate change emergency.

The Council is aware that the Fund has clear fiduciary responsibilities towards Fund members and beneficiaries, and it recognises that full divestment cannot be achieved overnight. However, we are also aware of the risks of not divesting from these investments, as the world increasingly and quickly moves towards reliance on sustainable fuel sources. As an organisation with a strong social responsibility, the Council would expect that the divestment strategy will have the objective of achieving divestment as soon as is practically possible.

Accordingly, I would ask that the Fund provide Stirling Council with a clear and detailed response on what Falkirk Council Pension Fund's strategy is for fossil fuel divestment, including timescales for achieving the ultimate divestment aim. If you would like to discuss any aspects of this request, please do not hesitate to contact me.

Yours Sincerely,

Jim Boyle
Chief Finance Officer

Motion referred to the Executive under Standing Order 31

The following motion was referred from Council to the Executive on 24 August 2021. Discussion was continued to this meeting.

Falkirk Pension Fund

Council recognises that the Falkirk Pension Fund supports low carbon initiatives through its direct investment portfolio, but is concerned that the Fund retains large holdings in fossil fuel industries that are driving the climate and ecological emergencies and perpetuating global inequalities;

Council notes the Council's fiduciary duty as administering authority for the Falkirk Pension Fund must be paramount in all decision making around the pension fund;

Council notes the calls made over many years from campaigners on the issue of fossil fuel divestment and notes that many other major public and private institutions have already made and acted on commitments to fossil fuel divestment, demonstrating leadership on the climate emergency at the same time as protecting the long-term interests of their individual investors;

Council believes that in the year of the COP26 climate summit, when the eyes of the world will be on Glasgow we, Falkirk Council, must show climate leadership;

Council therefore resolves to ask the Pension Committee to make a formal commitment to fossil fuel divestment prior to COP26, with the intention of divesting completely as quickly as possible, and no later than 2030; and that it further considers how it can reinvest the Pension Fund Members' hard-earned money to drive a green recovery for the Falkirk council area;

Council notes that the newly created post of Climate change co-ordinator which will play a key role in identifying opportunities for investment, from potential investors including the pension fund, in to the transformational projects required to deliver a green transition and recover from the pandemic, and

Council notes that the oil and gas industry supports up to 135,000 jobs in Scotland and that these jobs are particularly important in and around Grangemouth. Council believes in a managed transition away from fossil fuels and a just transition for those employed by the oil and gas industry. This Council further notes that many of those companies that would be classified as 'fossil fuel' companies are also those which are making significant investments into the Research and Development of new clean technologies.

Proposed by Councillor Garner

Amendment

In place of the motion I would ask the Executive to agree:

1. That the climate emergency requires action on a just transition from the use of fossil fuels and the move towards Net Zero but that any such action should be based on properly informed decisions;
2. That the Pensions Committee is not asked to make a decision prior to COP26 committing it to fossil fuel divestment with the intention of divesting completely as quickly as possible;
3. Instead the Pensions Committee is asked to give wider consideration to the question of divestment including the extent to which divestment can take place without detriment to the interests of the all stakeholders in the fund and whether continuing to hold investments provides a platform to influence companies in the fossil fuel sector to move to a just transition; and
4. Asks that any report setting out the consideration of these issues is reported back to the Executive following discussion at the Pensions Committee recognising that this may be a substantial piece of work that comes after COP26.