Corporate Policy & Resources Committee

28 November 2022

Title	*Environmental, Social & Governance (ESG) Policy for current and future medium-term investments.*
Purpose of the report	To make a decision and a recommendation to Council
Report Author	*Paul Taylor Chief Accountant*
Ward(s) Affected	All Wards
Exempt	No
Exemption Reason	*Refer to Guide on exemption/consult Legal and insert relevant category and Public Interest Test reason*
Corporate Priority	Community Affordable housing Recovery Environment Service delivery
Recommendations	**The Committee is asked to agree the criteria set out in 2.4 to 2.6 of the report below, as a starting point, to set the benchmark, which will enable the Council's investment advisers Arlingclose to carry out a review (Stage 1) of our existing medium-term investment portfolio and provide an orderly timetable for the diversification of our existing portfolio in order to meet the new criteria approved by Council, which will be presented for Council to approve by 30 April 2023 (Stage 2).** **All future medium-term investments will be expected to follow the ESG Policy.** **Where a managed fund can show that 85% or more of the companies included in that fund comply with the Council's ESG Policy, then overall that fund will have been deemed to comply with the policy and no further action on diversification is required.**
Reason for Recommendation	*The Council declared a climate emergency in October 2020 and the Council need to divest itself of the investments in companies that do not meet its investment criteria. Noting that the divesting of the portfolio needs to maintain the investment returns to safeguard existing Council services, regeneration, and housing projects, particularly at a time of increasing pressures on the Revenue Budget.*

1. Summary of the report

1.1 The Council declared a climate emergency in October 2020

1.2 This purpose of this report is to provide guiding principles to ensure that:

(a) The Council reviews its current £35m portfolio of medium-term managed investment funds with a view to divesting itself from funds or companies that are not compliant with Council's policy, whilst seeking to maintain its level of annual investment income, to protect Council services, regeneration projects and housing projects.
This will require a phased approach over the next five years.

(b) Ensures that all new medium- term investments comply with Council's ESG Policy.

1.3 The ESG Policy once agreed, will enable Arlingclose the Council's Treasury Management and Investment Advisers and Officers to begin Stage 1 and review our portfolio and asses where the Council needs to divest itself from a particular fund or company, together with alternative options for the Council to consider investing, whilst maintaining investment income returns.

1.4 Stage 2 of the process will be to agree the diversification plan, and this will be presented to Council by 30 April 2023.

1.5 This report is the starting point and will evolve over the next five years as investment indices and ratings schemes evolve, noting that the Officers will be reviewing each investment using the best indices available at the time.

1.6 As these indices are in their infancy and are not generally accepted across the investment sector, Officers will be monitoring the situation on a quarterly basis and will informally update the Corporate Policy & Resources Committee as appropriate, until there is standardisation of indices.

1.7 Officers will be formally updating this report on an annual basis.

1.8 This report does not apply to the Council's rental income from its investment and regeneration portfolio, which will be covered by a separate report in 2023.

Nor does it cover its short-term investments, which are mainly Inter Local Authority investments.

1.9 Because of the complex nature of managed funds Officers are recommending that as a starting point, if more than 85% of the companies within any one fund comply with this policy, the fund is deemed to have complied with the policy.

2. Key issues

2.1 The Council must maintain its forecast returns on investments on both classes of investment as the portfolio transitions into more ESG friendly sectors and companies, over the next two to five years, otherwise it will exacerbate the current cost of living crisis.

2.2 With the majority of the Council's medium-term investments tied up in managed funds, there are no suitable indices available to monitor or access the ESG credentials of each fund.

2.3 There are only a few qualitative general indices for establishing standards on investments, such as the United Nations – Sustainable Development Goals (UN-SDG), which are a universal call to action to end poverty, protect the planet, and ensure that by 2030 all people enjoy peace and prosperity. _

2.4 The 17 SDGs are integrated—they recognise that action in one area will affect outcomes in others, and that development must balance social, economic, and environmental sustainability.

2.5 However, these SDGs have not been widely taken up by financial institutions, as this is still a relatively immature market when it comes to ratings of investments, sectors and companies, which means that Officers are going to be required to exercise judgements based on Council's approved policy, as the market matures, indices become more coherent and investment managers begin to standardise an acceptable sector wide approach to ranking companies according to pre-set ESG criteria.

2.6 Until these indices mature, and an industry standard is established within the managed investment fund sector, Officers are recommending that the Council approve a list of sectors that are excluded from any further medium-term investments or providing future tenancies to.

