

PENSION COMMITTEE

MINUTES of a meeting of the Pension Committee held at County Hall, Lewes on 20 July 2022.

PRESENT Councillors Gerard Fox (Chair) Councillors Ian Hollidge,
Paul Redstone, David Tutt and Georgia Taylor

ALSO PRESENT Ian Gutsell, Chief Finance Officer
Sian Kunert, Head of Pensions
Russell Wood, Pensions Manager: Investment and
Accounting
William Bourne, Independent Adviser to the Pension
Committee
David O'Hara, ISIO
Charles Pringle, ISIO
Leah Worrall, ISIO
Tim Gooding, Baillie Gifford
Amy Anderson, Baillie Gifford
Roisin McGuire, Barnett Waddingham
Paul Freedman, Pensions Investment Analyst
Mya Khine, Pensions Accountant
Dillon Piggott, CIPFA Trainee
Elitsa Iskrenova, Pensions Accounts Assistant
Bekki Freeman, Solicitor
Martin Jenks, Senior Scrutiny Advisor
Thea Synnestvedt, Governance and Democracy Officer

Councillor Nick Bennett
Ray Martin, Chair of the Pension Board

20. MINUTES

20.1 The Committee discussed disruptions at County Hall which had taken place the previous day. The Committee RESOLVED to allow press only into the meeting to avoid further disruptions noting that the meeting would be webcast to the public.

20.2 The Committee RESOLVED to agree the minutes of the meeting held on 17 June 2022 as a correct record.

21. APOLOGIES FOR ABSENCE

21.1 There were no apologies for absence.

22. DISCLOSURE OF INTERESTS

22.1 There were no disclosures of interests.

23. URGENT ITEMS

23.1 There were no urgent items.

24. BAILLIE GIFFORD - GROWTH EQUITIES PRESENTATION (TRAINING ITEM)

25.1 The Committee received a presentation from Baillie Gifford regarding the place of growth equities in the current inflationary environment.

25.2 The Committee discussed a range of issues including:

- Baillie Gifford's Paris-Aligned portfolio – The Committee discussed the inclusion of amazon.com, Rio Tinto and CRH in the Paris-Aligned portfolio. Tim Gooding, Baillie Gifford, updated the Committee that amazon.com were ahead of their target to become net zero by 2040, including scope 3 emissions. Rio Tinto and CRH produced materials essential for renewable energy, e.g., copper and so remained in the portfolio. However, it was noted that Baillie Gifford had recently voted against Rio Tinto's climate plans. The portfolio had a two-stage screening process, with the first step being to exclude fossil fuel companies. Baillie Gifford noted that the portfolio did have a carbon budget, but they would not be investing in fossil fuel companies as this is a growth portfolio and they saw no long-term sustainable growth predicted in this industry.
- Engagement – The Committee discussed the efficiency of engagement noting that this will depend on the size and length of the holding. Baillie Gifford fed back that it was therefore beneficial to invest assets for a longer period of time and hold larger shares and that they generally hold around 10-20% of a share.
- Healthcare – The Committee discussed opportunities for healthcare investments, noting that many healthcare companies rely on patents, which lose value over time. However, many of these companies remain in business due to their reputational success, such as the success of the covid-19 vaccination created by Moderna. The majority of new healthcare companies also operated as data/software companies which enabled investors to better predict their future outcomes.
- Exposure to China – Chinese regulation places limits on overseas ownership of Chinese companies. Foreign exposure to Chinese industries, such as the tech industry is therefore often done through Chinese Cayman Shell Variable Interest Entities which are traded by investors on US exchanges in a similar manner to American Depositary Receipts (ADRs), although they are not ADRs.. Recent Chinese regulatory measures had however been amended to facilitate further cross-border regulatory co-operation. It was noted that holding Chinese Cayman Shell Variable Interest Entities posed a risk due to the nature of the ownership and it was difficult to engage with companies regarding their stewardship processes when owning a stock through an offshore vehicle. The Committee noted that Baillie Gifford had previously had a high exposure to China, which had reduced in recent months, with current exposure totalling 6-7% of the portfolio. Baillie Gifford had recently opened offices in Shang Hai which enabled them to get better traction in the Chinese market.
- The Committee discussed Baillie Gifford's position on volatility versus cumulative return and it was noted that Baillie Gifford would provide further information regarding their position.

25.3 The Committee RESOLVED to note the report.

25. BARNETT WADDINGHAM - INFLATION AND FUNDING POSITION PRESENTATION (TRAINING ITEM)

25.1 The Committee received a presentation from Barnett Waddingham regarding the 2022 valuation assumptions.

25.2 The Committee discussed the potential impacts of increased inflation rates, including the impact of Brexit and the impact of climate change on life expectancy. The Committee discussed the assumptions that would drive contribution rates including pension increases link to CPI, Salary increase assumptions and the discount rate assumptions linked to anticipated investment performance and although the initial results had not yet been run it was noted that it the expectation was the Fund may reach 110 per cent funding level at a whole fund level, which compared favourably with other Funds. The Committee was supportive of the approach for stability of contributions, as the first three years' experience would not necessarily reflect the average long-term assumptions due to high inflation experience and stability of contributions for employers is important in a period of financial pressure.

