Division(s): N/A

PENSION FUND COMMITTEE – 5 JUNE 2015

CORPORATE GOVERNANCE AND SOCIALLY RESPONSIBLE INVESTMENT

Report by the Chief Finance Officer

Introduction

1. Within the Fund's Statement of Investment Principles, the Committee have stated "The Council's principal concern is to invest in the **best interests** of the Fund's employing bodies and beneficiaries. Its Investment Managers are given performance objectives accordingly. However, the Council requires its Investment Managers to monitor and assess the social, environmental and ethical considerations, which may impact on the reputation of a particular company when selecting and retaining investments, and to engage with companies on these issues where appropriate. The Council believes that the operation of such a policy will ensure the sustainability of a company's earnings and hence its merits as an investment; it will also assess the company's sensitivity to its various stakeholders.

2. The Investment Managers report at quarterly intervals on the selection, retention and realisation of investments on the Council's behalf. These Report/Review Meetings provide an opportunity for the Council to influence the Investment Manager's choice of investments but the Council is careful to preserve the Investment Manager's autonomy in pursuit of their given performance. The Council will use meetings to identify Investment Managers' adherence to the policy and to ask Investment Managers to report regularly on any engagement undertaken."

3. There has recently been significant media interest in the issue of investments in fossil fuel companies, and this Committee received a speaker at its December meeting, and a petition at its meeting today on the subject. The speaker in December and today's petition both call on the Committee to undertake a process of divesting all fossil fuel investments. The media articles cover a broader range of issues.

4. This report covers the main issues raised, and askes the Committee to review its statement of investment principles repeated above, and to determine whether any changes are necessary.

Key Issues

5. There are a number of different ways at looking at the issue. Fossil Free Oxfordshire in their petition today, and in previous presentations and correspondence with the Committee have focused on the view that fossil fuel

investments are both morally and financially unviable. This view is based on the level of carbon emissions associated with the industry, the impact on climate change and the potential for future legislation which restricts the level of carbon emissions. There is therefore a clear risk that many of the current fossil fuel reserves will become stranded assets, and are therefore significantly over-valued.

6. The Fossil Free Oxfordshire campaign therefore calls on the Pension Fund to divest all current investments over a 5 year period and freeze all new investments. It suggests that the rapidly growing renewable sector offers many attractive alternative investment opportunities.

7. The law on investment policy is open to interpretation. It is clear that the Committee must act in the best interests of the Fund's beneficiaries. The Law Commission has stated though that trustees can make investment decisions on non-financial factors, as long as there is no risk of significant financial detriment. The argument from the Fossil Free Oxfordshire campaign is that there is a clear financial risk in remaining invested in fossil fuel companies, and no financial detriment to divesting.

8. There are a number of commentators in the media who support the views of expressed by Fossil Fuel Oxfordshire, and as stated in the petition, a number of organisations have begun a process of divesting.

9. There are though a number of commentators who put forward an alternative view. Many of these do not dispute many of the key facts, but do question some of the conclusions drawn and the appropriate actions required.

10. An issue covered in many of the alternative views is why the campaign is focussed on the fossil fuel companies and not the many companies who create the demand for fossil fuel companies. Recent articles in the Times and Financial Times drew attention to the conflict between those making a clear decision to divest their fossil fuel investments, whilst continuing to profit from businesses heavily dependent on fossil fuel usage (e.g. Richard Branson and Virgin Airlines in the Times).

11. The counter argument to divestment, therefore points out that whilst there remains significant demand for fossil fuel products, the markets will always ensure a steady supply. If divestment leads to the collapse of the current set of listed fossil fuel companies, then the unlisted and state producers will pick up the demand. The unintended consequence of this is therefore the potential for a reduction in the regulatory control and transparency of the fossil fuel industry, as well as increased prices for those businesses dependent on fossil fuel supply.

12. The question of alternative investments in renewable energy industries was raised in the training presentation provided by the UBS energy analyst in his training presentation prior to the December Committee. It was his clear view that the current industry is very much in its infancy, and heavily supported by state grants etc. Any significant investment at this time therefore carries a

high degree of financial risk, including the question of will the high initial investment costs ever produce the expected level of return if state aid is withdrawn, or the current consumers of fossil fuel energy are incapable of switching to an alternative energy supply.

13. A number of commentators have therefore focussed on the approach that Trustees should be taking to their fossil fuel investments without prescribing a divestment or retention policy. An example of such a paper was "The Fossil Fuel Transition Blueprint" published jointly by The Carbon Tracker Initiative and Energy Transition Advisors. This suggested a number of key questions that investors should be raising with company management based on a concern that a number of those in the industry were planning on an assumption of a continuation of business as usual, rather than a recognition of the impact of climate change, technological advances, future legislation etc.

14. Much of what is in the Blueprint paper, and in a number of the other recent articles on fossil fuel investments is well presented, and sets out the risk assessment process any investor should undergo before making a decision to invest or divest in a fossil fuel company. The same arguments apply equally to all investments, whether fossil fuel or not.

15. A number of the papers highlight that the fossil fuel industry covers a broad spectrum of companies, and it is inappropriate to blanket them all together into a single investment approach. The risks associated with a company focussed primarily on coal mining will differ to one focussed primarily on gas.

Conclusions

16. Having considered the above issues, it remains the view of Officers that the current investment principles provide the flexibility to deal with the differences within the industry and between individual companies, which any blanket policy on divestment would fail to address. Any blanket policy would carry the risk that the Committee is not acting in the best interests of the Funds beneficiaries by excluding well researched fossil fuel companies who are likely to be highly profitable in the future as a result of the management actions being taken in light of a comprehensive risk assessment completed in line with the Blueprint Checklist

17. The emphasis should therefore remain on challenging the Fund Managers to ensure that they are properly researching all investments, along the lines suggested in the Blueprint document, and that they are in a position to justify their decisions on individual investments.

18. It should be noted that over the last year whilst the discussions on divestment have continued, both Baillie Gifford and UBS have provided detailed responses to the Committee on their approach to investment in the energy sector, and fossil fuel companies in particular. Having considered the letter from Bailie Gifford at its meeting in September 2014 the Committee concluded it was happy that there approach did appropriately assess the risks of the current investments. Similarly, following the presentation at the December

2014 meeting, and the written paper at the March 2015 meeting, the committee satisfied itself that the UBS approach was also appropriately assessing risk in respect of its investments on the Funds behalf

RECOMMENDATION

19. The Pension Fund Committee is RECOMMENDED to note the content of this report, and endorse the current Statement of Investment Principles in respect of Corporate Governance and Socially Responsible Investment.

Lorna Baxter
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Background papers: Nil
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