

**Agenda Item No.4 (a)**

**DERBYSHIRE COUNTY COUNCIL**

**PENSIONS and INVESTMENTS COMMITTEE**

**2 AUGUST 2017**

**Report of the Director of Finance & ICT**

**CLIMATE CHANGE**

**1 Purpose of the Report**

To outline Derbyshire Pension Fund's approach to incorporating the implications of climate change into its investment process and to assist the Pensions and Investments Committee to consider its response to a petition from Transition Chesterfield dated 23 March 2017.

**2 Information and Analysis**

The responsibility of Derbyshire County Council (the Council) as the administering authority for Derbyshire Pension Fund (the Fund) is to accumulate sufficient assets to meet members' benefit payments when they fall due. Assets are accumulated through a combination of contributions from employees and employers within the scheme and from investment returns (both income and capital).

The Council has fiduciary duties as the administering authority of an LGPS fund to invest in a wide variety of suitable investments to achieve the best financial position for the fund, balancing risk and return in the normal way. This was confirmed in a Counsel's Opinion from Nigel Giffen QC obtained by the LGPS Shadow Scheme Advisory Board and attached as Appendix 1. The 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.

Officers believe that over the long term, the best returns will be available to those investors with the widest possible choice of investments open to them. Investments are considered with a long term perspective, with fundamental analysis aiming to capture all the relevant possible risks and opportunities.

Responsible investment is an approach to investment that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long term returns.<sup>1</sup>

---

<sup>1</sup> UN Principles for Responsible Investing

The Pensions and Investments Committee (the Committee) believes that responsible investment covers both incorporating ESG factors into the investment process and Fund stewardship and governance through considered voting and engagement with investee companies.

Effective management of financially material ESG risks should support the requirement to protect investment returns over the long term. The Fund's investment team seek to understand relevant ESG factors alongside conventional financial considerations within the investment process, and the Fund's external investment managers are expected to do the same. Non-financial factors may be considered to the extent that they are not detrimental to the investment return.

A strategy of engagement with companies, rather than negative screening to exclude stocks from the portfolio on ESG/ethical grounds, is more compatible with the administering authority's fiduciary duties and supports responsible investment.

### **Transition Chesterfield Petition**

A petition from Transition Chesterfield, dated 23<sup>rd</sup> March 2017, addressed to the Chair and Members of the Committee has been received, calling on Derbyshire Pension Fund to: immediately freeze any new investments in fossil fuels; and divest from direct ownership and any commingled funds that include fossil fuel public equities and corporate bonds within five years. The covering letter accompanying the petition (attached as Appendix 2) explained that the main objective of Transition Chesterfield is "to reduce the risk of catastrophic climate change due to the burning of fossil fuels". The campaign group also believes that fossil fuels represent an investment risk as "climate change forces companies to leave oil, natural gas and coal in the ground" (commonly referred to as "stranded assets").

The letter quotes from The Pension Regulator's April 2016 guide to Investment Governance for trustees of defined contribution schemes which states that:

"You should bear in mind that most investments in DC schemes are long term and are therefore exposed to the longer-term financial risks. These potentially include risks relating to factors such as climate change, unsustainable business practices, unsound corporate governance etc. These risks could be financially significant, both over the short and longer term. You should therefore decide how relevant these factors are as part of your investment risk assessment."

The referral of the "Local Government Pension Scheme and Climate Risk" to The Pensions Regulator by NGOs ClientEarth and ShareAction is also quoted in the letter from Transition Chesterfield. The main premise of the referral is that many LGPS administering authorities: view climate change as only an ethical issue that does not pose financial risks; think that by delegating day-to-

day investment decisions to external investment managers, the administering authority has discharged its legal duties to address climate risk; consider that by delegating stewardship engagement activities to the Local Authority Pension Fund Forum (LAPFF), the administering authority has discharged its legal duties to address climate risk; expect climate risk to be dealt with at the pool level; and reason that scheme members should not concern themselves with this issue as any losses caused by poor management of climate risk will be met by the taxpayer.

Transition Chesterfield acknowledges that the Committee has stated that its position is one of engagement rather than divestment, but doubts the effectiveness of engagement in the case of the fossil fuel companies.

## **Climate Change**

Scientists purport that human activity, including burning fossil fuels, cutting down rainforests and farming livestock, is adding to the concentration of greenhouse gases (e.g. carbon dioxide, methane and nitrous oxide) occurring naturally in the atmosphere, increasing the greenhouse effect and global warming.

Some dispute the science behind the increase in the average global temperature and question the emerging increase in the volatility of weather patterns and the higher frequency of extreme weather events, citing the previous tropical climates and ice ages experienced by the Earth over several billion years. However, the rate of increase in the average temperature of the planet's surface since the Industrial Revolution has caused considerable alarm.

According to the Intergovernmental Panel on Climate Change (IPCC), about half of the anthropogenic (due to human activity) CO<sub>2</sub> emissions between 1750 and 2011, which are believed to be largely responsible for the sharp increase in global warming, occurred in the last forty years. The IPCC estimate that emissions of CO<sub>2</sub> from fossil fuel combustion and industrial processes have contributed almost 80% of the total greenhouse gas emissions increases from 1970 to 2010, with economic and population growth continuing to be the most important global drivers of increases in CO<sub>2</sub> emissions from fossil fuel combustion.<sup>2</sup>

In 1992, an international treaty, the United Nations Framework Convention on Climate Change, was drawn up as a framework for international cooperation to combat climate change by limiting average global temperature increases. In 1997, the Kyoto Protocol was agreed with legally binding emission reduction targets for developed country participants. Following a long period of ratification, the Protocol's first commitment period started in 2008 and ended in 2012. It set emission reduction targets for 37 industrialised countries and the European Community with the overall targets adding up to an average 5%

---

<sup>2</sup> IPCC 2014, Climate Change 2014: Synthesis Report

reduction in emissions of greenhouse gases compared to 1990 levels over the five year period. As of 6 July 2017, 79 countries had ratified the Doha Amendment which established the second commitment period of the Kyoto Protocol beginning on 1 January 2013 and ending in 2020, aiming to reduce the signatories' overall emissions by at least 18% below 1990 levels in the five year period to 2020.

