Review of the approach of East Sussex Pension Fund to Environmental, Social and Governance (ESG) Issues

June 2020

1 Report Summary

1.1 PIRC has been commissioned by East Sussex County Council to conduct a review of the approach and practices adopted in managing Environmental, Social and Governance issues arising from the investment strategy of the East Sussex Pension Fund.

1.2 The review is to consider the regulatory expectations on the Fund and assess the degree of compliance. It will also consider the Fund's position on ESG matters relative to recognised best practice by funds highlighting areas where enhancements could be made.

1.3 PIRC has used its knowledge and understanding of how asset owners are responding to ESG issues and challenges to evaluate the Fund's position and identify the opportunities available.

1.4 The brief requires five specific questions to be addressed. The table below summaries the response to these questions which are detailed in the report.

Table 1 - Summary of Responses

The brief for this report details the following specific questions that need to be considered	**Summary of responses to the questions**
The Funds position in light of its need to fulfil its obligations to all its pension scheme employers and members	The Fund currently meets all of its statutory and regulatory obligations with regard to ESG. See Section 2 Recommendation 1 Conclusions 1, 2, 3 and 4
Detail any weaknesses in the current arrangements and propose a set of actions that the Fund may like to implement	Enhancements have been identified around setting ESG priorities, meeting new regulatory requirements and working with the ACCESS pool. These should complement the work underway or planned by the Fund See Sections 2, 3, 5 and 8 Recommendations 2, 3 and 13 Conclusions 5, 6 and 7
A specific focus on the long-term risks and opportunities to the Fund associated with climate change	The Fund has good understanding of climate change issues and now needs to define in detail the financial risks and how they will be managed in its strategy and implement practices to achieve its ESG priorities. See Section 4 Recommendations 4, 5 and 10 Conclusions 4, 5 and 10
How it might further integrate ESG considerations into its monitoring of the Fund	Using the Funds ESG priorities as a guide the Fund can establish its own voting guidelines and define its engagement expectations. It can then monitor the fund managers against these priorities. See Sections 5, 6, 8, 9 and 11 Recommendations 6, 7, 8, 9 and 12 Conclusions 8 and 9

How it might further integrate ESG considerations into setting the investment strategy of the Fund, including specifically those relating to its approach to fossil fuel exposure.	The Fund should continue to build its knowledge and understanding of ESG matters and commit to the new Stewardship code, TCFD reporting and build upon the carbon footprint assessment to explore alternative investments using ESG criteria. The use of a member survey and enhanced communications will provide further evidence to inform the future direction of the investment strategy. See Sections 6, 7, 10 and 11 Recommendations 11, 14, 15 and 16 Conclusions 10 and 11

1.5 The investment implications of ESG and climate change are continually evolving with the regulatory regime responding and best practice emerging. The Fund has already identified and progressed a number of actions in response. Therefore some of the recommendations in this report will quickly be overtaken by the Fund's planned actions.

1.6 LGPS funds spend varying amounts of time addressing ESG matters. Obviously, those that commit the most resources will have a greater breadth and depth to their polices, strategies and activities. This leads to some best practice activity being difficult for smaller funds to achieve with more limited resources. Even the largest of funds cannot address all ESG issues and need to prioritise what is important to them once they have meet regulatory requirements.

Working Methods

1.7 We have reviewed a range of documents produced by the Fund such as policies, strategies and committee papers as set out in Appendix 1. In addition, a number of telephone interviews were conducted with key individuals as shown below and data regarding the Fund has been analysed to identify trends and outcomes.

- Michelle King, Interim Head of Pensions
- Russell Wood, Pensions Investment Officer
- Cllr Gerard Fox, Pension Committee Chair
- Ray Martin, Local Pension Board Chair
- William Bourne, Independent Investment Adviser
- Paul Potter, Hymans Robertson
- Ian Gutsall, Chief Finance Officer
- Kevin McDonald, Interim Director, ACCESS

1.8 This report offers options on the issues the Fund can consider in meeting its ambitions on ESG matters making comparisons with leading funds. All funds have to consider what their ESG priorities are and how they resource achieving them.

Covid 19

1.9 The lockdown requirements have impacted the gathering of information and access to members and officers. In particular, the cross checking of information and conclusions has relied heavily on Pension Fund committee papers and policy documents in order to overcome the difficulties of not having face to face meetings.

Report Structure

1.10 The structure of the report is as follows:

2. Summary of Fund's position on the level of understanding of ESG issues, operating polices and setting of priorities - for meeting existing and emerging requirements

Analysis of Funds position on major ESG activities and emerging requirements follows

3. ESG polices and strategies - summary position followed by evaluation and comment upon the significant matters.

4. Climate change, fossil fuels and Taskforce on Climate-Related Financial Disclosures (TCFD) requirements

Comments on specific ESG Activity

5. Voting

6. Engagement

7. Impact/Sustainable Investing

8. Asset Pooling

9. Fund Managers' Role

10. **Communications**

11. **Resources and Governance**

12. **Summary of Conclusions**

2 Summary of Fund's position on level of understanding of ESG matters, operating policies and setting of priorities

2.1 The Fund is required to meet the LGPS investment management regulations which cover matters such as having an up-to-date investment strategy, making use of expert advisers, clearly setting out its approach to addressing ESG issues and having sufficient knowledge and understanding of investment matters amongst its members and representatives. The Fund meets the regulatory requirements as reflected in its policies and strategies. Some examples follow.

2.2 In October 2019 the Fund published its Environmental, Social and Governance Statement. This included the Funds Responsible Investment (RI) Policy and its views on climate change. It is clear this statement has been well considered and developed over a period of time which has allowed the Fund to understand many of the issues involved to a significant depth. A Statement to this level of detail is a robust starting point and demonstrates the Fund's stated aim of being a leader in this area amongst LGPS Funds. The statement reflects the fiduciary duty of the Fund to act in the best (financial) interests of its members but also recognises that ESG issues can be considered in the investment strategy where they do not lead to significant financial detriment and that this approach would be supported by members of the Fund – See Recommendation 14. It is imperative that in making these decisions the Fund can demonstrate good governance and transparency.

2.3 Pension Committee Members and officers have a good knowledge of ESG Issues which is reflected in the content of Committee agendas, the range of issues considered and depth of investigation into ESG issues. This has resulted in some very long meetings. It is evident that with this background of knowledge the Fund is now in a position to move forward with a number of initiatives to enhance its approach to ESG issues. These are identified it its latest Business Plan and work given to its advisers.

2.4 Investment performance has historically contributed positively to the Fund which has led to a strong solvency position. Net returns of 5.6% pa over the last 20 years are above average compared to their peers and show that the investment strategy and the selected fund managers have largely done a good job for the Fund over the longer term. *(Source: Local Authority Pension Performance Analytics 2019/20).*

2.5 A number of working groups have been established following a recent governance review (See 11.4) to focus on specific aspects of the Funds work plan. One of these Groups focuses on ESG issues and has spent time considering the regulations and guidance explained in Section 3. For constitutional reasons these Groups do not appear to have a formal status but due to the range of membership they provide a useful forum for debate and give direction to the Committee when agreeing policy decisions. There are no clear published outcomes from these meetings and it may improve transparency if an official record was kept and reported periodically to the Committee.

2.6 The Fund is well positioned relative to other LGPS funds on seeking to address a range of ESG issues. As part of this review PIRC has used its own model to identify where the Fund sits on the spectrum of high level ESG activity as shown at **Appendix 2**. This highlights for each asset class where ESG activity is occurring and the types of areas being addressed either via ACCESS or directly with fund managers. This has led to an assessment of the Fund against our 'ESG Depth and Breadth' model to determine a rating for each of the three levels of activity. A summary of our ratings are shown below. These are subjective assessments based upon the information gathered and the Fund can revisit this model to monitor progress over time. It is the larger funds that devote major resources to ESG matters that achieve the highest ratings.

