POWYS PENSION BOARD 12 January 2018

Paper from the Chair of the Pensions Board

LGPS (Investment and Management of Funds) Regulations 2016

1. <u>Objective</u>

For the Pension Board to consider what views it may have on the process for the Pensions and Investments Committee complying with the guidance on formulating its Investment Strategy Statement (ISS) generally, and in particular on Regulation 7 (2) (e):

"How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments."

and to consider other related issues.

2. <u>Regulatory Background</u>

2.1 Under these Regulations, each Administering Authority must include in its Investment Strategy Statement a description as to how social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments.

2.2 The Department of Communities and Local Government (DCLG) has issued guidance regarding these Regulations "Local government pension scheme: guidance on preparing and maintaining an investment strategy statement".

2.3 With regards to its guidance relating to Regulation 7 (2) (e), the following is stated:

"The law is generally clear that schemes should consider any factors that are financially material to the performance of their investments, including social, environmental and corporate governance factors, and over the long term, dependent on the time horizon over which their liabilities arise.

Although schemes should make the pursuit of a financial return their predominant concern, they may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision. Investments that deliver social impact as well as a financial return are often described as "social investments". In some cases, the social impact is simply in addition to the financial return; for these investments the positive social impact will always be compatible with the prudent approach. In other cases, some part of the financial return may be forgone in order to generate the social impact. These *investments will also be compatible with the prudent approach providing administering authorities have good reason to think scheme members share the concern for social impact, and there is no risk of significant financial detriment to the fund".*

2.4 Summary of requirements under Regulation 7 (2) (e)

In formulating and maintaining their policy on social, environmental and corporate governance factors, an administering authority:-

- *Must take proper advice*
- ***Should explain the extent to which the views of their local pension board and other interested parties who they consider may have an interest will be taken into account when making an investment decision based on non-financial factors***
- *Must explain the extent to which non-financial factors will be taken into account in the selection, retention and realisation of investments*
- *Should explain their approach to social investments*

3. The Current Position with regards to the Investment Strategy Statement of the Powys Pension Fund

3.1 Process: the ISS was discussed as Item 11 by the Pensions and Investment Committee on 9 February 2017 and contained the following procedures for review:

"*1.3 Therefore, this ISS will be reviewed every three years after the investment strategy has been reviewed and is confirmed as fit for purpose. In addition the ISS will be reviewed following changes to the investment strategy."*

3.2 The minutes of the Committee are as follows:

"1. That the Investment Strategy Statement be approved and

2. That it be delegated to the S151 Officer to agree any minor amendments to the Investment Strategy Statement"

3.3 The relevant, and indeed current, policy of the Fund, as reflected in the Paper under Item 11, is as follows:

9. Socially Responsible Investment

9.1 The County Council has delegated responsibility for the selection, retention and realisation of investments to the investment manager(s).

9.2 The County Council's policy is to invest part of the Fund's assets on a passive basis. The County Council does not consider it appropriate for a passive investment manager to take account of social, environmental or *ethical considerations in the selection, retention and realisation of investments.*

9.3 The County Council's policy in respect of the actively managed portion of the Fund's assets is that the extent to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments is left to the discretion of the active investment managers. However the County Council expects that the active investment manager(s) in the exercise of their delegated duties will take the extent to which social, environmental or ethical issues may have a financial impact on the portfolio into account.

4. <u>Aspects for Discussion by the Pensions Board</u>

4.1 The Board may wish to consider in advance what its views would be if, as permitted under Regulation 7 (2) (e) it was consulted on by the Committee regarding the impact of social, environmental and governance factors in the investment process, or indeed independently wished to express thoughts and recommendations to the Committee.

4.2 If so, it is important that firstly a solid understanding of the issues is obtained by all Board members prior to reaching any conclusions. This would have an immediate impact on the training programme of the Board. However, there are several readily accessible sources of good information, e.g. LAPFF publications and reports by individual asset managers.

4.3 The DCLG guidance under Regulation 7 (2) (e) is very carefully worded, but the Chair's understanding is that it was so written to respect the fact that Boards do contain representatives of scheme members, who may individually or collectively have a view on these dimensions.

4.4 When reflecting on Paragraph 9.2 of the Committee report (passive investing), the Board may be interested to learn from its passive provider what proportion of other LGPS clients take a similar agnostic view to Powys, and what proportion do expect ESG issues to be taken into consideration. The Chair is aware that benchmarks can easily be identified for passive portfolios which do take ESG factors into account.

4.5 When reflecting on Paragraph 9.3 of the Committee report (active investing), the Board may wish to consider the extent to which it could / should be appropriate for the Committee (or perhaps the Board on behalf of the Committee) to receive reports on the extent to which each asset manager takes ESG issues into account and the extent to which, if measurable, it impacts on investment performance. The DCLG guidance states that "*Poor governance can negatively impact shareholder value. Stewardship aims to* *promote the long term success of companies in such a way that the ultimate providers of capital also prosper."* The Chair is aware that a well-respected international professor of investment governance claims that investing in well governed companies and focusing on the long term should outperform by at least 1.5% per annum.

4.6 The Chair is aware of lobby groups who scrutinised the ISS's of the LGPS sector with a view to identifying how few referred explicitly to the financial risks emanating from climate change. The Board notes that the Powys ISS does not address the issue of climate change risk on investment performance.

5. Regulation 7(2)(f) - The exercise of rights (including voting rights) attaching to investments

5.1.1. The DCLG guidance states that:

> "*Administering authorities should become Signatories to the (Stewardship) Code and state how they implement the seven principles and guidance of the Code, which apply on a "comply or explain" basis."*

5.1.2. The ISS shows the following:

> *"11.2 The County Council is aware of the UK Stewardship code. Although it has not formally signed up to the Code it aims to abide by the principles of the code where appropriate*."

5.1.3. The Board, acknowledging that the guidance reads "***should** become signatories*" rather than "must", may wish to comment on the Powys position.

6. The Wales Pensions Partnership

6.1 The Board recognises that work will have taken place within the Wales Pensions Partnership on the above issues, and equally recognises the fact that this might be leading to future changes in the ISS of Powys. Nevertheless, the Board will retain its role is assisting the Authority comply with legislation and manage its administration efficiently.

7. Further Information

7.1 The Board may wish to request sight on any proposals for an ESG policy on an All Wales basis.

7.2 The Board may wish to learn whether any of the eight Boards in Wales have had an involvement with ESG issues under Regulation 7 (2) (e), and if so, what was their role.

7.2 The Board may wish to identify how many of the eight Funds in Wales are now signatories to the UK Stewardship Code.

The Board is invited to offer its comments on this paper.

Gerard Moore

Independent Chair: Powys Pension Board 28 December 2017