PENSION COMMITTEE

MINUTES of a meeting of the Pension Committee held at County Hall, Lewes on 1 March 2021.

++Please note that Members attended the meeting remotely++

PRESENT	Councillors Gerard Fox (Chair) Councillors Nigel Enever, Andy Smith, David Tutt and Trevor Webb
ALSO PRESENT	Ian Gutsell, Chief Finance Officer Sian Kunert, Head of Pensions Russell Wood, Pensions Manager: Investment and Accounting Paul Punter, Head of Pensions Administration Dave Kellond, Compliance and Local Improvement Partner Nigel Chilcott, Audit Manager Danny Simpson, Principal Auditor William Bourne, Independent Adviser Philip McCloy, Northern Trust Anastasia Guha, UN PRI David O'Hara, ISIO Andrew Singh, ISIO Martin Jenks, Senior Democratic Services Adviser Harvey Winder, Democratic Services Officer

62 MINUTES

62.1 The Committee agreed the minutes of the previous meeting held on 30 November 2020 were agreed as a correct record.

63 APOLOGIES FOR ABSENCE

63.1 There were no apologies for absence.

64 DISCLOSURE OF INTERESTS

64.1 There were no declarations of interest.

65 URGENT ITEMS

65.1. There were no urgent items.

66 PENSION BOARD MINUTES

66.1 The Committee considered the minutes of the Pension Board meeting held on 15th February 2021.

66.2 The Committee RESOLVED to note the minutes.

67 PRI PRESENTATION

67.1 The Committee considered a presentation from Principles for Responsible Investment (PRI) on its goals to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The East Sussex Pension Fund (ESPF or the Fund) recently became a signatory of the PRI.

67.2 The Committee's discussion included the following key issues:

- While it was made very clear that the PRI could not give investment advice and that they cannot take a position on the merits of investment vs divestment, it was noted that from the perspective of effecting change in company behaviour, unilateral divestment achieved little.
- The Fund is being lobbied to divest from companies that operate in areas where human rights violations occur, particularly the Occupied Territories in Israel. The Fund has exposure to 4 of the 112 companies on the UN Human Rights listed companies within its passive equity mandate – two travel companies, a milling company and Motorola – and three of these four through its Smart Beta passive manager, Storebrand (excluding Motorola). None have their principal operations in the Occupied Territories. This list is not produced by PRI (which is endorsed by the UN) and it would not be possible for PRI to produce a similar global list of all the companies that its signatories hold stocks in that may have involvement in areas where human rights abuses occur, due to the complexity of the task. PRI will be doing more work in relation to human rights, however, in the future.
- It was acknowledged that there are physical limitations to engagement or divestment imposed on indirect asset owners whose market exposure is achieved through collective actively managed or passive index vehicles. Passive equity managers exercise relatively little influence over the companies they hold shares in, as they invest in a broad list of companies tracking the stock market. Storebrand, the funds new passive-like manager however, undertakes a vetting process before purchasing each stock that involves engagement over their ESG position and the fund do not invest in companies that do not meet its standard. Three of the four companies in the UN list currently meet the standards Storebrand sets.
- The PRI representative underlined the criticality of ensuring that many companies and sectors make the energy transition, adding that this requires investors to remain heavily involved and engaged. It was also acknowledged that the different levels of challenge to companies and sectors required government policy to assist in making the economics of the transition work for them. It was discussed that the direction of travel of any company is perhaps more critical than its current absolute alignment with a particular global warming scenario at this stage. Some industries, such as steel, will find it harder than others to transition away from carbon. PRI takes the view that fund managers should pay close attention to which companies are moving towards decarbonisation, even if they have not achieved it in the short term, as there are likely to be winners and losers in the transition to a low carbon economy.
- The argument against divesting from fossil fuel companies has historically been that they provide dividend payments to the Fund, which helps ensure the Fund achieves its fiduciary duty to provide a pension to its members. The economy appears, over the last year in particular, to be beginning to move away from fossil fuel companies and in favour of tech companies. This makes aligning a fund's investments around ESG matters less

of a risk than it was 10 years ago and also means the need to encourage fossil fuel dependent companies that the Fund invests in (via fund managers) to reduce emissions begins to become part of the Fund's fiduciary duty, as those companies that fail to adapt to a low carbon economy could cease to exist. There is evidence that this is happening, for example, the PRI representative cited Shell Oil – which is making significant progress but is not yet aligned with 2° - as a good example of such company engagement with the energy transition, and where leaders in the industry may be considered by asset owners and investment managers as opportunities, because Shell has committed to being carbon neutral by 2040 as a result of shareholder pressure.