Table 2- PIRC Assessment against the Depth and Breadth Model

Level	Score Range	East Sussex Score
Level 1 - Compliance	1 to 5	5
Level 2 - Good Practice	1 to 5	3
Level 3 - High Conviction	1 to 5	2

2.7 All funds are under pressure from many interests to do more than address the minimum requirements. The Fund is aware of this and a number of actions set out in its business plan are aimed at addressing some of them, for example the new Stewardship Code, and engagement on climate change. This will require the Fund to formulate its priorities such that they can be incorporated into the Fund's ESG practices. Table 3 below highlights a range (not exhaustive) of ESG issues which the Fund needs to consider and prioritise to inform future policies and specific approaches to matters such as proxy voting and company engagement. It is not possible to address all ESG issues and funds have to select the issues that are important to them and how they will respond e.g. company engagement, proxy voting policy, use of shareholders resolutions etc.

Recommendation 1:

a) From the broad range of ESG issues, the Committee reviews and confirms what ESG issues are a priority and those that are not and how it will respond. This will help demonstrate its ambition and inform its responses to regulatory requirements.

b) Detail on how it will respond to the issues that arise from (a) should cover policies on - engagement, avoidance of holding some assets, collaboration and positive investing in respect of its priorities.

c) A timetable should be determined for the coverage of all asset classes.

d) Outcomes from the ESG Working Group are produced and reported as appropriate to demonstrate transparency and strengthen the governance arrangements.

Table 3 - Range of ESG Issues to prioritise

<u>Climate change</u>

- Energy Efficiency
- Carbon Management
- Carbon Footprint Assessment of Equities
- Carbon Footprint Assessment of whole portfolio
- Emissions management relative to comparable organisations and government expectations
- Scenario Analysis
- Value at Risk and Actuarial Analysis
- Renewable energy investments
- Infrastructure Investments

<u>Environmental</u>

- Pollution
- Resource management

<u>Social</u>

- Human capital management and employment standards
- Impact investing
- Child Labour
- Health and safety
- Fair tax contributions

- Employee representation
- Community relationships
- Supply chain management
- Equality, etc.

Governance

- Company best practice – Structure of the Board, executive pay, reliable accounts, board diversity
- Treatment of shareholders and alignment with their long-term interests
- Governance risk relative to other investments
- Securities Litigation & Company Governance Reform

2.8 The Fund has already recognised the urgency of the need to address climate change, subsequent to the IPCC's 2019 report, in its Environmental, Social and Governance Statement.[1]. Following the Paris agreement of 2015, this report sets out the likely consequences of global warming of 1.5 degrees and the additional damage that global warming of 2 degrees could cause. To avoid this, green-house gas (GHG) emissions will not only need to drop by half in the next 10 years, they will then have to reach net-zero around mid-century.

2.9 In recognising this urgency, a key priority will be for the Fund to set out its approach to climate change in more detail, explaining how this will influence its policies and investment decisions. Such a position statement would provide clarity to stakeholders and inform the investment strategy and expectations of the fund managers. The Fund may wish to set a net zero goal which would set the stage for the Fund joining others to being 'best in class' in this regard. An example of how this can be incorporated into the Responsible Investment Strategy is shown in the GMPF policy which includes the statement 'We aim for all our investments to have net zero carbon emissions by 2050 at the latest, in line with the Paris agreement on climate change': https://www.gmpf.org.uk/about/how-do-gmpf-invest .

Other investors such as the Brunel Pension Partnership have said they plan to reduce real-world carbon emissions by 7% per annum.

2.10 Noting the large range of issues within ESG beyond climate change, the Social (S) and Governance (G) aspects encompass a broad range of issues which the Fund may feel strongly about and wish to reflect in its ESG priorities. Social issues such as employment standards, child labour and taxation, and Governance issues such as executive pay, board diversity and independent audit are common concerns across LGPS Funds and also form significant elements of the Local Authority Pension Fund Forum (LAPFF) work plan. By identifying which issues the Fund wishes to prioritise, it can then seek to influence both ACCESS and its fund managers to take certain actions and report back to the Committee on the outcomes of these actions. This is the level of information the FRC is looking to evidence in the new Stewardship Code Principles.

[1] East Sussex Pension Fund, Environmental, Social and Governance statement (including climate change)

3 ESG Polices and Strategies

3.1 The Fund has previously received reports from its investment consultants highlighting the increasing external requirements and expectations on responsible investment (RI) for institutional investors. These have been included in the Fund's planning of matters it needs to address. Whilst most are not direct statutory requirements they identify areas of good practice that many institutions are progressing and the Fund has made certain commitments to.

These include:

- The Stewardship Code (2020) – compliance with new enhanced standards
- UN Principles of Responsible Investment (PRI) – membership considerations
- Task Force on Climate Related Financial Disclosures (TCFD) - adopting reporting requirements
- Transition Pathway Initiative (TPI) - supporting positive action to address Climate Action 100+

3.2 The Fund has already produced a number of useful documents setting out its approach to ESG and RI which explain its beliefs and objectives and start to demonstrate the activities it is undertaking in achieving these aims. In particular, these documents include:

- Environmental, Social and Governance Statement (including Climate Change) Investment Strategy Statement (October 2019)
- Responsible Investment Policy
- Investment Beliefs
- UK Stewardship Code Statement
- Risk Register
- Business Plan

3.3 These documents have been updated to reflect the recent work of the Fund on developing new or additional requirements on ESG issues and provide a sound platform for the Fund to move forward. The Fund has also agreed a work plan highlighting the issues it would like to address in the year ahead. This now needs to be elaborated upon following Recommendation 1 to identify specific tasks that will help it achieve its ambitions. Significant issues to consider will be the new Stewardship Code, requirements of being a PRI signatory and various climate change initiatives which reflect the Fund's priorities.

The Stewardship Code

3.4 The new Code issued by the FRC has significantly increased the expectations on asset owners and asset managers to 'apply and explain' their stewardship objectives and how they are incorporated into the investment strategy. There are 12 Principles as shown below which the Fund must report progress against to the FRC in order to remain a signatory. The Fund has identified the need for work on meeting the requirements and is capable of achieving the requirements. In broad terms we have identified where we consider the Fund currently complies or has work to do to meet the requirements.

Table 4 - Assessment against new Stewardship Code Principles

Stewardship Code Principle	Compliance
1. Explain your investment beliefs and how effectively they have been applied	Partial
2. Explain effectiveness of governance structures in supporting stewardship	Partial
3. How potential or actual conflicts of interest are managed	Partial
4. Assess effectiveness in responding to market wide or systemic risks	No
5. How review has led to improvement of policies and practices	No
6. How the views of beneficiaries have been collected and considered	No
7. Disclose ESG priorities involved in investment decision making	Yes
8. How service providers have been monitored against the Funds beliefs	Yes
9. Disclose outcomes of engagement either directly or in collaboration	Partial
10. Explain collaborative engagement activities	Partial
11. Explain outcomes of engagement escalation	No
12. Report on voting activity and rationale for decisions (Equity and Fixed Income)	Partial

Recommendation 2: The Fund uses the outcomes from Recommendation 1 to update is policies and practices to meet the requirements of Stewardship Code Principles 1, 2, 3, 4, 5, 7 and 8.

Recommendation 3: The Fund reviews its role in collaborative engagement (LAPFF and ACCESS) and develops reporting arrangements to demonstrate the outcomes relevant to how the Fund meets the requirements of Stewardship Code Principles 9, 10 and 11.

