

ETHICAL INVESTMENT POLICY

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

1. Introduction

- 1.1 Standing Order 23 (2) of Devon County Council's constitution states that "Any member of the Council may put an item on the agenda of any committee relevant to the functions of that committee." Under this standing order Councillor Hook has placed an item on the agenda for this meeting of the Committee on the Pension Fund's 'Ethical Investment Policy'.
- 1.2 This report provides an outline of the Devon Fund's current policy and relevant considerations in the determination of that policy, to provide members with background information to inform their discussion of Councillor Hook's agenda item.

2. Fiduciary Duty

- 2.1 The Pension Fund has a fiduciary duty to seek to obtain the best financial return that it can for its members. This is a fundamental principle of the management of Pension Funds that has been established in law.
- 2.2 The case of *Cowan v Scargill* (1984) concluded that "the duty of trustees is to be entrusted with the funds of other people and the most important is to return a financial reward on behalf of investors". This has been widely held to demonstrate the illegality of decisions on investment being made on anything other than financial grounds. However *Bishop of Oxford v Church Commissioners* (1992) appears to conclude that "in some circumstances it would be appropriate for trustees not to invest in certain products if the objects of the employer, company or charity were such that investments of a particular type would conflict with the fundamental aims of that company or charity".
- 2.3 More recently, in March 2014, a legal opinion on fiduciary duties of administering authorities under the LGPS was published by Nigel Giffin QC. The Opinion confirms that "The administering authority's power of investment must be exercised for investment purposes, and not for any wider purposes. Investment decisions must therefore be directed towards achieving a wide variety of suitable investments, and to what is best for the financial position of the fund (balancing risk and return in the normal way)."
- 2.4 However, it goes on to say that "so long as that remains true, the precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as that does not risk material financial detriment to the fund. In taking account of any such

considerations, the administering authority may not prefer its own particular interests to those of other scheme employers, and should not seek to impose its particular views where those would not be widely shared by scheme employers and members (nor may other scheme employers impose their views upon the administering authority).”

- 2.5 If the committee wished to adopt an ethical policy it would be difficult to determine where to draw the line. There are a wide variety of ethical issues that have been raised by various lobby groups. These include: tobacco investment, investment in alcohol, issues in relation to the health impact of fast food and confectionary companies; experimentation on animals by pharmaceutical companies; exploitation of third world labour by textile companies; impact on the natural environment of energy/oil companies; investment in gambling and pay day loan companies; investment in certain countries. If the Fund excluded the companies involved in all of these different activities, it would severely restrict the Fund’s investment opportunities and could have a significant impact on the financial performance of the Fund in breach of its fiduciary duty.

3. Statement of Investment Principles

- 3.1 The Fund’s policy in relation to social, environmental and ethical issues is set out in the Statement of Investment Principles (SIP) which is regularly reviewed. The SIP was last revised in June 2015, and the Committee made no changes to the section on social, environmental and ethical issues.
- 3.2 The current policy states in relation to ethical issues:
- (a) Future investments will not be banned nor existing investments sold solely on social, environmental or ethical grounds.
 - (b) Other than the monies set aside for investment in Ethical Unit Trusts (up to 1% of the Fund), investment will not be made in companies solely because of their good record in social, environmental or ethical issues. Many of the Fund's investments would qualify as ethical, however, even though not chosen for that reason.
 - (c) It is recognised, however, that the interests of investors on social etc. grounds may coincide with those solely on investment grounds in which case there will be no conflict of interest. Indeed, the Committee believes that in the long run, socially responsible and fiduciary investment will tend to come together since adverse performance on social, environmental or ethical issues will ultimately be reflected in share prices.
 - (d) The Fund will encourage its Investment Managers to adopt a policy of engagement with companies to make its view known to their management and to seek to change their behaviour where necessary. This is more likely to be successful if the Fund continues to be a shareholder.
- 3.3 In relation to paragraph (c) above, the Fund’s active equity managers will exercise their own judgement as to whether social, environmental or ethical issues will have an impact on the financial performance of a company or its shares.

4. Stewardship / Local Authority Pension Fund Forum

- 4.1 The Statement of Investment Principles also outlines the Devon Fund's support of the UK Stewardship Code and the Fund has a firm commitment to being a responsible shareholder. In pursuing its stewardship objectives the Fund expects its external investment managers to engage with the companies they are invested in and to vote at AGMs. The Fund is also a member of the Local Authority Pension Fund Forum (LAPFF) who conduct significant engagement with companies that LGPS funds are invested in.
- 4.2 LAPFF have engaged with companies on a wide variety of issues. One example is that LAPFF has long been concerned about climate and carbon-related risks to the underlying investment portfolios of member funds and has been engaging with companies and on public policy since 2002 to address the many risks related to climate change. Over the last year the Forum coordinated with member funds to co-file and support shareholder resolutions to both the BP and Shell 2015 AGMs on strategic resilience for 2035 and beyond. The resolutions asked the companies to report on their operational emissions management; asset portfolio resilience to the International Energy Agency (IEA)'s scenarios; low-carbon energy research and development and investment strategies; relevant strategic key performance indicators and executive incentives; and public policy positions relating to climate change. Subsequently EU based oil and gas companies have raised their profile in calling for a global carbon pricing regime and more investment in low carbon energy sources, on the back of heightened shareholder support. LAPFF have also engaged with Shell in relation to environmental concerns about their Arctic drilling proposals.
- 4.3 LAPFF does not support divestment from fossil fuel companies but considers active engagement with companies producing fossil fuels as a productive approach to effecting change. The approach of direct and collaborative engagement contrasts with blanket divestment. Once an asset owner divests, their ability to influence both the short and long term direction of individual companies and the national and international energy sector is severely curtailed. The same approach is applied to other ethical issues. This is consistent with the Devon Fund's Statement of Investment Principles, as set out in paragraph 3.1(d) above.

5. Conclusion

- 5.1 The Devon Fund fulfils its fiduciary duty by not excluding investments solely on social, environmental or ethical grounds. The Fund is able to exercise more significant influence on social, environmental and ethical policies by remaining a shareholder and engaging with the companies concerned via both LAPFF and the external fund managers.

Mary Davis

Electoral Divisions: All

Local Government Act 1972

List of Background Papers – Nil

Contact for Enquiries: Mark Gayler

Tel No: (01392) 383621 Room G97