

SURREY COUNTY COUNCIL

SURREY PENSION FUND COMMITTEE

DATE: 2 JUNE 2017



SUBJECT: LOCAL PENSION BOARD REPORT ON ENVIRONMENTAL, SOCIAL AND GOVERNANCE COMPLIANCE

SUMMARY OF ISSUE:

The Pension Fund Committee requested that the Surrey Local Pension Board review how environmental, social and governance factors are taken into consideration in forming the Investment Strategy Statement of the Surrey Local Government Pension Scheme (LGPS) Fund. This report shares detail of this review, alongside a series of recommendations for the Committee's consideration.

RECOMMENDATIONS:

It is recommended to the Pension Fund Committee that:

1. The Local Pension Board continue to gather evidence from peers, such as South Yorkshire Pension Authority, the Environment Agency and Avon, with a view to recommending proposals to the Committee for long term ambition in regard to sustainable investment for consideration later in 2017.
2. That the Fund publishes its Stewardship Statement with the Financial Reporting Council (FRC).
3. That the Pension Fund Committee develop a set of principles on its approach to climate change as part of its Investment Strategy Statement (ISS).
4. That the Committee consider what additional transparency and reporting arrangements could be made in regard to its Responsible Investment activities, including reporting its interaction with the Local Authority Pension Fund Forum (LAPFF), annual Environment, Social and Governance (ESG) ratings and stewardship reports.
5. That the Pension Fund Committee consider the advantages and disadvantages of becoming a UN Principles for Responsible Investment (PRI) signatory, or other industry alternatives such as the UK Sustainable Investment and Finance Association (UKSIFA).
6. That the Pension Fund Committee consider the fiduciary prudence of adopting a target of investment in low carbon assets.
7. That the Committee support the following expectations with the Border to Coast Pensions Partnership (BCPP) asset pool:
 - That portfolio level monitoring of ESG metrics and carbon foot printing is developed as part of the pooling arrangements.

- That the pooled fund use its scale and influence to develop a consistent RI approach.
- That the pooled fund appoint managers with clear ESG policies in place.
- That the pooled fund retain specialist expertise in respect of responsible investment.
- That the pooled fund make arrangements to develop a specific low carbon passive investment vehicle.

REASON FOR RECOMMENDATIONS:

These recommendation have been drafted following the Local Pension Board's discussions to date, the detail of which is summarised below. The Local Pension Board believes that these recommendations set out both a short-term and long-term approach to incorporating ESG considerations into the investment decisions made by the Fund, and reflect industry standards around good governance, transparency and fiduciary prudence.

DETAILS:

Background

1. On 11 November 2016, the Surrey Pension Fund Committee requested that the Surrey Local Pension Board review how ESG factors are taken into consideration within the Investment Strategy Statement (ISS) of the Fund.
2. The Board produced a scoping document to support its review, shown as Annex 1.
3. Following discussion at a workshop on 25 January 2017, the Local Pension Board commissioned Mercer to conduct a Responsible Investment Peer Benchmarking Review, shown as Annex 2.
4. The Local Pension Board had a further workshop on 19 April 2017, in order to consider the report findings and make recommendations.

Key Findings

5. The Board discussed the increasing profile of both Responsible Investment (RI) and Sustainable Investment (SI), in ensuring fiduciary prudence, and the various approaches adopted by different funds to manage this.
6. The Fund could look to strengthen its RI approach over time, seeking to augment the strong governance practices already in place. The Board commends the Fund's adoption of an active approach to share voting, and recognises that it is engaging companies through its membership of the LAPFF.
7. The pooling arrangements around investments present new opportunities to shape ESG policy and practice in light of the changing role ESG has to play in the fiduciary duties of funds.

