PENSION COMMITTEE

MINUTES of a meeting of the Pension Committee held at County Hall, Lewes on 12 July 2021.

PRESENT	Councillors Gerard Fox (Chair) Councillors Sam Adeniji, Julia Hilton, Paul Redstone and David Tutt
ALSO PRESENT	Ian Gutsell, Chief Finance Officer Sian Kunert, Head of Pensions Russell Wood, Pensions Manager: Investment and Accounting David O'Hara, ISIO Andrew Singh, ISIO Willam Bourne, Independent Advisor Harvey Winder, Democratic Services Officer

21 MINUTES

21.1 The minutes of the meeting held on 22nd June 2021 were agreed as a correct record.

22 APOLOGIES FOR ABSENCE

22.1 There were no apologies for absence.

23 DISCLOSURE OF INTERESTS

23.1 There were no declarations of interest.

24 URGENT ITEMS

24.1 There were no urgent items.

25 INVESTMENT STRATEGY REVIEW

25.1 The Committee considered a report requesting approval of the East Sussex Pension Fund's (ESPF or the Fund) investment strategy and direction of travel for the Fund.

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

- The Fund requires a rate of return of 3.7% to maintain its current size, but to maintain the current funding levels and account for future accrual of benefits, as more pensioners reach retirement age, it requires an increase of 5.5% per annum. In 2019 the funding rate was 107% and the primary employer contribution rate was 18%. By March 2021 it was 106% but the primary employer rate has increased to 21%. This is because the expected return in 2019 was 5.7% and best estimate now is 5.3%, as result of long term interest rates coming down and making opportunities to find other return-generating assets harder to achieve. The Fund therefore has less chance of achieving its targets relative to 2019, however, by making the proposed changes the Fund can improve its rate of return without increasing the risk to the Fund, i.e., it will provide a better risk adjusted return than the current strategy. This should help reduce pressure on employers to make up the funding gap.

- Inflation poses a significant risk to the Fund. Infrastructure investments will help mitigate against this risk, as income from infrastructure tracks inflation well and provides greater returns than index linked gilts, which is why it is the focus of the strategy review.
- The proposals include a reduction in the allocation of the Fund in the diversified growth funds – currently held by Ruffer and Newton – as this allocation is overweight. It is proposed that strategic reduction is made in the Newton allocation, as Ruffer provide capital preservation and protection against inflation, which is in keeping with the plan to protect against inflation.
- Under the proposed plan, the diversified credit allocation will be taken from the corporate bonds allocation as it will maintain capital preservation during poor market conditions. This increase in diversified credit could either be an increase in the allocation to the M&G Alpha Opportunities Fund or to a diversified credit sub-fund in the ACCESS pool.

25.3 The Committee considered a number of arguments for the sale of equities held in fossil fuel companies.

- Whilst inflation is a considerable risk to the Fund, it was argued that climate change is the greatest risk and limiting global warming to 1.5C is the only way to protect the Fund long term. The Fund’s fiduciary duty should compel it to take all possible actions to mitigate against this risk and there is no more than nine years left to reduce carbon emissions before the 2C warming scenario can no longer be prevented.
- Shareholder engagement has had little impact on changing the behaviour of fossil fuel companies to date and many are still discovering new oil and gas fields. Even though the Fund’s exposure is now low, which is to be commended, fossil fuel companies play a central role in driving climate change and need to be singled out. Divesting all holdings in fossil fuel companies will show real leadership and show that that the Fund means business in regards to climate change.
- The Fund’s Responsible Investment Policy says it retains the right to disinvest from certain companies or sectors in the event that all other approaches are unsuccessful, so this would be a possible route for the Fund to take.
- Fossil fuels are becoming an increasingly risky, overpriced asset to invest in. this is because they rely for their valuation on more reserves than they can possibly exploit; Governments are introducing policies to encourage the creation of renewable infrastructure; and Governments are beginning to subsidise the cost of green and renewable sources of energy to consumers. Renewable infrastructure offers better returns and is a safer long term investment than oil and gas companies, so the money allocated in oil and gas companies should instead be invested in renewable infrastructure.

