



Statement of Responsible Investment Principles

September 2020

1. Introduction

- At East Sussex Pension Fund (**ESPF**), we believe that Responsible Investment (RI) supports the purpose of the Local Government Pension Scheme (**LGPS**) – the provision of retirement income for individuals. We believe that it should reduce the risk associated with the invested assets that the Fund owns to pay pensions when they are due. Responsible investment is therefore a substantial factor driving returns alongside other investment considerations.
- This Statement of Responsible Investment Principles (**SRIP**) complements ESPF's Investment Strategy Statement (**ISS**), which is a statutory requirement codified in the Local Government Pension Scheme (Management and Investment of Funds) (England) Regulations 2016. The SRIP explains our (ESPF's) approach to the oversight and monitoring of the Fund's investment activities from a Responsible Investment (**RI**) and Stewardship perspective.
- RI is an approach to investing that aims to incorporate environmental, social and governance (**ESG**) factors into investment decisions, to better manage risk and to generate sustainable, long-term returns (according to Principles for Responsible Investment). Stewardship is the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society.
- While acknowledging the potential benefits of incorporating ESG factors into the investment process, the Fund recognises that there are many different approaches, there is no universally agreed standard of ESG measurement or assessment, and some methodologies may enhance returns while others may not. There may also be inherent conflicts between the Ethical., and Social., factors forming the ESG frame.
- As a consequence, while acknowledging the opportunities for these factors to reduce risk and highlight opportunity, careful attention is required in manager or index selection to methodologies which incorporate both qualitative, quantitative and forward-looking approaches.
- RI is not the same as Ethical Investment (**EI**). EI is an investment approach determined by an investor's specific views, usually based on a set of personal values. These values can take precedence over financial considerations. ESPF should not be considered as either an "Ethical" or an "Unethical" investor, but as a responsible steward of capital. The management of ESG issues is a question of identifying and mitigating material financial risks, not a question of ethics.
- At ESPF, we are guided in our roles as quasi-trustees, executive officers and investment managers by the legal principle of fiduciary duty. Guidance on our fiduciary responsibilities is provided by the Scheme Advisory Board, which took legal advice on this matter (<https://lgpsab.scot/fiduciary-duty-guidance/>). It advises the English Government (the Responsible Authority for the Fund) and English LGPS Funds themselves on policy issues.
- The ESCC Pensions Committee (**the Committee**), comprising elected councillors, is responsible for fund oversight and policy setting. In carrying out its obligations, this group of quasi-trustees must take into consideration the views of its main stakeholders, members and employers.
- The East Sussex County Council (ESCC) is the administering authority for the Fund, but the Fund is neither owned nor controlled by ESCC. Pension fund assets, which are earmarked for pension payments over the life of the fund, are ringfenced from 'Council Money'. There are more than 130 employers and 78,000 members, whose pension payments will be funded by these and further employer and member contributions. The Fund's investment policy cannot be influenced by outside parties or by personal, political or moral beliefs. The Fund must seek to find a balance between its statutory and fiduciary obligations, and the views and interests of all of its member stakeholders.

2. Annual review

The SRIP will be subject to review by the Committee at least annually.

3. Objectives of ESPF's Statement of Responsible Investment Principles

The objectives of ESPF's RI policy are to:

- 1 reduce the likelihood that ESG issues and Climate Risk (**CR**) will negatively impact asset values and returns;
- 2 inform stakeholders on the action ESPF is taking to address and manage ESG and CR issues.

4. Responsible Investment Beliefs

The following beliefs in respect of RI underpin ESPF's RI principles and policies. ESPF believes that:

- 1 ESG issues and CR can present material financial risks to asset values and returns;
- 2 Implementation of effective RI policies can reduce risk and has potential to enhance returns;
- 3 Engagement with investment managers ("**IMs**") and investee companies can be effective in protecting and enhancing the long term value of investments;
- 4 Collaboration with other asset owners and IMs will help improve the effectiveness of engagement on ESG and CR issues;
- 5 Effective oversight of RI requires monitoring of ESG and CR metrics and the actions of IMs and investee companies;
- 6 RI is aligned with ESPF's fiduciary responsibilities in the management and oversight of ESPF's investments.

5. Responsible Investment Principles and ESPF Approach

ESPF is a signatory to the United Nations Principles for Responsible Investment (**PRI**), an organisation which supports and enables asset owners and asset managers to work collaboratively towards RI best practice. As a signatory, ESPF has committed to implement the six principles with the aspiration of contributing to the development of a more sustainable global financial system.

Principle 1

We will incorporate ESG issues into investment analysis and decision-making processes.

