

| | |
|--------------------|----------------|
| Agenda Item | 4 |
| Report No | PC/2/22 |

HIGHLAND COUNCIL

Committee: Pensions Committee

Date: 14 February 2022

Report Title: **Highland Council Pension Fund Responsible Investment policy**

Report By: Head of Corporate Finance

1. Purpose/Executive Summary

- 1.1 This report provides a copy of the Responsible Investment policy for the Highland Council Pension Fund (“the Fund”) for approval.
- 1.2 During 2021, a series of 3 workshops were held with the Pensions Committee and Board members as follows,
 - initial training session on Responsible Investment (10 September).
 - survey was issued to Members of the Pensions Committee and Board on Responsible Investment and session held to agree consensus on the approach to Responsible Investment (22 September).
 - draft Responsible Investment policy was reviewed by Pensions Committee and Board members (4 November).
- 1.3 The key objective from these workshops was to establish a consensus on principles and beliefs and develop a Responsible Investment policy for the Fund.

2. Recommendations

- 2.1 It is recommended that Committee approve the Highland Council Pension Fund Responsible Investment policy.

3. Implications

- 3.1 Resource – As covered in the report.
- 3.2 Legal – none

- 3.3 Community (Equality, Poverty and Rural) – none
- 3.4 Climate Change / Carbon Clever – As covered in the report.
- 3.5 Risk – As covered in the report.
- 3.6 Gaelic – none

4. Background

- 4.1 The Committee recognises that they have a fiduciary duty to act in the best financial interest of members of the Fund and ensure that the objectives of the Fund are met and aim to seek the best investment return to meet the funding objective subject to an appropriate level of risk and liquidity.
- 4.2 Alongside the fiduciary duty, as a long-term investor, the Committee (and, by extension, our appointed fund managers and our advisor) recognise that they should incorporate Ethical Social Governance (ESG) risks into investment decision making process, as the long-term value of investments may be negatively impacted if these risks are not understood or evaluated properly.
- 4.3 As noted in 1.2 above, 3 workshops were held to establish a consensus on principles and beliefs which are documented in the section 3 of the Fund's Responsible Investment policy and the policy then sets out the responsible investment approach that will be implemented by the Fund.
- 4.4 In order to implement the Responsible Investment policy, during the next year Officers will set up new processes and develop reporting with support from the Investment Advisor as required.
 - Section 4 of the Responsible Investment policy outlines the areas where processes will be introduced for ESG risk monitoring and assessment and sets out the Fund's expectations of our Fund Managers and monitoring, as well as the requirement for ongoing training for the Committee on responsible investment.
 - Section 5 details the work that will be undertaken on monitoring and reporting Stewardship, Voting and Engagement.
 - Section 6 recognises the benefits of collaborating with others and supporting broader initiatives as a powerful tool to influence behaviours.
- 4.5 The Responsible Investment policy will be a dynamic document which Committee and Officers will review regularly and update to reflect the Fund's view and the changing landscape with respect to ESG issues and broader industry developments (section 7).

Designation: Head of Corporate Finance

Date: 2 February 2022

Author: Catriona Stachan, Principal Accountant



**Highland Council Pension Fund
Responsible Investment Policy**

February 2022

1. Purpose

- 1.1 The purpose of this policy is to set out our Responsible Investment beliefs and principles, and to detail the approach we are taking to fulfil our commitments.

2. Introduction

- 2.1 The Highland Council (the "Council"), in its capacity as Administering Authority, has responsibility to administer the Highland Council Pension Fund (the "Fund"). The Council has delegated to the Pensions Committee (the "Committee") all the powers and duties of the Council in relation to its functions and authority. We are therefore responsible for making all investment decisions regarding the Fund.
- 2.2 As the Committee, we recognise that it is our fiduciary duty is to act in the best financial interest of members of the Fund and ensure that the objectives of the Fund are met. We therefore aim to seek the best investment return to meet the funding objective subject to an appropriate level of risk and liquidity.
- 2.3 *We define Responsible Investment ('RI') as the integration and consideration of environmental, social and governance ('ESG') issues into both initial asset investment processes and then ongoing asset ownership practices.*
- 2.4 We recognise that, as a long-term investor, we (and, by extension, our appointed fund managers and our advisor) should incorporate ESG risks into our investment decision making process, as the long-term value of investments may be negatively impacted if these risks are not understood or evaluated properly. When referring to ESG issues, we consider financially material considerations (including climate change).
- 2.5 In developing the Fund's approach to RI, we seek to understand and manage ESG considerations to which the Fund is exposed, to the extent that these may impact on the Fund's asset portfolio or overall strategy.
- 2.6 This policy sets out our beliefs and approach to RI, including actions taken on behalf of members and other stakeholders which aim to capitalise on ESG opportunities and to protect the Fund from ESG-related risks.

