

# East Sussex Pension Fund: Responsible Investment

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# Agenda

- Background
- Fund's approach
- Key themes
- Potential next steps

# What is responsible investment?



*Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and governance factors, and of the long-term health and stability of the market as a whole. It recognises that the generation of long-term sustainable returns is dependent on stable, well-functioning and well governed social, environmental and economic systems.*

UNPRI, [What is responsible investment?](#)

***“Responsible investment isn’t about changing the world; it’s about understanding how the world is changing and how companies will be affected”***

*Jane Ambachtsheer, Mercer*

# Ethical investment is different

- Ethical Investment is an approach to investment that seeks to directly impose the beliefs of the investor on assets held through the imposition of exclusions or limitations.
- The difference between Responsible Investment and Ethical Investment is the difference between “Value” and “Values”



# Material environmental, social and governance factors

| ENVIRONMENTAL            | SOCIAL                | GOVERNANCE             |
|--------------------------|-----------------------|------------------------|
| Climate Change           | Stakeholder relations | Board Structure        |
| Resource scarcity        | Supply Chains         | Accounting & Audit     |
| Water Availability       | Working Conditions    | Executive remuneration |
| Greenhouse Gas emissions | Diversity issues      | Bribery & Corruption   |
| Pollution                | Health & Safety       | Shareholder rights     |
| Energy efficiency        | Population Growth     | Transparency           |

**Differentiate between systemic and operational risks**

# ESG - Timeframe matters

## **Systemic risks:**

Potential long term impact, but can be influenced by shorter term changes

## **Operational risks:**

Potential shorter-term impact

# RI in equities

## Can be divided into two main strands:

### Sustainable Investment

- Understanding the level of ESG analysis carried out by managers, and the integration of this analysis into the research/portfolio construction process
- More relevant for certain investing styles than others – the more concentrated and long-term/lower turnover the approach, the more relevant ESG analysis becomes (doesn't apply to passive)

### Governance & Stewardship

- Investors, as owners of the underlying businesses, have a responsibility to act as effective stewards of these companies; clients, as ultimate owners, should accordingly monitor managers' behaviour
- Applicable to all equity managers, although managers with bigger shareholdings and influence (such as passive managers) arguably have a greater responsibility

# RI in fixed income

- Ethical investing – mainly driven by negative screens (alcohol, armaments etc.)
- Bond investors no voting rights so arguably less impact on governance and stewardship than equity investors however engagement does occur
- Role is protecting client's interests as creditors – covenant change, input to re-structuring
- Bond managers responsible investment policies generally have evolved from their equity model
- Sustainable investing – driven by positive screens focussing on products/services with positive social benefit e.g. social housing
- Key is knowing the level of E, S and G taken into account in the decision making process – how much weight is applied to these factors?
- Some managers assign an 'ESG score' as input to credit analysis, others adopt a more informational approach



# RI in real estate

- Property has a visible impact on the environment, consuming resources in both its construction and ongoing use
- Legislation from 1 April 2018 impacting the ability to let property with an EPC rating of F or G
- Responsible Property Investment can reduce the costs of occupation, thereby making buildings more attractive to potential tenants
  - Resource usage
  - Energy procurement
  - Waste reduction
- Sustainability characteristics of a building/portfolio can be measured
  - Global Real Estate Sustainability Benchmark (GRESB)
  - Building Research Establishment Environmental Assessment Method (BREEAM)

*Responsible Property Investment [document](#)*

# Myners Principle 5: Responsible ownership

“Trustees should adopt, or ensure their investment managers adopt, the Institutional Shareholders’ Committee Statement of Principles on the responsibilities of shareholders and agents.

A statement of the scheme’s policy on responsible ownership should be included in the Statement of Investment Principles.

Trustees should report periodically to members on the discharge of such responsibilities.”

