CITY OF YORK COUNCIL

Climate Change Policy & Scrutiny Committee 10 March 2020

Report of the Head of Corporate Finance & Commercial Procurement (interim s151 officer)

Responsible Investment

Summary

1. This report outlines the current position on both the council’s investments and those of the North Yorkshire Pension Fund to ensure funds are invested responsibly. It also outlines the statutory regulations that cover the investment of council funds and the work that has already been done in this area by other committees, including Audit & Governance Committee and the Executive.

Recommendation

2. The Committee are asked to consider the issues outlined in the report.

Background

3. The way councils invest their funds is heavily regulated through statute and formal guidance. This investment guidance, both statutory and from CIPFA, makes clear that all investments must adopt SLY principles – security, liquidity and yield: any other issues must play a subordinate role to those priorities.
4. The council therefore has a statutory obligation when considering where to invest any surplus funds. The SLY prinicples mean that we are required to firstly ensure that funds we invest will be returned to us. Secondly that we can access the funds when needed. And thirdly, we are required to secure the best possible return on taxpayers funds after considering the requirements of security and liquidity.
5. The council’s investment policy, including the management of risk and the process to be followed in determining where to invest, is set out in the Treasury Management Strategy Statement and Prudential Indicators for 2020/21 to 2024/25 as reported to Executive and agreed by Full Council in February 2020.
6. The council is a member of the North Yorkshire Pension Fund. Pension Funds are invested on behalf of their members, ie staff who pay into and receive a pension from the fund.

Analysis

7. Much work has already been done by the council to ensure we invest funds responsibly. Executive have recently agreed that a 4^{th} criterion is added to cover ethical, social and governance issues. Therefore, after the statutory SLY principles have been considered, the council will then consider this 4^{th} criterion using the FTSE4GOOD index.

8. To be included in the FTSE4Good Index, companies must, for example, support human rights, have good relationships with the various stakeholders, make progress to become environmentally sustainable, ensure good labour standards not only for their own company but for companies that supply them as well, and fight bribery and corruption. An independent committee of experts develop the criteria and regularly update and review conformity to their Ethical, Social and Governance (ESG) standards.

9. Companies automatically excluded from the index series are tobacco companies, manufacturers of nuclear weapon systems, manufacturers of whole weapons systems, utilities involved in producing electricity from nuclear power, and businesses involved in the mining or processing of uranium. Oil and gas companies are not dismissed out-of-hand; instead, they are evaluated based on their efforts to reduce production of fossil fuels and evolve their business into more environmentally-friendly operations.

10. In February 2016 Audit & Governance Committee received a report that covered;

    - information on CYC's own investments;
    - information gathered from other Local Authorities and;
    - details of North Yorkshire Pension Fund investments policy and investment in fossil fuels.

11. That report outlined that, whilst the council does not have any direct investments with fossil fuel companies it could, indirectly, be investing in fossil fuels. The council only invests in money market funds or directly with banks and building societies but has very little information as to where these counterparties place their funds. A money market fund is comprised of short-term securities representing high-quality, liquid debt and monetary instruments. Money market funds are widely regarded as being as safe as bank deposits yet providing a higher yield. Unlike stocks, money market fund investments are always worth the same. What changes is the rate of interest they earn.

12. It is important to note that the surplus funds the council has available are predominantly of a short term duration as they depend on the cash flow of payments in and out of the authority. This means that they are of little interest to anyone other than bank type institutions where they help with their liquidity. They would not, for example, be attractive to any other institutions

looking for longer term investment funding. There is never any direct council investment in companies and there is no trading on the stock market.

North Yorkshire Pension Fund

13. The North Yorkshire Pension Fund (NYPF) is actively working on a responsible investment strategy and is currently looking to work alongside Borders to Coast Pensions Pool (BCPP) to develop its strategy and that involves another 11 Pension Funds. There is a responsible investment strategy workshop due to be held in the next few weeks in order to gauge the views of all 12 members of BCPP. This also provides an opportunity to share the thinking and will be led by the responsible investment team employed within BCPP.

14. North Yorkshire Pension Fund also holds just over £1bn of equities outside of BCPP. The plan is that just under half of this will eventually be invested in other assets so in the longer term should be discounted. There is still, however, a significant investment in 1 particular fund which is run by Baille Gifford and is called the Local Term Global Growth Fund. This particular fund is invested in stocks that are seen to have long growth potential and it holds a significant stake in Tesla for example. Stocks with a long term outlook will inevitably be concerned with sustainability so NYPF is well placed in this regard.