Short to long term considerations for the Fund

8. The Surrey LGPS Fund has a reputation for good governance, and there were discussions about how this could be augmented with additional transparency and reporting arrangements. An example of this was publishing the Stewardship Code with the Financial Reporting Council (FRC). It was also highlighted that there was scope to improve reporting on RI activities at a Fund level, including annual publication of ESG ratings and a more comprehensive stewardship report.
9. The Fund is able to sign up with a number of organisations committed to evidencing good RI practice. These include the UN Principles for Responsible Investment (PRI) and the UK Sustainable Investment and Finance Association (UKSIFA). The Local Pension Board feels that the reporting requirements for these options come with an additional resource implication for the Fund, and that the Committee should consider the financial prudence of becoming a signatory, while also making a clear commitment to good RI practice.
10. The Local Pension Board recognises that the management of long-term investment and liabilities requires a similarly long-term appreciation of risks and opportunities, such as the impact of climate change. These could include investment in new and emerging technologies and minimising exposure to less sustainable asset classes such as fossil fuels. The Local Pension Board felt the Fund could articulate its approach to climate change related investments, with a view to setting a strategic direction on how it will respond to these risks and opportunities in the coming years.
11. The Local Pension Board proposes to support the Pension Fund Committee in these considerations by gathering evidence from identified leaders in the field of sustainable investments: South Yorkshire Pension Authority, the Environment Agency and Avon Pension Fund.

Border to Coast Pensions Partnership (BCPP)

12. The governance of the BCPP asset pool will need to define its own policy in respect to ESG, although the Local Pension Board wishes to encourage a first principle of clear and transparent reporting on how these factors will be taken into consideration.
13. In order to do so, BCPP could consider retaining ESG knowledge and expertise at a pool level. The increased scale and additional influence of the pooled investment fund also enable it to set a clear expectation to fund managers and the industry about how it intends to take ESG factors into consideration.

CONSULTATION:

14. The Local Pension Board has consulted with the former Chairman of the Surrey Pension Fund Committee, Cllr Denise Le Gal. It has also sought advice from representatives of Mercer and officers from the Pension Fund and Treasury team.

RISK MANAGEMENT AND IMPLICATIONS:

15. Any long-term or strategic change in how the Fund invests will carry a degree of risk, both financial and reputational.
16. The Local Pension Board would strongly support a prudent approach to enacting the recommendations it has put forward in order to ensure that the Fund continues to meet its fiduciary responsibility to employers and members. It draws particular attention to page 8 of Annex 2, which sets out the need to take a broader perspective on economic risks in regard to long-term investment strategies.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

17. Annex 2 sets out an estimated range of costs associated with some of the activities proposed at a Fund level. There will also be financial and resource implications for the BCPP, depending on the approach agreed. These will require further investigation and assessment by the Pension Fund Committee and officers for the likely implications for the Fund.

WHAT HAPPENS NEXT

The Local Pension Board would welcome a response to these recommendations confirming next steps. It proposes that the Pension Fund Committee commission officers to take forward an appropriate options appraisal with regard to the recommendations concerning the Fund.

It would support a joint communication from the Board and Committee to BCPP communicating the findings of the report and recommendations for the asset pool to consider.

Contact Officers

Neil Mason
Senior Specialist Advisor, Pension Fund
neil.mason@surreycc.gov.uk

Andrew Spragg,
Scrutiny Officer, Legal, Democratic and Cultural Services,
andrew.spragg@surreycc.gov.uk

Local Pension Board Contact

Nick Harrison
Chairman, Surrey LGPS Local Pension Board

Consulted:

Denise Le Gal, former Chairman of the Surrey Pension Fund Committee

Annexes:

Annex 1 – Scoping document

Part 2 Annex

Annex 2 – Mercer Report: Responsible Investment Peer Benchmarking Review

Sources/background papers:

Local Government Pension Scheme (Management and Investment of Funds)
Regulations 2016

2014 Law Commission review of fiduciary duties of investment intermediaries

Task Force on Climate Related Financial Disclosures Recommendations Report,
December 14, 2016

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