At the Paris climate conference (COP21) in December 2015, building on the work undertaken under the Convention, 195 countries adopted the first universal, legally binding global climate change deal. The agreement set out a global action plan to keep the increase in global average temperature to well below 2°C above pre-industrial levels and to aim to limit the increase to 1.5°C. Countries have submitted national climate action plans (NDCs) to reduce carbon emissions which in total were not enough to limit global warming to below 2°C. Governments agreed to come together every 5 years to set more ambitious targets as required by science; report to each other and the public on how well they are doing to implement their targets; and track progress towards the long term goal through a robust system of transparency and accountability.

Different countries have taken different approaches to reducing emissions. Generally speaking, many of the emerging market economies are focusing on low-carbon energy generation such as wind and solar power, whereas the developed regions are placing a greater emphasis on improving energy efficiency.

In June 2017, President Trump announced that the United States would withdraw from the Paris climate accord, citing the imposition of unfair environmental standards on American businesses and workers, and would start to negotiate a better deal for the US. Countries cannot withdraw from the agreement until three years after it took effect (November 2016) and must then give a one year notice to withdraw. This suggests that the US will not be able to extract itself from the agreement until around the time of the next Presidential election in November 2020.

The risks associated with climate change are wide-ranging and could have major economic, political, social and financial impacts. The precise impacts of climate change are very difficult to predict and would occur over a long time horizon. However, the issue of climate change is gaining traction as a global policy initiative, a key risk factor and an emerging investment theme. It cannot be disputed that investors face a growing tide of climate-related regulations and technological disruption. Nevertheless, climate-aware investing is possible without compromising on the objective of maximising risk-adjusted investment returns and climate change provides investments opportunities as well as risks. The following table sets out many of the potential risks and opportunities related to climate change:

# CLIMATE-RELATED RISKS AND OPPORTUNITIES

Type	Climate-Related Risks	Type	Climate-Related Opportunities
Transition Risks	<b>Policy and Legal</b>	Resource Efficiency	- Use of more efficient modes of transport
	- Increased pricing of GHG emissions		- More efficient production and distribution processes
	- Enhanced emissions-reporting obligations	Energy Source	- Use of recycling
	- Mandates on and regulation of existing products and services		- More efficient buildings
	- Exposure to litigation		- Reduced water usage and consumption
	<b>Technology</b>		- Lower-emission sources of energy
Physical Risks	- Substitution of existing products and services with lower emissions options	Products and Services	- Supportive policy incentives
	- Unsuccessful investment in new technologies		- Emergence of new technologies
	- Upfront costs to transition to lower emissions technology	Markets	- Participating in carbon market
	<b>Markets</b>		- Energy security and shift towards decentralization
	- Changing customer behavior	Resilience	- Develop and/or expand low emission goods and services
	- Uncertainty in market signals		- Climate adaptation and insurance risk solutions
Physical Risks	- Increased cost of raw materials	Markets	- R&D and innovation
	<b>Reputation</b>		- Diversify business activities
	- Shift in consumer preferences	Resilience	- Shifting consumer preferences
	- Stigmatization of sector		- New markets
	- Increased stakeholder concern or negative stakeholder feedback	Resilience	- Public-sector incentives
	<b>Acute</b>		- Community needs and initiatives
Physical Risks	- Increased severity of extreme weather events such as cyclones and floods	Resilience	- Development banks
	<b>Chronic</b>		- Participate in renewable energy programs and adopt energy-efficiency measures
	- Changes in precipitation patterns and extreme weather variability	Resilience	- Resource substitutes/diversification
	- Rising mean temperatures		- New assets and locations needing insurance coverage
	- Rising sea levels	Resilience	

Source: Financial Stability Board Task Force on Climate-related Financial Disclosures

Global asset manager BlackRock<sup>3</sup> summarize that climate change presents markets risks and opportunities through four channels:

- Physical – more frequent and severe weather such as storms, flooding, droughts and wildfires over the long term and creeping rises in temperatures and sea levels over time;
- Technological – advances in energy storage, electric vehicles or energy efficiency undermining existing business models. Technological changes are disruptive and could shorten investment horizons;
- Regulatory – tightening emissions and energy efficiency standards, and changing subsidies and taxes; and
- Social – changing consumer preferences and pressure groups advocating divestment of fossil fuel assets.

## Fossil Fuels

Fossil fuels are hydrocarbon deposits, formed over millions of years by plant and animal decomposition, such as coal, oil, natural gas and tar sands, that are burned for fuel. Accounting for around 85% of the global supply of energy, fossil fuels are the world's dominant source of energy. They are non-renewable sources of energy and the majority of fossil fuel reserves are held by non-OECD countries. The following table and charts set out global energy consumption by fuel and individual fuel consumption by region:

<sup>3</sup> Adapting portfolios to climate change September 2016

## Global Energy Consumption

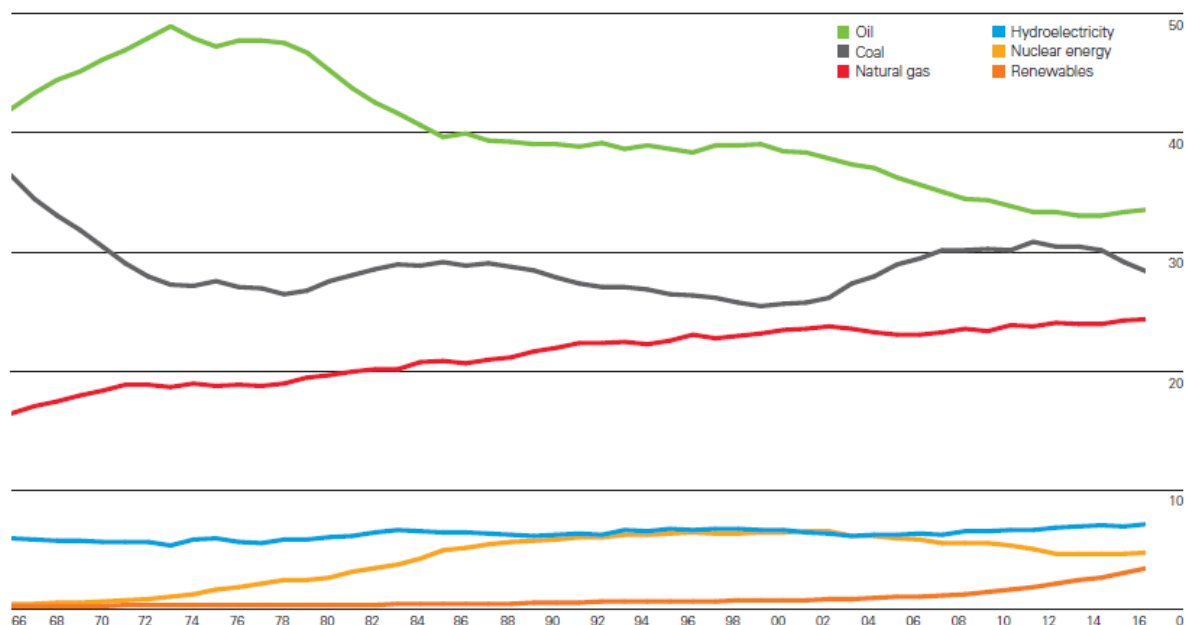
	Share 2015 %	Annual Growth 1995-2015 %
<b>By fuel:</b>		
Oil	32	1.3
Gas	24	2.5
Coal	29	2.7
Nuclear	4	0.5
Hydro	7	2.3
Renewables *	3	12.0

\*Renewables includes wind, solar, geothermal, biomass and biofuels.

Source: BP Energy Outlook 2017

### Shares of global primary energy consumption

Percentage

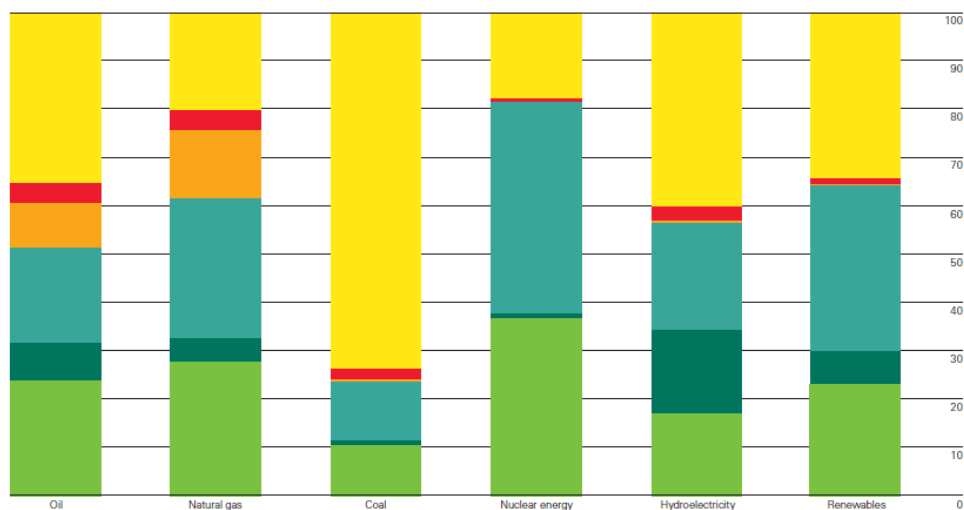


Oil remains the world's dominant fuel, making up roughly a third of all energy consumed. In 2016 oil gained global market share for the second year in a row, following 15 years of declines from 1999 to 2014. Coal's market share fell to 28.1%, the lowest level since 2004. Renewables in power generation accounted for a record 3.2% of global primary energy consumption.

### Fuel consumption by region 2016

Percentage

Asia Pacific  
Europe & Eurasia  
Africa  
S. & Cent. America  
Middle East  
North America



Asia is the leading consumer of oil, coal, hydroelectricity and for the first time in 2016, the leading consumer of renewables in power generation, overtaking Europe & Eurasia. Europe & Eurasia remains the leading consumer of natural gas and nuclear power. Asia dominates global coal consumption, accounting for almost three quarters of global consumption (73.8%).

Source: BP  
Statistic Review  
of World Energy  
June 2017

There are five main energy consuming sectors: industrial; transportation; residential; commercial; and electric power generation. The electric power sector consumes primary energy to generate most of the electricity consumed by the other four sectors. In the US, the industrial and transportation sectors each account for around 30% of end use energy consumption, with the commercial and residential sectors each accounting for around 20% of end use consumption.<sup>4</sup>

Advocates of LGPS divestment of fossil fuel holdings appear to suggest that LGPS investment in fossil fuel companies encourages the burning of fossil fuels as well as putting pension fund assets at risk in case companies are forced to leave resources in the ground.

Divestment is very unlikely to result in a reduction in the use of fossil fuels or an end to exploration activity. The root cause of the problem is the world's insatiable appetite for energy, which is exacerbated by the growth in the global population and the industrialisation of emerging markets with the attendant demand for higher living standards.

Fossil fuels are expected to continue to provide a large proportion of the global energy mix for many years to come as they provide abundant and "cheap" sources of energy compared to the alternatives. Renewables and nuclear are not expected to provide sufficient consistent, safe and reliable sources of energy to satisfy world energy demand for several decades.