15. Section 7 of the North Yorkshire Pension Fund (NYPF) Investment Strategy Statement deals with Socially Responsible Investments. An indication of the percentage of the fund that is invested in fossil fuels was not available at the time of writing but a verbal update will be provided at the meeting.

16. The overriding obligation of the NYPF is to act in the best financial interests of the Scheme and its beneficiaries. It is recognised that environmental, social and governance (“ESG”) factors can influence long term investment performance and the ability to achieve long term sustainable returns. Investment advice received by the Fund implicitly includes these factors. Therefore, as a responsible investor, the Committee wishes to promote corporate social responsibility, good practice and improved performance amongst all companies in which it invests.

17. The Committee also considers the financial impact of ESG factors on its investments through regular reporting by the Fund’s investment managers. Engagement with company management and voting behaviour are integral to investment processes aimed at improving performance in companies in which they invest.

18. As well as delegating the Fund’s approach to ESG issues to its investment managers, NYPF is also a member of the Local Authority Pension Fund Forum (LAPFF) which is the UK’s leading collaborative shareholder engagement group. This organisation promotes ESG good practice on behalf of over 70 LGPS funds. Its activity acts as a complement to that undertaken by the Fund’s investment managers. Any differences in approach are discussed with the Fund’s investment managers so that the reasons are fully understood.

19. Any evaluation of social investments is made on the same basis as other investment opportunities, in taking into account financial and non-financial factors.

20. All pension fund investments are made by external investment management companies, all of which are signatories to the UN PRI (principles for responsible investment) which states:

    “As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

    - We will incorporate ESG issues into investment analysis and decision-making processes.
    - We will be active owners and incorporate ESG issues into our ownership policies and practices.
    - We will seek appropriate disclosure on ESG issues by the entities in which we invest.
    - We will promote acceptance and implementation of the Principles within the investment industry.
    - We will work together to enhance our effectiveness in implementing the Principles.
    - We will each report on our activities and progress towards implementing the Principles.

21. Pension funds can be instrumental in improving the behaviours of the companies in which it invests and can be a positive way of encouraging change.

Implications

Financial

22. There would potentially be financial implications if the council were unable to invest in the best value investment opportunities available. As outlined in the report, the council only invests surplus funds that are available on a temporary basis. As at 31st January 2020, the council has £27m invested in banks, building societies and money market funds and was earning an average return of 0.73%.

Legal Implications

23. Treasury Management activities have to conform to the Local Government Act 2003 and statutory guidance issued under that Act, the Local Authorities (Capital; Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), which specifies that the council is required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and also the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414), which clarifies the requirements of the Minimum Revenue Provision guidance.
24. In 2014 the Local Government Association (LGA) obtained legal opinion, on behalf of its members, on the duties owed by local government pension funds and the factors they can legitimately take into account when making investment decisions. The principles can apply equally to investment decisions made by local authorities generally. Public bodies making investments have both fiduciary duties and public law duties (which are in practice likely to come to much the same thing).
25. The power to invest 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 (or the council in the case of wider investment decisions) balancing risk and return in the normal way. This is consistent with the Government Guidance issued under the 2003 Act which indicates that investment decision should be made on the basis of security, liquidity and then yield in that order.
26. The council could only use other considerations (including those around fossil fuels and other ethical considerations) to choose between investments which were otherwise broadly equivalent in terms of security, liquidity and yield.
27. However, 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).

Other Implications

28. There are no HR, Equalities, crime and disorder, information technology or other implications as a result of this report

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<tr><td colspan="2">Contact Details</td></tr>
<tr><td>Author</td><td>Chief Officer responsible for the report</td></tr>
<tr><td>Debbie Mitchell
Head of Finance & Commercial Procurement (interim s151 Officer)

Ext 4161</td><td>Debbie Mitchell
Head of Finance & Commercial Procurement (interim s151 Officer)</td></tr>
<tr><td></td><td>Report approved 28/02/2020</td></tr>
<tr><td>Wards affected</td><td>All</td></tr>
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Background papers

February 2016 report to Audit & Governance Committee -Treasury Management Strategy Statement and Prudential Indicators for 2016/17 to 2020/21

North Yorkshire Pension Fund investment policy

February 2020 report to Executive – Treasury Management Strategy Statement and Prudential Indicators for 2020/21 to 2024/25