

Highland Charter for Responsible Investment: Report on the discussion of the Statement of Investment Principles at the meeting of Highland Council Pension Fund Committee (18.03.2021)

1. Revised Statement of Investment Principles

Compared to the previous version (08.02.2018), the revised *Statement of Investment Principles*, clearly shows the influence of local campaigning and of the campaign for a *Highland Charter for Responsible Investment*, in particular.

The relevant section of the document, Section 17, has been renamed *Responsible Investing*.

Although paragraphs 17.3 - 17.6 are broadly similar to the earlier document, there are some important differences in Section 17 over all, and one very significant addition to para 17.6.

Para 17.1 contains a new acknowledgement of the Fund's 'responsibilities as an institutional asset owner with long term liabilities' and a commitment to 'effective stewardship of all the Fund's assets'. There is a degree of ambiguity in the final clauses of para 17.1 when it talks of focusing on 'good corporate governance to deliver sustainable investor value'. Does 'good corporate governance' include attention to environmental, social and ethical issues?

Para 17.7 draws attention to the pension fund's recent membership of *the Institutional Investors' Group on Climate Change (IIGCC)*.¹ 'This allows the Fund to be aligned with and contribute to one of the leading organisations challenging corporate entities over their climate change policies such as Climate 100+.'

Para 17.6 contains an important additional statement compared to the equivalent paragraph from 2018. It now says that the Fund will 'Consider potential Fund Manager's approach to ESG issues during the procurement process.' This is significant because it introduces an element of screening into *HCPF's* investment practices. According to the minutes of an Investment sub-Committee meeting held on the 5th February, the committee is considering appointing a new fund manager, *Robeco*, who are committed to the *United Nations Sustainable Development* goals and consequently do not 'invest in any companies involved in the Arms trade or for example, companies that had a large carbon footprint.'

Most significantly, from our point of view, para 17.2 commits the fund to holding a workshop for committee members, 'With a view to developing and publishing a *Responsible Investing Policy Statement* that is consistent with the Fund's fiduciary duty.' Drawing up such a policy was a central recommendation of the *Charter*. The Head of Finance, Edward Foster, made it clear in the meeting that this workshop will have a key role in determining future investment policy [14:36].

2. Fiduciary duty and environmental, social and governance issues

Throughout the discussion, committee members of all shades of opinion consistently contrasted their 'fiduciary duty' with the need to take account of 'ESG issues'.

¹ Major UK pension funds worth nearly £900bn commit to net zero (<https://www.theguardian.com/business/2021/mar/10/major-uk-pension-funds-worth-nearly-900bn-commit-to-net-zero>)

Cllr Craig Fraser, for example, argued that, 'The Highland Council has a humanitarian duty as well as a fiduciary duty and rightly so.' [11.20] Expressed in these terms, this is, unfortunately, quite a weak argument when set against opinions based on some English and Scottish pensions case law. Legally, pension funds are competent to take account of ethical issues in regard to their investments, and that legal competence needs to be clearly recognised and stated as such.

The two Conservative members of the committee, Cllr Peter Saggars and Cllr Andrew Jarvie, argued in favour of a narrow definition of fiduciary duty: 'We have a fiduciary duty to invest for the benefit of the members of the pension scheme and for the employers to achieve the best financial position for the scheme.' [19.33] While investment fund managers are encouraged 'to engage with the companies they invest in on ESG matters', they should do so only in so far as 'an investment may be adversely affected by any ESG factors ... we must not allow any personal feelings about armaments companies, oil, coal-mining, to affect the decisions or the instructions that we give to our investment managers.'

They based their arguments on two legal cases: 'Cowan v Scargill' (1985) and 'Martin v City of Edinburgh' (1988). Both cases concern the scope of pension trustees to determine the direction of investment decisions, and their responsibility towards the financial interests of scheme members. 'Martin v City of Edinburgh' refers to a legal challenge brought against Edinburgh Council's decision to disinvest assets in South Africa during the Apartheid period.²

Both cases are now more than thirty years old, and there has been a significant evolution in legal arguments regarding 'fiduciary duty' since then. However, even in the case of 'Martin v City of Edinburgh', Lord Murray expressed the opinion that, 'I cannot conceive that trustees have an unqualified duty .. simply to invest trust funds in the most profitable investment available. To accept that without qualification would, in my view, involve substituting the discretion of financial advisers for the discretion of trustees'.

It's notable that Cllrs Saggars and Jarvie didn't cite more recent judgements such as 'PSC v Secretary of State for Housing, Communities and Local Government' (2020).