# Institutions for occupational retirement provision

- Environmental, social and governance factors as referred to in the UN Principles for Responsible Investment are important for the investment policy and risk management systems of IORPs. Member States **should require IORPs to explicitly disclose where these factors are considered in investment decisions and how they are part of their risk management system.**
- IORPs should, as part of their risk management system, produce a risk assessment for their activities relating to pensions. That risk assessment should also be made available to the competent authorities and should, where relevant, include, inter alia, **risks related to climate change, use of resources, the environment, social risks, and risks related to the depreciation of assets due to regulatory change ('stranded assets').**

Wording from 2016 IORPII

# Law Commission Report & Fiduciary Duty

- “The most important distinction is between the factors relevant to increasing returns or reducing risk (financial factors) and those which are not (non-financial factors)”



**Test 1** - Trustees should have good reason to think that scheme members would share their concerns

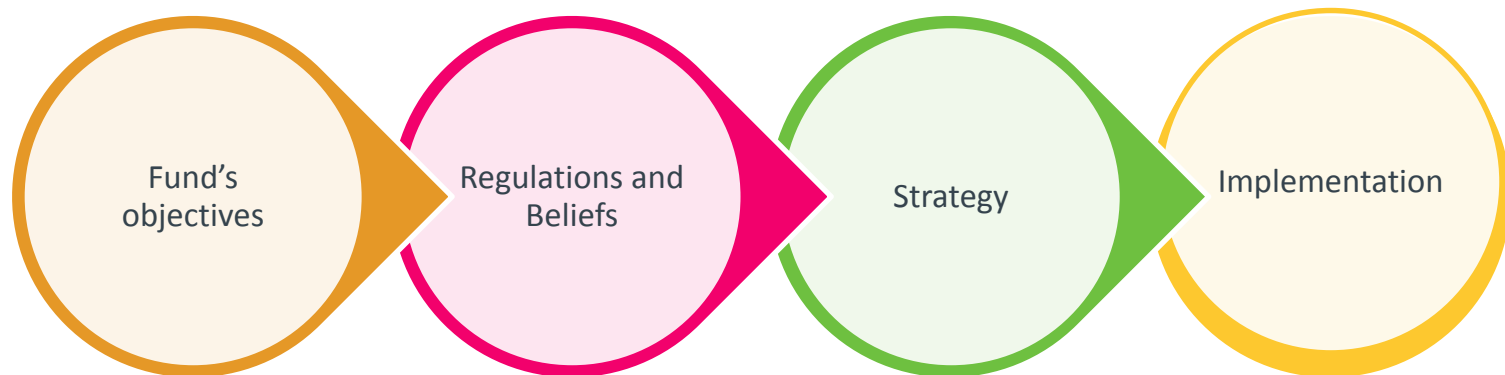
**Test 2** - The decision should not involve a risk of significant financial detriment to the Fund

# Fund's focus to date

- Regularly considered by Pensions Committee
  - Last discussed at Q1 2016 Committee meeting;  
and
  - Annual strategy day
- Agreed policy in place (SoIP) and Myners
- Collective engagement: Fund a member of Local Authority Pension Fund Forum
- Fund's managers have signed up to UNPRI and UK Stewardship Code

# Fund focus going forward

- Focus of today
- Focus on Fund's key objectives
- Agree procedures and policies for future success





# Topical item: stranded assets

**MPS' PENSION FUND AT RISK  
FROM FOSSIL FUEL INVESTMENTS**

17 February 2015, The Guardian

**GREENWICH POLITICIANS SIGN OPEN LETTER  
URGING GREENWICH COUNCIL TO PULL £17M  
INVESTMENT FROM COMPANIES ASSOCIATED  
WITH FOSSIL FUELS**