3.5 The Fund has stated that all of its fund managers, consultants and other service providers should be committed to the new Code and become signatories at the earliest opportunity.

UN Principles for Responsible Investment (PRI)

3.6 The PRI was established to promote the role of ESG factors in financial markets. It produces research and lobbies on behalf of its signatories to ensure responsible investment is recognised by all financial market participants. Primarily it supports asset owners (such as pension funds) committed to responsible investment by encouraging adoption of the Principles and improving collaboration with investment managers and consultants. On its website it states:

> *The PRI is truly independent. It encourages investors to use responsible investment to enhance returns and better manage risks, but does not operate for its own profit; it engages with global policymakers but is not associated with any government; it is supported by, but not part of, the United Nations.*

3.7 The six Principles for Responsible Investment are a voluntary and an aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. In the table below we have set out the Principles and our assessment of how East Sussex currently compares:

Table 5 – Assessment against Principles for Responsible Investment (PRI)

UN Principles for Responsible Investment	Compliance
1. We will incorporate ESG issues into investment analysis and decision making	Yes
2. We will be active owners and incorporate ESG into policies and practices	Yes
3. We will seek appropriate disclosure on ESG by the entities in which we invest	Partial
4. We will promote acceptance and implementation of the Principles	Partial
5. We will work together to enhance our effectiveness	Yes
6. We will report our activities and progress towards implementing the Principles	Partial

3.8 The Fund has stated that all of its fund managers, consultants and other service providers should be signatories to the PRI and will continue to challenge them to demonstrate their compliance through engagement and reporting.

4 Climate Change, Fossil Fuels and TCFD Requirements

4.1 The Fund recognises the implications of climate change on the Fund's investment returns and has stated it will include consideration of climate change risks as part of setting its investment strategy. The investment implications of climate change continue to evolve and the Fund has committed time and resource to monitor these risks as they emerge and to identify investment opportunities across asset classes, amending the investment strategy when appropriate.

4.2 Whist the Fund has noted the IPCC Special Report on Global Warming 2019 and considers itself a signatory to Climate Action 100+ through LAPPF and its fund managers. It has not however specifically stated that climate change is **financially material** to its long term investment performance. Equally climate change is not included in the Fund's risk register. It would be helpful for the Fund to be more explicit in its ambitions around climate change by for example stating its support for the 'Paris Agreement' and in the context of the IPCC report setting a long term goal in line with limiting global warming to a rise of 1.5 degrees and aiming for a net zero carbon economy by 2050 i.e. *The Funds long term goal is for 100% of assets to be compatible with the net zero ambition by c.2050 in line with the Paris agreement.* (See 2.9 above)

4.3 This kind of statement provides a clear instruction to fund managers about the Fund's expectations and can be directly assessed through the managers' asset selection, voting and engagement with individual companies.

4.4 There are also a number of other initiatives that the Fund may wish to explore further and support including the Investor Agenda and the Net-Zero Asset Owner Alliance, the latter in particular, which is orientated at investors making a commitment to transition investment portfolios to net-zero GHG emissions by 2050.

4.5 In addition, LAPFF is involved in initiatives and groups including Climate Action 100+ which focuses on engagement, the Institutional Investor Group on Climate Change (IIGCC) which lobbies on policy issues, specific sectors are covered by the Transition Pathway Initiative (TPI) and the UK focused 'Investing in a Just Transition'. Each of these can help the Fund to respond to its climate change priorities and demonstrate its commitment in different aspects of its strategy to address climate change. In this regard we note that TPI analysis is to be conducted on the Fund's active equity holdings with Longview.

4.6 Reporting requirements for these initiatives alongside the new Stewardship Code and PRI will allow the Fund to demonstrate its ambitions and approach to climate change to its stakeholders and also highlight where future action is planned/needed.

4.7 The Local Authority Pension Fund Forum (LAPFF) published a Climate Change Investment Policy Framework in 2017 which many funds use as a basis to develop investment policy on climate change. The framework incorporates the four themes of the Task Force on Climate Related Financial Disclosures (TCFD) (see below) in providing guidance on establishing a climate change policy.

4.8 The Task Force on Climate Related Financial Disclosures (TCFD) was created in 2015 to enable stakeholders to better understand the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks. Its recommendations have been widely supported by national governments. The reporting requirements are being adopted by an increasing number of leading funds on ESG matters.

4.9 A pension fund seeking to achieve best practice will disclose as a policy document its approach to addressing the issues raised in the TCFD's four thematic areas:

Table 6 - TCFD Policy Disclosure Themes

Governance	**Strategy**	**Risk Management**	**Metrics and Targets**
Disclose funds governance of climate related risks and opportunities (CRRAO)	Disclose the impacts on the fund's investment strategy and asset management arrangements of CRRAO	Disclose how climate change risks are identified, assessed and managed	Disclose the performance metrics and targets associated with the risks and opportunities
a) Disclose fund's oversight arrangements of climate related risks and opportunities (CRRAO)	a) Describe the risks and opportunities identified over short to long term from CRRAO	a) Describe the process for identifying CRRAO	a) Disclose the assessment metrics
b) Disclose the management arrangements for assessing and CRRAO	b) Describe the impact of CRRAO on the fund's activities and strategy	b) Describe the process for managing CRRAO	b) Disclose weighted average carbon intensity (where data is available or can be reasonably estimated) for each fund

	c) Describe the resilience of the CRRAO strategy	c) Describe how the approach is integrated into the fund's overall risk management arrangements	c) Describe the targets used to manage the risks

4.10 In responding to the TCDF reporting framework, the Fund will need to consider the depth and breadth of its climate change investment activities. This requires the Fund to consider how it positions itself in respect of the wide range of options available. The table below is based upon the analysis of funds reporting TCFD assessments. The headings across the top of the table represent the areas of reporting and the columns show examples of activity with those at the top being the minimum level and increasing as you move down the columns. Funds will determine where they want to position themselves.

Table 7 - TCFD Assessment of climate change investment activities

Engagement	**Green, positive, sustainable and impact investing**	**Apply climate change policy to assets**	**Approach to carbon intensive or high carbon risk assets**
Degree of active engagement and by whom	**Priority given to investing in new opportunities**	**Range of assets brought into the Fund's climate change policies**	**Policy on any disinvestment criteria**
Delegate to asset managers accepting their in-house approach based upon ESG assessment from the RFP		Apply to major quoted companies	
Engage with policy makers directly or in association with others	Allocate a small % of fund to funds with low or zero-carbon targets, renewable energy or impact investing (less than 2%)	Manager appointments take into account application of climate change activity for some quoted equities	No investments in thermal coal companies.
Proxy voting with specific focus on '1.5 degrees'			
Engage with companies directly or with others through correspondence and face to face meetings			Blanket policy of not having any investments in assets that are dominated by carbon intensive or high carbon risk assets.

Join with other active investors to enhance the opportunity to achieve change	Link new investment with reduction in exposure to poor performing companies or sectors	Development of net zero-carbon strategies for parts of the assets under management	
Support or propose AGM shareholder resolutions	Allocate 5 to 10% to 'funds with low or net-zero carbon mandates		Triggers in engagement can identify individual companies within sectors for consideration for disinvestment
Delegate to asset managers with a strong bespoke brief and enhanced monitoring	Direct investments in renewable energy, impact investments or sustainable infrastructure	Climate change is taken into account in selection criteria in all asset classes	Significant disinvestment linked to replacement by comparable assets that have a lower carbon risk profile

4.11 We have reviewed the Funds position against the options above and used a red/amber/green rating to show where the Fund currently compares. Green text indicates where the Fund is already active, amber text for partial action and red text where we consider the Fund is not active. For this assessment it is important to note that it is not intended to be aspirational that the Fund fully meets each of the above options but rather uses the table to determine where its priorities lie and how it will monitor its fund managers voting and engagement.