Even if listed companies were forced to exit the industry, due to an inability to attract capital, a growing portion of energy production and exploration would be likely to move to unlisted companies putting it in the hands of less transparent and less accountable investors. Being listed imposes a high standard of governance, responsibility and transparency onto fossil fuel companies, subjecting them to additional scrutiny and challenge regarding their strategy for the transition to a low carbon economy.

Around 80% of fossil fuel resources are already controlled by state-backed companies such as Aramco (Saudi Arabia), Rosneft and Gazprom (Russia) and CNPC (China). Divestment from public listed companies will have no impact on the behaviour of such firms or on the demand for energy.

It is important to remember that fossil fuel companies have different resource profiles and different levels of environmental impact from their operations and products. The amount of CO<sub>2</sub> produced when a fuel is burned is a function of the carbon content of the fuel. Natural gas is primarily methane which has higher energy content relative to other fuels and therefore has a relatively lower CO<sub>2</sub>-to-energy content. BlackRock<sup>5</sup> sees gas as a key component of the global energy mix for years to come.

---

<sup>4</sup> [www.eia.gov](http://www.eia.gov)

<sup>5</sup> BlackRock Adapting portfolios to climate change

Pounds of CO2 emitted per million British thermal units (Btu) of energy for various fuels:

Coal (anthracite)	228.6
Coal (bituminous)	205.7
Coal (lignite)	215.4
Coal (subbituminous)	214.3
Diesel fuel and heating oil	161.3
Gasoline (without ethanol)	157.2
Propane	139.0
Natural gas	117.0

Source: [www.eia.gov](http://www.eia.gov)

Also, many energy companies are developing alternative low carbon technologies for a carbon constrained world. EU based oil and gas companies have called for a global carbon pricing regime and for more investment in low carbon energy sources.

At the present time, officers do not believe that divesting the Derbyshire Pension Fund holdings in carbon-intensive investments would be in the best interests of the members of the Fund. Risks associated with climate change are evaluated as part of the investment process alongside other risk factors and it is vital that the Fund is able to access the widest possible choice of investments in order to secure the best risk adjusted returns.

Divestment from fossil fuel companies would significantly alter the composition of the portfolio increasing the volatility of returns against the benchmark indices. At 30<sup>th</sup> June 2017, the Oil & Gas and Mining sectors accounted for just over 17% of the FT All Share Index, against which the UK Equity portfolio is measured. In the year to March 2017, the UK Mining sector, after a period of weakness, was amongst the strongest performers in the index, up just over 72% compared to the index which rose around 18% and accounted for a large proportion of the Fund's UK Equity return for the year. Blanket divestment would prevent the Fund from taking advantage of such opportunities caused by market mispricing. The Oil & Gas companies, in particular, also currently provide the Fund with a large portion of the dividend income it receives, accounting for almost 20% of UK dividend income in 2016/17.

It is worth noting that, similar high profile campaigns have been carried out over the last twenty years to encourage pension funds to exclude a variety of stocks from their portfolios which would have prevented funds from investing in some of the strongest performing companies over many years.



As a responsible investor, Derbyshire Pension Fund engages with the companies it invests in and seeks to understand the social and environment impacts of the companies within the portfolio as it recognises that environmental, social and governance factors can materially affect companies' financial returns over the long term.

The Fund will continue to actively engage with companies via the LAPFF to encourage climate-resilient business strategies. As an example of engagement via the LAPFF, the Fund expressed its public support for LAPFF's Anglo American, Rio Tinto and Glencore special resolutions – strategic resilience for 2035 and beyond. The resolutions asked the companies to report on asset portfolio resilience to the International Energy Agency's scenarios (including setting out their business strategy in alignment with a 2°C increase in global temperature), low carbon energy research and development and investment strategies and public policy positions relating to climate change.

It will take time for companies to adapt to the rapidly changing regulatory and market environment. As a long term shareholder, the Fund understands the time frame and will continue to influence corporate behaviour throughout the period of transformation.

### **Renewables**

The transition to a low-carbon economy requires capital and pension funds as long term investors are well placed to invest in new technologies which may take some time to become profitable. According to BlackRock, renewable power has doubled its share of total global capacity to 16% from 2007, while making up over half of new installations.

Since 2014, the Fund's investments in renewable energy generation and transmission assets have increased significantly via the Infrastructure Portfolio. These include some of the largest solar, onshore and offshore wind farms in the UK, batteries and the connections to the national grid. The Fund also has investments in small scale hydro-electric power in Norway, which will flow via an interconnector to the UK from 2021 onwards. Entry into these assets coincided with low points in the forward energy price curves providing valuations which offered the prospect of good long term returns.

In addition to providing capital to fund the production of lower carbon electricity, the Fund has also invested in new bi-modal trains that use less fossil fuel which will run on the East Anglia and South-West rail franchises in the UK later on this decade. These trains are hybrid diesel-electric trains that can switch between fuel sources and can be run entirely on electric mode when the entirety of the rail network has been electrified. The Fund's portfolio also includes natural gas transmission, storage and distribution assets which are essential to ensuring back-up power supply given the highly intermittent, non-dispatchable nature and low load factors of renewable energy generation. A resilient, low-carbon, secure energy future will require a much smarter, more

diversified supply chain. The Fund's aim is to support the energy transition and to invest in renewable opportunities where attractive returns can be made for members.

### **Position of Derbyshire Pension Fund**

Material climate change risks and opportunities could be experienced across the whole pension fund portfolio. Officers will continue to evaluate the risks on a case by case basis as part of the investment process alongside other risk factors whilst continuing to keep up to date with research on the financial materiality of climate change. From April 2018, as part of the LGPS Central pool, the Fund will also have access to a dedicated Responsible Investment officer increasing the ability of the Fund to participate in collaborative initiatives with respect to climate change.