It's clear that members of the HCPF Committee are unclear about their legal responsibilities and their scope for decision-making, and have not been properly-briefed on the concept of a 'modern fiduciary duty'. Even Cllr Jarvie seemed uncertain: 'But chair, could you direct my question to the right person, of exactly what we are here for? And to address some of the comments made by some members because it's certainly not what I understand but I'm happy to stand corrected if that's the case.' [58.26]

This highlights the need to ensure that councillors are properly briefed ahead of the workshop.

3. Divestment and the UN Convention on the Rights of the Child

Councillors Derek Loudon and Craig Fraser both made strong cases for HCPF divesting its shares in US arms company, *General Dynamics*. They linked this argument to the Scottish Government's intention to incorporate the *UN Convention on the Rights of the Child (UNCRC)* into Scottish law.

The four core principles of the *UNCRC* include 'devotion to the best interests of the child' and 'the right to life, survival and development'.

² <https://www.sackers.com/pension/martin-v-city-of-edinburgh-ct-sess-13-november-1987/>

The United Nations Convention on the Rights of the Child (Incorporation) (Scotland) Bill would make it ‘unlawful for public authorities to act incompatibly with the incorporated UNCRC requirements.’

Investment in an arms company that manufactures weapons that cause wide-scale civilian deaths threatens the right to life of children. Therefore, the HCPF could be acting unlawfully by investing in General Dynamics.

This highlights the relevance of an argument we have made previously, that all levels of government, including local authorities, have a duty not only to observe the law but to uphold it, and that applies to international law and international humanitarian norms just as much as to national and local legislation.

4. Divestment or engagement

We have argued that HCPF, in effect, delegates responsibility for its ethical practices to its investment fund managers, and that it operates a weak form of the ‘stewardship model’. The ‘stewardship model’ is an approach to investment that entails shareholders engaging with and holding to account the companies they invest in. While this is a valid approach to monitoring investments it needs to be based on the application of clear criteria, which should be explicit and consensual. There are, surely, though, some investments that are unacceptable, and should be excluded by common consent.

We have argued that the profile of shares held by HCPF is clear evidence of the deficiency of this approach. We have argued that the HCPF needs to introduce criteria for screening the shares it holds, and there is evidence HCPF is moving in this direction.

Paras 17.4 and 17.5 of the *Statement of Investment Principles* express HCPF’s continuing commitment to the ‘stewardship model’ of engagement. In his introductory remarks, Head of Finance, Edward Foster was at pains to stress that HCPF is putting more emphasis on fund manager engagement and on the reporting of their engagement activities. ‘And they do report that back, we have an increasing focus on that when we are meeting our managers through the investment sub-committee, they are reporting back to us with much more information on their engagement with companies.’ [03.20]

Cllr Ben Thompson, Chair of the Investment sub-Committee, clarified what this entails: ‘Engagement is fundamental to what we do in terms of our ESG policy and I would encourage anyone who has questions about our ESG policy to look at the engagement statistics of our managers. The number of times they vote against company proposals, the changes they seek, from equal pay through to workers’ rights to health and safety.’ [33.14]

This highlights a potential flaw in this approach. Large corporations have the capacity to offer superior employment conditions while, nevertheless, inflicting severe damage on the environment, or worse. HCPF needs to ensure that its investment managers don’t just engage on issues relating to company governance, while ignoring environmental, social or other ethical issues.

Cllr Thompson argued that whether the fund’s policy on ESG issues is viewed as too strong or too weak, ‘it comes down to a choice between divestment and engagement with companies. I am strongly of the view that shareholders have the responsibility to make sure that the

companies they invest in act ethically. And that can only be done through engagement.’ [33.14]

There is an inconsistency here. As we have pointed out, para 17.6 states that HCPF intends to take account of a fund manager’s ‘approach to ESG issues during the procurement process’. In other words, they are considering excluding in advance certain kinds of investments. If they can do this prospectively why can they not do it retrospectively, and possibly make amends for what turned out to be poor investment decisions?