4.12 We note that the Fund's active managers already do not consider carbon intensive sectors such as the oil and gas sector a good financial investment for the Fund and thus do not have holdings in such companies.

4.13 In addition, the Fund could consider other measures such as reviewing the mandates of managers that do not reduce exposure to climate risk by a certain date (Brunel Pension Partnership has said it would do this by 2020).

4.14 As most effects of climate change will emerge over the medium to longer term, this presents challenges for investors. The Fund can consider how climate-related risks and opportunities may evolve by building on the scenario analysis instigated by the adviser.

Recommendation 4: From the themes and requirements from Table 6, the Fund prepares its own climate change-related financial disclosures and using the options shown in Table 7 it can decide which activities it will action in support of the priorities identified from Recommendation 1.

Risk Management

4.15 Risk management is one of the four primary themes of the TCFD which states 'Asset owners should describe how they consider the positioning and active management of their total portfolio with respect to the transition to a lower-carbon energy supply, production and use'.

This should include engagement with companies to encourage better reporting and practices around climate related risks. It is noted that the adviser is addressing the risk in the review of the Fund's strategic asset allocation review.

4.16 Within the Responsible Investment Policy the Fund describes its approach in terms of long-term sustainable returns and states that it has identified climate change as a potential long-term financial risk, however, this is not reflected in the risk register.

Recommendation 5: A more detailed analysis of the financial related risks of climate change be adopted by the Fund and this should be included in the risk register, along with the various mitigations such as activism, diversification, engagement, measurement and reporting.

Carbon Measurement

4.17 Within the new ESG Statement, the Fund has published an assessment of its carbon footprint as at June 2019. This a very positive step and has enabled the Fund to identify its carbon exposure across each of its individual mandates. This information has already influenced the investment strategy and it is vital that this exercise is established as a central part of the Fund's monitoring and reporting with the proposed quarterly analysis of fossil fuel exposure and associated voting and engagement reporting.

4.18 Currently there are no internationally defined characteristics for carbon measurement which means comparison between Funds and different approaches is inconclusive. We are aware that the Fund is currently reviewing its provider of carbon measurement services. At this time there has not been an agreed approach set out by the UK Government or the LGPS Scheme Advisory Board and so individual funds are making their own decisions. This is an area where asset pools can assist with achieving consistency, although we are aware this has not been agreed within the ACCESS pool. The Fund should determine what it considers to be best practice in this area and seek the views of the SAB and other pools/funds when selecting a new provider.

Recommendation 6: Following consultation with various parties, a carbon measurement service is re-commissioned and used to inform fund manager engagement and stakeholder communications.

5 Voting

5.1 The Fund has delegated the exercise of voting rights to its investment managers. For those managers selected via ACCESS (including the UBS Equity portfolios) there is a set of voting guidelines produced by LINK on behalf of ACCESS which is used to inform managers on the pool's voting intentions.

5.2 A review of these guidelines suggests they are fairly basic in comparison to current ESG accepted best practice and fall well below the expectations set out in LAPFF policies, which are most likely to represent the Funds views. Climate change is not specifically referred to, and the guidelines on environmental issues only apply to voting on the annual report. The guidelines could be improved by included a section on voting on climate-related shareholder resolutions, which are increasingly common in various markets.

5.3 They might also specify how boards will be held accountable for company disclosures, policies and practices related to climate change. Investors are increasingly willing to oppose the election of directors where companies fall short, and a number of LAPFF Alerts have recommended opposition due to climate concerns.

5.4 In respect of application of the guidelines, our analysis of voting data supplied shows a very significant variation between managers. For example, in the period 1 April 2019 to 31 March 2020, Ruffer voted with management in 92% of cases, whereas Longview voted for management in 61% of cases.

5.5 Looking at the detailed voting record supplied by Longview, this is driven by factors such as a robust voting position on the appointment of auditors. This is in line with the policy position set out in the ACCESS guidelines to oppose audit firms that have been in place for over 10 years. It seems unlikely that Ruffer is applying the policy in the same way. In the case of UBS, based on its reporting for Q1 2020 it appears to oppose auditors that have been in place for over 20 years, rather than 10.

5.6 Given the variation in manager voting on a relatively straightforward governance issue, and the apparent lack of alignment in some cases with ACCESS guidelines, it is likely that similar variation will occur in respect of voting on climate-related resolutions.

5.7 The Fund publishes the results of the managers' voting in its Annual Report and also produces a quarterly update for the Committee. However, this information does not highlight the impact or outcomes of the voting and only covers the active equity (Longview), absolute return funds (Newton and Ruffer) and passive equity (UBS) portfolios. The Fund has yet to look at the requirements around fixed income as set out in the new Stewardship Code Principle 12.

5.8 In order to meet the requirements of the Stewardship Code and more specifically the Fund's own ambitions in respect of RI, additional work will be necessary to develop a bespoke set of voting guidelines for the Fund and to establish the monitoring procedures to assess how these are being followed. At this stage the ACCESS Voting Guidelines have limited value to the Fund and there will need to be discussions with ACCESS and the fund managers to ascertain their anticipated level of compliance. This would be an easier conversation at pool level but if that is not possible then the Fund should prepare to have its own approach. This is of particular note as the new Stewardship Code requires much more on voting disclosure, including on climate-related matters. The Fund itself and its fund managers should publish voting records on a quarterly basis to meet new Stewardship Code requirements which are currently only produced by a very small number of LGPS funds.

5.9 Given that voting is a crucial part of engagement with companies, in certain instances the voting stance may be informed by specific engagement with the company in question and the voting guidelines should set out parameters for this.

Recommendation 7: The Fund agrees a set of voting guidelines that reflect its ESG priorities and determines how these can be applied with ACCESS and the fund managers.

Recommendation 8: The Fund establishes a reporting framework (including publication) around the voting activities of its fund managers against its own voting guidelines in line with Stewardship Code Principle 12.

6 Engagement

6.1 The Fund recognises that through active shareholder engagement it can convince the companies it invests in to improve their corporate governance. Engagement in the main is carried out via the activities of the Fund's managers. Other organisations are also available in the market to provide dedicated engagement services and, as previously referred to, the TPI can be a useful measure for certain sectors, not only to assess engagement success but to identify 'triggers' for engagement.

6.2 The Fund also believes that collaborating with likeminded investors greatly increases the likelihood of success through engagement. The Fund is a member of the Local Authority Pension Fund Forum (LAPFF) which undertakes a range of engagements based upon its own work programme set by the Forum Executive. In order to increase the influence of the Fund and its ESG beliefs it may wish to consider having a greater involvement with LAPFF through participation in business meetings and potentially nominating a representative to stand for election to the LAPFF Executive. Some of these duties can be shared between officers and Members but it will increase time commitments and demand for internal resource. The Fund has already agreed in its budget to increase the level of internal resources in anticipation of additional demand from its ESG ambitions and supporting LAPFF would be a beneficial way of achieving some of its objectives and would increase ESG knowledge within the Fund.

6.3 In order to meet the requirements of the new Stewardship Code the Fund should also consider how to incorporate specific elements of LAPFF engagement activity into its own reporting to demonstrate the effectiveness of actions taken and associated outcomes. The Fund has specifically stated that its preferred approach is engagement rather than divestment and as part of the TCFD it could provide greater clarity on this approach and the circumstances where disinvestment may apply i.e. where a company consistently fails to achieve its stated carbon reduction targets.