ESPF approach: The implementation of ESPF's investment strategy is delegated by the Pensions Committee to officers and external investment managers (IMs) to invest the Fund's assets.

How ESG factors are incorporated into investment analysis and decision-making processes varies according to the asset category and manager. All investments are externally managed; however, asset managers are required to have regard for the government's consultation on integrated risk management of climate change (1).

The Fund gains its exposure to equity markets by recourse to a combination of Active managers and Passive index funds. The holdings of Active Managers are by their nature transitory and subject to continual change through the manager's stock selection process. Managers of index funds replicate an index and so have in a longer run exposure to companies and sectors over which limited due diligence is performed. The choice of passive index is therefore an important deliberation. Where possible, the Fund seeks to acquire exposure to indices that are tilted in favour of companies that benefit from greener revenues, are less carbon intensive, and are better positioned than their peers to adapt to the Energy Transition. In some markets this option is not possible.

The ESPF have the following categories of asset managers:

Active Equity managers: As a part of the appointment process, we ensure that Managers demonstrate that they incorporate ESG filters into their investment analysis and asset acquisition processes. We monitor the managers' performance on a quarterly basis alongside all other investment matters, and review the PRI transparency reports of external managers, where available. Managers are encouraged to join PRI, IIGCC and Climate Action 100+ as signatories, where they are not already members.

Passive Index Funds with ESG tilts: Passive indices offer a low-cost complement to Active Managers. We select Passive indices based on the index's ability to reduce exposure to climate risks and to capture opportunities for investment in companies that are forward looking, generating green revenues, and better aligned to navigating the Energy Transition

Passive Index Funds without ESG tilts: we hold other forms of Passive investment to gain exposure to markets at lower cost such as Emerging Markets. These market cap indices are not adjusted to reflect ESG or responsible investment criteria.

Corporate Credit managers: during the appointment process, we assess the approach of managers to incorporating ESG issues into their investment analysis and decision-making processes. We monitor the managers' implementation of the approach on a quarterly basis alongside all other investment matters, and review the PRI transparency reports of external managers, where available. It is our ambition to appoint managers who devote greater focus in providing finance to companies or projects that are more compatible with the aims of the Paris Agreement.

Property managers: The capacity for Managers to incorporate ESG factors into the investment process alongside other key investment criteria will be required, monitored, and regularly reviewed. Managers will be encouraged to adopt PRI Transparency and GRESB reporting and to utilise CRREM assessment tools, as recommended by the IIGCC, in assessing their property portfolio alignment with the Energy Transition.

Real Asset management (infrastructure) managers: during the appointment process, we assess the approach of managers to incorporating ESG issues into their investment analysis and decision-making processes. We monitor the managers' implementation of the approach on a quarterly basis alongside all other investment matters, and review PRI transparency and GRESB reports of external managers, where available.

Principle 2

We will be active owners and incorporate ESG issues into our ownership policies and practices.

ESPF approach:

Voting: The Fund's asset managers vote on resolutions at the Annual General Meetings (AGM) and Extraordinary General Meetings (EGM) of the Fund's equity holdings.

Shareholder resolutions: The Fund's asset managers also file or co-file shareholder resolutions on important issues at the Fund's investee companies in the interests of agitating for better governance.

Stock lending: ESPF does not participate in direct stock lending but may invest in investment funds which use stock-lending.

Corporate engagement: The Fund's managers engage with our investee companies on material ESG issues. The Fund are members of the LAPFF, IIGCC, Climate Action 100+ and the UNPRI.

Government engagement: we engage with government through responding to government consultations.

Manager monitoring: we actively and regularly monitor the approach of our investment managers to ESG issues, and what portfolio activity has occurred as a result of managing ESG risks.

Principle 3

We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Investee companies: through our investment managers we encourage the companies, whose shares the Fund owns, to report on relevant ESG metrics. These include the reporting of greenhouse gas emissions in line with the recommendations of the Taskforce for Climate-related Financial Disclosures (TCFD).

Investment Managers: we encourage the Fund's investment managers to provide transparency by reporting relevant and accessible ESG-related information. This includes their commitments to and alignment with the UK Stewardship Code 2020, the TCFD, the PRI and GRESB, where appropriate.

Principle 4

We will promote acceptance and implementation of the Principles within the investment industry.

Commitment to PRI: we are transparent about being a signatory to the PRI and about how we implement the Principles. The Committee monitors its carbon footprint and energy transition at portfolio level and asset manager level. The Committee also review asset manager voting and engagement on a quarterly basis. The quarterly reports are published on the Fund's website to demonstrate implementation of the Principles and to promote them.