The widest possible investment opportunity set will help to ensure that the Fund is invested in a wide variety of assets preventing overconcentration in any one area, given inherent risks to markets, policy, technology and geo-politics, and balancing risk and potential returns in line with the fiduciary duties of the Council as the administering authority.

### **3. Legal Considerations**

The Local Government Association instructed Nigel Giffen QC on behalf of its members to provide advice to enable it to understand in certain particular respects, the nature of the duties which fall upon the administering authority of a fund established for the purposes of the Local Government Pension scheme. Specific advice was requested in relation to whether: a LGPS administering authority owed a fiduciary duty and if so to whom and how the wider functions, aims or objectives of the administering authority influence the discharge of its LGPS investment duties.

The conclusions provided by Counsel, following his advice, were as follows:

- 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 administering authority's power of investment 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 (balancing risk and return in the normal way).

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).

#### **4 Other Considerations**

In preparing this report the relevance of the following factors has been considered: financial, human rights, human resources, equality and diversity, health, environmental, transport, property, social value and prevention of crime and disorder considerations.

#### **5 Officer's Recommendations**

- 5.1 That the approach of Derbyshire Pension Fund, as outlined in this report, to incorporating the implications of climate change into its investment approach be noted; and
- 5.2 That the Director of Finance & ICT prepare a response to the petition from Transition Chesterfield on the basis of the information contained in the report.

PETER HANDFORD

Director of Finance & ICT

## **APPENDIX 1**

### **DUTIES OF ADMINISTERING AUTHORITIES UNDER THE LOCAL GOVERNMENT PENSION SCHEME**

#### **OPINION**

1. I am instructed to advise the Local Government Association (“the LGA”). The LGA, on behalf of its members, is concerned to understand, in certain particular respects, the nature of the duties which fall upon the administering authorities of funds established for the purposes of the Local Government Pension Scheme (“LGPS”). This Opinion is by way of confirmation of advice previously given in consultation.
2. The LGPS is a defined benefit scheme, the terms of which are prescribed by delegated legislation made under s 7 of the Superannuation Act 1972. The main current governing instruments are the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (SI 2007 No 1166), and the Local Government Pension Scheme (Administration) Regulations 2008 (SI 2008 No 239). From 1 April 2014 it will be the Local Government Pension Scheme Regulations 2013 (SI 2013 No 2356 – “the 2013 Regulations”), albeit with transitional provisions to protect benefits accrued under the earlier version of the LGPS. The 2013 Regulations are designed in part to satisfy the requirements of the Public Services Pensions Act 2013 when it comes into force. Although there are important differences between the old and new schemes from a benefits perspective, I do not see any changes which would affect the issues discussed in this Opinion. Since the LGA is principally concerned with the position going forward, I shall refer below to the provisions of the 2013 Regulations. Also relevant to the question of investment of scheme funds are the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009 No 3093 – “the Investment Regulations”), which will continue in force after 1 April 2014.

3. Under r.53 of the 2013 Regulations, each of the administering authorities listed in Part 1 of Schedule 3 must maintain a pension fund for the LGPS, and the administering authority is “responsible for managing and administering the Scheme” in relation to any person for whom it is the appropriate administering authority. Under r.2(2), it is also the scheme manager (as provided for by s 4 of the 2013 Act) “responsible for the local administration of pensions and other benefits payable under these Regulations”. All of the administering authorities are local authorities, save for the London Pension Funds Authority, the South Yorkshire Pension Authority, and the Environment Agency.
4. There may be, and usually will be, a number of different employers in relation to any given LGPS fund. They may be the bodies listed in Schedule 2 to the 2013 Regulations, or they may be admission bodies<sup>1</sup>. They are required to make the pension contributions and other payments into the fund provided for at r.67 et seq of the 2013 Regulations.
5. The first question I am asked to address in this Opinion is whether the administering authority owes fiduciary duties, and if so, to whom<sup>2</sup>.
6. In my view the administering authority does owe fiduciary duties, both to the scheme employers, and to the scheme members. I would accept that, as the Court of Session held in relation to the similar Scottish scheme in *Re Bain* 2002 SLT 1112, there is no free-standing trust apart from the statutory scheme, and therefore that the administering authority is not a

---

<sup>1</sup> It is possible for separate admission agreement funds to be established, but I understand that this is unusual (if indeed it has occurred at all), and this Opinion is directed to the position of the ordinary fund.

<sup>2</sup> I am aware that there is a pending claim, due to be tried in the early part of 2015, which involves a dispute between a claimant administering authority (Wolverhampton CC) and a defendant contractor/admission body, and in which the counterclaim raises certain issues about alleged fiduciary obligations owed by the claimant to the defendant. There is some potential for any judgment that may be given in this case to affect the issues discussed in this Opinion.

trustee as such<sup>3</sup>. But fiduciary duties are not limited to trustees. A classic case in which fiduciary duties are held to exist is that in which one person administers the property or the financial affairs of another (see the speech of Lord Browne-Wilkinson in *White v Jones* [1995] 2 AC 207). 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 and members.

7. That is most acutely true, and most immediately apparent, in the case of scheme employers, who are liable to have to pay for mismanagement through increased contributions. But it is also true of members. Whilst a member's statutory entitlement to his or her defined benefits subsists regardless of whether the fund is doing well or badly (and the contributions required of the member do not vary with that performance), it would be naïve to suggest that there is no scope for members to be affected by fund performance. If the fund is doing badly, and employer contributions rise as a result, it is easy to see that the various discretions for which the 2013 Regulations provide are less likely to be exercised in members' favour. Further, as a practical proposition, if the fund is running into severe financial problems and employer contributions threaten to reach unsustainable levels, legislative measures are likely to be taken to curtail benefits or raise employee contributions well before the point of exhausting the fund is reached, regardless of what the position might be if such exhaustion actually occurred<sup>4</sup>.
8. I should say, however, that I rather doubt that the existence of fiduciary duties will in this context make very much difference to what the position

---

<sup>3</sup> The judgment in the earlier Scottish case of *Martin v City of Edinburgh DC* 1988 SLT 329 proceeds on the basis that the LGPS fund is a trust fund, but it seems to me that this is clearly incorrect (and the point does not appear to have been argued).