6.4 Some examples of LAPFF engagement achievements worthy of note include; LAPFF has long advocated for 'reliable accounts' highlighting problems with international financial reporting standards and with the UK regulator, the Financial Reporting Council (FRC). Pressure from LAPFF on the FRC's short-comings paid off in the spring of 2019 with the Kingman Review. The then LAPFF chair was one of the first people to meet Sir John Kingman in relation to his Review. The main positions proposed by LAPFF, including that the FRC needed to be replaced by a body properly accountable to Parliament, were mirrored in the Review's recommendations. One crucial recommendation that is now underway is for the FRC to be replaced by a new regulatory body; the Audit, Reporting and Governance Authority (ARGA).

6.5 LAPFF also has a long history of engaging on climate risk, producing its first report on the investment impact of climate change in 2004 (two years before the UK government's ground breaking Stern Review) and calling for mandatory corporate carbon reporting which was later introduced in 2012. The Forum's experience of working positively with company chairs, led to the first ever shareholder resolutions being supported by company boards in 2015. LAPFF funds co-filed the resolutions to BP and Shell on strategic climate reporting and the Forum was the only investor that met both company chairs. These positive outcomes have continued since then, with most recent engagement in 2020 with the Barclays' chair, Nigel Higgins, resulting in overwhelming support for a company resolution committing to measures to address climate risk as well as strong support for a shareholder resolution on the same topic.

Recommendation 9: Increase involvement with LAPFF and seek to incorporate some relevant elements of their work into the Funds own reporting.

Recommendation 10: Further to the adoption of the Fund's statement on climate change, the fund managers are required to report regularly on their engagement activities to demonstrate their support of the Fund's position and wider requirements of TCFD, PRI and Climate Action 100+, see Recommendation 3.

7 Impact/Sustainable Investment

7.1 As part of the work undertaken by the Fund over the past year there has been consideration of impact investing and sustainable equities which could be part of the Fund's investment strategy. So far the only significant ESG influence to the investment strategy has been the switch to the Low Carbon Passive Equity mandate. However, the global equity with Longview already excludes high carbon risk companies and the private equity investments have a renewable focus.

7.2 There are a number of different investment opportunities that are aligned with a low or net-zero carbon transition, including through private equity investment, such as renewable energy, sustainable infrastructure and impact investing which can be identified and considered. It is not the role of PIRC within this report to provide direct advice on impact or sustainable investment but we do recognise the potential merits of this type of investment which could easily be aligned with the ESG priorities identified by the Fund. Further work in this area with the Fund's investment advisers would provide the Committee with some options to make initial investments in these areas.

7.3 The Fund has a stated ambition of developing a long term sustainable investment strategy and has started to review its current strategy in terms of fossil fuel exposure and the role of benchmarks. Any changes to the strategy should be in line with the ESG priorities identified as a result of Recommendation 1 and the Fund should also consider possible metrics to measure the effectiveness of the investments it makes towards these priorities. Currently this is a developing area that lacks agreement on global definitions and indices and will require further guidance from the UK Government and LGPS Scheme Advisory Board in time to support the Funds progress.

Recommendation 11: In line with the Responsible Investment Policy the Fund will evaluate the financial risks of existing and potential investments as it seeks to identify appropriate low or zero-carbon mandates as well as investing in renewable energy, sustainable infrastructure or other impact opportunities.

8 Asset Pooling

8.1 East Sussex is part of the ACCESS asset pool and has already transferred a significant proportion of its assets over to mandates managed via the pool. These include the active global equities, Bonds, Absolute Return Funds and technically the passive global equities via a joint procurement arrangement. The fund recognises that the appointment and management of fund managers will in future require co-operation with other pool members. However, the current arrangements are not providing the desired level of ESG interaction to enable the Fund to achieve its ambitions. The Fund therefore needs to determine what activities are currently or likely to be available going forward via ACCESS and then form a view on what additional support and information it wishes to source from elsewhere.

8.2 It has been established that the ACCESS asset pool is still in the development phase and has not progressed to the same extent as some other asset pools particularly in aspects such as ESG. East Sussex is considered a leader on ESG within the pool and as part of its commitment to the pool should continue to raise emerging issues and demonstrate best practice to encourage collaboration with other pool funds. However, it is also clear that at this stage the ESG ambitions of the Fund are being impaired by its involvement with the pool in terms of a collaborative approach to issues such as climate change, voting and engagement, carbon measurement and impact/sustainable investing.

8.3 Despite limited support and interest in these issues from other pool funds it is clear the regulatory environment will require all Funds to respond in more depth to ESG issues and so East Sussex has the opportunity to take the lead in terms of influencing future decisions of the pool and identifying best practice approaches to achieve the regulatory requirements and RI best practice. We do not consider this would be in conflict with the Fund's role within ACCESS as long as it remains transparent in its activities and continues to lead on these issues for the pool.

8.4 Since the introduction of asset pooling in 2015 all LGPS Funds have been developing approaches to manage the new relationship between themselves, the pool and fund managers to ensure the fiduciary responsibilities of the Fund continue to be appropriately discharged. One of the main criteria for successful pooling was the improvement in governance arrangements largely delivered through collaboration and sharing good practice. It remains a key role for the Fund to establish oversight arrangements to monitor and manage its asset pool. In terms of ESG there are a number of areas where the Fund will need clarity on the outcomes it can expect from the pool and understand how these impact upon its own ESG ambitions (See 8.2). More information on the how pools might respond to different ESG matters is included in the PIRC Note at **Appendix 3**.

8.5 The Fund may require additional support to implement some of its ESG objectives and should investigate what services and advice it needs to achieve the requirements of the Stewardship Code, PRI and TCFD. Options could be shared with ACCESS and the other pool funds to establish the potential for collaborative procurement but this should not meaningfully restrict the positive outcomes that this support could deliver to East Sussex.

Recommendation 12: The Fund embraces its leading role on ESG within ACCESS and continues to promote good practice and monitoring the latest developments. Based upon its own ambitions, the Fund should seek support to implement ESG objectives such as bespoke voting guidelines, carbon measurement and impact/sustainable investment opportunities.

9 Fund Managers' Role

9.1 The Fund has delegated some of its ESG activities to its appointed fund managers and has insisted that all its fund managers are signatories to the Stewardship Code. Given the level of internal resources available and the complexity of many of the issues, this approach is perfectly acceptable. From the Fund's perspective it is important that they are able to monitor the ESG activities of their fund managers and particularly receive reports on their voting and engagement activities – see Stewardship Code Principle 8. The Fund currently collates and reports the voting records of its equity managers and voting is based around the voting guidance produced by LINK. As noted above, these guidelines are fairly limited in comparison to best practice and the voting analysis shows how the fund manager voting in practice varies between the managers and often differs from what LAPFF has recommended. In order to move towards the voting outcomes which would match the Fund's priorities, it needs to encourage its managers to apply its own voting guidelines. This could be part of a wider conversation within the ACCESS pool or directly with each fund manager. **See Recommendation 8**

9.2 In terms of engagement, the fund managers are expected to reflect on their activities in their quarterly reports to the Fund and in presentations made directly to Committee meetings. This is a positive activity for the Fund but it could be expanded to reflect the Fund's specific ESG priorities and lead to a dialogue where the fund manager has taken an alternative view. The Fund can also draw on LAPFF recommendations to inform its view on certain companies and add to the discussions with the fund manager. It is understandable that at times there may not be agreement on issues with some companies but the Fund will be in an informed position and can consider how it may respond in the future. **See Recommendation 10**

9.3 It has been established in section 8 that the ACCESS pool will be taking responsibility for the selection and appointment of fund managers going forward. A key element of the relationship between the Fund and the fund managers are the contractual arrangements, many of which would be assessed during a procurement. The Fund should review its existing mandates to clarify the level of ESG expectations and seek to influence ACCESS when agreeing contracts to demand best practice clauses in relation to ESG i.e. signatory to the Stewardship Code, PRI signatory, provision of voting records, engagement activities etc. When selecting a manager these contract terms should be taken into consideration to ensure the Fund is satisfied otherwise it should consider other options either within ACCESS or beyond.