Investment Managers: we endorse the Principles to our managers and encourage them to become full signatories to PRI. Where this is not possible, we encourage our managers to use the six principles to guide their RI approach.

Partnership with PRI: we partner with PRI to promote the universal use of the principles, and work with PRI during any consultations to improve the effectiveness of the principles and further improve RI adherence across the industry.

Principle 5

We will work together to enhance our effectiveness in implementing the Principles.

Collective Approach: we are committed to working collaboratively to increase the reach, efficiency and effectiveness of RI. We work with a host of like-minded partner funds, service providers and related organisations striving to attain best practice in the industry and to improve industry standards. A list of our collaborative partners and their roles are available on our website.

Principle 6

We will each report on our activities and progress towards implementing the Principles.

PRI Assessment: we provide extensive details of our investment activities annually to the PRI for its independent assessment of our approach to RI.

PRI Reports: we publish our PRI transparency report annually on our website and we publish our PRI assessment results on our website and in our annual report.

TCFD: we are committed to report annually in accordance with Taskforce for Climate-related Financial Disclosures (TCFD) recommendations.

UK Stewardship Code: we report annually in accordance with the UK Stewardship Code requirements, and we are committed to adhering with the requirements of the new UK Stewardship Code 2020.

6. Integrating RI into Strategy Implementation

- At ESPF we are committed to acting as responsible investors and fully integrating our approach to ESG and CR into investment processes.
- The Fund's approach is to invest in companies that have a high and sustainable return on investment.
- The Fund does not exclude companies from its investible universe on the basis of their participation in certain industries. Rather the emphasis is on assessing the sustainability element of a company's returns.
- Fully integrating ESG into the Fund's investment process means that the Committee, the legal person making the investment decision and the 'risk taker' is in possession of all the facts, it can determine how ESG impacts the investment case, including valuation and is in a position to engage with the managers of the business representing the interests of asset owners. This approach ensures that there is no gap between the assessment of ESG and the investment decision. Both are embodied in one decision by the Pension Committee. Short-termism and viewing ESG as an overlay to other assessment criterion is a sub-optimal approach.

7. Engagement with investee companies

- The Fund scrutinises governance at every stage of our investment process and aims to influence governance through voting and engagement. This is an integral part of what makes a business sustainable, successful and a suitable investment target.
- We will engage with their investee companies and appointed managers, either directly or via their collaborative partners. Where material risks remain following engagement activity, we retain the ability to divest, since the failure to engage destroys value in the longer term. The issue of engagement is a vital aspect of ownership.
- The Fund entrusts its assets to investment managers whose duty it is to represent the Fund's interest. Representing the Fund's interests as owners through engagement increases the Fund's knowledge and understanding of the company and leads to more accurate assessment of the firm's risks and opportunities and therefore the valuation assumption. Engagement through voting can effect corporate change and improve businesses to derive a broader social benefit.

8. Energy Transition

- The Fund recognises that a prolonged Energy Transition is under way. It also acknowledges that a number of energy incumbents through their size, capacity to mobilise capital and engineering expertise offer the potential to play a substantial role in that transition. It seeks to balance the economic reality that fossil fuels currently provide 80% of the world's primary energy and that energy demand will grow by up to 50% by 2050, with global commitments, as yet not fully backed by detailed policy, to decarbonise the energy system by the second half of the century. Where viable opportunities arise, the Fund will seek to increase its exposure to renewable infrastructure assets.
- The Fund is aware that there are a range of possible transition scenarios, evolving physical climate related risks and potential opportunities. There are also many uncertainties. This makes portfolio construction around such scenarios very challenging. Instead, ESPF seeks to broadly align its investment approach with the objectives of IIGCC and Climate Action 100+ initiatives.

9. Climate Change & Compliance with Taskforce for Climate-related Financial Disclosures (TCFD)

ESPF recognises the importance of the Paris Agreement of the United Nations Framework Convention on Climate Change¹. The central aim of the agreement is to strengthen the response to the global threat of climate change by:

- keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius;
- strengthening the ability of countries to deal with the impacts of climate change through appropriate financial flows, a new technology framework and an enhanced capacity building framework;
- enhancing transparency of action and support through a more robust transparency framework.

ESPF understands that the Paris Agreement is creating change that represents both significant risks to, and opportunities for, the Fund.