NewsShopper 5 May 2015

**EXPOSED: THE WORST (AND BEST) UK  
SCHEMES FOR MITIGATING CLIMATE  
CHANGE RISK**

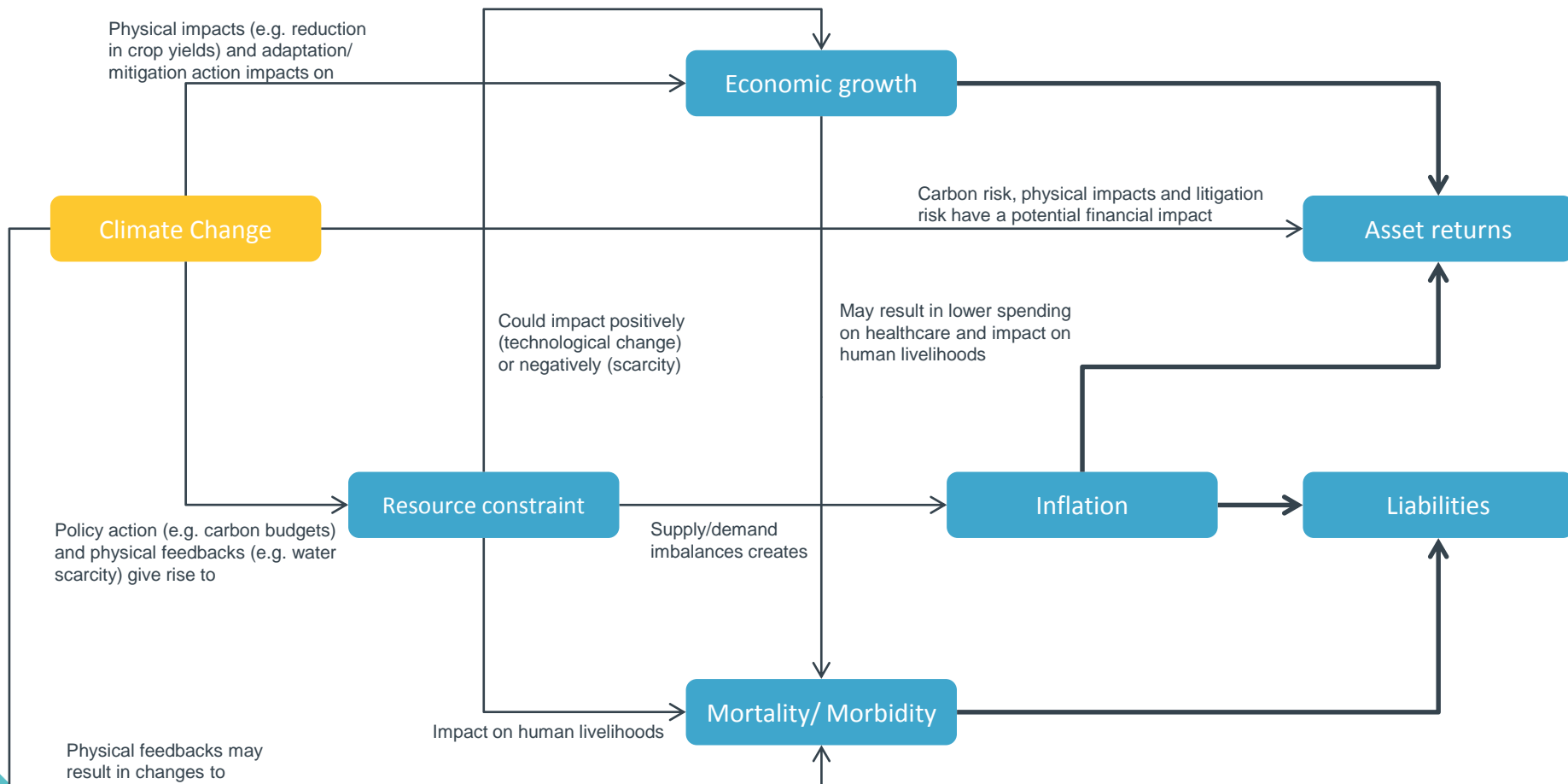
Professional Pensions 28 Apr 2015

**WEBSITE LAUNCHED TO HELP  
MEMBERS PRESSURE SCHEMES  
ON HIGH-CARBON ASSETS**

Professional Pensions 14 May 2015



# How climate change could affect pension schemes



# In simple terms

**Natural Environment**



**Real Economy**



**Financial Economy**

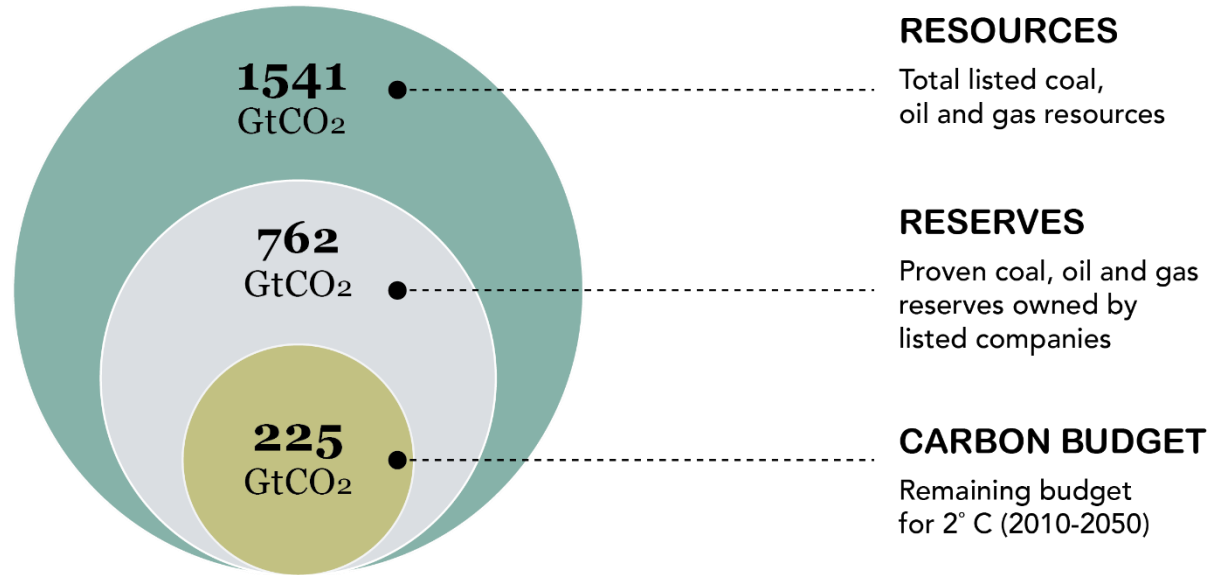


# COP21



- 21st Conference of the Parties to the United Nations Framework Convention on Climate Change. Aimed to set a new international agreement on climate change to reduce carbon dioxide emissions (“CO<sub>2</sub>”) and keep global warming below 2°C
- The agreement (not legally binding):
  - Target a temperature rise of below 2°C up to 2100
  - Emissions should peak as soon as possible
  - All countries will aim to achieve carbon neutrality in the second half of this century
  - Framework to measure, monitor & verify carbon reduction to improve transparency
  - Countries will submit updated reduction plans every 5 years
  - \$100bn per year from developed countries will be donated to support adaption and migration in least developed countries and small island developing states
- Possible implications for investors:
  - Increased regulation - identification of vulnerable industries is important
  - Introduction of new government policies - e.g. new law in France for most asset owners to disclose their carbon footprint
  - Increased focus from media & potential for continued lobbying for divestment of fossil fuels

# ESG - Current issue: Carbon risk



- If we stay within the carbon budget, some fossil fuel reserves will have to stay in the ground and have no value: “Stranded assets”
- UK target to cut carbon emissions by at least 80% of 1990 levels by 2050.
- COP21 (Paris, December 2015): Limit temperature rise to 2% up to 2100.