9.4 The ESG Working Group provides an opportunity to spend time discussing ESG issues with existing and potential fund managers as well as being a less formal arrangements for training on ESG matters. The working group should reflect upon its terms of reference to ensure it has a structured approach to monitoring all existing fund managers against the Fund's ESG priorities and seeks to promote active engagement with new market developments as they arise. This would be an opportunity to review voting and engagement experience and make recommendations back to the Committee. **See Recommendation 1(d)**

Recommendation 13: A review of the current fund manager contact terms is undertaken to identify current expectations and to inform best practice which can then be used in future negotiations and shared with ACCESS.

10 Communications

10.1 A significant element of the various new pieces of Guidance and Regulation mentioned above is the two way communication between the Fund and its stakeholders and particularly with its members (beneficiaries) and employing bodies.

10.2 Stewardship Code Principle 6 looks at how beneficiaries' views are gathered and considered and this can be a key instrument in showing the Funds willingness to listen and engage with the views of external parties. There are clearly resource implications in developing a member survey and analysing the results but the benefits in terms of demonstrating transparency and being able to respond directly to members' opinions will go a long way towards building relationships which can be developed over time. These will then provide channels for further debate and allow the Fund to act more quickly when specific issues arise.

10.3 A number of Funds have attempted member surveys and it would be worthwhile investigating the relative success of each approach to understand good practice and avoid unwanted outcomes. For example the structure of the questions could be designed in such a way as to get feedback on support for specific ESG activities and confirm priorities and non-priorities, rather than asking open questions which may well result in a wide range of opinions which the Fund may struggle to reconcile with its own responsibilities. Previous experience of these surveys tends to suggest that most members will share the views of a Fund which has developed a strong set of investment beliefs. A good example to review is the Environment Agency Survey (see link below) which had an excellent response rate and gave the Fund some clear messages about members views.
https://www.eapf.org.uk/news/public/2020/05/what-you-think-about-responsible-investment

The Fund may want to ask more specific questions within this, such as ascertaining member views on particular investments, for example, renewables or sustainable infrastructure.

Recommendation 14: The Fund considers options to gather the views of its members with regard to ESG and this information will be used to influence future decision making.

11 Resources and Governance

11.1 The Fund is currently in the process of recruiting additional resources whilst its collaborations via ACCESS and LAPFF offer the opportunity to extend its influence on ESG issues. However, this is a complex and time consuming area with the Fund also relying on its advisers to highlight emerging themes and monitor compliance with regulation and guidance. These resources, collaborations and advice should be recognised in the work plan to implement the Fund's ESG priorities and, where appropriate, additional support may be considered to offer expertise and monitoring services.

11.2 Following the investment governance review by the independent adviser, a working group for ESG issues was established. This does not appear to form an official part of the Council's formal meeting arrangements but does provide a platform to discuss these multi-faceted issues in more depth. The working group includes representatives outside the Committee and Local Board, including employers and environmental groups, which will facilitate a wider and more informed discussion. Whilst we appreciate this group is in its infancy, it would be sensible to establish some terms of reference particularly around its relationship with the Committee and it should publish a written record of each meeting, e.g. an action log of recommendations to demonstrate the transparency of its workings.

11.3 The Fund in its business plan has a very full set of investment objectives which this review fully supports. The range and complexity is such that the Fund should consider the introduction of detailed project planning which could help the officers and Committee set out how they will achieve their objectives over the next 12 – 24 months and ensure limited resources are used to their best effect. By producing a detailed plan it will provide a realistic timescale to move forward in line with Committee meeting dates and ensure specific deadlines are met. It will also help quantify the level of resources and external input required to achieve the targets which can better inform the budget process and ensure the level of resources available are sufficient. By attaching responsibility for individual targets the Committee will be able to allocate resources appropriately and hold those responsible to account in terms of outputs and deadlines.

11.4 The Fund has recently reviewed its governance arrangements with the support of AON and has implemented a number of changes including updated Terms of Reference and established working groups to tackle key issues such as ESG. Overall the governance arrangements are effective and with the Local Pension Board and use of external advisers the decision-making process is robust and there is a clear understanding of fiduciary responsibility by the administering authority (East Sussex County Council).

11.5 In addition to its internal resources the Fund employs an investment consultant (Hymans Robertson) and an independent adviser (William Bourne) to support the governance arrangements. Both advisers have contributed significantly to the Funds current investment strategy and have supported the various training activities around ESG activities. As part of their quarterly report to the Committee, Hymans Robertson include an ESG rating of the fund managers based upon their wider knowledge of the sector. This could be a useful tool to support the Committee in monitoring its managers although currently only a couple of the fund managers are covered and the exact basis of the rating is not defined. This is an area the Fund could explore further to establish what other ratings are available and what other LGPS funds receive.

Scheme Advisory Board Good Governance Review

11.6 The LGPS Scheme Advisory Board (SAB) is currently reviewing the governance arrangements across the LGPS and the results are likely to see a revised governance compliance statement which will produce a set of recommendations against which funds will be required to ‘comply or explain’. There will be a broad range of governance recommendations but from an ESG perspective they may include Funds producing an ESG statement, adoption of the new Stewardship Code, membership of the PRI and specific reference to climate change in Funds’ risk registers and investment strategy statements. Whilst the recommendations may be ‘optional’ it is likely that non-compliance will reflect on the Funds overall governance arrangements and potentially draw external criticism.

Recommendation 15: The newly established governance arrangements should be reflected in the Fund’s policy documents and the structure of the working groups be clarified to include its role in monitoring fund managers and providing documented feedback to the Committee.

Recommendation 16: Produce a detailed project plan for its Business Plan investment related priorities so as to identify specific targets and deadlines required to achieve ESG ambitions and allocate appropriate resources and budget. The plan should include how the Fund will implement its priorities in areas including voting, engagement, impact / sustainable investing, collaboration, communications and reporting.

12 Summary of Conclusions

1. East Sussex Pension Fund currently complies with all statutory regulations and relevant guidance with regard to its environmental, social and governance (ESG) obligations.

2. The Fund is considered a leader on ESG by its peers in the ACCESS asset pool and has made more progress than the average LGPS fund in responding to ESG issues.

3. There is a clear awareness of the Fund's fiduciary duties and the need to act in the best interests of the Fund's members. The governance arrangements including the Local Pension Board and new working groups provide a reasonable challenge to the Fund's officers and advisers.

4. Over the past 18 Months the Fund has made significant progress in gaining a better understanding and knowledge of a range of ESG issues and specifically climate change which has led to actions including a carbon footprint assessment and the production of an ESG Statement.

5. Within the Fund's current work plan, the Fund has identified areas it needs to address and develop including meeting the new Stewardship Code Principles and preparing a response to the Task Force for Climate Related Financial Disclosures. These will put the Fund into a strong position for its investment response to ESG matters and climate change.

6. The progress of the ACCESS pool and a requirement to agree with other pool funds on a range of issues has led to considerable discussion and delays to the Fund's ESG ambitions.

7. The Fund has recently approved a business plan and is in the process of recruiting to a number of senior posts which should address some of the resourcing deficiencies which have hindered the Fund's progress on prioritising and addressing ESG issues. Completing the ESG projects set out in the business plan will put the Fund in a strong position but will require significant project management skills to be certain of achieving the outcomes set in the plan.

