

Report to: **Pension Committee**

Date: **4 September 2017**

By: **Chief Finance Officer**

Title of report: **Environmental, Social and Governance (ESG)**

Purpose of report: **To follow up the Environmental, Social and Governance aspects that have been discussed over recent meetings.**

RECOMMENDATION

The Committee is recommended to consider and comment on the report.

1. Background

1.1 The Local Government Pension Scheme (LGPS) regulations identify the County Council as the administering authority for the East Sussex Pension Fund (ESPF). The role of the administering authority is to manage the pension scheme on behalf of all the members of the scheme, their employers, and set the investment strategy to secure the best realistic return over the long-term, given the need to control for risks.

1.2 The ESPF invests in various company shares and bonds, property and cash around the world. The rates achievable on long term investments allow them to ensure affordable employer contributions rates, enabling authorities to spend more money on front-line services.

1.3 With reference to the Committee's previous deliberation on ESG, i.e., ethical issues and investment strategy, it is appropriate for the Committee to consider the ESG issues outlined below.

2. Fiduciary responsibility

2.1 This responsibility given to the County Council by the LGPS regulations is delegated by the Council to the Pension Committee. The members of the Pension Committee are required to act in the same way as trustees of pension schemes within other sectors of the economy and they have a fiduciary responsibility to protect the pension benefits of members by securing the best realistic return over the long-term to keep contributions affordable.

2.2 It would not be satisfactory merely to refer in a generalised way to ethical considerations being taken into account without giving an indication of how that is to be done. Such a policy will need to be limited by reference to an overriding requirement that it is not to risk material financial detriment or result in a failure to invest in a sufficiently wide range of investments. It would be appropriate to build in some regard for professional advice.

3. Consideration of ESG issues

3.1 ESG risks have a potential financial impact on long-term investors and it is appropriate that the Committee determine how they integrate ESG considerations into the fund's investment decision making. The Committee has engaged positively with ESG matters to date and, following the dedicated ESG training day and Annual Strategy day, are considering taking forward the following:

- Beliefs – agreeing additional investment beliefs which relate specifically to incorporating ESG issues into decision-making.
- UK Stewardship Code – first published in 2010, the Code is a set of guiding principles, the main aim of which is to make institutional investors, who manage other people's money, be active and engage in corporate governance in the interests of their beneficiaries.
- Carbon measurement – there are a number of ways in which the 'carbon footprint' of investment portfolios can now be measured. Further information and reporting in this area

should help improve the level of understanding and help inform future decisions in this area.

- Alternative index-tracking funds – where assets are invested on a passive, index-tracking basis, the Committee are aware that their selection of the relevant benchmark index is an important decision.

3.2 In addition, the Committee continue to meet with the Fund's investment managers on a regular basis. The questions put to the managers for discussion at these meetings frequently contain specific content relating to ESG or responsible investing considerations, and discussions have addressed the entire spectrum of ESG factors.

4. ESPF approach to ethical investments

4.1 The investment strategy of the ESPF fund is detailed in its Investment Strategy Statement (ISS) and is broadly in line with that of other LGPS funds, i.e. to secure the best realistic return over the long-term, to meet pension commitments, within an acceptable level of risk, by ensuring there is diversification across all asset classes and keeping employer contribution rates stable. The fund pursues this strategy by appointing expert specialist investment managers who have an unconstrained ability to invest within their individual mandates.

4.2 The ISS also details the fund's policy on ESG that the Fund is permitted to adopt a policy of ESG providing they treat the financial interests of scheme members as paramount and their investment policies are consistent with the standards of care and prudence required by law. The financial performance of the fund, proper diversification and prudence are paramount.

4.3 The Fund also requires their segregated fund managers to be active in their constructive shareholder engagement with companies regarding socially responsible investment issues and the proactive engagement of fund managers with these companies does influence positive change.

4.4 The Fund does not interfere in the day-to-day investment decisions of the Fund's investment managers, and does not actively invest or disinvest from companies solely or largely for social, ethical or environmental reasons. The Fund will listen to special interest groups that may oppose some of the Fund's investments, for example in tobacco, alcohol, fracking, gambling or pharmaceuticals, but are clear that this cannot detract from the Fund's duty.

4.5 In the Fund's view, simply disinvesting from a particular company is a denial of responsibility. The Fund believes that responsible institutional investors should seek to influence companies' environmental, human rights and other policies by positive use of shareholder power. The Fund does reserve the right to, on a case by case basis; apply ethical or environmental criteria to investments if it is considered relevant and appropriate.

4.6 The Fund is a member of the Local Authority Pension Fund Forum (LAPFF). LAPFF is a coalition of around 72 LGPS Funds, which seeks to engage with companies on behalf of their member funds. LAPFF actively considers the issue of ESG investments, in particular issues relating to poor labour practices, poor wage equality, the arms trade, tobacco and major oil companies.

6. Conclusion and recommendations

6.1 The cornerstone of the ESPF's policy on ethical investment is their interpretation of the legal position. The Committee should take into account ethical, environmental, governance, or any other non-commercial policy when considering investments generally or selecting fund managers. The Fund seeks to use its influence as a corporate investor to positively influence

company behaviour, although it reserves the right to apply ethical or environmental criteria on a case by case basis if considered relevant and appropriate.

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BACKGROUND DOCUMENTS

None