

THE HIGHLAND COUNCIL

7th May 2009

Highland Council Pension Fund

Investment in Tobacco Stocks

Report by Depute Chief Executive and Director of Finance

Agenda Item No.	
Report No.	

Summary

This report updates Members on actions taken following the Council's consideration of a report on Investments in Tobacco Stocks at the Council meeting on 5th March 2009. It refers to a Briefing for Members which will be held on Wednesday 29th April 2009 and provides details on the implications of negative screening.

1. Background

1.1 The Council, at their meeting on 5th March 2009, considered a report on the Council's investments in tobacco stocks in response to concerns on this matter which had been expressed on ethical grounds.

1.2 Investments

1.3 The Council was advised that, as Trustees for the Local Government Pension Scheme, Common Good Fund and Burial Grounds Commutation Fund, the Council held a sizeable number of shares in tobacco stocks.

1.4 The current consensus among the Council's investment managers is that, whilst they appreciate that tobacco investments can be controversial, the tobacco companies have strong cash flow and balance sheets. Tobacco stocks can provide relatively high, stable and predictable returns, particularly relative to other potential investments, particularly during difficult economic times such as this.

1.5 In summary, it was advised that over the last 7 years a tobacco restriction would have cost the Pension Fund more than 10 basis points per annum in absolute performance. This would have placed increased pressure on the need to increase employers' contribution levels over this period.

1.6 Local Authority Pension Fund Administering Authorities in Scotland and in the North of England (Members of the CIPFA Pension Fund Sub-Group) were asked if they operated any form of stock exclusion in their respective investment portfolios. All 11 Scottish Administering Authorities and two English Authorities have confirmed that they **do not** operate any stock exclusion policies.

2. Policy

- 2.1 The Council's Statement of Investment Principles (available on the Council's website) states that the Council's overall investment policy is geared towards the production of superior returns.
- 2.2 The policy recognises that social, environmental and ethical considerations are among the factors which Managers will take into account, where relevant, when selecting investments for purchase, retention or sale.
- 2.3 The Council has instructed the Fund Managers to take into account the key principles of socially responsible investment primarily through a policy of engagement with Companies that fail to demonstrate appropriate observance of these principles.
- 2.4 There have been a number of policy reviews in this area over recent years. The most recent was a report reviewing the Socially Responsible Investment Policy for the Council's Pension Fund, Common Good and Associated Fund investments which was submitted to the Council's Investment Advisory Group on 28th August 2008. The report, which fully explored the issues around ethical investing, recommended adhering to the Council's existing policy of engagement. Engagement in this context is to involve the Fund Managers in;
 - meeting and corresponding with companies on relevant issues
 - working with the representatives of other shareholders, where appropriate
 - voting against adverse proposals at Company AGM/EGMs
 - reporting regularly on actions taken in this regard"
- 2.5 This recommendation was approved by Investment Advisory Group and subsequently ratified through Resources Committee and Council.

3. The Legal Position

- 3.1 In administering the Highland Council Pension Fund, the Council is in a fiduciary position, that is, in a position of trust, in relation to the beneficiaries of that Fund and by extension, to the employers of beneficiaries other than the Council itself who are members and contributors to the Pension Scheme and to Council taxpayers
- 3.2 Trustees must treat the interests of the beneficiaries as their paramount consideration in relation to any investment; they must not, under any circumstances, compromise the security of those interests by making investments in accordance with social, ethical or political demands, thereby depriving the beneficiaries of investment income opportunities that they might otherwise have enjoyed.
- 3.3 Dundee City Council, as administering authority of the Tayside Pension Fund, sought Counsel's opinion in 2006 on whether it could disinvest from tobacco companies.
- 3.4 In providing his opinion, Counsel referred to Regulation 2 of the Local Government Pension Scheme (Management and Investment of funds) (Scotland) Regulations 1998, and Schedule 1 of the Local Government Pension Scheme (Scotland) Regulations 1998. His view was that this is consistent with a duty to preserve funds

in the best financial interests of the members, and therefore investments should only be excluded on financial grounds.

3.5 As a result, Dundee City Council took the view that it was severely constrained in its ability to consider social, environmental, and ethical considerations when investing.

3.6 The Council subsequently wrote to the Scottish Executive to obtain clarity of the existing legislation and to seek further legislation if required. In 2006, they were advised that there were no plans at that time to amend the existing legislation to restrict investment in stocks.

3.7 The Highland Council recently sought the Opinion of Philip Simpson, Advocate, on the following issues:-

- Whether the Highland Council, as Administering Authority for the Highland Council Pension Fund, and as holder of funds held for the Common Good of Inverness and of funds held within the Inverness Burial Grounds Commutation Fund can instruct the Investment Managers of those Funds not to instruct in particular investments on the grounds of ethical or social issues.
- If such an instruction is not lawful, what civil liability might be incurred by the Council and its Members should such an instruction be given.

3.8 The advice provided by Counsel can be summarised as follows:-

- That the Council is **not** entitled to decide to exclude investments on any ethical grounds from the investments available to its Investment Managers, in respect of each of the Pension Fund, the Inverness Common Good Fund and the Inverness Burial Ground Commutation Fund.
- A decision to that effect would be susceptible to challenge by way of Judicial Review although it would be difficult for any individual to claim to have title and interest to sue in relation to the Inverness Common Good Fund and the Inverness Burial Ground Commutation Fund.
- Although the position is less clear in relation to the other two Funds, insofar as the Pension Scheme is concerned, the Council would be legally obliged to make up for any shortfall in investment return should the Council decide to exclude such investments.
- Those Councillors who voted in favour of such a decision could be liable to the penalties available following an audit, namely, censure, suspension and disqualification.
- In addition, if aware that the decision was unlawful at the point of voting, they could be personally liable to pay to the Council's Pension Scheme any loss suffered in consequence of that decision.
- Liability would be joint and several, which means that each Elected Member who had voted in favour of the decision to exclude could be called upon to repay the whole sum.

4. Negative Screening

- 4.1 The Council's Pension Fund's Investment Consultants (Hymans Robertson) prepared a report which considers the implications of implementing a negative screening policy on the Fund's equity assets, and particularly considers the impact of excluding tobacco stocks.
- 4.2 The report was presented by the Consultants to Members at a briefing on 29th April 2008. A copy of the report is appended to this report for information.

Recommendation

Members should note that, in terms of the legal advice discussed in paragraph 3.8, they are **not** entitled to exclude investments on ethical grounds as the law currently stands.

Signature:

Designation: Depute Chief Executive and Director of Finance

Date: 27 April 2009

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