8. The voting records from the Fund's equity managers have been collated and reported against the ACCESS voting guidelines. However, it is unclear what priorities the Fund is seeking to address through its ownership rights and the ACCESS guidelines are limited in their scope and hence are unlikely to match the Fund's ambitions around ESG and climate change.

9. The Fund has been a member of the Local Authority Pension Fund Forum (LAPFF) since 2014 and reports on LAPFF activity to the Committee and within its annual report. Despite officers attending some business meetings, the Fund has not played a significant role in shaping LAPFF policy and with the ambitions of the Fund around ESG this could be an opportunity to demonstrate leadership and escalate its own priorities.

10. The Fund has a laudable ambition to develop a sustainable investment strategy and has moved one portfolio into a low-carbon benchmark but has also recognised the limitations of benchmark indices and is considering how to progress into Impact/Sustainable investing.

11. The Fund has received ongoing criticism from external pressure groups on its response to climate change. Fund and working group members and representatives have clearly been building a good understanding of the issues to develop the Fund’s response. Other funds in similar circumstances have reviewed and expanded their communications strategy as seen by the content of their websites and newsletters. As demonstrated by some other funds, the regular use of a member survey on ESG issues facilitates interaction with a range of stakeholders and would provide the Fund with clarity and evidence of external views which it can then address.

Summary of Recommendations

Recommendation 1:

a) From the broad range of ESG issues, the Committee reviews and confirms what ESG issues are a priority and those that are not and how it will respond. This will help demonstrate its ambition and inform its responses to regulatory requirements.

b) Detail on how it will respond to the issues that arise from (a) should cover policies on - engagement, avoidance of holding some assets, collaboration and positive investing in respect of its priorities.

c) A timetable should be determined for the coverage of all asset classes.

d) Outcomes from the ESG working group are produced and reported as appropriate to demonstrate transparency and strengthen the governance arrangements.

Recommendation 2: The Fund uses the outcomes from Recommendation 1 to update is policies and practices to meet the requirements of Stewardship Code Principles 1, 2, 3, 4, 5, 7 and 8.

Recommendation 3: The Fund reviews its role in collaborative engagement (LAPFF and ACCESS) and develops reporting to demonstrate the outcomes relevant to the Fund to meet the requirements of Stewardship Code Principles 9, 10 and 11.

Recommendation 4: From the themes and requirements from Table 6 the Fund prepares its own climate change financial disclosures and using the options shown in Table 7 it can decide which activities it will action in support of the priorities identified from Recommendation 1.

Recommendation 5: A more detailed analysis of the financial related risks of climate change be adopted by the Fund and this should be included in the Risk Register along with the various mitigations such as activism, diversification, engagement, measurement and reporting.

Recommendation 6: Following consultation with various parties, a carbon measurement service is re-commissioned and used to inform fund manager engagement and stakeholder communications.

Recommendation 7: The Fund agrees a set of voting guidelines that reflect its ESG priorities and determines how these can be applied with ACCESS and the fund managers.

Recommendation 8: The Fund establishes a reporting framework (including publication) around the voting activities of its fund managers against its own voting guidelines in line with Stewardship Code Principle 12.

Recommendation 9: Increase involvement with LAPFF and seek to incorporate some relevant elements of their work into the Funds own reporting.

Recommendation 10: Further to the adoption of the Fund's statement on climate change, the fund managers are required to report regularly on their engagement activities to demonstrate their support of the Funds position and wider requirements of TCFD, PRI and Climate Action 100+, see Recommendation 3.

Recommendation 11: In line with the Responsible Investment Policy the Fund will evaluate the financial risks of existing and potential investments as it seeks to identify appropriate low or zero-carbon mandates as well as investing in renewable energy, sustainable infrastructure or other impact opportunities.

Recommendation 12: The Fund embraces its leading role on ESG within ACCESS and continues to promote good practice and monitoring the latest developments. Based upon its own ambitions the Fund should seek support to implement ESG objectives such as bespoke voting guidelines, carbon measurement and impact/sustainable investment opportunities.

Recommendation 13: A review of the current fund manager contact terms is undertaken to identify current expectations and to inform best practice which can then be used in future negotiations and shared with ACCESS.

Recommendation 14: The Fund considers options to gather the views of its members with regard to ESG and now this information will be used to influence future decision making.

Recommendation 15: The newly established governance arrangements should be reflected in the Fund's policy documents and the structure of the working groups be clarified to include its role in monitoring fund managers and providing documented feedback to the Committee.

Recommendation 16: Produce a detailed project plan for its Business Plan investment related priorities so as to identify specific targets and deadlines required to achieve ESG ambitions and allocate appropriate resources and budget. The plan should include how the Fund will implement its priorities in areas including voting, engagement, impact / sustainable investing, collaboration, communications and reporting.

Appendix 1

List of East Sussex documents reviewed in production of this report:

1. Environmental, Social and Governance Statement (including Climate Change)
2. Responsible Investment Policy
3. Investment Strategy Statement (2019) (including Investment Beliefs)
4. Investment Strategy Review by Hymans march 2020
5. Action Log and Investment Work Plan March 2020
6. Pension Fund Committee Papers
7. Pension Fund Strategy Board
8. Pension Fund Advisory Board
9. Investment Steering Committee
10. RI Collaboration – Further Opportunities Paper March 2020

Appendix 2

PIRC Assessment of the depth and breadth of the current approach to ESG.

Appendix 3

PIRC Note on How to Evaluate a Pool's approach to ESG matters

Background Papers

References to good or best practices of some other Fund's that could be useful reference points

1. LAPFF Climate Change Investment Policy Framework and Implementation Guidance
2. LAPFF Climate Change Survey Results
3. Environment Agency Responsible Investment Survey Results
4. GMPF Responsible Investment Policy 2019
5. GMPF Approach to Climate Risk
6. Brunel Responsible Investment Policy 2019
7. PLSA Stewardship Guide and voting Guidelines 2020
8. Church Commissioners policy on active engagement
9. Strathclyde Pension Fund on climate change and stewardship code
10. HSBC Bank Pension Scheme Statement on TCFD 2018
11. WMPF Responsible Investment Framework 2018
12. LAPFF Note – Protecting pensions against climate risk exposure

Extent of ESG/Climate Change activity

Collection of Information for Evaluation

1. Asset Class

What asset classes are covered by the East Sussex ESG/ climate change policies or activities? Please cross out any asset class not being used and indicate from those remaining the ones covered by the Funds ESG/climate change policies.

Asset Class	Non-Pool	Non-Pool	Pooled	Pooled
	ESG activity (Please indicate Y/N	Climate change activity	ESG Activity	Climate Change
Equities				
– Pooled Global			Y	Y
– UK			N	N
~~– Pooled overseas~~				
~~– North America~~				
~~– Europe (Excluding UK)~~				
~~– Japan~~				
~~– Asia Pacific (Excluding Japan)~~				
– ~~Emerging~~				
Bonds				
~~– Pooled~~				
– Conventional UK Gilts			N	N
– Corporate UK Bonds			N	N
~~– Conventional Overseas bonds~~				
– Inflation linked UK			N	N
~~– Inflation linked Overseas~~	N	N		
– Absolute Return Credit				
Alternatives				
– Private equity	N	Y		
~~– Hedge funds~~				
– Infrastructure	N	Y		
– Diversified Growth			N	N
~~– Active currency~~				
~~– GTAA~~				
– ~~Commodities~~				

Property – Pooled Global ~~– UK~~ – ~~Overseas~~	N	N		
Cash	N	N		
Other (please specify)				

2. Type of ESG Activity

A fund cannot address all ESG issues and needs to determine which are important and a priority for them. Please indicate the areas of ESG /climate change activity that are a priority for East Sussex and add any activity not listed.