- It was suggested that effective company engagement strategies might involve a set of escalating steps. A number of possible different investor engagement approaches were discussed in this context. It was confirmed that the engagement approach taken by The Institutional Investors' Group on Climate Change (IIGCC), with whom the PRI work closely, which employs an escalating company engagement strategy, and of which ESPF is a member, is completely aligned with and to some extent more aggressive than that advocated by the PRI currently. This is because PRI operates globally and IIGCC is European focused, where action on climate change is more advanced. The two are otherwise completely aligned, for example, on the goal of limiting climate change to 1.5C. PRI recommends an escalation approach with divestment as the final step. While divestment as escalation on passive mandates is difficult or not possible these managers can still vote against a company's accounts or board of directors (as shareholders of the company) each year. Over time, this should still send a strong message as it gathers momentum and more sign up to PRI.
- Local Government Pension Scheme (LGPS) are expected to retain exposure to passive mandates, but there is increasingly limited appetite for generic index funds. The Fund has moved a large amount of its assets from generic index funds into a Smart Beta fund that take into account ESG matters in their index of stocks, although this comes with an additional cost. It is expected that new products are likely to emerge that are more competitively priced that still provide reduced carbon exposure as ESG tilted index funds begin to provide the same returns or outperform generic index funds. It was observed that increasing value is seen in Impact investment approaches as opportunities for investors. This is an approach that the Fund has embraced and in which it has invested 25% of its equity portfolio.

67.3 The Committee RESOLVED to note the presentation.

68 <u>INVESTMENT REPORT</u>

68.1 The Committee considered a report providing an update on the investment activities undertaken by the ESPF.

68.2 The Committee's discussion included the following key issues:

- The Committee welcomes the new investment adviser, Isio's, plans to undertake climate change scenario modelling of the Fund's assets, as it will help make it clear what the Fund's climate risks are in relation to both assets and liabilities.
- Commercial property is under huge pressure due to COVID-19, but office and industrial property is likely to recover, although high street retail property is likely to continue to struggle. The Fund's exposure to property, via Schroders, is mainly in industrial property.
- Funds with an ESG tilt have performed well due to the low oil prices and challenges to the industrial sectors from COVID-19. Nevertheless, Isio is confident the Fund is aligned

with the general direction of investment (in favour of ESG) and will benefit from early adoption of these equity funds as more money is poured into them.

- The Committee will in future consider reports on how ESG considerations are factored in to the M&G Alpha Opportunities Fund, which has exposure to fossil fuels via its holding private credit. M&G is on the IIGCC advisory group.
- The Fund now has exposure to Bitcoin via Ruffer. It was highlighted that Bitcoin mining is very carbon intensive – Isio advised that they had discussed this holding and ESG credentials with Ruffer, who believes that Bitcoin is less carbon intensive than gold mining which this holding replaced. In addition it was noted that the institutional investment in it has reduced its previous association with criminal activities.
- It has proven difficult to increase the Fund's asset allocation in infrastructure to the stated goal of 8%. The Fund is currently at 6% having recently invested 2% in ATLAS Global Infrastructure. This could be resolved potentially by investing more in ATLAS, which was not the original plan, or waiting for other opportunities for investment in illiquid assets, however, investor demand is currently very high so it is difficult to find opportunities. Officers were asked to look into the options to bring this asset class up to the agreed allocation.
- In response to Isio's review of the Fund's passive market capitalisation, the Committee took the view that officers should increase equities held in active management to 62.5% and withdraw all assets held in UBS Developed and UBS Emerging markets (passive regional equities) to equity funds that favour companies more aligned to the funds responsible investment position, namely consideration of Osmosis Resource Efficiency, if this can be accessed through UBS and remain within the ACCESS pool; Longview; and a new allocation to one of the active managers in the ACCESS pool, for example, Bailie Gifford. The Active managers would also be able to retain exposure to emerging markets, which is an important element of the Fund's strategy. The preferred mix of mandates is set out in resolution 2).
- The Committee also recognised that UBS may not be able to access Osmosis Resource Efficiency mandate cost effectively. If that is the case, officers should implement an alternative mix of mandates set out in resolution 3) by increasing assets held in Storebrand Global ESG Plus and 'Core' Active ACCESS pool managers. This would increase the ratio of active management to 67.5%.
- The Committee continued to discuss the UN Human Rights Council list of companies involved in business activities in the Occupied Territories. It was noted that Osmosis Resource Efficiency is a fund that screens its portfolio of stocks against companies for UN Compact violations. Storebrand also screens the companies it invests in. Local Authority Pension Fund Forum (LAPFF) has also begun correspondence with companies on the list with regards to human rights. The Committee agreed it should consider how best to approach this issue by engaging with LAPFF on a form of words that it can commit to with regards Human Rights issues.

68.3 The Committee RESOLVED to:

1) note the report and its appendices;

2) agree the following strategic equity allocation approach for the equity mandate to replace the current passive market capitalisation investment:

Storebrand Global ESG Plus	10%
Osmosis Resource Efficiency	5%
WHEB Sustainability	5%
Wellington Global Impact	5%
Longview Global Equity	10%
‘Core’ Active (ACCESS Pool)	5%

3). If the Chief Finance Officer believes the Osmosis mandate is not cost effective or not possible to access via the UBS passive platform, agree the following strategic equity allocation approach for the equity mandate to replace the current passive market capitalisation investment:

Storebrand Global ESG Plus	13%
WHEB Sustainability	5%
Wellington Global Impact	5%
Longview Global Equity	10%
‘Core’ Active (ACCESS Pool)	7%

4) delegate implementation to the Chief Finance Officer of the preferred strategic allocation for the equity mandate and the alternative strategic allocation if necessary;

5) agree not to engage in currency hedging as set out in Appendix 3;

6) request a future training session on crypto currency;

7) request a report on options for meeting the objective of having 8% of the Fund allocated in infrastructure; and

8) request a report on Local Authority Pension Fund Forum (LAPFF) recommended approach to companies with activities based in areas that infringe on human rights.