25.4 The Committee considered a number of arguments against the sale of equities held in fossil fuel companies.

- Department of Work and Pensions (DWP) guidance to Pension Funds is against the use of divestment as a tool of engagement with companies and the Pension Minister has said it is not a sensible approach to moving the energy transition forward. It may also have limited impact due to the majority of oil reserves being held by state-owned companies like Gazprom. Engagement with fossil fuel companies will help them to become useful actors in the energy transition process and some are beginning to invest in renewable infrastructure, albeit not yet enough. Engagement is also arguably a better way of showing leadership in tackling climate change than divestment.
- Recent engagement by The Institutional Investors' Group on Climate Change (IIGCC) members, Climate Action 100 members and other members to take control of Exxon Mobil's Board goes to show the impact shareholder escalation can have on a fossil fuel company. Half of the IIGCC's target of the 160 biggest polluting companies have agreed to align their activities to 1.5C pathway as a result of IIGCC engagement. All of the Fund's investment managers are signed up to the IIGCC.
- The Fund is moving rapidly in the direction of carbon alignment. It has moved from 6.6% of assets in fossil fuels in 2015 to 4.5% in 2018 and 2% at the end of March 2021. 0.67% of that is in UBS passive fund the Committee has committed to selling and transferring into Osmosis and Bailey Gifford funds. This will leave 1.2% of which 0.3% will be in M&G Corporate Bonds that the Committee is recommended to sell if it agrees this year's strategy review. The private equity portfolios account for 0.1% and that will disappear as those funds are wound down.
- The Fund has moved its exposure to fossil fuels from passive index funds into fossil free funds like Osmosis and Storebrand; impact and sustainability funds like WHEB and Wellington; and the Paris Aligned active fund, Bailey Gifford. The Fund will have 15 or 16 times the assets in climate solutions, resource efficiency, forward looking index, green tilted index, and impact and sustainability funds than it will in residual fossil fuel exposure.
- Once the new strategy is agreed and implemented the Fund will have no strategic exposure to fossil fuel companies, meaning there will no longer be a structural risk to the Fund from fossil fuels. The only exposure at that point will be the two diversified growth funds, Newton and Ruffer, which may invest in fossil fuel companies tactically and who both accept that in the long term exposure will ultimately likely be zero. Both managers have significantly more research resources devoted to analysing investment risk and how effective oil and gas companies' carbon transition plans look, so it would be difficult to dictate to them which companies they should not invest in. If the Fund had prohibited these managers from owning fossil fuel stocks, for example, then in November 2020 they would not have been able to buy into stocks that have doubled in value in six months. Ruffer and Newton are also more heavily involved in Climate Action 100. Ruffer sold the majority of its stake in Exxon when engagement appeared to not work and used its remaining stake to vote in climate activist board members.
- It is very difficult to divest from an individual company, as the Fund invests in financial products not companies and the Fund would have to sell entire holdings to divest from individual companies. This is especially difficult where the Fund is invested in the ACCESS pool, as it is not the only investor and cannot instruct the other LGPS to also sell. Newton and Ruffer funds sit in the ACCESS pool and there are no alternative diversified growth funds that do not invest in fossil fuels in the ACCESS pool, meaning

that the Fund would need to withdraw from that pooled fund in order to invest in alternative diversified growth funds. It would be very difficult to explain to the Ministry of Housing Communities and Local Government (MHCLG) in this circumstance why the Fund's money should be withdrawn from the ACCESS pool.

- Fossil fuel exposure includes exposure via utility companies that may produce electricity from fossil fuels, such as EDF. Utility companies appear to have set out plans for alignment to a below 2C warming scenario, although the Fund has not been able to verify their deliverability. Any divestment would need to be clear whether it would include divestment from utility companies as well as oil and gas companies.

25.5 The following amendment to the recommendation was moved by Councillor Tutt and seconded:

1) *note the Investment Strategy report (Appendix 1);*
2) *Agree the following proposed strategic asset allocation (as set out paragraph 4.1-4.7):*

Asset Class	*%*
Global Equity	*40.0*
Diversified Growth	*17.0*
Private Equity	*5.5*
Balanced Property	*7.0*
Inflation-Linked Property	*4.0*
Infrastructure Equity	*11.0*
Private Credit	*5.0*
Diversified Credit	*10.5*
Corporate Bonds	*-*
Index-Linked Gilts	*-*
Cash	*-*

3) *delegate authority to the Chief Finance Officer, in consultation with the Chair, to take all necessary actions to give effect to the implementation of the above recommendation; and*
4) *propose to divest from all fossil fuel companies excluding utility companies and to use that money to invest in green infrastructure funds subject to advice from the Fund's professional advisers at the next meeting.*

The amendment was put to the vote and LOST by three votes to two

25.5 The Committee RESOLVED to

1) note the Investment Strategy report (Appendix 1);
2) Agree the following proposed strategic asset allocation (as set out paragraph 4.1-4.7):

Asset Class	%
Global Equity	40.0
Diversified Growth	17.0
Private Equity	5.5
Balanced Property	7.0
Inflation-Linked Property	4.0
Infrastructure Equity	11.0
Private Credit	5.0
Diversified Credit	10.5
Corporate Bonds	-

Index-Linked Gilts	-
Cash	-

3) delegate authority to the Chief Finance Officer, in consultation with the Chair, to take all necessary actions to give effect to the implementation of the above recommendation; and
4) Request a report at the September Committee meeting setting out the specific oil and gas company holdings held by the Fund's absolute return managers (Newton and Ruffer), identifying any of those companies still actively seeking new oil fields; the engagement activity undertaken by these managers, including what escalation measures they have in place if engagement does not work; and the potential cost to the Fund of full divestment over five years.

26 WORK PROGRAMME

26.1 The Committee considered its work programme.

26.2 The Committee discussed the benefits of reducing the number of items on future agendas, particularly where they relate to areas of focus of the Pension Board, such as governance and employer engagement; or where they are being presented to the Committee 'to note' and could instead be circulated by email for information. The Committee was also in favour of using the call-over function for reports that require agreement but are not controversial, for example, policy documents that regulations require a new version is agreed every three years or when changes are made to it. This would enable the Committee to focus its time on more complex or controversial issues.

26.3 The Committee agreed to:

1) agree its work programme; and

2) agree to let officers advise which reports currently listed as standing items should be considered less often by the Committee in future.

27 EXCLUSION OF THE PUBLIC AND PRESS

27.1 The Committee RESOLVE 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).

28 ENVIRONMENTAL SOCIAL AND GOVERNANCE IMPACT ASSESSMENT

28.1 The Committee considered a report containing a review on the investment managers' Environmental, Social and Governance (ESG) activities.

28.2 A summary of the discussion is set out in an exempt minute.

28.3 The Committee RESOLVED to agree actions which are set out in an exempt minute.

29 INVESTMENT REPORT

29.1 The Committee considered a report providing an update on the investment activities undertaken by the Fund that are exempt in nature.

29.2 A summary of the discussion is set out in an exempt minute.

29.3 The Committee RESOLVED to agree actions which are set out in an exempt minute.

The meeting ended at 1.15 pm.

Councillor Gerard Fox (Chair)