<sup>4</sup> That is one of the issues to be addressed in further written advice. For present purposes it suffices to say that, whilst I think it unlikely as a matter of political reality that matters would ever be allowed to reach the stage of exhaustion of the fund, there is at any rate a theoretical potential for members' interests to be prejudiced in that scenario.

would be if analysed simply in terms of the obligations imposed upon the administering authority as a matter of public law – notably, the normal *Wednesbury*-type obligations to exercise discretionary powers rationally, for a proper purpose and by reference only to legally relevant considerations. It is well established that the nature and content of a fiduciary duty will vary according to the circumstances of the case and the precise nature of the relationship between the parties: the classic analysis is that of Millett LJ, as he then was, in *Bristol & West Building Society v Mothew* [1998] Ch 1. There is an analogy to be drawn with the recent decision of the Court of Appeal in *Charles Terence Estates Ltd v Cornwall Council* [2013] LGR 97, where the court acknowledged the line of authority which stated that local authorities owe a fiduciary duty to local taxpayers, but nonetheless treated the content of that duty in a manner which was for practical purposes indistinguishable from *Wednesbury* unreasonableness. The defendant authority’s contention in *Charles Terence* was that it was free of any obligation to make further payments under certain leases concluded by its predecessors, because those leases were void, having been entered into in breach of fiduciary duty. The alleged breach of fiduciary duty consisted of a failure to have regard to market rents when the leases were concluded. At paragraph 20, Maurice Kay LJ said that the facts, taken at their highest, established significantly less culpability than in cases where breach of fiduciary duty arguments had succeeded. Those had been cases of “eccentric principles” or “flagrant violation” or the making of a gift or present of public money, or of the doubling of ratepayers’ financial burden. It was pointed out that it was wrong to seek to justify excessive judicial intervention “by adopting an expansive approach to *vires* and fiduciary duty”. Caselaw about *Wednesbury* unreasonableness in the balancing of different interests was said to “resonate” in the context of fiduciary duty arguments as well. In *R (Nash) v Barnet LBC* [2013] EWHC 1067 (Admin) the language of “reckless disregard” of proper financial principles was used to indicate what was necessary to make good a claim of breach of fiduciary duty.

9. One potential difference is that a breach of fiduciary duty is capable of sounding in damages (or at any rate an obligation to pay compensation in equity), whereas a breach of public law, as such, is not. Equitable compensation was described in *Target Holdings Ltd v Redferns* [1996] 1 AC 421 as being designed “to make good a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach.” But it is to be noted that acting negligently but in good faith is not a breach of fiduciary duty: see e.g. *Royal Bank of Scotland plc v Chandra* [2011] EWCA Civ 192. It is not necessary for the purposes of this Opinion to consider whether an administering authority owes a duty of care in negligence to scheme employers<sup>5</sup>, although in view of the fact that the authority’s role is imposed upon it by statute and without any element of profit, this seems to me unlikely.
10. The next issue I am asked to address is how an administering authority may approach the discharge of its functions, and in particular, what considerations may legitimately influence the exercise of investment decisions.
11. The practical context is that the way in which superannuation fund monies are invested is capable of having an impact upon matters with which administering authorities are legitimately concerned in the context of their broader local government responsibilities. Such an impact might be positive or negative. For example:
  - (i) Looked at positively, the investment of fund monies might enable or sustain some project or activity which is of benefit to the authority’s area. That might be an infrastructure project, it might

---

<sup>5</sup> I cannot imagine that any such duty is owed to individual scheme members, at least in relation to the general administration of the fund.



be the provision of social housing, or it might be an undertaking offering local employment<sup>6</sup>;

- (ii) Looked at negatively, there might be certain investments which were thought<sup>7</sup> to be harmful to the broader interests of the authority's area or in its inhabitants – such as their health (e.g. equity holdings in manufacturers of alcohol or tobacco), or their environment (e.g. oil companies engaged in fracking). There might be other cases in which a particular investment was regarded by the administering authority as ethically objectionable (e.g. in a company alleged to be engaged in aggressive tax avoidance, or to be sourcing supplies from factories with inadequate labour conditions).

12. How far can any such considerations legitimately influence the investment decisions of the administering authority (or the instructions which it gives to appointed investment managers)? I shall assume for present purposes that any investment decisions taken would be consistent with the investment policy formulated by the administering authority under r.11 of the Investment Regulations.

13. It seems to me that there are two relevant points to make. The first point is that the power (in fact the duty) to invest fund monies under r.11 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. This must be right

---

<sup>6</sup> Some of these possibilities might, in addition to the issues upon which I have been asked to advise, raise questions of state aid. However, there would not normally be unlawful state aid if the so-called market economy investor principle was satisfied i.e. if the public body in question has acted in a way that a private commercial investor would act in a market economy. As will be apparent from the analysis below, if that test was not passed, it is unlikely that the investment would in any case be a proper one for the administering authority to make.

<sup>7</sup> Obviously these are issues upon which views would differ, but an opinion that the activities I mention are harmful in nature would be unlikely to be one which was *Wednesbury* unreasonable in itself.

as a matter of principle, again regardless of whether the situation is analysed in terms of fiduciary duty or in terms of public law principles (or in terms of r.11(2) of the Investment Regulations, which requires a policy to be formulated with a view to suitability and to a wide variety of investments). The same point about purpose was made in *Harries v Church Commissioners for England* [1992] 1 WLR 1241, a case of a statutory obligation to hold and invest assets for certain charitable purposes.