In relation the HCPF’s shares in General Dynamics, Cllr Fraser asked the Chair of the Committee, ‘what’s the actual procedure for Highland Council to consider divesting this asset and also consider divesting some of the fossil fuel held assets?’ [11.20] At which it became clear that currently there is no procedure. Edward Foster suggested that this would be an issue they could consider at the forthcoming workshop. ‘I think actually going for an approach where you are looking at excluding particular sectors, that may well have one, an administrative element of it, but two, looking at what any financial implications of that might be are also key. So I think that workshop is maybe the next step to look at what can we do and how quickly can we do it.’ [14.36]

Cllr MacWilliam asked for an example ‘of where the committee has made a request of the fund manager to shift an investment to either take an investment out or to invest in a particular stock as a result of public representations through the democratic process?’ [51.25] To which Cllr Thompson replied, ‘Chair, can I offer a very brief comment as the chair of the committee which regularly meets with the investment managers? We meet investment managers at every meeting of the ISC and part of those discussions are around the investments within the portfolio and we regularly challenge them on individual investments. It’s their decision as to how they act not the sub-investment committee’s, but we do challenge them.’ [53.53]

We would argue that ‘engagement’ on its own is insufficient, and that a clear policy on screening of investments would strengthen the ISC’s ability to engage with fund managers and to challenge their decisions.

5. Transparency, accountability and representation

There is evidence that HCPF is responding to concerns raised by the local community and that it is trying to interpret its fiduciary duty in a way that takes account of longer-term, sustainability issues. The commitment to holding a workshop ‘with a view to developing and publishing a *Responsible Investing Policy Statement*’ is very welcome, and a direct response to one of the key recommendations of the *Highland Charter for Responsible Investment*. However, there is also resistance, and not only the more obvious resistance exemplified by Cllrs Saggars and Jarvie. While some committee members happily acknowledged the need to represent and reflect the views of the wider community, others seem uncomfortable with being ‘lobbied’ by their constituents. This goes to the heart of the issues raised by the *Charter* campaign: whether and to what extent HCPF regards itself as democratically accountable, and what appropriate forms or format that accountability should take?

In response to a question from Cllr Nicholson regarding the *Charter*, Cllr Thompson made two statements that fundamentally misrepresent the recommendations of the *Charter*. First of all, he suggested we were advocating extensive ‘internal investment control’ that, in his view, would require employing a substantial staff. On the contrary, we have recommended establishing an ‘advisory body’ to perform a certain, limited number of functions. One of

these functions, formulating a *Responsible Investment Policy*, they are planning to achieve through a workshop. The Charter also recommended that the 'advisory body' should address the issue of exclusions and inclusions, something that Edward Foster has suggested could also be dealt with through the workshop. In these respects, the 'workshop' could fulfil the functions of the 'advisory body'.

The *Charter* also advocated maintaining 'a public register of *Responsible Investment Criteria*', i.e. a transparent and consensual set of performance criteria that would facilitate accountability. Cllr Thompson has said that the Investment sub-Committee 'engages with' and 'challenges' fund managers. In other words, the ISC exercises judgement, which implies that they have criteria against which they evaluate performance. So what are they? Where can we find them? Who is responsible for formulating and maintaining them?

Cllr Thompson also stated that we were recommending removing 'the selection of investments from democratic control if you like, from a committee that is made up of those who are democratically elected and hand[ing] it over to an unelected advisory body.' [33.14] In fact, we made no stipulation as to the composition of the 'advisory body', only that it would perform certain functions and be responsible to the HCPF Board. Are we being asked to rely simply on the 'democratic wisdom' of Cllr Thompson as an elected representative and 'someone who worked in the industry in the past'? [33.14]

As a matter of fact, the Investment sub-Committee has employed on a number of occasions an external consultancy, Aon³, in an advisory capacity. For example, at the meeting on the 5th February members of the sub-committee received 'Members only Report No INV/1/21 by Aon'. This report was, as it says, for the eyes of members of the ISC only. 'Following research of the Multi Asset Credit market, Aon had shortlisted funds appropriate for the Committee to consider and key aspects of each fund were detailed.' Aon as a team consisting of 'a unique mix of consultants and insurance industry practitioners' are probably very good at their job. But was employing them to act as external advisers on 'the selection of investments' democratic or undemocratic?

If HCPF can fulfil the recommendations of the *Charter* without establishing a *Responsible Investment Advisory Body*, all well and good. What the *Charter* is fundamentally addressing is the question of how *HCPF* can be transparent, accountable and representative. As Cllr Nicholson said, 'We have 30,000 members have we engaged with them in regards to ESGs and what their thoughts are?' [23.11] There may be better solutions to these challenges than establishing an 'advisory body', but that won't be because such a body would be undemocratic.

As Cllr Bremner said, 'There are many of the pension fund members who may not be happy if we don't challenge or consider our investment strategy on their behalf and on behalf of the contributions they make. Who are we to sit back and say that we can't represent them, it shouldn't be all down to the fund managers and their understanding on how best to invest the funds.' [48.52]

³ <https://www.aon.com/inpoint/consulting/default.jsp>