69 EAST SUSSEX PENSION FUND (ESPF) QUARTERLY BUDGET REPORT AND 2021/22 PENSION FUND BUSINESS PLAN AND BUDGET

69.1 The Committee considered a report providing an update on the ESPF quarterly budget report and seeking approval for the 2021/22 Pension Fund business plan and budget

69.2 The Committee RESOLVED to:

1) note the revised forecast 2020/21 outturn position; and

2) approve the Business Plan and Budget for 2021/22 in Appendix 1

70 COMMUNICATIONS REVIEW REPORT

70.1 The Committee considered a report on the outcomes of the Communications Review completed by the Head of Communications and Marketing on the ESPF.

70.2 The Committee's discussion included the following key issues:

- The reason for stating that the number of scheme members interested in divestment issues was low is likely based on the low level of correspondence on the matter when taken as a percentage of the 78,000 members of the Fund. The Fund has not yet formally sought the views of its membership, although careful consideration of how this is done must be given. This is because it is difficult to ask simple questions on complex matters, and the fact that the ESPF is a defined benefit scheme with Trustees who have a fiduciary duty to provide a return on investment that may prevent them from enacting the preferences of the scheme membership.
- There is a need for the Fund to communicate with both its scheme members and the press and wider public. Consideration needs to be given to how this is done, for example, whether press and public communications come via the Corporate Communications Team.

70.3 The Committee RESOLVED to:

1) note the report and feedback from the Pension Board;

2) approve the recruitment of a designated Pension Fund Communications Manager;

3) approve the creation of a Correspondence Policy, which includes how the Fund should correspond with both employers and scheme members and with external queries from members of the public and the press; and

4) Endorse the establishment of a Pension Board Communications Working Group and request that the Board allow Committee Members to attend meetings of the Working Group.

71 GOVERNANCE AND EMPLOYER ENGAGEMENT REPORT

71.1 The Committee considered a report providing an update on various governance and employer engagement work completed and changes effecting the Local Government Pension Scheme (LGPS) and ESPF.

71.2 The Committee RESOLVED to:

1) Endorse the Terms of Reference for the Investment Implementation Working Group (Appendix 1);

2) Approve the strategic objectives for Isio as Investment Consultants (Appendix 2);

3) Note the update on the McCloud Working Group;

4) Note the update on ill health insurance for employers; and

5) Note the update on Employer Engagement

72 PENSIONS ADMINISTRATION REPORT

72.1 The Committee considered a report providing an update on matters relating to Pensions Administration activities.

72.2 The Committee RESOLVED to:

1) Note the updates; and

2) Note the progress of management in implementing the agreed actions arising from the internal audit report (Appendix 4)

73 INTERNAL AUDIT REPORT: PENSION FUND: COMPLIANCE WITH REGULATORY REQUIREMENTS 2020/21

73.1 The Committee considered a report on the outcome of the Internal Audit Report: Pension Fund: Compliance with Regulatory Requirements 2020/21.

73.2 The Committee's discussion included the following key issues:

73.3 The Committee RESOLVED to note the report.

74 RISK REGISTER

74.1 The Committee considered a report on the ESPF's Risk Register.

74.2 The Committee RESOLVED to note the report.

75 WORK PROGRAMME

75.1 The Committee considered its work programme.

75.2 The Committee RESOLVED to agree its work programme.

76 EXCLUSION OF THE PUBLIC AND PRESS

76.1 The Committee RESOLVED to exclude the public and press from the meeting for the remaining agenda item on the grounds that if the public and press were present there would be disclosure to them of exempt information as specified in paragraph 3 of Part 1 of the Local Government Act 1972 (as amended), namely information relating to the financial or business affairs of any particular person (including the authority holding that information).

77 INVESTMENT REPORT

77.1 The Committee considered a report providing an update on the investment activities undertaken by the ESPF.

77.2 The Committee RESOLVED to agree the recommendations as set out in the report.

78 BREACHES LOG

78.1 The Committee considered an update on the ESPF Breaches Log.

78.2 The Committee RESOLVED to agree the recommendations as set out in the report.

79 EMPLOYER ADMISSIONS AND CESSATIONS

79.1 The Committee considered a report on the latest admissions and cessations of employers within the ESPF

79.2 The Committee RESOLVED to agree the recommendations as set out in the report.

The meeting ended at 2.35 pm.

Councillor Gerard Fox (Chair)