# What can the Fund do?

1. Understand how carbon risk could affect investments
2. Understand their carbon footprint and impact on future investment returns, risks and opportunities
3. Potentially take action to manage carbon risk

## Divest

- Remove exposure to potentially compromised investments
- Strong lobby from organisations such as 350.org
- Focus only on equities?

## Tilt

- Ex-fossil fuels indices offers an option for passive investors
- Can bias portfolios positively

## Engage

- Asset ownership conveys responsibilities on investors
- Engagement can influence corporate behaviour
- Will we see more active investors in future?

4. Challenge managers on how they factor in the risks/opportunities (dealing with obsolescence is not new)

If it can be measured, it can be managed

# Client case study



- External challenge from group of members/press coverage
- Trustees have:
  - Listened to both sides of the argument
  - Agreed not to disinvestment
  - Developed a set of investment & responsible investment beliefs
  - Agreed to disclose details of fund holdings
  - Reviewing benefits of becoming a signatory to UNPRI
  - Reviewed manager disclosures and increasing reporting
  - Challenge all their managers as part of monitoring process
  - Looking to develop an engagement policy
  - Training on other forms of active and passive management



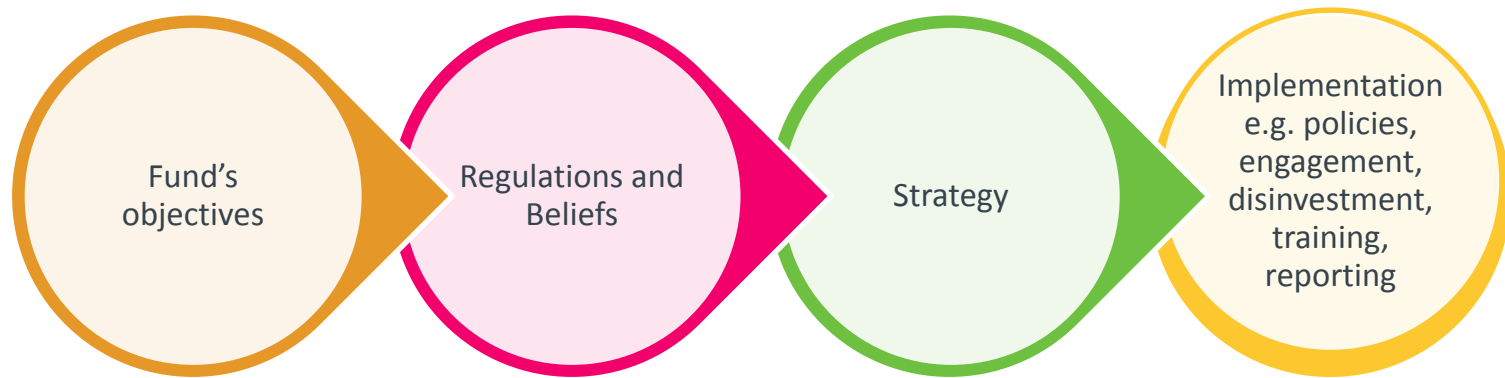
Next steps

# Range of options to consider


| Core practice  | Active practice  | Leading  |
|--|--|--|
| <p>Develop statement of investment beliefs</p> <p>Engagement with investment managers on ESG policies</p> <p>Regular reporting on manager voting and engagement activities</p> <p>Periodic training on responsible investment issues</p> | <p>Understanding/report on potential ESG risk exposures e.g. carbon</p> <p>ESG factors considered in some investment decisions, e.g. manager selection</p> <p>Support for broader industry initiatives, e.g. UK stewardship code, UNPRI</p> <p>Ongoing training e.g. carbon tilt passive</p> <p>Policies in place for key matters</p> <p>ESG form part of managers' review process</p> | <p>ESG issues embedded in all investment decision making</p> <p>Active engagement with investee companies for value enhancement</p> <p>Collaboration with other investors to create change</p> |



# Focus on objectives and beliefs



- Develop implementation plan
- Feed into pooling agenda



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Thank you