2.7 These could include the following, where a substantial part of the business includes either the production, distribution, supply or selling of:

(a) Alcohol

(b) Gambling

(c) Tobacco

(d) Adult entertainment

(e) Military weapons

(f) Fossil fuels

(g) Exploitative credit providers

(h) Third world debt exploitation

This is not an exhaustive list and can be added to through the year between reports on appropriate recommendation.

2.8 The Council could also consider excluding companies that often transgress the following:

(a) Failure to follow regulatory frameworks

(b) Ignore directions from regulators

2.9 Alternatively, Council could exclude those companies that have a significant involvement in the following exclusion lists:

(a) **Environment**

i) Adverse impact on land use, habitats, and biodiversity

ii) Causes water resource scarcity

iii) Contributes to carbon intensive industries

iv) Animal testing for cosmetic purposes

v) Exploits animals

vi) Poor supply chain management

(b) **Social**

i) Breaches of human rights principles

ii) Breaches of international labour standards

iii) Supports oppressive regimes and modern slavery

iv) Has a poor health & safety record

(c) **Governance**

i) Engages in bribery, fraud, or corruption

ii) Violation of international intellectual property rights

iii) Involved in unethical market behaviour or business practices.

iv) Does not pay the living wage where they operate, including supply chains.

v) Does not have a diversity & inclusion policy

vi) Does not have an ESG policy

2.10 The Council should be looking to invest in companies that can demonstrate some or all the following characteristics

(a) Is committed to the avoiding investing in the same companies listed in 2.6 above and does not have a significant issue with the criteria listed in 2.7 & 2.8 above.

(b) Has a strong ESG policy and delivers against it, i.e., is the opposite of the factors highlighted in 2.8 above.

3. Options analysis and proposal

3.1 **Do nothing -** This is not an option and will not be considered further.

3.2 **Recommended action -** once Council has agreed to the principles for its ESG Policy based on some or all of the above. Our advisers Arlingclose will be able to assess our portfolio of investments and provide Council with a recommended and orderly restructure of our investment portfolio, to deliver on the declared climate emergency, whilst maintaining cash receipts to support Council services, regeneration, and housing projects.

4. Financial implications

4.1 There could be significant financial implications to the Council, once Arlingclose have reviewed the existing portfolio based upon the Council approved criteria for our ESG Policy.

4.2 After the review has been conducted by Arlingclose and assessed by Officers, will make a recommendation on the planned diversification of the Council investment portfolio, which maintains the existing level of the Council's investment income in order to protect services, affordable housing and regeneration programme. This is expected to be sent to Council by 30 April 2023, at the latest.

4.3 It is difficult to provide detailed financial implications until Council have an agreed strategy, our Treasury Management advisors, Arlingclose have indicated that the result of transitioning our portfolio in this way the net annual revenue return (as distinct to any capital growth) could be between 0.5% to 1% lower than the current portfolio, which equates to between £250,000 and £500,000 reduced investment income.

5. Risk considerations

5.1 The risks to the Council are considerable, both in terms of reputational risk and financial risk.

5.2 This report is the first step in providing our advisors with some guidance on the types of companies the Council wishes to invest in from an ESG point of view that will allow them to assess our current portfolio of investments and provide a medium-term strategy for the Council to divest itself from non ESG compliant companies, without reducing the level of the council's investment income.

5.3 By agreeing the policy, Council will ensure that any future investments made through our intermediaries will take those criteria into account before the Council invests in a company or managed fund.

6. Procurement considerations

6.1 There are none.

7. Legal considerations

7.1 There are none.

8. Other considerations

8.1 There are none.

9. Equality and Diversity

9.1 By the not allowing investment in any industries which do not pay a living wage, have breaches in human rights or are involved in modern slavery, the Council will demonstrate these are activities are unacceptable and will set standards in align with the corporate priorities for the industry and will step towards to improving equality and diversity.

10. Sustainability/Climate Change Implications

10.1 The funding of the fossil fuel industry allows fossil fuel companies to continue to extract coal, oil and gas, which are not only the main driving forces of climate change but also a major source of pollution through spills. By disinvesting in these and other harmful industries the Council will no longer be funding these activities which will reduce the impact they have on climate change.

11. Timetable for implementation

11.1 Once agreed by Council, Arlingclose will be asked to complete the review in three months and Officers would be looking to report back to Council in April 2023, as this will be a structured and managed medium-term transition that cannot be achieved overnight if the Council is to protect its income, services and affordable & regeneration programme

12. Contact

12.1 p.taylor@spelthorne.gov.uk

Background papers: There are none.