25.3 The Committee RESOLVED to note the report.

26. INVESTMENT REPORT

26.1 The Committee considered a report providing an update on the investment activities undertaken by the East Sussex Pension Fund.

26.2 The Committee discussed the progress made by the Fund over the last 6 months to reduce carbon emissions, with a greater focus on energy transition and sustainable investments. The Fund is currently in a market leading position for sustainable investment which would help drive long term performance. However, in the short term there had been a significant impact on the performance of the Fund, much contributed to by the situation in Ukraine due to the Fund's limited exposure to fossil fuels and value stocks.

26.3 The following Motion was proposed by Councillor Taylor and seconded:

- *Note that the Fund has already made much progress as a climate friendly fund, and that several of the Fund managers are taking concrete steps to minimise exposure to fossil fuel assets, but more needs to be done.*
- *To fully divest from the top 200 publicly-traded fossil fuel companies (including any commingled funds that include fossil fuel public equities and corporate bonds) within 5 years, and that officers and advisers will explore a safe and prudent pathway towards this divestment over the next five years, bearing in mind the Fund's fiduciary responsibility to its members.*
- *To develop a policy around engagement that sets out possible escalations if engagement is unsuccessful.*

26.4 The Committee considered a number of arguments for the divestment of investments held in fossil fuel companies, including:

- The Climate Act requires all Councils to reach net zero by 2050 and so the Fund should comply with the requirements the Act.

- Engagement with fossil fuel companies is not progressing at the desired speed and the Fund is not investing in renewable energy on the scale needed. An engagement policy is required to ensure that clear policy objectives are outlined for when companies do not comply with the standards of the Fund.
- Fossil fuel companies continue to extract oil as well as exploring new extraction opportunities. It would therefore be important to clearly demonstrate to the sector that this would not be tolerated and does not comply with the standards of the Fund. If the Fund were to publicly state its concerns regarding fossil fuels and global warming it would demonstrate a stand against the sector with the potential to generate wider action.
- By making a commitment to divest over the next 5 years, the Fund can carefully consider its fiduciary duty and options for new investment pathways. Investing in sustainable growth funds would be essential to ensure positive returns over the longer term.
- The largest impact of divestment would be now. The current inflationary environment and energy crisis has caused a rise in fossil fuel shares over the last years. The Fund has also made significant changes to its portfolio already which would mean divestment would be less of a risk now than previously.

26.5 The Committee considered a number of arguments against the divestment of investments held in fossil fuel companies, including:

- The Fund operates under guidance from Government departments including the Department for Levelling Up Housing and Communities and the Department of Work and Pensions (DWP) and investment advisors, none of which advise divestment and so, operates fully within the law and in line with national government requirements.
- Impacts of the changes made to the Fund's sustainability over the last six months were beginning to emerge. However, until the real impact could be assessed it would not be prudent to make significant changes to the portfolio until the impact of the current implementations were clear.
- The Committee discussed the Fund's engagement policy noting that this had been successful in changing corporate behaviours. An example of this is Ruffer, whom in 2020 undertook engagement with Exxon Mobil whom at that time was not willing to make Ruffer's proposed amendments. Ruffer consequently divested from the company and has focused on investing further in renewable energy companies instead.
- Energy companies will play a significant part in the renewable energy transition. Equally, fossil fuels remain a part of the supply chain involved in creating renewable energy sources and infrastructure. As a result of engagement, many of these companies are working to make the transition to becoming an energy company rather than a fossil fuel company and as such, require support in their transitional period. By way of example, BP targets 50GW renewable energy capacity by 2030, Total 35GW by 2025 and Equinor is aiming for around 15GW by 2035. The renewable technologies that such companies seem particularly well-suited to contribute to, and are demonstrably engaged in, include: closed loop geothermal, offshore wind, floating offshore wind, hydrogen electrolysis, and Carbon Capture and Storage.
- The Fund is part of the ACCESS pool and therefore, to divest, investments would have to be taken out of the pool in order to cut fossil fuel investments, which would be against government direction to pool LGPS assets. Although the Fund's exposure to fossil fuel is low, the relevant remaining asset classes are less likely to have fossil fuel free options

as the Fund has already removed fossil fuels from equities which is the first asset class to offer sustainable alternative.. The Fund would need to go through segregated mandates to implement such a strategy, with details of the costs being unknown.

26.6 The Committee was advised that divestment was likely to have significant financial implications for the Fund and it was recommended that a detailed analysis be completed to review the implications of a potential divestment policy to ensure the Fund was able to comply with its fiduciary duties. Early evidence suggested that divestment had not been an effective approach as this enabled ownership of oil and gas companies to move into private ownership, which could result in less scrutiny.