3. Our beliefs and principles

- 3.1 We have discussed and agreed consensus beliefs and principles relating to RI. These beliefs and principles form the basis of our policy and are set out below.
- Environmental, social and governance (ESG) factors are financially material; taking them into account is consistent with the Committee's fiduciary duty to members of the Fund.

- The Fund is a long-term investor, and the Committee will invest in a manner that is consistent with that long-term outlook: investing in this manner is expected to generate greater and more sustainable risk-adjusted returns. The Committee expect the Fund's appointed fund managers to, likewise, make decisions with longer term ESG risks in mind.
- Taking ESG considerations into account may lead to better risk-adjusted returns, and it is therefore important that our appointed managers incorporate these matters into their decision making on asset selection, realisation, and retention.
- While risk and return considerations are key to ensuring the Fund's fiduciary duty to members is fulfilled, financial factors should not be the Fund's only consideration when making investment decisions: wider social and environmental impact are important. In particular, awareness of negative environmental or social impacts arising from the Fund's investments is important in considering mitigation.
- Climate change is a key risk factor to the Fund which may impact on the achievement of its investment return objectives over the relevant time horizon. Therefore, climate-related matters should be assessed and understood in order to protect the Fund from this risk, and capture opportunities arising as a result of the transition over time to a low-carbon economy.
- The Committee will seek advice and information from its advisor with regard to how the Fund's approach to climate risk mitigation and management can develop over time, including with respect to setting relevant targets (such as 'net zero') and ongoing monitoring of the Fund's position.
- Social and Governance factors are important, both from a financial and non-financial point of view. The Committee's three most important ESG issues are climate stability, healthy ecosystems, and basic needs, and the Committee will consider the UN Sustainable Development Goals pertaining to these issues in particular when considering the Fund's implementation.
- Acting as responsible stewards of capital is important, and the Committee believes in the value of engagement. To that end, the Committee expects that the Fund's voting rights are exercised to the fullest extent possible, and that the Fund's managers will actively engage with underlying assets to encourage continued development of sustainable business practices, transparency, and inform their decision making on investment selection, realisation, and retention.
- The Committee recognise that the Fund's members may have an interest in how RI is incorporated as part of the Fund's investment strategy. Accordingly, the Committee will incorporate the RI policy and approach into member communication and engagement.

4. Our Responsible Investment approach

4.1 We take the important steps and follow the procedures below in order to ensure our investment strategy is aligned with our beliefs and principles toward RI.

4.2 Committee decision making

We aim to integrate consideration of ESG issues throughout all aspects of our investment decision making process, including modelling and setting investment strategy and monitoring the Fund's investment managers. We are supported in these aims through regular and ongoing input from, and engagement with, our investment advisors.

We do not apply personal, ethical or moral judgments when making investment decisions, and instead remain focused on the primary objective of acting in the best financial interests of the Fund's members. With the support of our advisors, we consider the availability, suitability and depth of conviction in an idea or strategy prior to investing and will take into account the expected cost versus potential benefit from a member perspective in line with our fiduciary duty.

We undertake periodic training on RI to understand how ESG factors, including climate change, could impact the Fund's assets/liabilities and members' retirement outcomes.

4.3 ESG risk monitoring and assessment

Our processes to monitor and assess ESG-related risks and opportunities include the following:

- Our investment advisors monitor the Fund's underlying managers on an ongoing basis, including detailed due diligence to assign an 'ESG rating' to underlying managers which reflects the quality of and commitment to ESG integration. We discuss and monitor ESG ratings of the Fund's investment manager on an ongoing basis.
- We recognise that developments will continue in this area. We ask our investment advisors to highlight appropriate opportunities to invest in responsible investment strategies and will give due consideration to any proposals.
- We will include ESG-related risks, including climate change, on the Fund's risk register as part of ongoing risk assessment and monitoring.
- At least as part of each formal triennial investment strategy review, we will specifically consider RI issues, including the merits of strategies which seek to generate not only positive financial returns, but also seek to make a wider positive impact on society.
- With support from our advisor, we will consider the recommendations of the Taskforce on Climate-related Financial Disclosures ("TCFD"), which has established a set of clear, comparable and consistent recommended disclosures about the risks and opportunities presented by climate change.

- As part of formal investment strategy reviews, we will consider qualitative and quantitative climate change scenario analysis to review the potential risks and consider mitigating action as required.
- We expect our investment managers to understand our RI principles, beliefs and requirements. We provide our Policy to advisors and appointed fund managers and ask them to confirm their adherence.
- In the event that any fund manager or service provider does not meet any of the expectations listed in this policy, the Officers will engage with the respective stakeholders to encourage improvements in processes, transparency or activity as required.

