



Report of: **Assistant Chief Executive (Governance and HR)**

Meeting of:	Date	Agenda item	Ward(s)
Pensions Sub-Committee	15 July 2014	B7	n/a

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SUBJECT: STATEMENT OF INVESTMENT PRINCIPLES AND ETHICAL INVESTMENT

1. Synopsis

- 1.1 To report to the Pensions Sub-Committee on the latest legal advice on the extent to which social, ethical or environmental implications can be taken into account in investment decisions.

There are two tests to be applied: (i) whether a local or ethical investment will generate a risk-adjusted return which is at least as good as alternatives; and (ii) whether a local or ethical investment can be made without materially increasing risk because the diversity of investments chosen is significantly reduced.

2. Recommendations

- 2.1 To consider and note the advice of Nigel Giffin QC to the Council that changes would need to be made to the Statement of Investment Principles (SIP) to allow for social, ethical or environmental considerations to be taken into account in the choice of investments.
- 2.2 To consider whether changes should be made to the SIP to allow for ethical investment and, if so, to consider options for formulating what considerations are to be taken into account and in what way.

3. Background

- 3.1 Regulation 12(2)(f) of the Management and Investment of Funds Regulations requires that the Statement of Investment Principles (SIP) must be a statement of the principles governing the authority's decisions about the investment of fund money, which covers the extent to which social, ethical or environmental (SEE) considerations are taken into account in the selection, retention and realisation of investments.
- 3.2 The current SIP (Appendix A) does not allow for SEE considerations to be taken into account in the

choice of investments. Paragraphs 25-28 appear to relate only to the way in which shareholder rights will be exercised.

- 3.3 If Pensions Sub-Committee wishes SEE considerations to influence the choice of investments, it will need to consider what considerations are to be taken into account and in what way, as a matter of policy. It would not be satisfactory merely to refer in a generalised way to SEE considerations being taken into account without giving an indication of how that is to be done. Such a policy will need to be limited by reference to an overriding requirement that it is not to risk material financial detriment or result in a failure to invest in a sufficiently wide range of investments. It would be appropriate to build in some regard for professional advice.
- 3.4 Nigel Giffin QC has recently advised the LGPS Advisory Board that an administering authority for Local Government Pension Scheme Funds may choose to take into account, e.g., the public health implications of tobacco investment, but only if the result of such a choice is the substitution of those investments with assets producing a similar return.
- 3.5 The administering authority owes fiduciary duties both to the scheme employers and to the scheme members. Although not strictly speaking a trust fund, an LGPS fund is closely analogous to one. The way in which it is administered may have a significant financial impact upon employers, local taxpayers and members.

The existence of fiduciary duties does not make much difference to what the position would be if analysed simply in terms of the obligations imposed upon the administering authority as a matter of public law, i.e. obligations to exercise discretionary powers rationally, for a proper purpose and by reference only to legally relevant considerations.

This means that in managing an LGPS fund, the administering authority has both fiduciary duties and public law duties (which are in practice likely to come to much the same thing). The power/duty to invest fund monies is a power of investment. Therefore it must be exercised, when it comes to the discretion to choose one investment rather than another, for investment purposes, and not for some other purpose. 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).

It therefore follows that it would be impermissible, for example, for the administering authority to invest fund monies in local businesses, because it was thought important to the creation of jobs in the local area, in circumstances in which that was not likely to be a good or prudent investment (as compared with other investments that might be made). Investments generating benefits to the local economy can be chosen if they are as good as any other investments in an asset class, but care must also be taken to diversify risk which concentrating investments into a limited geographical area might cause.

Similarly, it would not be permissible to invest in social housing just because there was a need for more such housing, if that was not a good and prudent investment. Nor would it be permissible to exclude from the fund investments to which objection was taken on health, environmental or ethical grounds, if that was likely to have an adverse impact upon the returns achieved or to lead to the fund being exposed to an unduly narrow and undiversified investment portfolio.

However, 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. So, for example, if social housing was a good investment financially, and the precise location was immaterial, the authority for the Greater Manchester Pension Fund could choose to invest in social housing in Greater Manchester rather than in Cornwall. Similarly, if tobacco investments were seen as deleterious to the health of the population, they could be avoided if but only if that did not significantly reduce the diversity of investments or the returns likely to be achieved.

In having regard to 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). What this means in practical terms is that the administering authority, when acting as such, must be blind to its own wider interests insofar as they may diverge from or conflict with those of the other parties interested in the fund.

So it would not be permissible to invest in, say, a social housing project in the administering authority's own area, rather than one in the area of another authority, because of that location, unless the expected returns from the local project were at least as good as returns from investments in other areas (although it would be permissible if that project was chosen simply because it was the best investment proposition).

If it is only going to be possible to terminate an investment in, say, a payday lender by accepting a substantial financial cost, or at a substantial financial discount on its market value, that is probably going to be hard to justify (even though the total figures may not seem to be very large in the scheme of things). That aside, there is unlikely to be a legal problem in not investing in payday lenders on SEE grounds, provided (although this is a matter for investment advice) that they are too economically insignificant for this to represent a material narrowing of the diversity of the investments, and that they do not offer some especially attractive rate of return that could not otherwise be achieved. Ultimately, though, the effects of any SEE policy that may be formulated need to be considered as a whole. If it is suggested that the Council should not invest in a payday lender because its business model is not sustainable in the long term, i.e. it is a bad investment, then (if that is right) a decision genuinely taken on those grounds would have nothing to do with SEE considerations – it would be no different from any other investment decision.

- 3.6 Nigel Giffin QC has also advised the Council that changes would need to be made to the SIP in order that SEE considerations can be taken into account (so long as that does not risk material financial detriment to the fund).

4. Implications

4.1 Financial implications:

- 4.1.1 The financial implications are included in the body of the report.

4.2 Legal Implications:

- 4.2.1 The legal implications are included in the body of the report.

4.3 Equality Impact Assessment:

- 4.3.1 The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding.

- 4.3.2 An equalities impact assessment has not been conducted because this report is not considering any policy changes at this stage.

4.4 Environmental Implications

- 4.4.1 Environmental considerations can lawfully be taken into account in investment decisions.

5. Conclusion and reasons for recommendations

- 5.1 Members should consider what they wish the SIP to achieve and whether they wish officers, who deal with the investment of the fund, to formulate the nature of a possible policy for further consideration by Pensions Sub-Committee.

Appendix A – Statement of Investment Principles

Background papers: none

Final report clearance:

Signed by:

Received by: Assistant Chief Executive (Governance and HR) Date

Head of Democratic Services Date

Report Author: Peter Fehler
Tel: 020-7527 3126
Fax: 020-7527 3042
Email: peter.fehler@islington.gov.uk