	Non-Pool Assets under fund direct management		Pooled Assets under management
Climate change – Energy Efficiency – Carbon Management – Carbon Footprint Assessment of Equities – Carbon Footprint Assessment of whole portfolio – Emissions management relative to comparable organisations and government expectations – Scenario Analysis – Value at Risk and Actuarial Analysis – Renewable energy investments – Infrastructure Investments			X
Environmental – Pollution – Resource management			
Social – Human capital management and employment standards			

– Impact investing – Child Labour – Health and safety – Fair tax contributions – Employee representation – Community relationships – Supply chain management – Equality, etc. Governance – Company best practice – Structure of the Board, executive pay, reliable accounts, board diversity – Treatment of shareholders and alignment with their long-term interests – Governance risk relative to other investments – Securities Litigation & Company Governance Reform			
Other – please detail			

3. Depth and breadth of East Sussex activity on ESG and Climate Change

A fund has options as to the extent it will consider and address ESG matters. Three approaches are outlined below to illustrate the range of responses open to funds on a spectrum of options. This shows at Level 1 a fund meeting minimum regulatory expectations rising to a fund at Level 3 with a broad active approach, demonstrating a high conviction to ensuring they use their ownership rights to maximise their impact on ESG issues and concerns, commensurate with their Investment Strategy Statement. On a scale of 1 to 5 where would you position East Sussex in meeting the three levels based upon the descriptions below:

Level	Score Range	East Sussex Score
Level 1 - Compliance	1 to 5	5
Level 2 - Good Practice	1 to 5	3
Level 3 - High Conviction	1 to 5	2

Level 1: Compliance

The fund is principally concerned with ensuring that it meets expected legislative standards. This makes sure there is a strategy in place, a coherent proxy voting policy and some form of engagement by its asset managers. A passive contributor to joint working with other funds nationally. A major emphasis on Governance issues.

It is possible in terms of meeting the LGPS regulatory requirements to have a broad ESG strategy which puts the onus on asset managers supervised by the pool operator to operationalise such a strategy with regular monitoring reports on activity undertaken. This represents a minimum option. A fund has only high level views leaving the pool operator and asset managers to develop the strategy and operationalise it. The impact will be a responsive approach to issues when concerns get raised and an indirect access by funds to managers who are responsible for the management of ESG matters within a fund's high level policy reflected in its Investment Strategy Statement. Controversial or high profile issues are likely to be avoided.

1. Aims to meet expected legislative standards
2. ESG principle strategy
3. Coherent approach to proxy voting
4. Engagement though asset managers

Level 2: Good Practice

Some funds will go further than the compliance level and develop a more advanced approach to voting activity e.g. developing a bespoke voting template and join other lead funds with company engagement. They expect increased accountability from asset managers on ESG matters. There will be increased governance activity and the fund will take an interest in limited range of environmental and social issues.

Level 1 plus:

1. Bespoke voting template
2. Join other lead funds on company engagement
3. Expects greater accountability from asset managers
4. May require pool operator to take an active part in addressing significant issues

Level 3: High Conviction to ESG Issues to Protect and Enhance Shareholder Value

Funds integrate their ESG activity into their overall investment strategy, actively engage with companies, understand the governance risk in their portfolios and seek to actively manage that risk. They are likely to have significant dedicated resources allocated to achieving their ESG objectives.

The fund objectives would be detailed and based upon a comprehensive strategy that is operationalised as far as practical by the fund itself giving it much greater flexibility to respond to ESG matters it considers as important. It would make greater use of expert advice and appoint an agent to oversee and implement its strategy and ongoing determinations.

The high conviction approach requires the pool operator to facilitate the implementation of fund guidance on how ESG matters should be addressed in its share of the assets invested. Also, the operator could be required to facilitate a funds ESG agent in proxy voting and company engagement. A fund would want to be responsive to issues and have direct control over engagement on ESG matters.

1. Integrate ESG activity into investment strategy
2. Actively engage on a range of ESG matters
3. Seeks to manage ESG risks in assets held
4. Extensive reporting and accountability for engagement activity
5. Extensive collaboration with other concerned investors
6. Commissions research and analysis of ESG issues

How to Evaluate a Pools Approach to ESG Matters

1. How can we evaluate a pool's response to ESG matters from an administering authority (AA) point of view is a critical question in the relationship between an AA and its pool. Does an AA want a "passive" relationship and pool that meets good practice, but is not taking a "progressive "approach, or does it want to give ESG issues a high priority? What positioning will a pool be looking to take? ESG issues are complex and extensive making it difficult to give a simple answer to these questions. As a starting point an analysis of the characteristics of the two sorts of approach helps draw out the significant differences an AA must consider when reviewing its policies and required practices around ESG issues.

2. The following is a comparison of the characteristics of a pool taking a passive approach and one taking a progressive approach to ESG matters. It is not expected that pools will fall neatly into two categories and many are expected to have a mixture of characteristics depending upon their own circumstances. However, the analysis is useful in understanding the depth and breadth of a pool's proposed approach and as an evaluation of their approach relative to other pools and AA expectations.

ESG Characteristic	**Passive Pool Response**	**Progressive Pool Response**
1. Responsible Investment Statement Including compliance with stewardship code and recognition of ESG risks need managing/mitigating in interests of sustaining the value of the investments.	1. Comprehensive set of high level policies and objectives that meets good practice	1.1. Comprehensive set of high level policies and objectives exceeding good practice that has been the subject of extensive consultation and is reflected in all investment management activities. 1.2. Includes details of how ESG issues will be prioritised and addressed. Arrangements have breadth in terms of asset classes covered and depth in terms range of ESG issues being addressed.
2. ESG reporting	2.1 Linear reporting of outcomes of ESG activity – asset manager to pool,	2.1 Comprehensive regular reporting on ESG activity undertaken to all

	pool to AA 2.2 Largely written, limited involvement of elected members apart from discussing reports at Pension Panel/Committee meetings when received from pool.	interested parties including review of priorities and setting of revised priorities in response to changing issues 2.2 Frequent reports to AA panel/committee or special sub-committee by senior accountable officers of the AA and pool on activity and emerging issues 2.3 AA has significant influence on ESG priorities and agrees targets for their outcomes
3. Asset management contracts and responsibility for ESG issues	3.1 Managers with ESG experience and capacity appointed and governance activity delegated to them to manage and action in accordance with their policies e.g. proxy voting of equity holdings 3.2 Mangers responsive to major high profile environmental and social issues	3.1 Managers expected to integrate pool ESG priorities into their management of pool assets e.g. use pool proxy voting template, discuss and lobby companies on ESG priorities established by pool 3.2 Mangers and pool expected to implement any reasonable AA specific requirement on ESG issues of high priority locally within the AA. Could include variations to pool standard proxy voting template
4. Membership of organisations for investors seeking to improve ESG outcomes	4. Left to asset managers to determine, but pool is represented on high profile groups	4. Asset manager, pool and AA encouraged to join organisations that are relevant to their ESG policies and priorities and they can have influence

5. ESG issues important to AA not currently a priority with pool and asset managers	5. Request to pool to get asset managers interested, but no commitment to taking any action or extent of any action	5. Pool prepared to support AA facilitating the actions of itself and asset manager in any reasonable activity that enable the AA to achieve its objectives
6. Impact investing relating to social or local or regional matters	6. Largely outside scope as investments are likely to be relatively very small	6. Prepared to explore feasibility if AA support an initiative
7. ESG resources	7. Strategically ESG resource is at high level. Operational implementation of ESG policy with asset managers	7. Strategic and operational resource established within pool. Capacity to respond to and support AA members and officers on ESG matters