14. It therefore follows that it would be impermissible, for example, for the administering authority to invest fund monies in the local football club, because it was thought important to the area to keep the club afloat, in circumstances in which that was not likely to be a good or prudent investment (as compared with other investments that might be made). 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 the sorts of grounds set out in paragraph 11(ii) above, 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.
15. The harder question is how far such broader considerations may influence an investment decision where such adverse consequences would not follow. This has been much debated since *Harries* and the earlier decision in *Cowan v Scargill* [1985] Ch 270<sup>8</sup>. Leaving aside the case (irrelevant for LGPS purposes) where all the beneficiaries share a particular ethical position, *Cowan* seems to contemplate that such considerations could only be relevant on a strict “tie break” basis, i.e. where there is absolutely nothing else to choose between two possible investments. However,

<sup>8</sup> Again, *Martin* (see footnote 3 above) is a decision in the specific context of the LGPS, and relating to South African disinvestment, but the judgment is difficult to follow. The council’s decision was struck down primarily on the basis that it had been approached in the wrong way.

although the judge in *Harries* said that his conclusions were consistent with *Cowan*, I read the judgment as going a little further, so as to permit wider considerations to be taken into account where to do so would not risk significant financial detriment to the fund.

16. That would in any event be my view of the position in relation to the LGPS. I think that is consistent with r.12(2)(f) of the Investment Regulations, which requires the investment policy to state how far social, environmental or ethical considerations are taken into account. That would be an implausible provision if such considerations were invariably or almost invariably impermissible ones to take into account, and what is a proper consideration must be determined in the light of the statutory scheme as a whole.
17. It therefore follows that the administering authority can in principle have regard to wider considerations where that does not run the risk of material financial detriment to the fund. So, for example, if social housing was a good investment financially, and the precise location was immaterial<sup>9</sup>, the authority for the Greater Manchester Pension Fund could in my view choose to invest in social housing in Greater Manchester rather than in Cornwall. Likewise, if tobacco investments were seen as deleterious to the health of the population, they could be avoided if but only if that did not endanger the diversity of investments or the returns likely to be achieved.
18. Nothing I have said above, is in my view, affected by authorities' duties under the s 2B of the National Health Service Act 2006, or under s 149 of the Equality Act 2010. The duty under the former is only to take steps that an authority considers appropriate for improving health. It cannot be appropriate to exercise an investment power in a manner not consistent with the principles above. The administering authority *could* also lawfully decide that it was inappropriate, in that capacity, for it to try to make

---

<sup>9</sup> Perhaps not a plausible assumption in reality, but useful for illustrative purposes.

difficult judgments about the health implications of investments. The s 149 duty is to have “due regard” to equalities considerations, which again does not require an investment power to be exercised in a way inappropriate from an investment perspective (cf. *R (Lewisham LBC v Assessment and Qualifications Alliance* [2013] EWHC 211 (Admin) at paragraphs 145 to 148). At most, the administering authority might be obliged to have regard to health or equalities implications in cases where it was apparent that there were significant relevant implications of choosing one investment rather than another, and that choice was entirely neutral from an investment perspective: I would expect such situations to be rare, and it would be for the administering authority to judge whether (for example) the choice really was neutral in investment terms.

19. The second point is that, even where it is permissible to have regard to wider considerations when choosing between investments, it still cannot be legitimate for the administering authority to place its own wider interests (whether those of the authority itself, or those of its own area or inhabitants) above those of the other scheme employers, assuming that the administering authority is not itself the sole employer<sup>10</sup>. This is simply an application of the principle that at the core of a fiduciary relationship is a duty of loyalty. The fiduciary cannot, when acting as such, prefer his own interests to those of the party to whom the fiduciary duty is owed, and cannot use his position for his own profit (or not without informed consent). I have no doubt that the same result follows from public law principles of improper purpose and irrelevant considerations.
20. 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

---

<sup>10</sup> It is unlikely that, so far as this aspect of the discussion goes, there would be conflicting interests as between scheme members and the administering authority.

authority's own area, rather than one in the area of another employing authority within the fund, because of that location<sup>11</sup>.

21. I think it also follows that the administering authority should not impose its own view on, for example, the desirability of investing in oil companies, if that would differ from views likely to be generally held by other scheme employers and scheme members. For completeness I add that it is equally not open to employing authorities to impose their own views of such matters upon the administering authority. There is no mechanism by which they could seek to do so: investment decisions are for the administering authority to take. Save perhaps in the rare cases mentioned at the end of paragraph 18 above, the administering authority is in my view under no legal *obligation* to consider investment decisions from any perspective other than the maximisation of returns, whatever precise scope there may be for it to take account of wider matters if it chooses to do so.

## CONCLUSIONS

22. 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).
23. The administering authority's power of investment 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 (balancing risk and return in the normal way).

---

<sup>11</sup> Obviously the location would not preclude the investment if that project was chosen simply because it was the best investment proposition.

24. 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).
25. I shall be pleased to give my Instructing Solicitor any further advice which may be required.

NIGEL GIFFIN QC

11KBW

25 March 2014

11 King's Bench Walk  
Temple  
London EC4Y 7EQ

IN THE MATTER OF THE LOCAL  
GOVERNMENT ASSOCIATION

AND IN THE MATTER OF  
ADMINISTERING AUTHORITIES  
UNDER THE LOCAL GOVERNMENT  
PENSION SCHEME

OPINION

Thelma Stober Corporate  
Legal Adviser  
Local Government Association  
Local Government House Smith  
Square  
London SW1P 3HZ

## APPENDIX 2

**To: The Chair and Members of Derbyshire Pensions and Investments Committee**

**23 March 2017**

Dear Sirs,

On behalf of 13 organisations from across Derbyshire we would like to present you with this petition signed by over 1,000 people calling on the Derbyshire Pension Fund to:

- Immediately freeze any new investments in fossil fuels
- Divest from direct ownership and any commingled funds that include fossil fuel public equities and corporate bonds within 5 years.

