Report to: **Pension Committee**

Date of meeting: **25 November 2019**

By: **Chief Finance Officer**

Title: **Environmental, Social and Governance (ESG) Report**

Purpose: **To update the Pension Committee on ESG Matters**

RECOMMENDATIONS: The Pension Committee is recommended to:

1) note the Notice of Motion agreed by Full Council attached as Appendix 1;

2) agree the draft Environmental, Social and Governance (ESG) Statement of the East Sussex Pension Fund attached as Appendix 2;

3) agree the proposed specification for investment consultant advice on ESG investments attached as Appendix 3; and

4) consider how it would like to be updated on the progress of the Investment Consultant's work on ESG Investments.

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1. Background

1.1 The publication in August 2019 of the Special Report by Intergovernmental Panel on Climate Change (IPCC) Desertification, Land Degradation, Sustainable Land Management, Food Security and Greenhouse Gas Fluxes in Terrestrial Ecosystems focused public attention on the significance of systematically removing financial support from companies where industrial practices diverge with the recommendations of the Special Report. In turn, this has focused a spotlight on institutional investors and in particular public sector pension funds to influence a critical mass of financial divestment. In stakeholder mapping, the Pension Committee has ordinarily recognised its legal obligations to its members, investing the Fund's assets in order to seek returns to provide pensions for members over the long term. However, some Council Tax Payers and other members of the public are demanding accountability, under the IPCC agenda, on how the Fund should be invested, particularly in regard to companies with Fossil Fuel exposure. This added complexity, for which these stakeholders perceive is an overriding priority, over and above, the priority to provide pensions for LGPS member, is a precarious and emotive subject.

1.2 There is also a requirement that contributions by employers are stable and affordable over time and divestment in the manner described above, may decrease returns, constrain diversification and increase employers' contributions over the long term. Generating sustainable long term investment returns is the Fund's primary objective, and these objectives have been developed into a set of investment beliefs to underpin the Fund's ethical investment framework. A number of these beliefs – set out below - apply specifically to the consideration of Environmental, Social and Governance (ESG) issues and Responsible Investment (RI) in its wider sense.

- *We will apply long-term thinking to deliver long-term sustainable returns.*
- *We will seek sustainable returns from well-governed assets.*
- *We will use an evidence-based long term investment appraisal to inform decision-making in the implementation of RI principles and consider the costs of RI decisions consistent with our fiduciary duties.*
- *We will evaluate and manage carbon exposure in order to mitigate risks to the Fund from climate change.*

These beliefs are set out in the Fund's Investment Strategy Statement (ISS) and are currently under review by the Pension Committee.

1.3 As the fund continues to develop its response to ESG challenges, it has been necessary to prepare a draft ESG statement to communicate a consistent message to the increasing numbers of direct and indirect stakeholders to address questions and concerns about of the Fund's level of investment in fossil fuel companies and to demonstrate the Fund's commitment to working in accord with the provisions of the Paris Agreement. The draft ESG statement addresses these concerns and discusses engagement and divestment as mitigating measures to reduce fossil fuel exposure. The statement is attached at Appendix 2 and also exemplifies the Fund's commitment to responsible investment through voting and engagement with companies on the Fund's behalf by its investment managers.

2. Supporting Information

2.1 The Pension Committee has a fiduciary duty to ensure that long term ESG considerations including climate change are factored into decision-making. The consideration of ESG issues is relevant at all stages of the investment decision-making process; from the setting of objectives and beliefs, agreeing the high level investment strategy and detailed asset allocation; through to the appointment of investment managers and monitoring of their portfolios and engagement activities. The Fund and its Investment Managers are members of Climate Action 100+ and signatory to the Stewardship Code and the Principles of Responsible Investment.

2.2 In October 2019, the County Council received the following petition:

Divest the East Sussex Pension Fund from fossil fuels.

Investments in fossil fuels (oil, coal and gas) are damaging the balance of our climate and pose serious financial risks to investors, including many local pension holders.

Over 1,100 institutions, representing over $9.9 trillion in assets, have already committed to divest (i.e. move their money away) from fossil fuel companies.

We the undersigned call on East Sussex County Council to follow their lead and divest the East Sussex Pension Fund from its holdings in fossil fuel companies.

2.3 When submitted the petition contained 5,307 signatures. As the number of signatures exceeded 5,000 the Council's Petition Scheme allowed for the petition to be presented to, and debated by, the Full Council. The Chair of the Pension Committee was given five minutes to present his speech, the transcript for which is included at Appendix 1, addressing the concerns of the petition.

2.4 Following the debates a Motion was passed to:

1. recognise the concerns raised through the petition;

2. note that the East Sussex Pension Fund is already recognized as having a strong approach to socially and environmentally responsible investment with a below benchmark exposure to both carbon and fossil fuels; and

3. request that the Pension Committee asks its investment consultants to undertake a further investigation, with particular focus on the long term risks and opportunities to the Fund associated with climate change, and report back to the Committee on how, in the light of its need to fulfil its obligations to all pension scheme employers and members, it might further integrate ESG considerations including those relating to its approach to fossil fuel exposure, into its investment strategy.

2.5 Given the complexity of the scope of ESG, in the sense that ESG subject matter and therefore public interest is diverse and not solely confined to fossil fuel exposures, in addressing the motion, it is prudent to address ESG in a more holistic manner. Officers are therefore recommending to the Pension Committee that a specialist ESG advisor is retained to develop a richer picture on ESG matters, as opposed to a generalist approach held by most mainstream investment advisors. An outline specification is included at Appendix 3 and the Committee is recommended to agreed it.

3. Conclusion and reasons for recommendations

3.1 The Pension Committee is considering a number of options to address climate change, however, the ESG debate is much wider than climate change alone. The key imperative is to invest in a manner which aligns the desire to mitigate ESG risks with the statutory obligation to meet pension obligations over the long term. At the end of June 2019, the fossil fuel exposure was £167.8 million or 4.5% of the total assets under management. It is anticipated that with the help of specialist ESG advisers, across a range of asset classes such as equities, bonds, and real estate, the Fund will be able to better articulate its returns and ESG risks over the long term.

IAN GUTSELL
Chief Finance Officer

Contact Officer:	Michelle King, Interim Head of Pensions
Tel. No.	01273 482017
Email:	Michelle.King@eastsussex.gov.uk