26.7 William Bourne, Independent Adviser to the Pension Committee fed back that it remained important that the Committee is consistent with their fiduciary duty and have considered proper advice from investment advisors before making decisions. A full divestment policy would not be consistent with the Committee's fiduciary duty as the Fund's portfolio should remain diversified, with the opportunity to invest in fossil fuel companies if required. Investment managers are responsible for driving engagement and it is down to the managers to divest if the engagement process is unsuccessful. A Motion passed by the Committee to divest would need to evidence that the implications do not include any financial detriment and would require majority support from members of the Fund, neither of which could be evidenced at this point in time.

26.8 The following amendment was proposed by Councillor Fox and seconded:

26.9 *The Committee resolves to ask officers and the Fund's external advisers to conduct a piece of work concurrent with the completion of the triennial valuation which:*

1. *Assesses the fiduciary and legal consequences of fossil fuel divestment for the Fund;*
2. *Examines how such a move aligns with relevant guidance and advice;*
3. *Explores how practical an act it would be within the context of the ACCESS pool; and*
4. *Reviews evidence on the efficacy of such an approach in promoting the energy transition.*

26.10 The amendment was put to the vote and the Committee RESOLVED to agree the amendment. The Committee noted that it would be essential to look at a range of different sources when reviewing evidence in relation to divestment. The report should be completed in line with the triannual valuation and reported to the Committee in quarter 2 of 2023.

26.11 The following amendment was proposed by Councillor Tutt and seconded:

In principle, propose to divest from all fossil fuel companies excluding utility companies and to use that money to invest in green infrastructure funds subject to advice from the Fund's professional advisers.

26.12 The amendment was put to the vote and LOST.

26.13 The Committee RESOLVED to:

- 1) note the Investment Workplan (appendix 1);

- 2) note the Quarterly Investment Report from the Investment Advisor, Isio (appendix 2)
- 3) note the investment strategy review (appendix 3) and agree the following amendments to the implementation plan for the investment strategy:
 - maintain the absolute return mandates until the infrastructure equity mandate is drawn;
 - to continue using the corporate bonds to fund the new diversified credit mandate;
 - retain the index-linked gilt allocation over the short term;
 - trim the core property exposure and hold this in index linked gilts until decision made on inflation-linked property;
 - re-visit the case for inflation-linked property in the current environment ahead of implementing the strategic allocation.
- 4) note the equity performance and investment outlook considering investment style and exclusions;
- 5) note the update on the Carbon footprint of the Fund;
- 6) note the Q1 Engagement Report (appendix 4);
- 7) approve that officers make a submission of the Stewardship Code to the Financial Reporting Council (FRC);
- 8) note the External Assurance report update;
- 9) note the ACCESS update;
- 10) delegate authority to the Chief Finance Officer to take all necessary actions to give effect to the implementation of the above recommendations; and
- 11) to ask officers and the Fund's external advisers to conduct a piece of work concurrent with the completion of the triennial valuation which:
 - assesses the fiduciary and legal consequences of fossil fuel divestment for the Fund;
 - examines how such a move aligns with relevant guidance and advice;
 - explores how practical an act it would be within the context of the ACCESS pool; and
 - reviews evidence on the efficacy of such an approach in promoting the energy transition.

27. EXCLUSION OF THE PUBLIC AND PRESS

27.1 The Committee RESOLVED to exclude the public and press from the meeting for the remaining agenda item on the grounds that if the public and press were present there would be disclosure to them of exempt information as specified in paragraph 3 of Part 1 of the Local Government Act 1972 (as amended), namely information relating to the financial or business affairs of any particular person (including the authority holding that information).

28. INVESTMENT REPORT

28.1 The Committee considered a report providing an update on the investment activities undertaken by the East Sussex Pension Fund that are considered exempt under the Local Government Act 1972.

28.2 A summary of the discussion is set out in an exempt minute.

28.3 The Committee RESOLVED to agree the recommendations as set out in the report.

29. ESG IMPACT ASSESSMENT

29.1 The Committee considered a report providing a review on the investment managers' Environmental Social and Governance activities.

29.2 A summary of the discussion is set out in an exempt minute.

29.3 The Committee RESOLVED to agree the recommendations as set out in the report.

30. CLIMATE CHANGE AND CARBON FOOTPRINT

30.1 The Committee considered a report providing an update on the Carbon footprint of the East Sussex Pension Fund's liquid investments and the exposure to fossil fuel companies.

30.2 A summary of the discussion is set out in an exempt minute.

30.3 The Committee RESOLVED to agree the recommendations as set out in the report.

31. OCCUPIED TERRITORIES REPORT

31.1 The Committee considered a report providing an update on the exposure and engagement activities in relation to investments within the occupied Palestinian territories.

31.2 A summary of the discussion is set out in an exempt minute.

31.3 The Committee RESOLVED to agree the recommendations as set out in the report.

The meeting ended at 4.45 pm.

Councillor Gerard Fox (Chair)