Our main objective is to reduce the risk of catastrophic climate change due to the burning of fossil fuels.

### **Fossil fuels are an investment risk**

However, we also believe that fossil fuels represent a real investment risk. Industry experts, such as the Chair of Newton Investment Management, have pointed out that fiduciary duty compels divestment because fossil fuels are a bad investment.<sup>6</sup> Others have noted that fossil fuel companies risk losing \$33 trillion in revenue over the next 25 years as climate change forces companies to leave oil, natural gas and coal in the ground.<sup>7</sup> The risks of climate change (and fossil fuel investments) to investors have been comprehensively documented by the financial industry.<sup>8</sup>

### **Pension Fund Committee must consider climate risk**

As long term investors the Committee should be properly assessing the risks in advance instead of waiting until the point when markets properly price in climate risk. Climate change is a scientific certainty which is happening now, and will continue to get worse. It is incumbent upon the Committee to examine the risks properly. The Pensions Regulator pointed out in April 2016 that the long-term nature of pension schemes mean they are exposed to longer-term financial risks – such as climate change – which could be “*financially significant, both over the short and longer term.*”<sup>9</sup> Local Government Pension Funds that fail to address climate risk in their Investment Strategies are to be referred to The Pension Regulator, as the letter from Client Earth and Share Action, recently sent to the Committee, makes clear. Further, Pension Trustees who fail to consider climate risk could be exposing themselves to



<sup>6</sup> <https://vimeo.com/195647189>

<sup>7</sup> [www.bloomberg.com/news/articles/2016-07-11/fossil-fuel-industry-risks-losing-33-trillion-to-climate-change](http://www.bloomberg.com/news/articles/2016-07-11/fossil-fuel-industry-risks-losing-33-trillion-to-climate-change)

<sup>8</sup> Reports on climate risk by Blackrock, Schrodgers, Goldman Sachs, Economist Intelligence Unit etc are all listed in the Client Earth/Share Action Referral to the Pensions Regulator, 10 Feb 2017

<sup>9</sup> [www.thepensionsregulator.gov.uk/docs/draft-dc-investment-guide-2016.pdf](http://www.thepensionsregulator.gov.uk/docs/draft-dc-investment-guide-2016.pdf)



legal challenge in the future.<sup>10</sup> Legal opinion is that this analysis has to be done at the Committee level rather than being left to fund advisors.<sup>11</sup>

### Engagement is not working

Although the Committee has stated its position is one of engagement rather than divestment, and we agree that engagement in some instances can be very helpful (e.g. improving conditions for workers, corporate policy), we believe this is far less effective when what you are objecting to is part of a company's core business. While oil companies are investing in renewables this is a tiny fraction of their operations (<0.5% total for Shell). In May 2016, a shareholder meeting of Shell resulted in a 97% vote rejecting a proposition to invest profits from fossil fuels into renewable energy projects. Statoil, regularly touted as one of the "best" oil companies, state that by 2030 their investments will still be at least 80% fossil fuels.<sup>12</sup> Even within the most "progressive" companies, oil and gas will continue to be the main part of their **core business** well beyond the point necessary to meet our carbon targets.

### Alternative investments can provide value

While the fiduciary duty of the Committee compels you to look for investments which can provide good returns to finance the pension scheme, fossil fuel companies are only 7% of the global equity index and there are many other equity options that can provide equal or better returns than those from your fossil fuel investments. Perhaps your advisers can speak to other fund managers who have divested or who offer alternatives? A growing number of public sector or Local Government Pension Funds have announced that they will divest from fossil fuels and would presumably be able to offer advice on alternative investments.<sup>13</sup> Ideally these would be environmentally and socially beneficial investments that can also satisfy your Responsible Investment principles and improve the lives of Derbyshire residents.

We urge you and the new Committee to take note of our requests, and hope that the issue of climate risk and divestment from fossil fuels can be addressed as a matter of priority. Thank you.

The Divest Derbyshire campaign is supported by the following Derbyshire organisations (in alphabetical order):

---

<sup>10</sup> [www.clientearth.org/pension-trustees-face-legal-challenge-ignoring-climate-risk-leading-qc-confirms/](http://www.clientearth.org/pension-trustees-face-legal-challenge-ignoring-climate-risk-leading-qc-confirms/)

<sup>11</sup> [www.documents.clientearth.org/library/download-info/qc-opinion-the-legal-duties-of-pension-fund-trustees-in-relation-to-climate-change/](http://www.documents.clientearth.org/library/download-info/qc-opinion-the-legal-duties-of-pension-fund-trustees-in-relation-to-climate-change/)

<sup>12</sup> [www.statoil.com/en/news/2030-climate-roadmap.html](http://www.statoil.com/en/news/2030-climate-roadmap.html)

<sup>13</sup> The Environment Agency Pension Fund will divest 90% of its coal assets and 50% of its oil and gas stocks by 2020; South Yorkshire Pension Fund will divest from companies focussed on coal and tar sands; Haringey Pension Fund will move £200 million into a low carbon fund; Waltham Forest Pension Fund will divest from fossil fuels within 5 years; Southwark Pension Fund will divest from fossil fuels; Hackney Pension Fund will cut exposure to fossil fuel equity investments by 50% over the next 6 years. Ireland will be the first country to divest from fossil fuels.

Calow Against Gas Extraction (CAGE) Derby Climate Coalition  
Glossopdale Transition Initiative  
Melbourne Area Transition  
Sustainable Edale  
Sustainable Hayfield  
Transition Belper

Transition Chesterfield  
Transition Hope Valley  
Transition Matlock  
Transition New Mills  
Transition Wirksworth  
University of Derby Students' Union.

We also acknowledge the support of the Youth Mayor of Derby and the students of Landau Forte College in Derby