4.4 Expectations and monitoring of investment managers

- As part of our delegated responsibilities, we expect the Fund's investment managers to take account of financially material ESG considerations (including climate change) in the selection, retention and realisation of investments. Whilst we do not expect all our investment managers to explicitly take into account non-financial ESG considerations, we do expect transparency on these matters in order to facilitate a full understanding of the Fund's investments.
- We, with the support from our advisors, carry out a periodic review of the ESG profile of the investments. The use of third-party data from MSCI, manager data from the Principles for Responsible Investment ("PRI") alongside commentary from the advisor, can support the Committee in identifying areas of potential ESG risk and engagement opportunities.
- We expect investment managers to align with the UK Stewardship Code Principles and PRI objectives. Where managers are not signatories to these codified principles, we will assess with our advisor how the manager is implicitly aligned as part of our monitoring.

4.5 Implementation

- Where applicable, we invest in assets that meet at least a certain minimum threshold ESG rating/requirement, and this threshold will be reviewed on a periodic basis to ensure that it meets our evolving requirements.
- We recognise that new investment solutions often come to market which aim to address both risks and opportunities presented by global challenges. We will consider such new investment solutions (across all asset classes) that are raised by the Fund's advisor and will assess the suitability of such investments within the context of the wider Fund in discussion with its investment advisor. For example, , the Committee have re-allocated to the Paris Aligned version of the Global Alpha strategy managed by Baillie Gifford, which aims to address climate and societal challenges through the net-zero transition by 2050.
- We expect the Fund's appointed fund managers to be transparent in their approach,

including their approach to stewardship, how they integrate ESG into their investment decision making process and consideration of social and environmental impact matters.

- We expect the Fund's investment managers to provide their RI policy to us and our advisors periodically, including details of their approach to stewardship, how they integrate ESG into their investment decision making process and approach to non-financial factors. When we look to appoint a new investment manager, we request and consider this information as part of the selection process. We review responses with support and input from the Fund's investment advisor.

4.6 Training

On a regular basis, the Committee will receive training on relevant RI matters, not limited to evolving regulatory requirements.

5. Stewardship, voting and engagement

5.1 We recognise the importance of our role as a steward of capital. Whilst we recognise that we do not control (or wish to control) the investment decisions that our investment managers take on our behalf, we believe in using our influence, where possible, through those fund managers to promote the highest standards of governance and corporate responsibility in the underlying companies in which the Fund's investments reside. We recognise that ultimately this protects the financial interests of the Fund and its beneficiaries.

5.2 We therefore expect the Fund's investment managers to use their influence as major institutional investors to carry out our rights and duties as a shareholder including voting, along with – where relevant and appropriate – engaging with underlying investee companies.

5.3 We request details on an annual basis of how the Fund's investment manager is undertaking voting and engagement activity.

5.4 Where possible, voting information should include details of voting actions and rationale with relevance to the Fund, in particular, where:

- votes were cast against management;
- votes against management generally were significant and
- votes were abstained

5.5 Similarly, engagement activity disclosures should be of relevance to the Fund's investments and include information on the rationale and outcome of engagement activity.

5.6 We review the stewardship activities on an annual basis with input from the Fund's investment advisor and will engage with managers as required.

6. Initiatives and industry collaboration

- 6.1 We recognise that collaboration with others and support of broader initiatives can be a powerful tool to influence behaviour.
- 6.2 We expect the Fund's investment managers to consider collaboration with others, as permitted by relevant legal and regulatory codes, where collaboration is likely to be the most effective mechanism for encouraging positive change at investee companies/issuers.
- 6.3 We expect our advisors to keep us informed of relevant global and industry initiatives and may consider participating in opportunities where there is appropriate alignment with our beliefs and principles.

7. Evolving our approach

- 7.1 We acknowledge that the Fund's approach to RI will need to continually evolve, due to both the changing landscape with respect to ESG issues and broader industry developments.
- 7.2 We are committed to making ongoing improvements to our approach and the processes that underpin the delivery of this policy and are focused on making sure that it remains relevant and appropriate for our members.

8. Disclosure and reporting

- 8.1 We believe transparency is important. In support of this belief, we will consider our approach to incorporating this policy and its direction in engaging with members. This policy supplements additional disclosures and information available as part of our Statement of Investment Principles.
- 8.2 We will review this policy annually, as part of each formal triennial investment strategy review, or as required in response to changing regulations or broader governance issues.