As such we make the following commitments to climate monitoring and action:

- To continue to measure and report on carbon-equivalent emissions throughout the equity portfolios
- To continue our work with IIGCC and Climate Action 100+
- To continue to research and support the deployment of new impact capital into projects set to benefit from the transition to a low carbon economy
- To assess the carbon intensity of all assets (using estimates if necessary) by the end-2022 reporting cycle, supported by external managers and GPs
- Using data from the Transition Pathway Initiative (TPI), to engage alongside our collaborative partners to encourage companies to adopt business models and strategies that are in line with the aims of the Paris agreements.
- Financial returns from current and future investments will affect ESPF's ability to fund future pension payments, and so we have committed to implement processes that adhere to TCFD recommendations on mandatory reporting and governance requirements related to climate risk as they are expected to apply to the LGPS, namely:

(i) Governance: The Pensions Committee monitors stewardship of the Fund's assets with the first report due in March 2021 and thereafter annually. This includes reporting on RI issues and specific climate-related risks and opportunities. The Pensions Committee and Pension Board are committed to undertake a comprehensive CPD programme through physical, online training and/or personal reading on RI issues and climate change-related risks and opportunities. The Pensions Committee:

- affirms the Fund's commitment to integrate environmental, social and governance (ESG) considerations, such as carbon efficiency trends into its decision-making;
- delegates scrutiny and engagement with investment managers to Fund officers with advice from the Joint Investment Strategy Panel to ensure that they take ESG issues, including climate change and carbon risk, into account in their investment decision-making;
- affirms the Fund's policy of not divesting solely on the grounds of non-financial factors;
- notes that the Fund will monitor research on the link between ESG factors (including carbon-related factors) and financial performance to inform future investment strategy, such as stock selection criteria for quantitative strategies;
- agrees that the Fund will use its shareholdings in companies that perform poorly on carbon efficiency measures to influence engagement activity.

¹ <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>

(ii) Strategy: We work individually and with our collaborative partners to drive for openness and transparency on climate related issues affecting our investments.

- ESPF will review annually all strategy mandates and managers against climate metrics (e.g. impact on portfolio, manager compliance, exposure to certain sectors)
- We will review the weakest mandates based on this analysis and determine what action will be taken
- We will consider options for scenario analysis in respect of the Fund's mandates

(iii) Risk Management: We subscribe to data services and analytical tools, including company and industry specific data, and scenario models, to help understand and manage the climate risk within the Fund. Ways in which this data will be used for risk management include:

- Assessment of all existing mandates against quantitative risk metrics such as Weighted Average Carbon Intensity "WACI" on a regular basis. We will work to develop risk metrics appropriate to each mandate
- For all new mandates we will consider climate-related risks and objectives explicitly
- Engagement with managers on specific issues and risks identified by the data

(iv) Monitoring, Metrics* and Targets: We use various monitoring tools with the aim of mitigating risk to Fund assets from trends towards net-zero carbon and more broadly from climate change. We will select at least one Green House Gas (GHG) emissions and one non-emissions metric against which to assess Fund assets on climate related risks and opportunities as proposed under TCFD. At least annually, we will set one target to manage climate related risk with respect to the chosen metrics and measure performance against this target at least quarterly. The ESG Working Group reviews and scrutinises RI issues and specific climate-related risks and opportunities at least quarterly. We will develop regular reporting of ESG and CR metrics to inform decision making and help assess and monitor progress towards our RI objectives. (In the appendix we provide an illustration of the metrics and reporting we aim to develop.)

***Carbon Analysis:** We note that carbon-equivalent foot printing produces simple metrics that can be misinterpreted. It encourages selective divestment of the shares of high emission companies as some investors 'greenwash' their portfolios. Rather than divesting, we encourage our managers to incorporate an analysis of carbon output into their risk assessment of individual companies and their stocks. In addition, we actively engage with companies to align their business strategies with the targets of the Paris Agreement. Where analysis of carbon risk (or any other risk) points to poor financial outcomes, divestment is, of course, an option.

Footnotes:

The government consultation issued in March 2020, "Aligning Your Pension Scheme with TCFD Recommendations" which ended on 2 July 2020 includes recommendations within that consultation for asset managers to carry out climate scenario analysis in relation to portfolios which they administer on the Fund's behalf. Where the manager carries out scenario analysis, the Fund is recommended to ask for details of the scenarios as well as the output of the analysis in relation to the Fund's portfolio. Where portfolio-level analysis is not available, the Fund is recommended to ask for the results of any other analysis that the asset manager is using to identify and assess climate-related risks in relation to the portfolio, such as carbon footprint data. The Fund is also recommended to ask what the asset managers are doing differently as a result of the analysis, to mitigate the risks. Where no scenario analysis is taking place, particularly for easier-to-analyse asset classes such as equities and corporate bonds, the Fund is recommended to ask about asset managers' plans for adopting scenario analysis and encourage faster action if this is not ambitious enough.